COMMODITY RISK MANAGEMENT AND FINANCE pdf

1: Commodities | Fifth Third Bank

Commodity Risk Management When a company has exposure to commodities, it must decide how to manage the financial risk associated with price movement. Commodity risk is complicated and responsibility for mitigating risk can fall across disparate departments like procurement, treasury, and supply chain.

But times have changed: These days, procurement organizations within companies are playing pivotal roles in the success of global firms in ways that old-fashioned purchasing managers could never have imagined. In this special report, Wharton faculty and procurement experts at The Boston Consulting Group discuss why the procurement function has risen to such prominence in a highly competitive global environment, and how, as supplies of critical commodities tighten and prices rise, companies can strategize to mitigate these and other risks. Consider airlines, which have seen fuel costs rise seven-fold over the last few years, says Bob Tevelson, a partner and managing director at BCG. In this interview, Tevelson says commodity risks are associated with both price volatility and supply availability. More and more companies may wish to turn to hedging strategies to manage commodity risk, he notes, but such strategies can pose risks themselves unless they are properly implemented. How big a problem is commodity risk for most companies, and who is most at risk? I think that the commodity risk issue is significant and growing in importance for many companies. Are there certain companies or certain industries that are more at risk than others? Yes, I think the industries that are closer to the raw material sources are at greater and greater risk. The automotive industry â€" with steel and a lot of the plastics and the materials that they use â€" is clearly at risk. What types of risk can be addressed, and how do firms go about addressing them? I think the main commodity supply risks are associated with price volatility, and one that I think will grow in importance â€¦ is supply availability. On the supply availability issue, [the question is]: What are the risks to my ability to deliver to my customer based on the ability to acquire what I need, when I need it, and the right quantity and quality? That has always been an issue, but as companies have moved closer and closer to single and tighter supplier relationships, the degrees of freedom you have â€" when you have a failure in your supply chain â€" really have shrunk considerably over time. And then, another issue on the horizon is that, with supply chains extending, there are more points of failure in a normal system, and you are finding a growing constraint in terms of the available capacity for getting materials from Point A to Point B. Years ago, the strike at Long Beach [involving] the dock workers caused major disruptions. In terms of managing commodity risk, what practices are leading edge? What types of practices make you nervous? What makes me most nervous is when companies go ahead and get excited about hedging while not fully realizing what they are getting involved with. For example, a hedging program really requires a cross-functional approach. It requires senior management attention and careful thought around the accounting requirements to make sure that no one gets into any questions with the SEC, especially for publicly-held companies. Before we began recording our conversation, you and I were talking informally about who actually devises and implements the hedging strategies. Can you take just a minute or two to talk about that? In typical organizations, there is a finance function that gets involved in currency hedges. In more sophisticated, best-practice companies, you will find that there is a commodity trading desk or operation. But they just put together the facts and the options. They typically meet with a cross-functional team â€" sometimes with marketing and sales â€" because there are implications around the hedging strategies for how we set prices, but also with senior management from an operations perspective and clearly from a finance perspective. Those companies meet in those forums. They review what the commodity trading desk is finding in the marketplace and what they think their options are going forward. Getting back to our general discussion, how does a firm know which kind of risk management techniques to apply? Or maybe you need to introduce a more proximate supplier, even if it has to be done at a premium, so that if your more distant supply chain partner is not able to deliver, you have a backup plan. What should a company do to increase the odds that it will be successful? I think increasing the odds of success is having clear objectives. Obviously, the more speculative it is, the more informed it is [and] the better the strategy and hopefully the better the result. What changes do you foresee in commodity risk management in the months and years to come? So I think companies are going to increase their sophistication. The most simple of course is a financial instrument in a liquid market, where you could just basically buy the insurance in the marketplace. And then you look at: How do I hedge my price through, for example, longer supplier relationships, meaning contract duration? Or, two, looking at potentially vertical integration: Am I best suited to buy the raw materials to assure supply and manage the price? You are seeing a lot of consolidation in the steel market at the moment and also a lot of concentration in the raw materials, in terms of ore and coke going into the industry. And then finally, another thing that companies are doing is trying to identify things that are correlated in terms of performance, a proxy hedge if you will, hedging one item because it is correlated to another. And those get to be tricky because there are a lot of accounting issues. I think what we are seeing in the commodity markets right now is exposing companies to what the marketplace has been doing in maybe a smaller subset. And I think the impact, in terms of the growth of prices and the volatility up and down, is getting people to think more and more about what needs to be done. I think what will be interesting is to see what the evolution is on the more creative side, how industries may restructure based on commodity risk management, and how people will come up with innovative ways to work with their suppliers to offset that to a degree. Finally, do you have any views on where commodity risks are heading? What I mean by that is, we know that the price of oil has been soaring in recent months, for instance, and it is a key commodity to everyone, every business, every industry in the world. Are there other sectors where you see risks increasing in terms of supplier price that organizations should be aware of? I think part of it is the dynamics of the world economy â€” India and China pulling a lot more of the natural resources in terms of demand. Their economies are growing at a rapid rate and their consumption of basic commodities is growing. I think it will affect companies, some more so than othersâ€¦. I was talking to a senior executive in procurement just yesterday from one of the major [airline industry] players in the U. It has increased seven-fold over the last few years.

2: CubeLogic - BI enabled energy, commodity and finance risk management software

Commodity Risk Management - Commodities risk is the risk due to which business financial performance is adversely affected by fluctuations in the prices of commodities. In this article on Commodities Risk management, we look at the various commodity risks and the tools to manage those risks -.

These groups are exposed to maximum financial risks when there is any natural disaster or man-made disturbance. Commodity market in every country faces some of the common risks. These risks are caused by natural disaster as well as external factors like wars, political instability and so on. If not covered properly, these risks can cause huge financial loss to a number of groups. Proper commodity risk management is essential to provide stability to this sector as well as to make this sector financially secured. Types of Commodity Risk There are different types of commodity risk that are faced by the commodity markets across the world. These risks are as follows: Natural disasters Man-Made Risks: Political risks, price risks, quantity risks and so on Groups Facing Commodity Risk There are a number of groups that mostly face the commodity risk. Primarily there are the farmers, producers and plantation companies who face these risks. At the same time, the purchasers and exporters of commodities also come under the shadow of commodity risk. Last but not the least, is the national governments that are also bound to share these risks with others. Services Offered by Commodity Risk Management Firms There are several firms that are related to the management of commodity risks. Some of the services offered by these firms are the following: The weather risks are very important for the farmers, plantation companies and the exporters. Heavy rain, drought, cyclones or other types of natural disaster cause huge harm to several groups. These groups need sufficient coverage against the natural disasters to remain financially secured. There are a number of insurance products offered to cover these risks. These are self insurance, crop insurance, index based insurance and many more. There have been a number of incidents where crop prices have fallen suddenly because of over-production or something else. In these situations the farmers and plantation companies face huge financial losses. At the same time, there are many farmers who borrow from banks and other financial organizations for farming. These people are exposed to maximum risk due to the price volatility. As a part of commodity risk management, many firms are offering insurance products as well as other instruments to provide security to these people. The national governments also try to control the market volatility as much as possible. At the same time, there are many countries that offer guaranteed minimum income for a number of crops. More Information Related to Risk Management.

3: Commodity Risk Management | Methods | Strategies | WallstreetMojo

Commodity risk management and finance (English) Abstract. The collection of papers brought together in this volume was written to advance knowledge about the demand, pricing, and use of commodity-linked finance.

In this article we look at how the factors driving commodity prices can be assessed. We also consider general strategies which can be used to structure commodity price management activities and manage commodity price risk exposure. However, procurement often has the traditional objective of cost minimisation, rather than focusing on the management of risks resulting from cost volatility. Given the high volatility of commodity prices and their potential effect on earnings, there are solid arguments for including the management of commodity price risk exposures in the remit of the treasurer or the finance function so that these exposures can be managed in much the same way as other exposures, such as interest rate or currency risks. Centralised governance Commodity risk management should ideally be planned and executed by a centralised risk management function. Management of commodity price risks at the subsidiary level will lead to less than optimal results and will not sufficiently take into account other correlated risks for the group or potentially better pricing. The management of commodity risks through a centralised function will also bring finance and procurement departments closer together and enable the company to address issues with which both departments are concerned. Centralised commodity risk management should be based on a defined risk policy within a clear and monitored risk framework. A centralised function will also be able to monitor market developments more closely and review appropriate commodity sourcing and risk management measures on a periodic basis. In order to manage commodity risks effectively, the treasurer needs to: Understand the risk exposure. Determine the impact of commodity costs on business performance. Develop a risk management strategy in accordance with the risk tolerance levels set by senior management. Understanding the exposure In order to manage commodity price risk effectively, it is first necessary to understand the exact nature of the risk exposure and the factors that influence the price of commodities. This will increase the effectiveness of any hedging activity and help avoid basis risk. Avoiding basis risk Basis risk Basis risk is the risk that offsetting positions taken in a hedge will not match perfectly. As a result some risk may remain or new risks may be created by the hedging strategy. There are many possible sources of basis risk in commodity price risk management. In terms of energy prices, for example, the cost of electricity is determined by gas prices, which are themselves linked to oil prices, in addition to other demand and supply-side factors such as capacity. As a result, simply basing a hedge on buying gas contracts would not eliminate the risk entirely and would contain a significant amount of basis risk. Correlation between commodity prices and financial exposures There may also be a correlation between commodity prices and other financial exposures. For example, many investors have used investments in oil to hedge a US dollar devaluation, which has resulted more recently in a strong correlation between the price of oil and the US dollar. This means that a rise in commodity prices could be mitigated by other financial exposures. Understanding commodity price drivers To understand commodity prices, companies will have to consider a number of different factors. There are two types of analysis which can be used. Fundamental analysis The fundamental analysis takes into account supply and demand factors that will have an effect on prices. On the supply-side, commodity prices can be driven by an increase or decrease in supply as well as current and future production, transportation or storage capacities. These effects have to be seen in the context of cost structures, both within the production chain and across the supply chain, as well as in relation to macroeconomic trends over the medium and long-term. The difficulty of this type of analysis lies not only in predicting accurately the most likely scenarios, but also in determining which factors will be more influential than others and assigning the appropriate weighting to each component. As a result it is difficult to draw conclusions, particularly with regard to the timing of price changes. However, a proper understanding of what drives the prices of commodities will not only give an indication of the most likely scenarios but also support the management of these risk exposures. Technical analysis On a more sophisticated level, the fundamental analysis can be accompanied by a technical analysis that consists of mathematical indicators such as moving price averages, rates of changes, relative strength indicators and cyclical trends. In combination with a fundamental analysis, the mathematical models of a technical analysis yield a more detailed view of the likely future development of commodity prices. In particular, the objective of the technical analysis is to improve the timing of purchasing or hedging decisions. The technical analysis may, for example, compare actual commodity prices to the moving average of commodity prices. It may then use the points when actual prices exceed or drop below the moving average as a strong indication for future price developments and potential action points on which to base purchasing or hedging decisions. This type of analysis does not determine the extreme prices, ie the point when long-term price trends change direction a price increase becomes a decrease or vice versa , which would be the ideal point on which to base purchasing or hedging decisions. However, the results of a technical analysis in combination with the fundamental analysis will still yield better and more reliable results than the fundamental analysis on its own. The risk manager will support management and has to define and quantify the risk exposures and determine the amount of capital that is at risk. The level of acceptable risk or risk appetite will then function as the basis for devising, implementing and monitoring a risk management strategy. Determining the impact of commodity prices Crucially, senior management is concerned with how much price risk the company is exposed to as a result of its commodity requirements. The sensitivity of cash flow and financial ratios can be tentatively assessed by applying maximum and minimum price forecasts to a budget plan. This analysis may be complemented by a statistical cash flow at risk or a value at risk calculation. It is not really possible to model this effectively as it is at the extremes of the probability scale. However, present circumstances are exceptional and a prudent treasurer should recognise these risks exist. The results of such modelling may still mean that a large company has the financial strength to remain unhedged, given the most likely commodity price scenarios and production figures. However, the result may also indicate that, in order to support growth and other financial targets, some risk exposures will need to be avoided, reduced or transferred in some way. Generic risk management strategies There are a number of strategies which can be used to address commodity price risk. Accept the risk and transfer it through pricing. The risk exposure can remain unmanaged as such. The company may then absorb any increasing commodity prices with all the effects that this would have on margins, or may decide to transfer the exposure in part to its suppliers by changing supplier contracts or customers in order to increase end product prices. Companies may decide to reduce or replace product components that rely on costly commodities. This of course demands that product development processes and operations need to be adapted. In addition, the necessary changes to the supply chain must be reviewed and evaluated. As mentioned above, some commodity price exposure may at times correlate with other financial exposures for example oil and US dollar. While it is generally difficult to hedge actively based on these temporary correlations, their effect will need to be taken into account. Manage the risk through contracts. Provided that the company has a thorough understanding of the commodities markets, changes to contracts such as fixed or floating price agreements and the use of futures, options and other hedging instruments can enable the company to limit its price risk exposure. Dynamic planning and physical hedging If the analysis of commodity price drivers has yielded points which indicate a likely sustained price movement in a specific direction, risk managers can respond with a range of measures at these points, such as adjustments to contracts which may include physical and financial hedging. In any case, a commodity management strategy needs to be dynamic â€” in other words, it needs to have the flexibility to be able to respond to changing market conditions. Falling market prices generally call for floating price agreements, whilst increasing market prices ideally require fixed price agreements. This means that if possible, the risk manager aims to conclude long-term contracts at fixed prices in an increasing price environment or seek short-term contracts at variable prices given decreasing market prices. It is of course not always possible to change all existing contracts exactly at the point that indicates a sustained price movement. However, when a sustained price drop is expected, it is often possible to enter into flexible price agreements that contain clauses which trigger price increases in an increasing market but at the same time guarantee the same flexibility in a decreasing market and provide a reduction in prices. When a sustained price increase is expected, physical hedging would also require fixing contract prices for the medium to longer term and increasing commodity inventories. Flexibility in the contract agreements to deal with varying market scenarios is the important factor. This may or may not come at a premium as suppliers will be reluctant to take on the risks themselves. Hedging strategy and financial instruments The alternative to physical hedging, in other words the fixing of actual prices with suppliers, is financial hedging whereby prices are fixed in the financial markets. If financial hedging is chosen, the company must have an approved strategy and risk policy mandating the use of financial instruments in order to manage commodity price risks. The policy will impose limits on hedging exposures over a pre-determined timeframe and define the appropriate methods for independent monitoring, valuing and reporting the exposure to the board or risk committee. The hedging strategy can include both aggressive elements aimed at maximising profits and defensive actions with the objective of avoiding losses and reducing risk exposures. Each company will have to determine the appropriate hedging strategy in accordance with its expertise in the commodity markets and general business strategy. However flexibility is again key, as in most cases it is not advantageous to ensure a full price protection without flexibility. There are a large number of both sophisticated and less sophisticated hedging tools available, but the use of financial hedging necessitates sufficient experience in working with exchange traded futures, options, swaps and other instruments. Some of these products enable the risk manager to lock in a price for a specified time period forwards, futures, swaps , whereas option products may both eliminate the risks resulting from increasing prices and, against the payment of a premium, allow the company to benefit from falling pricing. Tools are available for short, mid-term and long-dated maturities to match annual budget or longer strategic risk management needs. This article does not address the use of every available hedging instrument, but a few general points can be made about what is required to execute a hedging strategy: Most hedging programmes will require a significant investment in infrastructure and corporate governance to support the functions involved in the various stages, such as risk analysis, deal execution, reporting, settlement and accounting. The risk manager must understand the instruments available in the market that can be used to mitigate the identified exposures. The benefits, costs and risks of the proposed hedging strategy and hedging instruments must be evaluated. This will include transactional costs of futures, swaps and options, inherent costs such as the forward price or the yield curve, management costs, operational costs and also the costs of complying with accounting and legal requirements. It is important to determine the accounting treatment for the suggested hedges. Systems and processes need to be IAS39 compliant and the efficiency of hedges must be tested and documented to qualify for hedge accounting. Risk resulting from hedging. The management board must fully understand the risks the company is exposed to, as well as the risks resulting from the hedging activities themselves. The effects of the hedging programme must be completely understood, managed, monitored and controlled. Less than appropriate control or management of hedging programmes can have a disastrous effect on business performance. Summary Commodity price risks have to be analysed and managed like other financial risks. This will require an integrated commodity risk framework, including the analysis of commodity price drivers and the centralised management of identified risk exposures. The physical or financial hedging strategies chosen to address any risk exposures have to be flexible and the effects of the hedging activities and their inherent risks need to be fully understood, managed and controlled.

COMMODITY RISK MANAGEMENT AND FINANCE pdf

4: Commodity risk management and finance

*Commodity Risk Management and Finance [Theophilos Priovolos, Ronald C. Duncan] on www.enganchecubano.com *FREE* shipping on qualifying offers. Commodity-linked finance has expanded rapidly in the s, but it has mainly been confined to entities in industrial countries.*

In portfolio approach, the risk is calculated utilizing stress testing for each variable and combination of variables. In this in addition to sensitivity analysis of changes in prices discussed above, the companies analyze the probability of event occurring. Accordingly, sensitivity analysis is applied using past price history and applying to current exposure to model the potential impact of commodity price movements on its exposures. I hope now you understand what risks are and how to calculate the commodity risks. Commodity Risk management Strategies The most appropriate method of managing risk depends on organization to organization and depends on following factors Process of Production Strategies adopted by company in marketing Sales and purchases timing Large companies with greater commodity risks will often appoint financial institutions or risk management consultants to manage risk through financial market instruments. While adopting diversification producer should ensure that alternative product should not subject to same price risk. This flexibility has effect of improving financial performance. Price Risk Management 1 â€" Price pooling arrangement: In this commodity is collectively sold to a cooperative or marketing board, which sets the price of the commodity based on a number of factors that result in an average price for all those within the group. In times where there is an increased production which resulted in reduced selling price, some producers may store the production till a favorable price is obtained. However, when considering this, storage cost, interest cost, insurance and spoilage costs needs to be considered. In this buyer approaches supplier for an alternative pricing plan. Companies generally have strategies in place to review the use of commodities within the business are risk compliant. Now that we understand the how to manage the commodity risks from producer and Buyer perspective, let us go ahead to see what are the various financial market instruments to manage the commodity risks. A forward contract is simply a contract between two parties to buy or to sell an asset at a specified future time at a price agreed today. In this case, the risk of changes in the prices is avoided by locking the prices. On a simple sense futures and forwards are essentially same except that Futures contract happens on Futures exchanges, which act as a market-place between buyers and sellers. Contracts are negotiated at futures exchanges, which act as a marketplace between buyers and sellers. The buyer of a contract is said to be long position holder, and the selling party is said to be short position holder. As both parties risk their counter-party walking away if the price goes against them, the contract may involve both parties lodging a margin of the value of the contract with a mutually trusted third party. Also, have a look at Futures vs Forwards 3 â€" Commodity options:

5: Managing commodity price risk | Treasury Today

What is 'Commodity Price Risk' Commodity price risk is the price uncertainty that adversely impacts the financial results of those who both use and produce commodities. For example, as the price.

6: Procurement - Managing Commodity Risk - Knowledge@Wharton

Commodity Risk Management Group (CRMG) provides consulting and brokerage services to producers, handlers, and end-users of agricultural commodities as well as diversification tools to individual investors.

7: Commodity Price Risk

Low coffee prices still call for disciplined risk management By Matthew Dunbar During a period of low prices like the one we are currently facing in the global coffee market, producers and trading houses are confronted with a conundrum.

COMMODITY RISK MANAGEMENT AND FINANCE pdf

8: Commodities | Financing | Macquarie

The Structured Commodity Finance team and Risk Management Group also enabled a temporary increase in Coffee America's working-capital finance facility, thereby allowing Coffee America to provide additional required collateral for its financing pool facility.

9: Commodity risk management and finance (English) | The World Bank

A commodity risk management program can help. Not all organizations can, or should, adopt the sophisticated mechanisms of a pure commodity business. However, most organizations, particularly those in the middle of the value chain, can improve their commodity risk analytics.

COMMODITY RISK MANAGEMENT AND FINANCE pdf

Artists and the literary landscape. Chibi Vampire Volume 4 China, East Asia and the global economy Filmography (p. 165-178). 20. Retrospect and Prospects Virtual office business plan Study of heredity of insanity in the light of the Mendelian theory The Science Of Ascension And The Great Answer Of Ontology The Complete Book of Pets Petcare Rebel Yell the Yankee Hurrah 36 Honeysuckle 76 Rosemary Poems of a rambling cowboy The american heritage dictionary of phrasal verbs The annihilation of space by law: anti-homeless laws and the shrinking landscape of rights Most famous lawyers in TV or movies Three days to dead The Golden Book of Resentments Sentencing disparity and discrimination Back Page Content/t 298 Islam and Christianity today New Jerseys multiple municipal madness What was it like before electricity? The subversive sources of power Spanish Elizabethans GURPS For Dummies (For Dummies (Sports Hobbies)) Basic Financial Management for Entrepreneurs (The Entrepreneurship) Allen Smith <To accompany Bill H. R. no. 534 . A brief, introductory look at some common views of the Law of Moses An accusative suitcase. The Bible says so! What do your soil food webs look like? Short Story Index Supp 1959 1963 (Twaynes English Authors) Bens Christmas carol George III speaks out. Connecting home and school Concha Delgado Gaitan Regulations of international business The address of Mr. Justice Livingston to the House of Assembly of New-York, in support of his right to a Complete Rietveld Furniture The life of David Gale Sherlock Holmes and the dukes son