

# [Selected marketing topics assignment](https://assignbuster.com/selected-marketing-topics-assignment/)

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Working papers may be republished through other internal or external channels. Please address correspondence to the managing editor, Rob Monish ([email protected]Com). Commodity trading at a strategic crossroad Introduction and executive summary The global commodity-trading business Is a central component of our modern ability to lay off or take on risk. Against a background of rising and uncertain prices for many core commodities In food and Industrial materials, the Industry Is on the verge of substantial change over the next two or three years.

It Is experiencing eroding margins as competitive intensity, price transparency, and the capital requirements of decrease. Imminent regulatory changes will lead to rising complexity costs and a further toughening of the financing environment, which look set to accelerate the industry transformation. The traditional composition of the landscape, featuring a small number of “ professionals” and a large number of “ customers,” is also about to change, with an increasing number of players acquiring trading skills.

This will enhance liquidity but will also reduce arbitrage opportunities. Commodity traders should act swiftly now, addressing four imperatives: First, traders need to prepare rigorously for the impact of regulatory changes on the global commodity-trading system. Leaders will have to develop proprietary strategic insights through systematic, analytical business-impact assessments, stand ready to adapt operating models quickly, and seize any opportunities that arise in the transition phase.

Second, contrary to the traditional culture of the sector, traders should put cost control on the agenda of top management. Third, traders should restructure heir balance sheets and explore alternative and innovative sources of capital. This will likely include more radical measures, such as large-scale asset sales, M&A among complementary houses, large private-equity placements and, potentially, Ipso. It will also require a thorough assessment of realistic working-capital costing for transaction evaluation, in those cases where it is not already happening.

Fourth, traders should develop mid- to longer-term company strategies that include substantial investments in differentiating downstream and upstream assets in core and new geographies. The trading units of large commodity producers/consumers will likely find it challenging to attract sufficient support and capital from their parent companies. Smaller independent trading houses are equally likely to struggle to adapt their business models fast enough and continue raising financing at competitively low costs.

The challenge for the largest independent trading houses is likely to lie in seizing the most attractive opportunities in physical and paper markets while embedding these in a consistent and differentiating strategy. Who will be the winners? Those players that have retooled for the new high-cost environment, increased discipline in capital deployment, created strategic clarity, and strengthened their balance sheet accordingly. Winners will have moved quickly to capture M&A or market opportunities.

Success in the future will be at the intersection of much more disciplined capital consumption and careful balance- sheet expansion around physical assets, as well as stronger positions in financial trading. Changes in global commodity trading We can identify three trends that will reshape global commodity trading over the next two to three years. Trend 1 : Increasing competitive pressure and customer pacification is likely to lead to further erosion of the profitability of core trading operations. This is exacerbated by an environment of low volatility across commodity markets. 0 Growing global profit pools, rising profiles of industry leaders, and generally decreasing barriers to entry have attracted a large number of new players into commodity trading. In Geneva alone, the number of contraindicating companies This has resulted in higher liquidity but also stronger competition and an erosion of trading margins. 00 Commodity producers become increasingly assertive in the price-discovery recess and in the centralization of their production. Rather than handing this business to trading houses, they are now setting up their own trading units.

For the production they do not actively place, they also increasingly resort to cost, insurance, and freight pricing and self-manage shipping or price risk management. 00 Beyond their initial paper focus, many financial institutions have expanded into physical commodity trading in the past five to ten years. The largest institutions own and operate storage facilities and can enter into long-term off-take agreements with producers 0 As a result of higher competitive pressure, traders must take on more risk. Locking in trading margins in well-hedged positions becomes more difficult.

Trend 2: Given high commodity prices and an increasing need to invest in physical assets, capital needs are set to increase substantially. 00 High commodity prices mean high working-capital needs for commodity traders. Over the last two years the price of Brent crude oil has increased by approximately $40 per barrel. For example, the financing requirement for a very large crude carrier (with carrying capacity of two million barrels or more) has risen by $80 lions. 00 Across the commodity-trading market, the competitive advantage from superior price information has largely disappeared.

For instance, the number of active price quotes on the Plants and Argus platforms has increased exponentially over the past two decades and now stands at almost 12, 000 quotes. To protect their margins traders increasingly seek to own and operate physical assets that they arrange into complex end-to-end supply chains. Such supply chains provide access to unique profit pools, for example, sourcing and blending streams to meet local requirements cross the Atlantic basin or to provide turnkey services such as fuel supply and conversion into power for smaller nations.

Some traders are venturing into new territories, such as distribution-system supply and operators (for example, Vital in Africa). Physical assets and end-to-end supply chains also open opportunities to gain access to exclusive and unpublished market information. Hence, while price- reporting agencies are relentlessly increasing price transparency, the informational value of physical-asset ownership is increasing. 00 Traders are also increasingly considering the ownership of physical upstream assets. Such assets are highly capital intensive and illiquid in the short term. 0 As a consequence, the balance sheets of traders are growing substantially-?? often much faster than income levels. The sustainability of commodity-trading profits now relies more than ever on balancers optimization and continued access to capital (Exhibit 1). This will force trading houses to seek new sources of capital and financing. Trading environments will further drive up financing and transaction costs while also creating new business opportunities for physical players as banks scale down their own commodity-trading activities (Exhibit 2).