Commodity trading

Monetizing digitization levers

Commodity trading suffers from shrinking margins and in some commodity classes also from low price volatility. At the same time operating environments struggle with manual routines, legacy processes and systems resulting in high cost income ratios (CIR).

How can this challenge be addressed and how can the profitability and the resilience of trading businesses be increased?

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Situation today

Commodity trading exhibits still several manual routines in its workflows, given the physical nature of the business and established processes in the industry. At the same time margin pressure increases as the inherent profitability of several trading businesses decreases. How can this be addressed?

Commodity trading business characteristics

Commodity trading businesses are typically lean by nature. Several years back, high performing businesses exhibited cost-income ratios (CIR) in the range of high 30% - medium 40%. These days these ratios are significantly higher. Large European commercial banks – as a comparison – even exhibit cost income rations in the range of 70 % - 90% +.

In order to tackle the profitability gap, analytics and middle office activities have been scaled down.

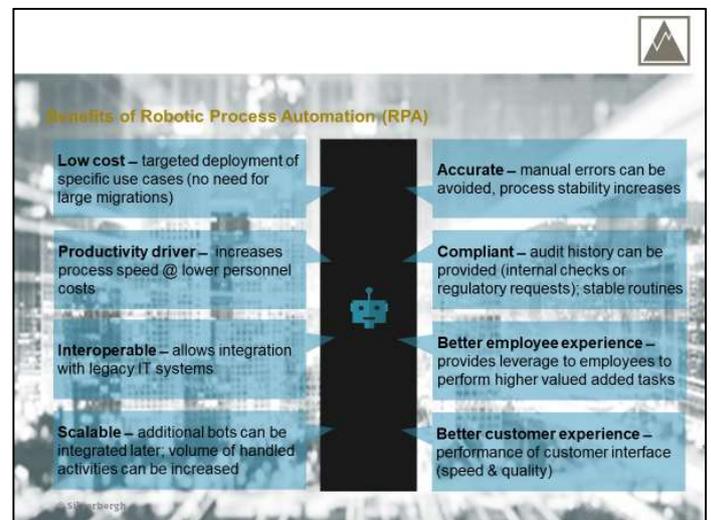However parts of the trading process have remained untouched.

How digitization can help

Targeted digitization initiatives can help to

- Imrove process quality and avoid errors
- Increase productivity within the end-to-end trading process
- Accelerate trade execution & administration

Identifying digitization opportunities will therefore help to improve the CIR while at the same time promising a high digital ROI.

Benefits of Robotic Process Automation (RPA)

Low cost – targeted deployment of specific use cases (no need for large migrations)

Productivity driver – increases process speed @ lower personnel costs

Interoperable – allows integration with legacy IT systems

Scalable – additional bots can be integrated later; volume of handled activities can be increased

Accurate – manual errors can be avoided, process stability increases

Compliant – audit history can be provided (internal checks or regulatory requests); stable routines

Better employee experience – provides leverage to employees to perform higher valued added tasks

Better customer experience – performance of customer interface (speed & quality)

What to look for

Manual routines are still quite widespread across the trading process. Examples are

- **M2M valuation of commodity stocks** based on up to date inventories
- **Creation of daily P&Ls** and reconciliation of positions (volume & price grid)
- **Trade confirmations & post-trade administration**
- **Reconciliation of payment data** with contract data
- ...

Additionally, reason for manual routines are e.g.

- **Several legacy systems** (e.g. CTRM, supply chain & storage, processing/ production, contract management)

- ▪ **Unstructured data** through communication by email, fax, phone etc.

If these characteristics are being observed, then digitizing some of these activities should be considered.

Reservations about digitization

At times there are reservations about digitizing initiatives and a bias to continue with legacy processes and routines.

1. **Costly larger scale migrations** of ERP and CTRM (as experienced in the past)
2. **Additional burden on key personnel** and as a result slippage of key commercial activities
3. **Operational risk** (stalling operations)
4. **Loss of control** (over automated routines and across the application lifecycle)

Each of the above reservations can be addressed by a well configured digitization approach.

1. **Legacy systems** like ERP and CTRM **can remain** in place. Distinct and well-defined process routines can be automated by providing the link into existing systems
2. **The need to draw on internal personnel can be limited** by avoiding larger scale migrations
3. **Individual process automations can be tested and even confirmed manually** (if required). One can opt for the degree of automation vs. cooperation with automation routines being introduced.
4. **Complete visibility & transparency** can be created by installing an integrated automation platform enabling
   a. full visibility of all automation routines established (Robotic Process Automation - RPA),
   b. processing status for each of the robots
   c. linkage to data sources (as required) for manual reconciliation,
   d. digitization of unstructured data into manageable data formats (e.g. from fax to CSV),
   e. transparency on automation requests, use cases and automation requests throughout the organisation.

How to approach trading digitization

A couple of aspects should be kept in mind when considering automation:

1. **Identify & quantify** automation opportunities
2. **Evaluate** impact on company
3. **Improve to be automated process** prior to automation
4. **Integrate execution** of tasks conducted by humans and robots
5. **Track end-to-end process performance** & integrate early warning signals in case of misperformance
6. **Continous administration** of process architecture
7. **Continous improvement** (and amendment of process architecture as required)

Additionally, technology selection should aim for a well respected and dynamic option. There are technology choices which are accepted in business environments with high security precautions and which have also been licensed by the US government.

Within a few weeks, automations use cases can be identified and implemented. Low hanging fruits should be pursued early on whereas automation opportunities with higher complexity might be pushed forward on the implementation agenda (e.g. image recognition).

If these considerations are kept in mind, financial performance will improve and the resilience of the business will increase.

Outlook

Automation opportunities in commodity trading are still not sufficiently leveraged. They are a key competitive factor going forward. From a cultural perspective, automation techniques match commodity trading organisations characteristics by providing lean and pragmatic access to productivity levers. There is no need to commit to large scale IT spending and hope for monetization in later years.

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