



Don't confuse trading with risk management

For many organisations, when looking at their energy requirements and considering how to manage this position, they start by looking at the best way in which they can trade their positions. Often this starts with a procurement director asking the energy manager to produce a procurement strategy. The energy manager will look at all the options available, this may mean that they look to fix out a large chunk of volume early. They may well decide to operate a protect budget policy, with targets and triggers, or a CaR (Capital at Risk) model trading when the market hits a certain level. All of these strategies are trading strategies, and would fit into the category of “managing” risk.

Powerisk tends to look at things slightly differently, we think that the most important parts of risk management are the measuring and communicating. This is what the starting position should be for an organisation. If we measure the risk and report it to all relevant stakeholders, it is more than likely to stimulate serious debate within the organisation. By leading with a procurement strategy, the energy manager may choose to hedge a big chunk early because his bonus is dependent upon not exceeding budget levels. While this strategy will certainly achieve a business aim (not to exceed a budget level) it may not optimise the energy contract. However, when measuring and communicating energy positions (both hedged and unhedged), all interested parties become involved in the process and understand that the risks are contained whilst the opportunity to optimise is released. Here, the finance director may well have seen low power prices in the past and feel that it is worth waiting for slightly lower prices; he is confident enough to wait because he is measuring and communicating the risk everyday (perhaps using mark to market reporting which calculates the value of the unhedged position against latest forward curve data). With this level of reporting, the market is not going to move against the company or damage budget limits because they are ready to respond as necessary. Suddenly the debate about how much to hedge and when to hedge (which is ultimately what all the above trading strategies aim to do) is framed round an overarching business aim. Therefore, both the energy manager and the finance manager know that their hedging strategies are aiming to deliver an overall risk strategy.

Of course measuring risk can be a bit boring, and certainly the process of endlessly explaining to parts of the business why you did not trade at the bottom of the market (hindsight is a wonderful thing) can wear most people down, but it does mean that you are more likely to develop better thought out trading strategies suitable to your business.