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A Digital Commodities Firm

The next paradigm: Trade houses v. Banks

Agribusiness services are dominated by two industries: First, trade houses provide services that vertically integrate from farmers to consumers. Second, financial institutions horizontally integrate the value chain by facilitating an efficient transfer of capital. There is a sweet spot where these two industries intersect in their service offerings: Risk management and Trade financing. The last two years have witnessed a lot of activity in this point of intersection where there has been a flight of human and financial capital from banks to the trade houses. In this article, I want to focus on the key reason of such a paradigm shift and also predict a futuristic scenario of how these two service industries will evolve given technological advancement.

Banks traditionally have been financiers, and have been providers of sophisticated risk management products that trade houses lacked the capacity to originate and distribute. Unfortunately, the organization of the bank's business has contributed to a decline in its ability to contribute much to its clients. A bank's organization structure attracts people with deep knowledge of industry/quantitative mind into research, trading or structuring functions. This leaves behind the sales role to be filled with people who have little freedom both in terms of the type and the cost of these products they sell to their clients. Worse, this brings a stress on both the bank and bank's clients. On the other hand, people who have a great deal of knowledge in the client's business, and the products they sell to their clients, fulfill the sales role in the trade houses. The trade houses have little incentive to develop their own tools both in financing and risk management areas to compete head on with the banks. This has meant that sales people in trade houses had little incentive to stay in trade houses both from a compensation and intellectual satisfaction. In the last couple of years these paradigms have changed. Banks have started leaving the arena of commodities, and trade houses have positioned themselves take an advantage of this gap.

This change benefits a question, what is next? In my opinion smart machines will replace people to both innovate products and service clients better. Banks and trade houses are both very well positioned to take advantage of data science to service their clients with the necessary solutions and products. This shall lower the human capital cost structure institutionally, while enhancing productivity. Trade houses and banks will compete to deliver these data science solutions going forward to their clients. They can either grow this platform organically or inorganically. My initial reaction is that banks will try to build it organically, while the trade houses will be consumers of these services. This will be the time banks will get into this business with the promise of cross selling and higher margins, while trade houses will look like the followers. The optionality is in favor of waiting and building data science firms inorganically. The key reasons are that there are too many unknowns, and any expectations on returns will be premature and immature. In both cases investment in inorganic opportunities is the best bet in the short run.

The key take away is that the commodity industry has seen a big shift and consolidation among trade houses. Machines will remove any inefficiency created by men but the key question is who gains to benefit: Trade Houses v. Banks?