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The rise of Asia has significantly changed the global commodities market. As the largest consumer of metals, China now dictates global prices, and its influence is not merely limited to metals. The commodities derivative market is also evolving at an unstoppable pace. As the US and Europe introduce regulatory changes limiting speculation, a new order is emerging in Asia where more commodities derivatives are available on regional exchanges. It is not to say that it's all hunky dory. Most of the Asian countries have some checkered history in commodity markets.

Whether it is China's closing down of dozens of exchanges in late 90's or India's trial and error method with some of the key commodities. For Asia to become emerging benchmark in commodity markets, it has to overcome problems with availability of trade & commodity finance, slow pace of reforms and confining exchanges to only domestic players. Each country has its own method and pace for solving this problem but countries should work cooperatively at a regional level to solve some of them.

For example working establishment of a regional trade finance database to facilitate information exchange and share experiences. China has many strengths including being the production house of many commodities and growth of consumption of two Asian giants but population of more than two billion who help to increase consumption also stand in the way when it comes trading in essential commodities such as rice and wheat. Many newly setup exchanges are fighting their way up leveraging their geographical and other advantages.

They are introducing many new and innovative products to tap the markets in Asia. In the end you can say that Journey has started and only time will decide its pace. HISTORY OF COMMODITY TRADING IN ASIA It believed that the commodities trade had its genesis in Sumerian, a region in modern day Iraq. Animals were the first commodities, which were traded between individuals. Those days” commodity contracts were carried out using clay tokens as medium of exchange. Slowly as time progressed, the commodities trade expanded and existed between different Asian nations.

For instance during the first half of the second millennium India and China had trading arrangements with Southeast Asia, Eastern Europe, certain Islamic countries and the Mediterranean region. Later on, the advancements in shipping and other forms of transport had facilitated the growth of trade in this segment. The unification of the Eurasian continent by the Mongols in the 13th century led to a wide plague that reduced the population of Europe and Middle East by one-third, has resulted in more per capita income for individuals and thus increased the demand for Eastern luxuries like precious stones, spices, ceramics and silks.

This has augmented the supply of precious metals to the East. This entire scenario resulted in the increased reliance on Indian Ocean trade routes and stimulated the discovery of sea route to Asia. The volume of commodity trading in Asia increased significantly after the discovery of sea route to Asia by European voyagers and explorers. The Old and New Worlds were connected by sea. With the discovery of Manila in the year 1571, trade linkages were formed between Asia, Africa, Europe and the Americas.

Initially spice trade was the main motivation because of its high value to weight ratio and thus the effective transportation costs was less for it. Later on huge volumes of silver were exported from America to Asia especially China. Asia has become the prime trader of spices, silk and tea. It is believed that even derivatives in commodity trading started in Asia. Though the first recorded futures trade was found to have happened in Japan during the 17th century, evidences reveal that the trading in rice futures was existent in China, 6000 years ago.

Changing Dynamics of Commodity Trading Predicting the financial markets can be very difficult. But few seem in doubt that Asia will extend its lead as the largest exchange-traded commodity market in the world. Unsurprisingly, Global Investors are bullish on the region” s prospects, especially those of Singapore. The runaway success of all the new exchanges in Asia has re-enforced the fact that Asia is the future in commodities . Asia has witnessed many Commodity exchanges start their operations in the past two years with most recent one being Hong Kong Mercantile Exchange, backed by mainland Chinese banking major CUBIC.

Hong Kong Mercantile Exchange is attempting to position itself as a gateway between China and the rest of the world, profiting from restrictions which govern Chinese derivatives trading. Singapore Mercantile Exchange (SMS), the first pan-Asian multi-product commodity and currency derivatives exchange went live for trading on 31 August 2010. With rapid economic expansion in the region and Sais’s demand for commodities, it is well questioned to offer an integrated and single-platform for multiple products.

SMS has witness trade turnover of \$ 153 million for the first nine months of its operation.

As I write this SMS has recorded trading volume hit a historic high of 9, 659 contracts and the turnover crossed USED 350 million with membership numbers doubled from 25 to 50. With the derivatives market still in its infancy, China's three commodity exchanges in Shanghai, Dahlia and Gunshot have shown staggering growth that reflects the country's rapid transformation into the largest buyer of a plethora of commodities. Already, by number of contracts traded, Multi Commodity Exchange of India (1 1 mm), Chicago Board of Trade (mom) and London Metal Exchange (mom).

India alone is characterized by two almost unique features in the developing world. First, a large number of contracts are traded at each exchange, spanning agriculture, metals and energy sectors. This has led to each exchange managing contracts for more commodity trading was stagnated due to split between Tokyo Commodity Exchange, Tokyo Grain Exchange, Kansas Commodities Exchange and the Central Japan Commodity Exchange (C-Com) , solutions have begun to emerge - notably, installation of the exchanges with C. Com announcing that it will close its doors in early 2011 .

With tenfold growth in a decade, you might be forgiven for thinking the Asian commodity derivatives markets had realized their potential. Changing Dynamics Risk Management in an Emerging Asia Shanghai Futures Exchange (China) is the world" s largest commodities exchange in 2010, with mom bargains Enzyme is next with mom, then Gunshot Commodity Exchange (China) (mom), Dahlia Commodity Exchange (China) (mom), ICE Futures

Europe (mom), Risk management is no longer a peripheral activity for Trader in Asia, In fact they are ring developing risk management as a core competence.

It is a key foundational skill which has enabled them to scale and grow our business. Capacity to identify, capture, measure, monitor, manage and control various risks which confront business, underpins their risk management competence. This competence is the foundation for future growth Trading houses have selectively invested in integrating their supply chain by entering into the upstream and midstream parts of the value chain and new business adjacency's leveraging latent assets. They have selectively deployed the best risk raciest to measure and quantify the risks in these new areas of businesses.

Some of these include yield analysis, scenario analysis on outruns, and exposure forecasting models. Most of trading house are improving their performance in risk management of some key risk such as Credit and counterparts risk which are being strengthened through improvements in the scorecard for rating counterparts as well as rigorous assessment and review of counterparts performance. Loam international is pioneer in this field. They have developed an institutionalized process in the governance of risk management by establishing Board level Risk

Committee comprising five Directors . The Board Risk Committee is the apex body for risk management in Loam. The Risk Committee recommends to the Board the overall risk limits for the Group. The Board will determine at the beginning of each financial year the overall risk capital of the Group. Risk

capital, expressed as a percentage of the equity capital of the Group, refers to the maximum potential loss if all the operational, information and trading risks across all products and geographic regions materialize at the same time.

In order to determine the amount of equity capital to be set aside as risk capital, the Risk Committee considers two key factors: the track record of management in managing its risks exposures in the prior period; and the financial budgets including projected volumes and turnover. Unlike Wall Street risk linked performance pay has already been implemented in a considerable number of trading companies to keep a check on managers who take enormous risks to earn huge bonuses.

To influence behavior and promote risk awareness and responsiveness, business performance measures are first selected performance measures, thereby influencing decision making on the basis of risk and return. Companies are also adhering to better reporting standards by regularly monitoring and reporting their risks.

Some companies are evaluating their risk management policies through rigorous testing of their policies by various tests such as stress testing. Stress testing introduces a unique way of better understanding the interrelation and interdependence of risks in a trading portfolio- particularly the interdependence of credit and market risk. Many risk management professionals seek to understand the nexus of risks that lead to sub-optimal or catastrophic risk. Hedging is no simple game for Asian companies.

Most of them have prepared a comprehensive framework to to create and review their hedging policy 1 . First, companies are considering the overall rationale for hedging and how exactly it could add value to their company – establish financial risk management objectives. 2. Second, they can undertake a structured consideration of the factors that should influence the decision to hedge and, if so, when? 3. Third, if, after consideration of other financial levers, a hedging programmer is required – what is the most appropriate hedging strategy and how should it be executed?

This kind of framework allows companies to have structured approach to hedging rather than having various methods with in the organization and sometimes defeating the entire purpose of hedging it self Sais’s potential to become the benchmark for commodities Sais’s strengths in its Journey towards supremacy in commodities trade The Asian countries have taken a decisive lead as importers and consumers of commodities – as measured by their growth, if not yet total consumption. Longer term that will happen too.

Asia has 60% of the world” s people, and some of its biggest infrastructural needs Apart from the growth story of India and China one of the main reason for Asia” potential to become benchmark for commodities is diverse resource base of Asia. Be it Rice or Coffee , Coal or Gold We cannot find any hot commodity which does not has substantial production from Asia , of course with the notable exception of oil . Len fact in most of the commodities Asia” s production is major force in price setting.

Internationalization of Indian and Chinese Commodity Exchanges markets may not be a distant dream for Institutions and investors eagerly waiting to

enter this market. Slowly but surely both countries are going let down the barriers for international players. China surprised many by the speed with which it opened up its new equity index derivative market to foreign participants. India” s Forward Markets Commission has suggested the idea of allowing foreign participants to act as brokers without becoming directly involved in the market.

More experts believe that internationalization is faster to happen in India owing to China” s methodical fashion in opening its markets. Emergence of regional trading hubs is one of major boosters for Asian trade markets. With global trade flows shifting to Asia, Singapore is well positioned to capture trading activities due to two key reasons. First, being close to many source and demand markets, and second, having a sophisticated physical and financial infrastructure for trading. The Hong Kong Mercantile Exchange will benefit from its proximity to mainland China to drive financial system. With our strategic location in Hong Kong, Hex is ideally positioned to facilitate trading in commodities between China and the rest of the world,” said exchange president Albert Helmet. Of Hex . The new exchange’s 15- ours trading day will overlap with US and European trading hours, which exchange officials say will encourage cross-continent trading and boost liquidity Sais’s Weaknesses in its Journey towards supremacy in commodities trade In global commodity trading Chicago, New York and London are still big hubs for agricultural goods, precious and base metals and oil and gas products.

Even though the volumes of Shanghai Futures Exchange are more than that of Enzyme and even double that CABOT when we look at value of underlying <https://assignbuster.com/marketing-of-services-telecom-assignment/>

volumes the whole picture changes dramatically. Western exchanges still dominate when it comes value and that too by gig margin. Asian nations are still wary of derivatives, and of the potentially disestablishing effects of foreign speculative inflows which is stopping them from moving fast in the path of reforms.

Educating huge domestic Investor populations about risks involved in Commodity market is the major obstacle for the growth of these exchanges Even though the pace of reforms is satisfying, basic premise or conceptions about functioning of commodity exchanges are far from western markets. For example China” s complex multi-level system of governance, which makes it necessary to secure agreement from the China Securities Regulatory Commission, the State Council and almost any ministry or agency that, has some interest in the product.

India suffers from a different problem as when ever commodity prices rise abnormally finger are pointed at Commodity trading if at all it happens in that commodity . Government has shown knee Jerk reaction in the past by banning sugar future and trading some commodities owing to pressure from different groups Major shifts expected in commodity trading Asian Countries which have significant say in any of the commodity are going to be “ price setters” rather “ Price seekers” with their domestic exchanges driving the highest volumes in that modify.

Malaysia is the world” s largest exporter of palm oil accounting for around 50% of the world production but highest trade palm oil happens in London. Bursa Malaysia is the home of the Crude Palm Oil future (PEPCO). Let is the

only liquid commodity future available in the world and Malaysia is now witnessing considerable volumes of trade in palm oil on par with London. Geoff Howe, strategist at MFC Global Singapore says “ historically, Asia” s extensive demand has either flowed overseas or through the over-the-counter market . We see so many international trades flow to the US and Europe “..

However, he believes the local markets will grow, demonstrated by the fact that 85% of Asia” s energy requirements flow through the Asian market. That has contributed to Singapore becoming the largest ETC energy trading market in the world. Asian Exchanges are fertile grounds for unique and innovative products. They are leveraging their strengths to come out with this one of its products given that markets in Asia can handle these complex products . Hex offers physical delivery of the underlying gold and silver at a purpose-built Precious Metals Depository at Hong Kong airport.

SMS CEO McMahon retain specifications which are unique to SMS or our regional clients. SMS” s Gold Futures contract, for example, is Singapore” s first physically delivered gold futures contract. Global commodity exchanges may collaborate or even setup their shops in Asia as the it emerges as trading center of the world in times to come. In July 2010, SEX struck a deal with the London Metal Exchange to list mini versions of the ELM” s monthly metal futures, cash-settled against ELM prices.

Copper and zinc will come first, with steel billet derivatives later, subject to regulatory approval. Perhaps more Han other financial risks, the hedging of commodity risks need to be coordinated with the business to incorporate the

effects on the physical supply chain and ultimate supply and demand dynamics Challenges to trade and commodity financing in Asia “ Trade” s Life blood” That” s what World Trade Organization calls trade finance— an apt Conclusion considering as much as 90% of trade needs credit.

The size of the trade finance market in emerging markets, including Asia, is about US \$2 trillion, of which up to 75% are syndicated, according to the International Monetary Fund. A pioneering study released late last year by the Triple-A rated DAB ND the International Chamber of Commerce provided data showing the low-risk nature of trade finance. The survey of nine banks active in trade finance showed defaults of only 0. 02% of 5. Million transactions worth \$2. 5 trillion conducted in the past five years. Dad’s Trade Finance Program has never suffered a default. These statistics which come across as a great opportunity for any firm fail to increase overall availability Commodity producers and processors need access to credit in order to meet working capital needs and to invest new farm assets, technology, and equipment for processing and post-harvest activities .

Traders need access to credit to optimize their turnover and keep transaction costs down. In many developing countries and countries in transition, access to credit is severely constrained, as most banks are willing to lend only against certain fixed assets and at terms and conditions that are often unfavorable to operators in the commodity sector Commodity financing in India needs many regulatory reforms for it to flourish on par with global markets.

Negotiability/transferability issues with the warehouse receipts , De-mat warehouse receipts , Private warehouse receipts not being funded due to credibility and lack of appropriate systems , Restriction on commodity exposure by banks and Options on commodities being not allowed are some of the problems that both bankers and traders are facing. RIB has also set limits to banks for exposure to commodities . Even though some steps have been taken by RIB such as formulation of Negotiable Warehouse Receipts Act. The overall pace of the reforms has been very slow owing to the lack of financial infrastructure.

Trade finance faces problems of non availability and high interest rates . The SEEM sector faces the biggest challenges when it comes to accessing trade finance from low-income Asian countries have been identified as an issue in the WTO since the Asian financial crisis, as such countries are prime victims in the general reassessment of risks and liquidity shortages that characterize periods of financial crisis Trade financing through international Institutions is vulnerable to ever changing risk profiles of countries .

Recently, China, Pakistan and Viet Name, have recently been added to a watch-list by Coffee, a world leader in trade risk management, due to rising risks in various sectors. Use of more intricate trade structures, typically centered on large bilateral relationships in high-value and usually Ross-border commodities flows, is central to financing some of these heavily Asia-linked trade flows. While commodities still play the major role. Precious metals will remain the main beneficiary of a strong interest in investor diversification, inflation and currency hedges.

What people tend to underestimate is how strong and how far the market can go when there is a limited supply to match a very heavy demand, he said. Volume of gold stored in the banks vault in Singapore is rapidly increasing. The froth certainly came off many commodity prices in the first week of May as investors sold gold and silver as well as other commodities. Whether it is the likes of hedge fund traders such as George Sore, or investment banks such as Goldman Sachs, big sellouts can impact the commodity market heavily.

Back in the real world, people need to eat and factories need raw materials. Another important aspect is that we are active in the full commodity chain and that we have clustered our energy, commodities and shipping activities in one group. If one looks at our client base one sees that we are active throughout the value chain of energy, commodities and transportation and that those three sectors follow increasingly a converging path. The market as a whole, while many banks have now returned, ongoing liquidity issues and Basel III preparation probably put a floor on pricing higher than it was pre crisis.

The market has undoubtedly improved and the commodity finance market is strong. Evidence of this is in the fact that commodity market players have been capable of raising the necessary working capital to sustain the huge hike in commodity prices since early 2009 - between 100%-150%, in some cases. The current situation has some characteristics of the 2006/2007 market: strong pressure on the margins, commodity companies flush with liquidity on the back of (near) record commodity prices, a strong move to more event-driven financing (acquisitions, capital expenditure etc. And,

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particularly on the oil side (mainly for Russian corporate), a more or less total move away from structured commodity finance (SF) to unsecured/unstructured corporate finance and bond issuance. As the [Basel III] rules become tighter the banks will have an issue to keep the return on their own equity on decent levels. Hence I expect that the focus will be more on ownership lending and the traditional banking activities like secured commodity trade finance.

We only see limited activity on the secondary markets. The good news is that commodity finance is breaking out of minority sport" status and is a much more mainstream" activity these days, not just in banks but also for insurers and, of course, the traders are now very visibly on the global finance map. The consolidation and the fact that the commodities asset class is a favorite for investors is also variety of reasons - political reasons egg. Food security and economical egg. Good returns. These investments are taking place either direct, mostly in land rights, or indirect by obtaining shareholdings in companies like Noble and Loam.

Korea Investment Corp. (KICK) is a recent example as they invested in Noble. In the aftermath of the global financial crisis, and along with very strong commodity prices, the credit metrics of most of the commodity producers has improved substantially - certainly supporting a more aggressive approach by the banks/financial markets in providing financing to commodity producers. What is aggravating the situation is the severe lack of deal flow (particularly on the energy side) leading to significant oversubscribing of any decently structured transaction in the market.

We see a big difference in risk appetite between larger and smaller players. The larger companies are getting tenors, structures and pricing that we did not even see before 2009, which is partly due to the general appetite for emerging market risk combined with a more active role by the local banks. Smaller players may still find some difficulties obtaining financing and here the structures are holding up for the moment, but we expect the liquidity to filter down to these smaller players soon.

The commodity finance market has not yet returned to pre-2009 patterns. Clearly liquidity is back again, especially in the Asian markets, as a result pricing is decreasing and structures are looser. However globally pricing and structures are still higher and more conservative compared to pre-2009. Selective domestic orientated banks in the US and Latin America are hot to enter into the agric-commodity markets. Increasingly we note that syndication markets are moving to Asia due to the high liquidity and general receptiveness for commodity opportunities.

We also note an increased need for committed financing versus uncommitted or transactional financing. As traders have converged to supply chain managers, we ETC (trade and commodity finance) bankers even to review our business model in order to capture the new opportunities. Economizing the value chain is a key objective of the supply chain managers/ traders and as a result there is a frenzy of M activity. The forward and backward integration strategies are a challenge for our global ETC franchise in lengthening the chain.

Our clients as the cornerstones are in the middle of our ETC, M and food & agric research activities optimizing market intelligence and commercial fire power. The product portfolio management is tight rope walk for any trade finance company. On one hand the newer types of products, like financial supply chain, are gaining more traction across Asia," says Venerates Samaritan, director and trade finance head in global transaction banking at Deutsche Bank. " There has also been a strong impetus and growth in classical trade business: documentary trade, issuance and negotiation of LLC [letters of credit]. "[The open account business] contracted for many players during the crisis as trade moved back to more documentary-type settlement," he says. " But now open account trade has come back to be the fastest-growing area of he business. Introducing new products while not losing control over popular products in kitty presents big challenge for any bank. Financial institutions have been very much focused on the trade finance side of commodities - through the front, mid relationship driven approach with the aim to accommodate the day-to-day business of clients.

They need to develop their very own structured commodity finance (SF) business solution with the hiring of external agencies who have expertise in this area. This will consist of finding structured solutions not only for pre-production hash but also for investment financing necessary for trading (storage, etc). One of the biggest challenges is liquidity for financial institutions. Asia has high inflation; central banks not just in China but all over the world are increasing reserve ratios; and domestic markets are getting squeezed for liquidity.

So what people want [from trade finance banks] is products that ease liquidity. Strategies to improve availability of finance for trade in Asia The short-term measures such as establishment of an Asia-Pacific Trade Insurance Network to facilitate intra- and extra-regional flows and investment through insurance cooperation among export credit agencies in the region are essential in times of crisis and it is heartening to see how quickly they have been agreed upon and implemented across the region.

However, many developing countries have very limited capacity to address national trade finance shortages on their own. Actions beyond the short-term emergency measures are necessary to strengthen trade finance institutions.

In the medium term, establishing or strengthening government-backed export credit insurance and guarantee institutions and/or export-import (EXIM) banks is essential. These institutions can play a major role in times of crisis. However, they are inefficient or missing in many developing countries of the region. Where this is the case, governments should examine different models (e.g., public-private partnerships) for the establishment of self-sustaining trade finance institutions In addition, establishing or strengthening domestic credit rating agencies and information-sharing and recording mechanisms – and their supervision – is critical. This would contribute to reducing the cost of trade credit and insurance, which heavily depend on how accurately the creditworthiness of the buyer or seller can be assessed. In the long-term, a strong, credible and well-developed banking and insurance sector is the key to ensuring access to a full array of trade finance instruments.

Good and stable macroeconomic fundamentals, prudential regulations, and a pragmatic approach to financial sector liberalizing are essential to achieve this goal. Asia is a unique and diverse market for trade finance. Methods and products used by financial institutions may be successful in one country while faltering in other country. Indonesia had very less penetration on new trade finance products but uncial institutions were able use Caution and reluctance to incur an incremental risk can typically be seen across the entire supply chain with buyers, suppliers was prevalent more after the financial meltdown.

As a result export and import settlements are shifting from open account to a letter of credit (L/C) base and financial companies are getting more inquiries from companies about the There has been a very interesting landscape change in Asian trade, Earlier there was a simple mantra of Asia-US, Asia-Europe, whereas now it” s getting more complicated Intra-Asian trade has changed: companies are looking at components getting sold room one country to another intermediary for production, to another for final assembly and then out of Asia.

Regional Institutions play a very critical role in increasing the availability of trade finance. The exporters in the Asian developing countries face challenges in obtaining finance from commercial banks due to perceived risks. To support these growing markets, Swiss Re through its commercial unit, Swiss Re Corporate Solutions, and the Asian Development Bank agreed to offer banks guarantees and loans that enable them to provide trade finance, “ particularly in so-called frontier economies. ” The insurer will

insure SIS\$250 million of trade finance conducted through the Dad's current trade finance program.

The bank noted the newly injected capital “ could result in around SIS\$500 million in additional trade finance support per year for developing Asia. ” In 2010, Dad's trade finance program supported 783 trade transactions worth SIS\$2. 8 billion, with banks in Bangladesh, Vietnam, Pakistan, Sir Lankan and Nepal, the five most active users. Demand in the first quarter of 2011 rose over 50% year-on-year across Asia, according to the bank DAB is also working with the supply side to increase the availability of trade finance in Asia.

DAB and Exporter Financing and Insurance Corporation formalized a financial risk sharing agreement. Australia” s exports to Asian markets reached A\$284. 1 billion in 2010, of which \$155. 9 billion, or 67. 3 percent, went to East Asia. Developing Asian countries should be able to import more Australian goods with the ADS-OFFICE credit risk sharing deal, it was noted Given the importance and intra Asia trade in the world trade it is important to have a commonly accepted currency except dollar or Euro.

Last year” s moves by the People” s Bank of China (Pooch) to make the remind international trade settlement aerogramme more accessible for companies and financial institutions globally, combined with the gradual evolution of the remind into a more international currency, have sparked a fundamental shift in how Japanese companies operate, and in particular, Japanese multinational companies (Macs) with manufacturing, production and service operations in China.

Due to this heightened interest in the remind, Japanese corporate are increasingly settling their trades in the currency, necessitating the re-alignment of their treasury operations very hot topic in Asia right now is the offshore settlement in remind (RMI). This is a part of China” s overall master plan to make the RMI an international currency, and it is something which has been developing for some time.