

Blurred lines – CM, ERP and CTRM

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By Commodity Technology Advisory LLC

One of the key topics in the recently released CTRM for Ags & Softs study report was the definition of Commodity Management and Commodity Trading and Risk Management (CTRM). We concluded in the report that, “historically, Commodity Management (CM) emerged as a set of business processes related to the handling of commodities in the context of supplier-relationship management and procurement in entities that essentially utilized (consumed) raw materials for creation of intermediate or finished goods. To that end, it could naturally be seen as an extension of ERP, as it included managing supplier relationships, inventory, movements/supply chain, accounting, purchasing, processing and so on.

As commodity and raw material prices became more volatile and as more regulatory oversight was introduced into commodity markets, many manufacturers and commercial packaged goods companies slowly began to look into hedging strategies for price risk management. Such activities required functionality not usually included in an ERP solution, but were perceived to offer competitive and strategic advantages. CTRM software, however, did offer risk management and derivative trading functionality and began to be adopted as an add-on to the ERP solutions already in use. Meanwhile, banks, funds and merchant traders were increasingly trading ags, softs and related commodities in a more diverse portfolio of natural resources helping spur the growth in the market for ags & softs-focused CTRM solutions.”

However, there is a two-fold issue with the nomenclature. First, many producers, processors and buyers of commodities – particularly unlisted commodities such as wool, tea and spices - are more or less unaware of the CTRM software category - these companies employ an entirely different lexicon to describe what we term CTRM functionality that can encompass terms such as ERP for commodities, CRM for commodities, Commodities ERP and so on...they may be even be unaware of the term “commodity management”. Secondly, there simply aren’t

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any standards that can be used define the differences between “ERP for commodities”, “CTRM” and “commodity management” anyway.

If we were to be precise and willing to produce an almost encyclopedic review, we would probably be able to neatly define each of the above; however, it's unlikely that such definitions would be broadly adopted as there has been a morphing of these categories of software such that no clear or precise definition can now be offered...a CTRM solution that has a good deal of physical supply chain functionality built in is venturing into ERP territory and an ERP solution specifically tailored for commodities is more than likely to include some CTRM functionality. Given these cross-category capabilities, we at ComTech view these terms (CTRM and ERP) as subcategories of the commodity management application area.

A Look at CTRM

In a CTRM solution, one would expect to find a trade-centric approach to its design. What we mean by this is that it will contain the ability to set-up and define trade book structures at multiple levels and to report physical and financial position by multiple levels as well. Transactions entering the system are seen as trades of various types, both physical and financial, so that more or less any kind of summary position or report can be built by combining trades by book, trader, strategy, location, commodity, instrument and so on. Another major differentiator is the availability of built-in risk metrics of one type or another. Here, one would expect to find a minimum of mark-to-market and PnL capabilities providing analysis of positions across a range of selectable variables. Ideally, risk functionality would also include various measures like VaR, EaR, stress testing, credit risk metrics and more. In CTRM, the emphasis is on the “T” (trades) and the “R” (risk).

Of course, CTRM solutions by and large include all sorts of other functionality around settlement, accounting, logistics, counterparty management and so on. For primarily physical commodity players, their CTRM solution of choice will also often include inventory management, support some aspects of processing from commodity to commodity, warehouse management, in-depth logistical planning by an entire range of transportation types and much more. In these areas, there will be overlap with ERP and CRM functionality.

Essentially, CTRM is minimally defined as trade and risk functionality, commonly extended to handle most or all



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parts of the physical commodity value chain. That being said, CTRM solutions will also capture and manage financial trading (including futures, options, swaps and so on), as well as exchange and OTC trading. They may also handle some level of hedge effectiveness testing.

In summary, CTRM is most often used by traders, speculators and physical commodity merchants, producers and marketers whose businesses require these explicit trading-oriented capabilities.

A Look at ERP for Commodities

An ERP solution in the commodity markets will naturally focus on the handling of physical goods. Usually, the primary functionality will focus on contracts and contract management and may well include origination functionality as well (although, this may be handled by a CRM solution). Obviously, such a system will include pricing functionality in common with a CTRM solution so that product prices can be valued by weight, volume, qualities and so on, including adjustments and penalties.

From there, the ERP solution will emphasize the movement and storage of the goods, either in bulk or packaged. The complexities here can be enormous, with functionality encompassing tracking and valuing of transportation and storage costs, inventory quality, blending of inventory, break-up of bulk to packaged (or packaged to packaged) and the ability to track a finished item back to its source(s). ERP commonly includes comprehensive logistics capabilities with an emphasis on tracking estimated and actual costs throughout the supply chain as well capturing and appropriately associating the myriad of documents associated with the product movements. For producers and processors, the ERP may include some production planning or demand planning functionality as well as some reporting of position to budget. It will also include invoicing and accounting functionality, and price fixation.

As ERP vendors continue to seek to grow their market coverage, they are increasingly adding additional capabilities that address commodity trading-like capabilities that may be required by their customers. Initially targeting producers, sellers, buyers and processors, these vendors are adding some rudimentary financial instrument coverage, helping their customers to address basic price hedging. Over time, we do expect additional trade and risk functionality to be added to the larger ERP solutions, leading to a further blurring of the lines between ERP and CTRM.

Summary

Commodity Management is a useful term that commonly references capabilities that includes both CTRM (trade and risk-centric applications for physical and financial commodities) and ERP (and potentially CRM) applications targeting commodities (production, sales and processing-centric applications for physical commodities), and we are seeing rapid crossover between the categories as vendors on each side continue to chase market. The continued morphing of CTRM and ERP is inevitable as vendors eye new markets – particularly as parts of the market shrink (i.e. banks and other financials) and others expand (merchants, CPGs, etc.).

That being said, there are significant differences in structure and design between these two types of applications that in the end may render their extension too costly or cumbersome to economically implement for either the vendor or the buyer. Buyers should carefully consider the nature of their business, their business processes and the suitability of any application to address their unique complexities prior to investing significant sums along a path that may very well turn out to be a blind alley.

The best answer for many merchants, CPGS and processors, at least for the foreseeable future and particularly for those that are increasingly developing centralized commodity procurement and/or trading functions, may be to acquire dedicated CTRM capabilities to augment their existing ERP solution.

Have you filled in our [ETRM In a Low Commodity Price Environment survey](#)? We're seeking your participation in a new research effort by Commodity Technology Advisory. This new project looks at the impacts and implications of low priced energy commodities as they relate to ETRM system use and value.

https://www.surveymonkey.com/r/ETRM_Cost

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