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Where is the finance in digital?

The accelerating digitalization of commodity trading and its associated financial processes seems inevitable. But for many of us, where, when and how to maximize investment in this new technology, remains less than clear.

You don't have to look far to see the impact of technological improvements to supply chains and operating procedures. Digital transformation holds much promise to further revolutionize the way transactions are processed, sales are logged and prices are tracked. Considering the potential, what's holding back organizations across the financial services sector that are not investing in this area?

Investors are looking closely at what will drive new efficiencies and new returns in the companies they support. Digital transformation is a moveable feast, with a constantly shifting landscape of blockchain, alternative payment systems, cloud-based data storage and artificial intelligence.

In terms of commodity trading, many global companies have already taken their organizations to the point where they can embrace new digital opportunities. Some have established consortia to drive digital transformation and provide the practical frameworks needed. They are aiming to streamline processes and transactions, away from a heritage of paperwork in commodity management and trading. For example, VAKT driven by nine leading energy companies and banks is establishing a digital ecosystem to make the complex process of trading oil and gas less risky and more seamless through the power of blockchain. Whilst it is still early days, the work done to date shows a lot of promise.

A new world of banking

Many banks have withdrawn from commodity trading. This is due to a combination of regulation and reducing margins. Physical commodity trading desks now no longer exist as they did five or ten years ago. Digitalization can make it easier to transact and trade in different markets. This can positively impact on barriers to market entry.

However, for existing banks the choice to embrace digitalization may be more about risk avoidance than seizing the opportunity. In a recent article on the future of banking, Senior Director, Financial Institutions Ratings, S&P Global Ratings, Markus Schmaus stated:

"We believe today's traditional banks have no other option than to digitize their business models. If they execute that well, they can better defend and potentially expand their franchises, and possibly offer new products or services. If not, their market positions and profitability could shrink. Digital solutions will not only allow banks to attract more clients and open up new revenue channels, but also become more efficient, all keys to succeeding in tomorrow's digital environment."

Additionally this article drew on evidence that smaller institutions could benefit from a shift in the banking landscape:

"Traditional banks are already bracing themselves for disruption. According to KPMG, 73% of the $100 billion poured into fintech investments over 2012-2017 were for innovation in banking services for retail and small and midsize enterprise (SME) clients. Fintech and Big Tech companies have already spotted the weaknesses of traditional banks, many handicapped by complex legacy systems, limited capacity to invest, and low customer confidence. On the other hand, some tech players are using their readily available know-how and material budgets to enter the financial services market."

Seeing beyond the hype

Beyond banking, and into broader finance and risk management, most investors are keen to understand the tangible results from digitalization, whatever the sector. The focus therefore is on impact, rather than the 'noise' traditionally associated with the introduction of disruptive technologies.

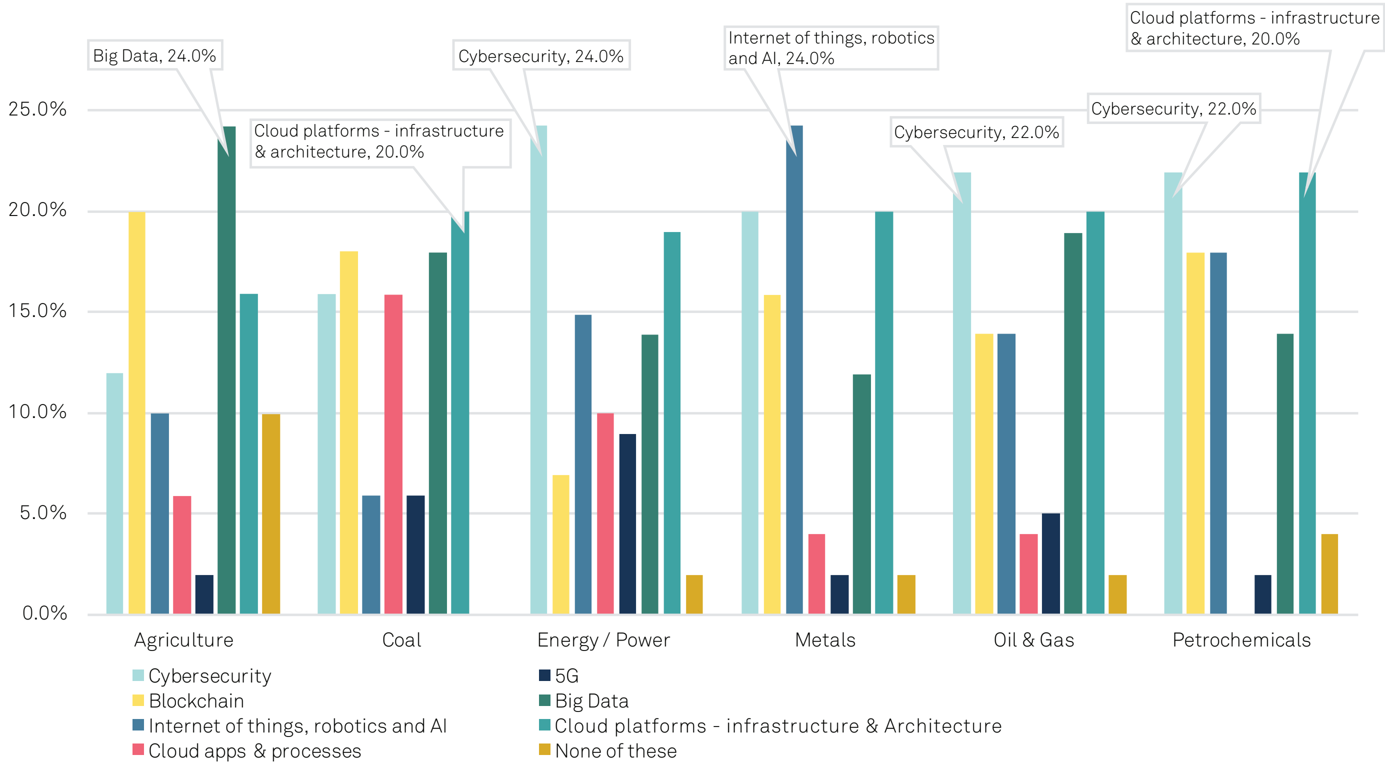
It is fair to say that many companies are already using sophisticated technology for physical measurement, quantum computing and particularly quantum sensor technology. Looking beyond can be challenging, and the returns less obvious.

In assessing companies and business models, investors need to see who is truly embracing the change. Who is moving towards optimum operational efficiency, or looking at exploration and production in different ways? Essentially, it will be these elements that sustain new cash flows and provide new revenue streams to justify the investment needed.

Senior Director, Innovation and Digital Strategy, S&P Global Platts James Rilett adds to the reasoning behind the shift being made by some companies towards digital technology:

"Regardless of a company's appetite to embrace change itself, the world is changing. Investment in technology is seen as vital. Digital advances can propel the most innovative companies to the top. For incumbents, this also brings challenges, the opportunity for overspending and under delivering is high. Advances in technologies such as machine learning for compliance monitoring, or blockchain for trade reconciliation offer real promise and are generating competitive advantage for early adopters. Likewise, the best traders will continue to harness the latest technology to generate opportunities, spotting what others may have missed in a rising flood of data."

Which tech developments will disrupt your industry the most over the next 5 years?



Source: Man Bites Dog, February 2019

Digital agility

At S&P Global Platts, we certainly see the considerable efforts being made within the financial and commodity sectors to transform processes around transactions. With reference to the diagram below, we see the challenges facing companies are constantly changing and the pressure to harness the promise of digitalization is increasing.

We strive to remain as agile as possible so that we can continue to meet the increasingly sophisticated needs of our clients for the data and services we provide. Traders, risk managers and back office professionals are demanding more data, in more structured and machine-readable formats. This suggests we are truly entering the era of the algorithm.

The skills with the S&P Global Platts team, and the infrastructure we invest in are our drivers. This is true across the S&P Global group and in 2017 we acquired the data science and machine learning business, Kensho. Our teams are working with Kensho's experts on a number of exciting initiatives that are ongoing and continue to bring efficiencies and new insights from our uniquely deep and broad reaching set of commodities data.

We are moving from batch data and static reports to something that's much more dynamic, utilizing constantly evolving streams of data and insight. In the world of seaborne commodities, for example we are now able to link prices to vessel movements, vessel movements to supply and demand balance calculations, and supply and demand balance calculations to news stories. This combination of proprietary and complimentary data, with new methods for linking and surfacing insights has already shown huge potential for delivering trading edge to our customers.

S&P Global Platts has run a dedicated innovation team since 2017, and is using and testing a host of technologies in real world scenarios, working closely with customers to address their needs. We are using blockchain to securely gather and standardize trade data in North American natural gas markets, bringing efficiencies to our own process but more importantly reducing the burden of compliance for our customers. This makes it much easier to report prices and participate in price discovery.

James Rilett elaborates further on the potential of innovation to help analysis in new commodity areas:

"S&P Global Platts innovation team has been working with a number of experts to imagine what the power markets of the future could look like. Many of our leading clients, such as global oil majors are investing heavily in the energy transition. There can be no doubt that we are moving from the hydrocarbon to the electron. Platts already publishes battery metals indices, including daily news and prices. The industrial implications of the energy transition remains a hot area for investors, and increasingly we see investors looking beyond this to the new investing and trading markets of an increasingly renewable era. With this top of mind, Platts, are launching a pilot project in the Port of Rotterdam, the world's first ever distributed energy micro grid, powered by AI agents, and settled on blockchain."

All aspects of the financial services and commodities sectors are likely to be seeing the implications of digitalization. How far they choose to utilize this shift in business models is different for each company. This is the challenging balance between embracing the opportunities and managing the risks of investing in unproven and emerging digital technology.

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