Real deal – the crucial role of the dealing room

Steve Nussey of BP describes the changes that have taken place in BP Finance's dealing room in recent years and how they have led to increased efficiency and profitability.

BP Finance's dealing room is based in London and staffed by 15 professional traders. By 'professional', I mean that most of them have learned how to trade in a bank dealing room, and all see their future as being in the dealing room. We do not have general staff passing through on a one or two-year tour of duty.

The dealing room is active in trading most foreign exchange and interest rate products, including spot, forwards, and options in foreign exchange, and lending, borrowing, issuing commercial paper, interest rate futures, swaps, and bonds in interest rate products. As well as transacting the financial business that BP needs to do, the dealers also take proprietary positions within strictly defined risk guidelines. The dealing room is run as a profit centre.

In BP Finance there is a clear management and personnel separation between risk taking (dealing), confirmation and payments (back office), and monitoring and reporting of credit and risk limits and valuation (control area). This helps ensure that there is a clear understanding of roles and responsibilities and reduces the potential of unforeseen errors.

Profit centre

Our understanding is that most corporate dealing rooms do not operate as a profit centre and only transact the business that the company is required to do. We view this as putting the company at a considerable disadvantage when operating in the financial markets.

Firstly, the company only transacting its natural business is usually predictable in respect of its purchases and sales and can therefore be read, on the price, by the bank.

Secondly, it is neither generally able, nor does it want to, attract professional dealers, and therefore uses more generalist staff to perform this function.

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Bank dealing rooms are staffed by professional dealers and obtaining the best service from them is more easily achieved by the corporate also employing professional dealers.

Actual dealing in the markets takes up the main portion of the time of the dealers in BP. Non-dealing work revolves around advising our business units and senior management as to the direction and potential strategic direction of financial markets.

Dealing room input is a very important part of the process when major hedging decisions are being considered by the company. The dealing room also has a training role, with a constant stream of employees from other areas spending time in the room to get a better understanding of how the financial markets work.

Economies of scale

Over the past few years there have been significant changes in the way we do business and the way in which the markets operate. In the early 1990s we had four dealing rooms: London, Brussels, Melbourne and Cleveland, Ohio. We employed over 40 dealers in total and clearly had a 24-hour trading network.

However, dealing rooms are expensive to run and with the continued need to be more efficient, and the constantly improving technology, we have been able to reduce this network to one room – London – and 15 dealers.

In doing so we have reduced our costs by over 70% but are still able to handle all BP's financial trading business efficiently. In fact, there has been a substantial increase in business due to the growth in the company and this has been handled easily, showing the enormous economies of scale that dealing rooms have.

We probably lose out a little because we no longer have 24-hour coverage, but we have someone on duty to take calls from our banks through the night.

All change

The financial markets have also changed enormously over the last few years. The banks have moved to transacting the bulk of their business electronically which has lead to the increasing commoditisation of the market, as well as reducing the amount of information flow. The foreign exchange market is now dominated by a small group of large international banks, with the banks on the periphery becoming increasingly marginalised. The appetite for risk-taking by the banks has been significantly reduced as profits in this area are poorly valued by shareholders.

All these factors have considerably reduced liquidity in the financial markets in the last few years. Although this makes it more difficult to operate in markets, it also means that it is even more important that the company has a very experienced group of dealers who can understand, interpret , advise, and hedge the company's exposures, as well as trade profitably. ■

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