Navigating volatile markets with speed and intelligence
2020–21 was a period of extreme turmoil resulting from the pandemic. The world witnessed the crash of the oil markets and rise of the gas markets, unpredictable demand for food products, and changing consumer behavior patterns. 2022 didn’t start with a positive note either – the Russia–Ukraine conflict sparked a series of market disruptions with traders and participants struggling to manage cash flows. These are a few indicators of how commodity markets across asset classes are experiencing major swings, becoming increasingly complex and subject to significant price fluctuations and supply chain disruptions.
Multiple market forces contribute to volatility and risk including:

**Price volatility**
The risk factors vary depending on the commodity asset class. Leading food and agri-business, Olam International can hedge agricultural commodities based on price risk but commodities such as cotton do not lend themselves to financial hedging in futures exchanges. Consequently, they are impacted by price volatility on the physical side.

**Fragile supply chains**
Physical risks associated with supply disruptions were exacerbated by COVID-19 with supply-demand patterns shifting. Commodities traded internationally encountered delays in shipping/air, and logistics restrictions in certain markets resulting in alternative markets.

**Increased competitiveness**
More players have entered the market hoping to gain from existing volatility.

**Regulatory changes**
Compliance demands on high-frequency trading, and ESG reporting punctuated by consumer behavior favoring renewable, sustainable alternatives have emerged as market control measures.

Event risk, cybersecurity threats, labor shortages in the energy space are some of the top risks that intensified post-COVID-19. Besides market risk, businesses continue to face risks stemming from factors pertaining to weather, geopolitical circumstances, sanctions and such.
Implications of inherent risks amid new challenges of COVID-19, war and geopolitics–related disruptions

The global pandemic and the Ukraine conflict both disrupted and dislocated the commodity ecosystem, introducing more risk implications in recent years.

- Post-pandemic, food and agri–businesses continue to face supply chain disruptions with constraints on logistics, shipping delays and more affecting international trading. They need to be able to shift and adapt to fast-evolving market dynamics due to sanctions imposed on geographies they were trading in earlier.

- Companies need to be better prepared for high-risk–velocity events. After the devastating winter storm Uri in Texas that left millions stranded without power, gas spot prices reached record highs.

- Energy markets are facing challenges they had never faced before. Exacerbated by Ukraine’s invasion by Russia, the world’s third-largest oil producer, European natural gas prices surged as much as 34% on 23 March 2022.

- Together, Russia and Ukraine are the largest exporters of grains. Their ongoing conflict is predicted to deplete global supplies and escalate price risks. According to an FAO report, if the conflict keeps crude oil prices at high levels and prolongs their reduced global export participation beyond the 2022/23 season, a considerable supply gap would remain in global grain and sunflower seed markets.

These incidents point to growing volatility resulting from myriad factors whether they are geo–political or related to climate change.
Challenges to monitoring and managing these risks in the future

2021 gave companies a cause to pause and rethink risk management strategies. The emphasis is now on managing risks better in an increasingly virtual environment, building resilience against pandemic-like situations, improving decision making to explore new opportunities and planning for scale in the next 10 years.

At Olam, for example, shifting their soybean market from China to Brazil led to a greater focus on managing counter-party risks. The organization implemented controls at the corporate level for integrated assurance frameworks, enterprise-wide scorecards, focus on parental guarantees and ensuring they apply to affiliates, so they are not ringfenced.

Typically, companies need to manage risks that are market, operational, credit or compliance-related. While experts vouch for the fact that several companies have been effectively managing overall long-term risks, they need contingencies in place to manage single-day event risks. Managing liquidity better and being aware of events that could hit them at any moment are top priorities.

In the new normal, businesses today face additional challenges: Is there timely visibility, transparency, and accountability into these risks? Is data being used optimally for better decision-making? Some businesses are further challenged by legacy, outdated on-prem systems with accessibility issues that cannot cope with modern security needs. Information silos prevent them from gaining a single, consolidated view of their physical and financial risks essential today.
The way forward for commodity trading companies

Irrespective of their business vision, companies need timely visibility of risk – the right insights, operational efficiency, control strategies, proper utilization of resources and a comprehensive reporting mechanism that will work together to control risk better. For example, tools that detect and report potential fraudulent/rogue trading incidents.

Companies planning to expand aggressively, for instance, need visibility into the full extent of their financial risk. Else, they may end up neglecting control measures, and that can have a negative impact on the bottom line.

As commodity markets continue to evolve, needs and challenges are changing too. Market participants need to rethink and modernize their IT landscape on various fronts including answering a few key questions: Is their control environment resilient enough? Are the right trading systems in place? Are they interconnected? Is there a robust reporting framework that can address upcoming compliance changes?
Why one size doesn’t fit all

Amid these challenges, it’s heartening to see attitudes and approaches to risk management evolving in companies. There is a significant shift from people-oriented to process-oriented standardization across the globe.

Commodities, however, differ from one another and so do their associated risks – as demonstrated in previous examples. Risk management strategies also need to be customized accordingly. Moreover, one monolithic system will not suffice to manage physical assets, logistics, documentation, taxation and more. Companies are increasingly looking to consolidate varied systems to gain a single version of the truth.

Major trends in the commodity trading market that capture what companies in general are looking for:

- **Automation**
  - Potential use of AI to trade directly from exchanges/non-exchanges; mitigate the cost of manual errors; faster reconciliation; access to data quickly; monitor risk and compliance needs

- **More hedging options**
  - Looking beyond simple futures and options towards more exotic options that require advanced risk management capabilities

- **A measurable risk framework**
  - That ideally complies with an accredited industry standard

By adopting Commodity Trading and Risk Management (CTRM) as an architecture, commodity trading businesses benefit from a system that addresses the specific nuances of their business and is flexible, making it ideal for critical pivots.
The advantages of effective risk management with a cloud driven CTRM

In terms of IT, there has been an overall shift by companies to more secure, cloud-based, easily accessible systems and tools that enable users to self-serve. Businesses are also looking for predictive modelling for analytics that can be leveraged at a more granular level and scalable with modern technologies. Low-code, no-code platforms that imply less dependence on vendor and IT – are also in demand.

Companies looking to leverage technology, CTRM in particular, will benefit from:

- Streamlining essential processes, while eliminating redundancies
- Connectedness and cohesiveness of all the processes at all nodal points – supply chain, sourcing, inventory and more
- Access to advanced data modelling methods to counter volatility, powerful embedded analytics and improved efficiency and productivity through smart data management – Olam uses such a tool for trader surveillance
- A holistic view across physical and financial risks with easy connect to ERP and existing landscape as per customer demands
- Access to the latest tools to enhance decision-making
- Setting the correct risk appetite, measuring, and mitigating risk effectively
- Improving compliance and risk governance
The aspiration for holistic hedging

While treasury and procurement functions have traditionally operated in isolation, a siloed approach eventually defeats the purpose of hedging to maintain profitability. To effectively improve the bottom line, there must be synergy among various risk management functions and a holistic view of risk across the enterprise.

When treasury and procurement act on timely, accurate, and standardized data that comes from a single enterprise-risk data source, both groups will have more transparency around input prices, drivers of corporate profitability, and margin management, as well as the opportunity to smooth out commodity price volatility using the precisely chosen hedges. In times of disruptions, treasures want to simulate ‘what if’ scenarios as per market outlook of the organization which will allow them to understand the impact of their decisions on profitability. Without a timely and unified view of data from procurement, arriving at an accurate ‘what if’ scenario is hard.

However, the unification of hedging can often be challenging. In most organisations, for instance, procurement hedges for commodity price risk and treasury hedges for currency and interest rate risks operate under different strategic siloes. The technology infrastructure is siloed too with different systems in place that capture data in different formats, periods, and currencies. All this leads to manual reconciliation and accounting process which is time-consuming and error prone.
Achieving a unified approach to hedging requires the following capabilities:

- Management of workflows in a single system: end-to-end derivative lifecycle management, hedge accounting
- Risk management against risk policies – mark-to-market, P&L, VAR Simulations
- Compliance management
- Reporting and monitoring: reporting on various risk metrics, such as cash flow at risk, earnings at risk, budget at risk, P&L
- Treasury management: bank reconciliation, managing global currency and hedging instruments
- Simulation of scenarios in real-time
Case study: unified view of procurement risk

One of the world’s leading food and beverage companies known for some of the most recognizable household food brands was managing its vast risk operations in two key centers located in North America and Amsterdam. Operating on a landscape of disparate systems and spreadsheets meant that the company was spending significant time manually extracting data from multiple systems and using different spreadsheets for critical business processes and analyses.

Eka recommended a phased implementation of its platform-driven applications for Derivatives, Risk and Monitoring, Reconciliation and Position and Mark to market to enable a unified view of their procurement risk across their operations worldwide. With this, the company could achieve complete data consolidation and automate manual processes and enable informed decisions with real-time visibility.
Conclusion

Analytics and insights are guiding decision making across industries and functions, and the risk management function in organizations, is certainly ripe for adoption.

Companies are increasingly looking for a risk management system with powerful embedded analytics. The focus is on adopting a highly secure cloud-based system with strong self-service analytics and the ability to scale into the future with AI/ML models. They are also building data lakes to consolidate information from various systems whether risk management, ERP, legacy etc.

With growing volatility, the CFO function is increasingly moving from being a reporting office to a decision-making office. To make those decisions, they must be empowered with the right information at the right time. They require a single version of the truth and a single system that incorporates data from across functions and a unified view of data will be the cornerstone for efficient risk management in the future.
One team, one vision, one platform.

We help enterprises build the bridge between commodity management and direct materials.

We put customers, employees and our community first.

We forge long term relationships through one strategy, one team and one platform.

To learn about how Eka can add value to your operations.

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About Eka Software Solutions

Eka Software Solutions is a global leader in providing innovative, cloud solutions that unify a whole range of workflows from procurement to payments. Its platform driven solutions for commodity and supply chain management, source-to-pay, treasury and sustainability help customers to overcome complex challenges and accelerate their digital journey in an environment of continuous change. With over 600 employees, Eka supports more than 100 customers globally and has proven industry expertise in helping customers achieve digital transformation, solving complex business challenges in an environment of continuous change.

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