

# MISSING MILLIONS



Transforming a culture of passively transferring funds abroad to a practice of actively purchasing local currency at the most competitive price

**STAMP  
OUT**  
**Poverty**

## About the author

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A paper for Stamp Out Poverty  
Written by Nana Yaa Boakye-Adjei  
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# Foreword

The story of how this paper came about is a testament to how sometimes, as you determinedly set about one course, you may occasionally discover something unexpected, but of great importance, that you never would have observed had you not already been a fair way along the road. For Stamp Out Poverty, that road has been the pursuit of a small levy on foreign exchange transactions to raise new revenue in order to increase the levels of finance devoted to development, such as for clean water, education and healthcare. The members of the Stamp Out Poverty network include some of the most well-known charities in the UK: ActionAid, CAFOD, Christian Aid, Oxfam, Save the Children, Tearfund and War on Want. All support the campaign for the introduction of a Currency Transaction Levy (CTL) at the earliest opportunity.

Why the foreign exchange (fx) market? Three simple reasons:

- 1) it is the largest market in the world, worth a staggering \$800,000 billion a year
- 2) it is an anomaly that currency transactions have remained exempt from taxation when duties on bonds and shares yield large incomes to governments around the world
- 3) the proposal is widely accepted as technically feasible, and simple and inexpensive to implement, because all large-scale fx transactions are electronic so payment would be automatic with no scope for avoidance.

Over the last three years our extensive research into the functioning of the market has included working with leading academics as well as prominent City think-tank Intelligence Capital. Through this consultation we identified a rate for a CTL that would not adversely affect business but would yield a potential income if applied to all the world's leading currencies of more than \$30 billion a year.

In the course of gaining knowledge to take the campaign forward, it became apparent to us that organisations in the charity sector were likely to be paying considerably over the odds for the currency they needed to operate in the developing countries in which they work. This prompted us to commission this study firstly to establish whether our concerns had substance and secondly, if our concerns were valid, to offer some pointers as to how practice could be improved.

Stamp Out Poverty's mission is to boost funds to developing countries. We believe that, by following the recommendations set out here, the UK charity sector may be able to make potential savings amounting to many millions of pounds each year. If this money, rather than being lost in excessive charges to banks, can instead be spent to benefit people in more disadvantaged parts of the world, then I believe this paper will have served its purpose well.

*David Hillman – Coordinator  
Stamp Out Poverty*

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# Executive summary

## Hidden losses

Between £20–50 million could be saved by UK charities when sending funds overseas.<sup>1</sup> Many millions do not make it to their intended destinations because charities, going about the purchase of the local currency they need to operate in developing countries, often encounter uncompetitive rates and misleading transfer fees. In this way, the full amount of money that ought to reach the field to save lives and improve livelihoods, is not realised.

The losses we have identified are not immediately evident. This is because neither those giving the money – institutional funders such as the Department for International Development (DFID) – nor those receiving the money – UK charities and their partners abroad – necessarily know this money is being lost. The reason for this is that donors do not ask of recipients that they seek the best price for local currency. At the same time, recipients may trust a financial institution, such as their banks, to deliver them a reasonable price for the currency they require. As a result there has been little focus on the difference between what organisations have actually been paying for local currency and the best price that this currency could have been purchased for.

It is certainly not our intention to blame any parties for this state of affairs; rather, we seek to look for possible remedies. Our conclusion is that the problem may, to a large extent, be overcome through a more comprehensive use of competitive tender.

## Competitive tender

Competitive tender is used by both the public and private sectors to achieve best value for money. Whether purchasing office equipment, buying in additional communication services or distributing humanitarian relief, competitive tender allows organisations to utilise resources efficiently. Achieving, and being seen to achieve, the most cost-effective price for goods and services is an accepted norm. Indeed, donors themselves employ this process when deciding which organisations receive their grant allocations. If this widely employed approach was extended to include the purchase of local currency, it would help ensure that the highest proportion of every pound was spent overseas. Operating such a procedure would also improve transparency and accountability.

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<sup>1</sup> This calculation is based on data from the Charity Commission relating to total expenditure of UK registered charities working in Africa, Asia, South America and the Caribbean of £6 billion for the year 2007/08. From a sample of UK charities we calculated the proportion of expenditure used to purchase local currency to be between 33–83% of the total. An analysis carried out in **Section 3** of this paper identifies percentage volatilities in daily spot rates for ten exotic currencies. From this data we extrapolated a 1% average saving from competitively tendering local currency procurement. The proportion of total expenditure spent on foreign currency procurement was multiplied by this 1% to provide the range of £20–50 million in 2007/08.

## Foreign exchange

Non-Governmental Organisations (NGOs) that operate overseas regularly require what are termed *soft* or *exotic* currencies, i.e. currencies that are traded in quite small volumes compared to *hard* currencies, such as the dollar, the euro, the pound and the yen. Whereas the motivation for currency traders to purchase hard currencies can often be to speculate on small changes in value, the motivation to purchase exotics is usually demand-led, i.e. there is an actual requirement for the currency for use within the country. NGOs purchase most of their operational currency on a spot rate basis, i.e. a cash price per unit of currency for immediate delivery. This is because the traditional tools used to manage risks associated with buying currency, such as derivatives, are difficult to obtain when procuring exotic currencies that are traded at relatively low volumes.

## Recommendations

A clear recommendation of this paper is that donors and NGOs should approach foreign exchange (fx) procurement in the same way as they approach any other procurement, rather than as a simple transfer of money abroad. Acquiring currency should not be viewed as different from the purchase of any other high-value item made by an organisation. Indeed, it is something of an anomaly that local currency procurement has not been treated in this way.

This situation where fx procurement is currently not competitively tendered in the UK's development sector can be overcome through constructive dialogue between donors and NGOs. The UK is fortunate in that open lines of communication already exist between these actors. This ought to allow guidelines of best practice to be developed without the need for overly prescriptive policy.

## Donors

DFID is well placed to take a lead in producing guidelines and information on sound fx procurement policy for its grantees, possibly through collaboration with other government departments to utilise their expertise in this field. We would hope that it would be possible for donors to work together to produce guidance of best practice on how to secure the most competitive rates when buying exotic currencies. A more unified position from institutional donors on this issue would potentially be of great use to grant recipients.

## NGOs

A key recommendation is that NGOs can ensure more money reaches projects on the ground through the use of a more flexible and proactive approach to purchasing fx, particularly through the employment of competitive tender. Organisations ought to research and make use of exotic currency specialists whose network of trading partners' in-country offers the greatest opportunities to identify the best rate on the day of purchase.

Historically some NGOs have obtained 'exclusivity agreements' with retail banks on the purchase of fx. This practice limits choice and encourages the misconception that foreign

currency savings can be made through low transfer fees and not through the underlying currency unit price. A recommendation therefore is that NGOs adopt a more flexible approach to currency purchasing that allows various offers to be considered.

In order to address variances in prices between providers a 'no chance to improve' procedure can be introduced. This means that if a provider were to be outbid by a rival there is no further opportunity to improve on the rate, meaning they lose out on that particular deal. Once all parties used to purchase currency are aware of this process they endeavour to offer their most competitive rates to obtain the trade.

For the smaller NGO that may be making an fx purchase of less than £10,000, the way to secure savings is not so clear-cut. Economies of scale are a principal driver of price. Especially below the threshold of £10,000 there is less possibility of achieving competitive prices. It is thus of particular importance that smaller players ask what spread they are being charged in order to secure best value whilst still maintaining a competitive tender process. Such an approach helps create price transparency and foster good practice. A further suggestion, although it carries with it certain logistical problems, is for smaller NGOs with a similar geographical focus to collaborate when buying exotic currencies, as their combined purchasing power will secure them better rates. A long term sector-wide objective could be a centralised semi-independent fx purchasing operation. This would see UK NGOs combining their fx procurement to increase their purchasing power to achieve better value for money.

Our research suggests that there is a lack of information about where organisations can buy exotic currency at competitive rates. NGO networks such as Bond, the Charity Finance Directors' Group (CFDG) and Management Accounting for non-governmental organisations (MANGO) are well placed to develop and disseminate information amongst their members on how best to procure currencies abroad.

The example of Plan International outlined in **Case Study 2** demonstrates how savings have been achieved and that the amount saved far outweighs the costs associated with institutional adoption of a competitive tender process. Savings equivalent to 0.5% across their local currency delivery were achieved for the salary cost of a part-time finance officer. This example could provide a benchmark for best practice for similar-sized organisations in the NGO sector.

## Closing remarks

In conclusion, our research indicates that tens of millions of pounds are being paid in charges and uncompetitively wide margins to the financial sector that could be being spent on people in need abroad. However, these are hidden costs only apparent when considering what might be possible if a better procurement approach for local currency was followed. The opportunity cost of not instituting better practice we calculate to be £20–50 million a year – such is the potential saving to the UK development sector.

Having highlighted this problem we believe it is beholden upon both donors and NGOs to work together to improve procedures relating to the procurement of foreign exchange so that every penny granted or donated by governments or individuals makes the maximum impact in the places in the world to which these funds are intended.

# Introduction

The current financial crisis has cast a spotlight on the extent to which the most competitive price is regularly sought from financial institutions in the procurement of local currency to pay for projects in the developing world. As organisations that consistently buy foreign currency, one would expect that, for donors and NGOs, securing the best rates would always be a priority, irrespective of the economic climate. Although the issue of foreign exchange (fx) has received much attention from within the NGO sector, as a result of the depreciation in sterling and the reduction in the purchasing power of the UK pound, we contend that the general subject of currency procurement and the maximising of value for money has not, to date, received the kind of attention it arguably deserves. This paper examines the policy gap on the part of both donors and recipients in this regard.

We show how competition is fostered by donors to increase efficiency when allocating funds to NGOs – a process employed by most public sector agencies when dealing with the private sector. In light of this culture, the lack of attention given to the cost saving potential of encouraging competition amongst fx providers when purchasing local currency stands out as an anomaly. It will be suggested that through open dialogue between the major stakeholders within the UK development sector, best practice guidelines could be developed for how NGOs buy local currency, increasing the competitiveness of the rates they receive and consequently increasing the volume of aid they send abroad.

The research conducted for this paper included interviews and correspondence with finance directors (FDs) of UK-based NGOs and grant managers of the four main donors discussed: DFID, the Big Lottery Fund (BLF), Comic Relief and the Disaster Emergency Committee (DEC). Interviews were also carried out with foreign exchange traders specialising in exotic currencies, to better understand the process behind obtaining most competitive rates. The information gained provided insight into the UK funding landscape and relationships between donors and NGOs, common perceptions on foreign exchange risk management, and whether our recommendations outlined at the end of the report would be useful and easily implemented.

**Section 1** describes the fx market, identifying the difference between hard and exotic currencies. It highlights why NGOs who procure developing country currencies face particular difficulties in managing fx risk.

**Section 2** outlines the UK context of development funding, from large scale to smaller funding initiatives. It describes how competitive tender has been used by donors in allocating funds, identifying why larger NGOs receive more funding from donors and how this demonstrates a policy gap relating to currency procurement. We explore this policy gap further, describing donor positions and the absence of guidelines that would improve value for money when buying foreign currency. It concludes with a case study comparing the levels of competition within the UK development sector and Sweden's development sector, exploring the flow of funding from official development agencies to NGOs.

**Section 3** explores NGO policy on fx procurement through interviews carried out within the sector. It illustrates the lack of consistency in approach. An analysis of the potential losses resulting from not procuring currency under competitive tender is carried out. Through the identification of funds pledged to partners in ten of the most volatile currencies (with regards to the spot rate provided on a given day) we outline how much money could be saved. This is followed by a case study exploring Plan International's currency procurement procedures and how their methods could contribute to developing best practice guidelines on how to save money in this area.

We conclude that the benefits gained from competitively tendering currency procurement are specific to the size of NGOs. Transnational NGOs have a real opportunity to take advantage of their size to ensure they receive the best rates for the currencies they buy. For smaller NGOs savings might be achieved through sharing the costs of local currency procurement by partnering other organisations with a similar geographical focus.



# Foreign exchange

The foreign exchange (fx) market is the largest market in the world. The 2007 Triennial Survey by the Bank of International Settlements (BIS) shows an average daily turnover of \$3.2 trillion.<sup>2</sup> Traditionally the demand for foreign exchange arises from international trade, tourism, foreign direct investment and international capital flows as well as trading and speculation between the major banks and brokers. If the foreign exchange market is understood as a hierarchy, the major banks would be the highest level, where the purest price is quoted,<sup>3</sup> and the retail customer would be the lowest, where service charges and profit margins are included in the rates obtained. In between these two levels are the various brokerage firms who have access to electronic trading platforms, and the retail providers.

Currencies such as the dollar, euro and British pound, often described as *hard* or *major* currencies, are liquid.<sup>4</sup> The spread between the bid and ask price<sup>5</sup> is narrow and the level of volatility is low.<sup>6</sup> The BIS 2007 Triennial report quoted a 20% increase in emerging market currency trades. These currencies are generally referred to as *minors* or *exotics*. They are not considered major currencies because they are not easily traded in a standard brokerage account. It is important to also note that in many developing countries, foreign exchange transactions are subject to government regulation, as part of foreign exchange management, but also to prevent money laundering, which can minimise the ability of organisations to freely buy and sell particular currencies.

The market for major currencies is mainly driven by a combination of speculation and risk allocation by traders to turn a profit. Demand is directed by intra-market information on trading strategies of competitors as well as herd behaviour. For exotics the market is heavily based on the demand for the currency on a given day, as opposed to speculating on how the price will move.

Another distinction between the markets for major and minor currencies is how risk is managed. Through the use of fx derivatives (including forward contracts)<sup>7</sup> traders are able to manage their exposures when buying foreign currency. Two thirds of the average daily turnover in the fx market is attributed to traditional fx forward and swap

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2 BIS Triennial Survey, 2007 – [www.bis.org/publ/rpfx07.htm](http://www.bis.org/publ/rpfx07.htm)

3 With the most minimal profit margin included in the rate quoted.

4 Liquidity in this context refers to an abundance of buyers and sellers in the market, resulting in large volumes traded without significant price swings.

5 The bid/ask spread (also known as buy/sell spread) is the difference between the price quoted by a market maker for an immediate sale (bid) and an immediate purchase (ask). The size of the bid-offer spread in a given commodity is a measure of the liquidity of the market and the size of the cost of the exchange.

6 Volatility risk in financial markets is the likelihood of fluctuations in the exchange rate of currencies. It is a probability measure of the threat that an exchange rate movement poses to an investor's portfolio in a foreign currency. Volatility in hard currencies may be very high during a crisis.

7 A forward contract or simply a forward is an agreement between two parties to buy or sell an asset at a certain future time for a certain price agreed today. The difference between the spot and the forward price is the forward premium or forward discount, generally considered in the form of a profit, or loss, by the purchasing party. Forwards, like other derivative securities, can be used to hedge risk.

contracts.<sup>8</sup> It is hard to obtain a forward or swap contract where one leg of the currency pair is denominated in an exotic. If one is available it is likely to be very expensive.<sup>9</sup> Across the exotic currency portfolio, NGOs arguably work with the most infrequently traded currencies, making it difficult to purchase instruments that would fully secure them against shifts in prices.<sup>10</sup> For these reasons the majority of trades carried out that include an exotic currency are carried out as a spot transaction. Spot trades account for about one third of all fx transactions and involve trades in which two brokers agree on an exchange rate and then trade currencies based on that rate.<sup>11</sup>

The costs associated with buying exotics at a spot rate can become expensive because such currencies are traded at low volumes. There are three main reasons behind these costs:

1) **The number of transactions needed to obtain the desired currency**

An NGO may carry out a number of transactions with a number of traders to obtain the desired currency. For example, they may be forced to first purchase dollars, transfer those dollars to the country in question and then exchange within country. In this instance they have been charged at least twice, when the trade could have been carried out in one straight transaction. For both of these trades either a commission was taken, or the customer would have encountered a margin, increasing costs.

2) **Using organisations that are not specialists in exotics and therefore are less likely to identify the best price**

Costs linked to purchasing exotics can also relate to the type of organisation being used when buying exotic currency. If the provider used to carry out the trade does not specialise in exotics, it is highly unlikely that the most competitive price will be obtained. This point is best illustrated with an example. For an NGO with £100,000 they need to send to Malawi, there is a real opportunity to achieve a competitive rate of exchange. This is because hard currency is in short supply for the broker in Malawi and is unevenly distributed. Those banks inside Malawi without regular access to hard currency will be willing to pay a much higher price for this sterling amount than those banks with more regular supply. This price differential may be as much as 10%. A specialist UK trader with an extensive network in Malawi is more likely to identify this need, providing their NGO client with a highly competitive rate for their sterling. This example tells us that NGOs increase the probability of obtaining the most competitive rate when using specialist currency providers whose fx trading function pays close attention to the exotic currency market. The likelihood of identifying this need through a retail bank is diminished because they will focus on currencies that are traded in higher volumes, i.e. major currencies such as the euro and will have, at best, one correspondent in Malawi. Through using a retail bank, when purchasing an exotic such as the Kwacha, the rate obtained is likely to be uncompetitive, minimising value for money and increasing costs.

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8 A swap is a derivative in which two counterparties exchange certain benefits of one party's financial instrument for those of the other party's financial instrument. Specifically, the two counterparties agree to exchange one stream of cash flows against another stream. These streams are called the legs of the swap. The swap agreement defines the dates when the cash flows are to be paid and the way they are calculated.

9 Interview with specialist currency broker in exotics.

10 Some exotic currencies are pegged to hard currencies such as the euro, allowing NGOs to manage their fx exposures in the traditional way, such as through the purchase of forward contracts.

11 Griffiths and Epstein 2004.

3) **A focus on service charges related to the transfer of funds as opposed to identifying the underlying unit price for the currency being bought**

Through our research we have found that some NGOs approach the realising of funds abroad by comparing different rates of service charge offered by providers in the market place. This is not comparing the underlying unit price for the local currency, meaning organisations can leave themselves exposed to being overcharged. Focusing on service charges is not following a process which increases the best rate to maximise value for money. Moreover, as soon as an instruction to transfer funds is made, an NGO loses financial control of the process and is totally in the hands of the currency provider as opposed to actively seeking a best price before committing the funds. Concentrating on service charges, one can argue, points an organisation in the wrong direction, distracting them from identifying the actual quantity of local currency they will realise on the ground for a specific given price.

A final issue for consideration relating to price for both hard and exotic currencies is the impact of the size of trade on the rate obtained. There is a clear benefit of economies of scale when purchasing currency. Organisations which convert larger volumes of hard currency into local are likely to receive more competitive unit rates. This would suggest that larger NGOs with extensive partnerships in-country, which as a result buy greater quantities of local currency, are more likely to receive the most competitive rates. Smaller NGOs whose operations abroad in some instances require transfers of less than £10,000 may find it difficult to work through organisations that are best placed to achieve the most lucrative rate. For the smaller NGOs, managing this situation is addressed in the **Recommendations**.



# Donors

Both the public and private sectors employ the use of competitive tender to achieve best value for money. Whether purchasing office equipment, buying in additional communication services or distributing humanitarian relief, competitive tender allows organisations to utilise resources efficiently. Achieving, and being seen to achieve, the most cost-effective price for goods and services is an accepted norm. Indeed, donors themselves employ this process when deciding which organisations receive their grant allocations. If this widely employed approach was extended to include the purchase of local currency, it would help ensure that the highest proportion of every pound was spent overseas. Operating such a procedure would also improve transparency and accountability.

This section sets out the UK funding context and argues that donors, through open and constructive dialogue with their NGO partners, can ensure that millions more of funds pledged can reach their intended destination – humanitarian and development work in developing countries.

For the purposes of this paper the UK's four major funding organisations have been examined: the Department for International Development (DFID), the Big Lottery Fund (BLF), Comic Relief and the Disaster Emergency Committee (DEC). Although the four agencies researched vary in their strategic focus, they all to some extent employ the principle of competitive tender in deciding on which organisations they partner.

## 2.1 The UK funding landscape

The Partnership Programme Agreement (PPA), Civil Society Challenge Fund (CSCF) and Humanitarian Focused Funding Schemes are the three main schemes managed by DFID in the UK.<sup>12</sup>

The PPA sees the largest amount of funds available to NGOs. In an interview with a PPA member, it was made clear that retaining a PPA with DFID was of the highest importance. Indeed, they had restructured their programmes to further align their strategic focus with DFID's to help guarantee this flow of funding. Given the potential amount of funding available – VSO, for instance, received £27 million in 2007/08 – such behaviour is understandable. The vast majority of PPA partners are relatively large, well established UK NGOs whose relationships with DFID in some cases have lasted since its inception in 1997.

A particular feature of the PPA is its flexibility with regards to reporting. The majority of agreements are classified as unrestricted funding; meaning NGOs receiving grants under the scheme are not limited to spending funds on a specific project. The flexibility and trust given to DFID partners under this scheme evolves through long term relationship building. This is often in the form of collaborating on policy development, good governance issues and aid efficiency.

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<sup>12</sup> Our analysis does not include the allocation of funds through schemes managed by DFID country offices.

It has been argued that having highly developed operations abroad ensures that DFID funds can have the highest impact at the lowest cost.<sup>13</sup> Furthermore it is suggested that Transnational NGOs (tNGOs) provide official agencies with a vehicle to move large amounts of money quickly and efficiently into countries of strategic importance, which contributes to explaining why they hold the highest proportion of PPA agreements.<sup>14</sup> Given the credibility afforded to tNGOs because of their ability to move funds efficiently, the lack of attention given to how their local currency is procured is all the more striking.

The DEC is an umbrella organisation that is composed of 13 members.<sup>15</sup> Because the organisation exists as a body to increase awareness of humanitarian crises and to raise funds for the humanitarian work of its members, its role in policy creation is directed by its current member NGOs. With that said, organisations have to meet certain criteria in order to obtain membership. One of these is to have a framework agreement or partnership agreement with an official agency; in that only UK NGOs can apply for DEC membership, essentially only PPA-funded organisations can be DEC members. Having a framework agreement with DFID provides assurances to other member NGOs that an organisation upholds principles of good governance, alongside being an effective humanitarian agency.

Although it is accepted that the DEC is not a traditional donor organisation, its role as a major fundraiser and allocator of public finance means it also has a responsibility to ensure that funds are being spent efficiently. As seen with the PPA, members' projects are funded continuously throughout their membership, even though there are no rigid reporting expectations. The more flexible approach to reporting in the case of DEC members and PPA organisations reflects the perception that organisations admitted into each agreement have demonstrated their effectiveness in financial management. With that said, neither the DEC nor DFID assess these organisations on how they ensure value for money when buying currency. Given the amount of available funds to individual organisations under both these schemes, this oversight stands out as an anomaly. It is important to note that in the case of the DEC, where there is no clear distinction between the NGO members and the DEC as an institution, there is a real opportunity for discussions to occur on how to best manage this policy gap.

Although the larger sources of funding within the UK development sector are essentially off limits to smaller NGOs, they are encouraged to apply for project based funding through DFID's CSCF funding scheme, and the programmes developed by the BLF and Comic Relief. Unlike the PPA, funds received through these schemes are deemed restricted funding with a clear project focus.

Under the CSCF scheme, NGOs are eligible to receive grants of up to £500,000 per year per project. The BLF schemes offer a wider range of funding from £10,000 to £5 million. Comic Relief offers up to £1 million for project grants, whilst strategic funding has no upper limit. For all the schemes mentioned, applicants are required to have viable overseas partners. Reporting on project development under all the schemes mentioned requires greater amounts of information from the NGOs over the funding period when compared to larger funding schemes. Comic Relief expects grantees to provide annual reports on how funds have been spent and whether strategic objectives are being met.

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13 Section 2.1 of DFID and International Services Second PPA Agreement 2005–2010 offers useful example. [www.dfid.gov.uk](http://www.dfid.gov.uk)

14 International NGO Training and Research Centre (INTRAC) Report 2006.

15 The Disaster Emergency Committee (DEC) is an umbrella organisation comprising thirteen development agencies that is convened in the wake of a particular disaster to alert the public, politicians and the media and generate funds. Work in the field is carried out by its member agencies: ActionAid, British Red Cross, CAFOD, Care International UK, Christian Aid, Concern Worldwide, Help the Aged, Islamic Relief, Merlin, Oxfam, Save the Children, Tearfund and World Vision.

For the smaller NGOs institutional donors make up a large proportion of grants received, so ensuring funding from the likes of BLF and Comic Relief is essential to fulfilling their mandates.<sup>16</sup> NGOs that are able to illustrate good reporting and evaluations of projects alongside good delivery are more likely to receive further funding, or extensions to existing contracts.

Around two thirds of UK NGOs conducting development work overseas have a total income of under £3 million, and for the purpose of this paper they are being classified as small to medium in size. The vast majority of these compete against each other for funding under the CSCF fund. They also compete against the larger NGOs for project and strategic grants from Comic Relief and BLF.<sup>17</sup> For this reason competition for funding at this end of the market is more aggressive, which provides donors with the opportunity to expect more from applicants in the way of ensuring efficiency and effectiveness in the use of aid. For all donors, fostering civil society in developing countries is a dominant strategic objective and NGOs with viable partnerships in the countries they work in are favoured. However, how efficiency is guaranteed in converting British pounds into the local currency of those partners is not a requirement in deciding on which organisations receive money. Why a culture for seeking the best rates for the operational currency is not encouraged is unclear, since the expectation is for NGOs to guarantee that the highest proportion of each pound received is spent achieving developmental objectives.

For many of the organisations interviewed, introducing a policy that requires a clear reportable tendering procedure for local currency procurement was an unattractive prospect given the considerable amount of reporting they have to carry out already. However, the additional obligations required to ensure efficiencies in how partners receive funding via UK NGOs would more than pay for themselves and free up aid money to be used on the ground. This process would not necessarily be overly burdensome in terms of reporting.

Given the current nature of competition in the UK funding landscape, donors should recognise the benefits available to larger NGOs regarding fx procurement. This is not to suggest that larger NGOs should be favoured, but merely to point out that they have the opportunity to be highly efficient in procuring foreign currency, and therefore expectations of them should be greater.

## 2.2 Donor policy

This section outlines positions taken by donors regarding their policy, or the lack thereof, on foreign currency procurement, with the reasons behind their positions. The data used in this section is from interviews and email correspondence with donors and NGOs under contract, as well as from publicly available sources.

DFID policy on foreign exchange varied depending on the scheme. NGOs with a CSCF grant usually have to obtain three quotes when purchasing project-related goods. Where grants are country specific, the Civil Society Department ask applicants to use the *Financial Times* exchange rates to assist in understanding costing relating to the project.

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16 Transnational NGOs also receive grants from institutional donors in other countries.

17 Strategic grants under Comic Relief offer no upper limit on funds which is why tNGOs apply for such funding. The BLF International Strategic grant programme offers up to £5 million for projects meaning tNGOs apply here also.

However, there are no guidelines on how to actually ensure you get those rates listed in applications, or that the rate quoted on the FT website for the exotic currency in question is the best rate available on that day. For the PPA, DFID stated that at the end of each funding period all partners would undergo an independent external assessment. This is the main reporting criterion, and usually includes a financial evaluation. Unfortunately the terms of reference for those evaluations were not available during our research and so DFID was not able to comment on whether reviewing partner policies and procedures concerning fx procurement would be included in the assessments at the end of each agreement.<sup>18</sup>

The value for money team at the National Auditing Office reviewing DFID policy in this area stated that foreign currency procurement had never been an issue for consideration, and for that reason they had no official stance. They did suggest, however, that the NGOs funded by DFID should individually decide on how to manage fx procurement given variations in their geographical focus and organisational structures. For these reasons they stated that providing regulations on how to procure would be difficult to achieve. They also mentioned that they endorsed the general principles of effective procurement, and expected that for all areas of procurement a tender process should be introduced to ensure value for money.

In the Big Lottery Fund's Annual Report for 2007/08 it was stated that the organisation was not exposed to material foreign currency risk.<sup>19</sup> This was attributed to the fact that the majority of its funds were spent within the UK, with only a small proportion going to overseas development work. Although they did not comment directly, one can surmise that the lack of risk envisioned by them would see them take a similar position to that outlined by the National Auditing Office, suggesting that guaranteeing the most competitive rates was the responsibility of the NGO or development partner.<sup>20</sup> Similarly, the Disaster Emergency Committee stated that they prescribed no policy for foreign currency procurement specifically because the organisation itself did not partake in any of these transactions. They suggested that their members were better placed to manage these concerns internally.<sup>21</sup>

The International Grants team at Comic Relief argued that because of the variation in the organisations they partnered it would be difficult to offer a policy that was broad enough to cover the uniqueness of each partner's circumstances whilst still being able to suggest something of use. They went on to state that their contracts offered no specific guidelines on procurement; however, their emphasis on good and transparent financial management encouraged their grantees to procure commodities in the most cost-effective way possible. The organisation did recognise the importance of promoting discussion surrounding foreign currency procurement, and stated they would welcome any policy developments on the issue, as long as they were constructive and useful for all their development partners.<sup>22</sup>

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18 06/05/2009. Email Correspondence DFID Civil Society Department. DFID Value for Money Team made no comment.

19 £36 million has been awarded by BLF to projects overseas during 2007/08. P18 BIG annual report and accounts 2007/08.

20 Big Lottery Fund made no comment.

21 06/07/2009. Email correspondence with DEC.

22 06/07/2009. Interview with International Grants Manager at Comic Relief.

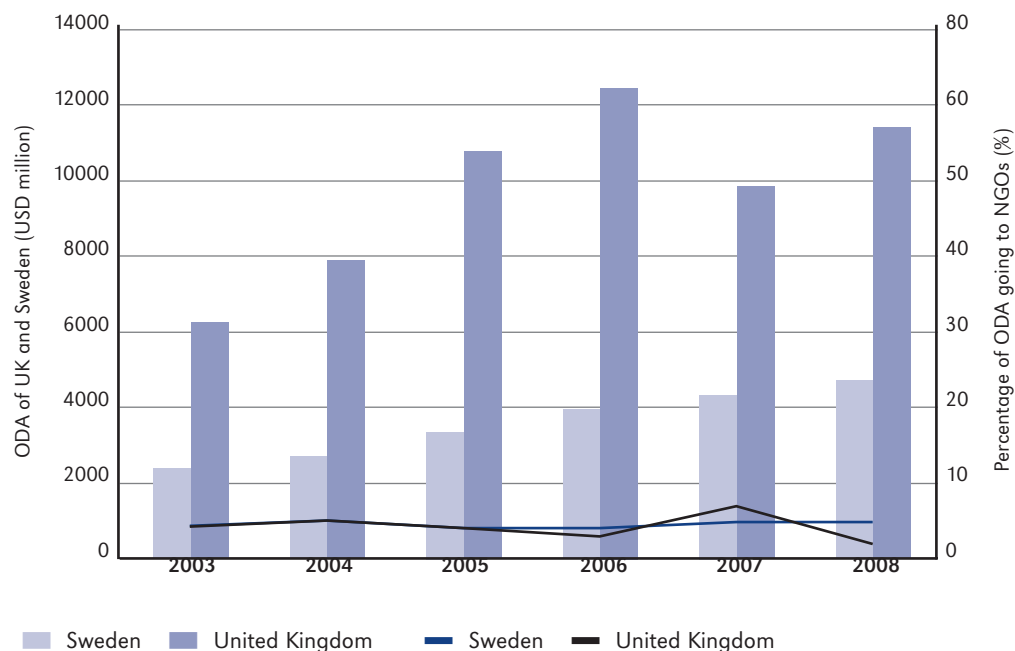
It is important to note that prior to the financial crisis, for UK NGOs buying local currency the increasing purchasing power of the pound had relegated in importance the focus on getting the best rate. However, this argument is not sufficient to explain why the issue has been ignored by donors when increasing aid efficiency has always been on the agenda. Many of the arguments presented by donors highlight the point that promoting a one-policy-fits-all approach to the issue is neither helpful nor effective, which is an argument not devoid of merit. With that said, encouraging discussion on the issue so as to identify common threads of concern across the industry seems uncontroversial and greatly beneficial. To argue that foreign currency is an issue for NGOs alone suggests that donor organisations have no role to play in improving efficiency. DFID places importance on collaboration in policy creation with its grantees, and case study one, which explores the opportunity for open dialogue with institutional donors such as DFID, concludes that its reach within the UK sector provides unique opportunities to encourage discussion amongst NGOs on fx procurement. Moreover, donors such as the DEC have a real opportunity to encourage discussion on issues relating to foreign exchange risk management, given that its board consists of trustees from member organisations. Of all the organisations spoken to, Comic Relief demonstrated the most interest in the issue of fx procurement and the difficulties faced by their development partners in securing competitive rates when buying currency.

### **2.3 CASE STUDY 1 Comparing official agencies: DFID in the UK and Sida in Sweden**

This case study compares the UK official development agency, DFID, with the Swedish International Development Agency, Sida. The purpose of this section is to understand how the two organisations encourage competition within the development sector to increase aid efficiency. The study will first look at general trends in the development landscape of these two countries, followed by an outline of the movement of funds through the various funding schemes each agency employs. It will then assess competition for funding between NGOs and whether the competitive environment within the sector for both countries is conducive to maximising value for money relating to the procurement of foreign currency, or whether it limits opportunities to increase efficiency in this area.

Charting Official Development Assistance (ODA) from DFID and Sida illustrates why they are a good pair for comparison. As **Figure 1** illustrates, ODA and the year on year percentage allocated to NGOs follow a similar trajectory. Although actual amounts pledged by both countries differ greatly, the pattern of spending follows a positive correlation, meaning amounts pledged increase generally year on year. Although ODA figures for Sweden and the UK differ greatly, the percentage allocated to NGOs are very similar.

**FIGURE 1 Official Development Assistance (ODA) and percentage of ODA going to NGOs for Sweden and the UK**



The X axis and Y axis on the left, relate to the bar chart, outlining Official Development Assistance of both the UK and Sweden. The Y axis on the right charts the percentage of ODA going to NGOs and corresponds to the two line graphs.

*(Source: data used can be found at [www.oecd.org/dac/stats/idsonline](http://www.oecd.org/dac/stats/idsonline))*

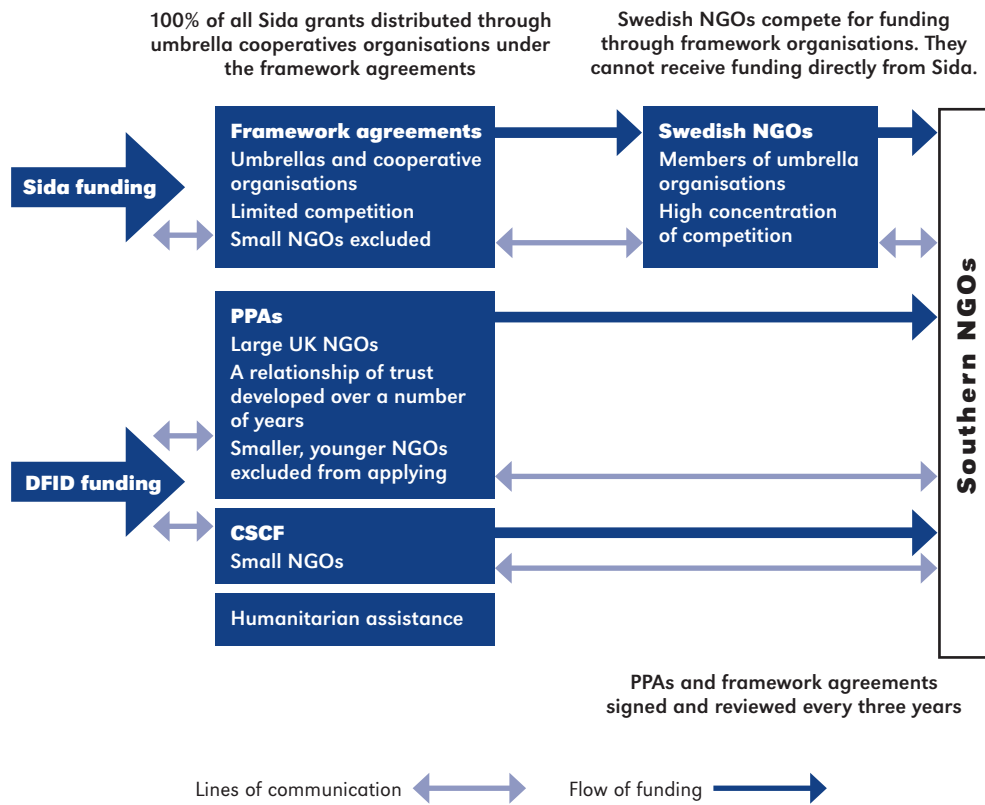
Directing bilateral aid through NGOs via a competitive tender process is a method that has been employed by both Sida and DFID. Although both agencies subscribe to the concept of open competition as a means of dividing funding amongst national NGOs, the level of openness and their policies for ensuring efficiency differ.

Since the 1980's Sida have employed a system that sees three levels of competition for funding:

- 1) Umbrella organisations competing to obtain a framework agreement with Sida
- 2) Swedish NGOs competing for funding from framework organisations
- 3) Southern partners competing for funding from Swedish NGOs.

**Figure 2** depicts these levels, comparing them to DFID. Sida argue that their funding structure is in place to encourage organisations with a clear development strategy, alongside ensuring sustainable development through continuous and open dialogue relating to policy creation and lesson learning. Although this in many ways is similar to DFID, the schematic outlined below offers a useful illustration of why these may not necessarily be being achieved. The schematic describes the flow of funding from the two official agencies discussed to their development partners. Alongside this, it also highlights the flow of information and the open lines of communication between the various development partners.

FIGURE 2 Schematic of movement of funds and communication



(Source: [www.sida.se](http://www.sida.se), [www.dfid.org.uk](http://www.dfid.org.uk), Interview with Communications Officer at Sida)

When looking at the flow of communication to Sida through the Swedish development sector a number of conclusions can be drawn. Firstly, the lack of communication between Sida and the vast majority of Swedish NGOs makes it difficult to encourage lesson learning or to be innovative in the development of policies relating to aid disbursement. Moreover, the forum for open dialogue with Sida appears to be relatively closed off. Relying on umbrella organisations to provide an environment that fosters such activities reduces the level of control Sida has in ensuring development objectives are met in the most efficient manner. Research carried out in 2006 by the International NGO Training and Research Centre argues that this framework is in place to reduce staffing and administrative cost for the agency itself. However, the lack of contact with Swedish NGOs and the funnelling of information through umbrella organisations makes the assessment of the effectiveness of Swedish aid difficult. The same report compared the various funding schemes available to NGOs across Europe. It found that in the case of Sida obtaining quality reporting from the umbrella organisations on what objectives were met as a result of the agency's funding was an area of difficulty.

When compared with DFID, it is clear that there are some similarities. The relationship of both development agencies with national NGOs has a hierarchical nature. In the case of DFID, the PPA members are usually well-established NGOs that have had long-lasting relationships with the agency. As a result the level of communication between the agency and these organisations exhibits a partnership-like quality, as the name of the scheme would suggest. The nature of this relationship is comparable with the framework organisations under the Sida system. The main difference is that the line of communication between DFID and the smaller NGOs remains open, allowing for dialogue

and lesson learning between the agency and most organisations in the UK development sector. DFID's wide reach into the sector means that useful policy creation through open dialogue is more likely, and its ability to respond to changes in the development climate (e.g. the effective devaluation of sterling in 2008) is sharper. NGOs interviewed commended DFID on how it responded to the consequences of the financial crisis on their operations.

In understanding foreign currency procurement and developing best practice guidelines relating to it, DFID seem to be better placed to foster discussions with UK NGOs. Many of the UK NGOs interviewed for this report praised DFID's flexibility in managing their relationships, and described them as forward thinking in their approach to overseas development. This would suggest that the UK donor-recipient climate is conducive to tackling the issue of fx procurement and best practice.



# 3 NGOs

This section will outline what the hidden costs associated with currency procurement could be for NGOs currently buying exotic currencies. Through an analysis of ten currencies,<sup>23</sup> looking at the potential variations in the spot rate available on a given day, we estimate how much money cumulatively NGOs could be losing through not applying a process of competitive tender when buying currency. The section will then go on to discuss the current policies and procedures of NGOs regarding fx procurement, and their positions on how to increase efficiency in this area. It will be concluded with a case study detailing the process employed by Plan International when procuring currency. The data used in this section was taken from interviews with nine NGOs, whilst the analysis on the potential losses applied data extracted from the statements of financial accounts (SOFA) for the following agencies:

<i>ACTIONAID</i>	<i>Action Against Hunger UK</i>
<i>ADD UK</i>	<i>APT Enterprise Development</i>
<i>Basicneeds UK Trust</i>	<i>British Red Cross</i>
<i>CAFOD</i>	<i>Childhope</i>
<i>Concern Universal</i>	<i>Concern Worldwide</i>
<i>Conciliation Resources (IWPR)</i>	<i>GOAL</i>
<i>Halo Trust</i>	<i>Health Unlimited</i>
<i>Homeless International</i>	<i>Interact Worldwide</i>
<i>IPPF</i>	<i>IRC</i>
<i>Islamic Relief</i>	<i>Malaria Consortium</i>
<i>Marie Stopes International</i>	<i>Médecins Sans Frontières</i>
<i>MERLIN</i>	<i>One World Action</i>
<i>Plan International</i>	<i>Save The Children</i>
<i>Skillshare International</i>	<i>VSO</i>
<i>Wateraid</i>	<i>Womankind Worldwide</i>

## 3.1 NGO policy

This section analyses answers provided in interviews carried out with nine UK NGOs of varying sizes. Their responses provide a snapshot of the NGO sector, offering some useful insight into how foreign currency procurement is perceived throughout the sector and the role NGOs believe donors should assume in policy formation relating to foreign exchange. The section also outlines the processes used by the NGOs interviewed in procuring foreign currency.

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23 Six of the countries included in the analysis are listed in the top 20 receivers of official development assistance from the UK.

The majority of development agencies interviewed had a foreign currency procurement policy in place. It was found that organisations had varying policies, and this variation depended on the country the funds were being sent to. For some of the organisations interviewed they discussed how in some instances sending hard currency was the only option given the difficulty in procuring the local currency within the UK, an example provided was the Sudanese pound. It was also found that in some cases exchange controls prevented the procurement of a currency outside of the country. Others argued that Southern development partners preferred to have hard currency sent as opposed to local, because they were concerned with the volatility of the exchange rate. In some cases Southern NGOs had hard currency bank accounts and therefore requested payments to be made in that same currency. As a result, even if it was more cost effective to buy local currency through a provider in the UK (which they had found for some countries) they still sent hard currency to their partners overseas, arguing that the long term benefits of not trading in a highly volatile currency outweighed the short term benefits of buying the local currency and sending it abroad.

One NGO interviewed outlined a policy that was directed by how they produced their budgets for projects. Because they completed their budgets in pound sterling they sent funds abroad in the same currency, as a result, the risk associated with fluctuations in exchange rate or in spot rate prices were shifted to the Southern partner. Conversely, another NGO outlined their policy of budgeting in local currency in an attempt to centralise exchange rate risk. With that said, they also bought hard and local currency depending on the country in question and the availability of currency within the UK. With this particular NGO they had an elaborate foreign exchange policy which included competitively tendering out their procurement alongside conducting extensive economic analysis on their country portfolio to help hedge against other risks related to foreign exchange. For areas like Francophone Africa, they were buying forward contracts in euros because many of the currencies in that region are pegged to it, providing them with a synthetic hedge.<sup>24</sup> They generally found that through having a competitive tender they were given more flexibility on how they decided to move funds. Being a tNGO with a high volume of transactions, they also found that service providers were approaching them with their rates, meaning the process was relatively easy to sustain.

One of the smaller NGOs interviewed had a policy which not only paid attention to procurement, but focussed heavily on the area of expertise of the service provider. They found that there were great savings to be made through using currency specialists, and generally felt that using retail banks to transfer funds was a highly inefficient process. The FD of this NGO argued that through using a number of foreign exchange specialists they had established a useful tender process that increased efficiency when buying currency. Another organisation also found that retail banks with an emerging or developing country focus tended to offer very competitive rates for *minor/exotic* currencies. The position taken correlates with the demand driven nature of the *minor* currency fx market. This demonstrates that to achieve the best rates for the local currencies you buy, the demand for the currency in country needs to be identified. As mentioned, this is more likely to be achieved with institutions and brokerage houses that have a similar geographical focus (in relation to the currency they buy) to NGOs working in those areas of the world. It is also noteworthy that the above comments come from one of the smaller NGOs who would be unlikely to see some of the benefits enjoyed by tNGOs regarding cost

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24 Some exotic currencies are pegged to hard currencies such as the euro, allowing NGOs to manage their fx exposures in the traditional way, such as through the purchase of forward contracts. This is known as a synthetic hedge.

savings associated with fx procurement. This would suggest that when fx procurement is efficiently carried out smaller organisations can also make substantial savings.

Another FD interviewed argued that the context of foreign currency procurement could not be discussed without including the benefits of using derivatives. He suggested that many NGOs receive a number of quotes from their banks when buying currency, however given the depreciation of pound sterling many were finding it difficult to deliver on project objectives agreed with donors. He believed organisations were losing a great deal by not considering the use of financial instruments in securing their positions. As outlined in **Section 1**, however, obtaining a forward contract or another hedging tool is particularly difficult when the traded currency pair has one denominated leg in an exotic currency. With that said, when buying currencies that are pegged to major currencies such as the euro or US dollar, the use of financial instruments may be an option to consider.

The interviews conducted illustrate the variety of approaches taken alongside the myriad of perceptions relating to the procurement of foreign currency. It is clear that currency procurement is not an area that has been overlooked by finance personnel within NGOs, however the sharing of information on how to increase efficiency in this area is lacking. We would hope that one of the main points taken from our findings is the importance of encouraging dialogue on best practice through sharing information and lesson learning. Like many non-financial sectors, the development sector is characterised by multiple approaches to dealing with foreign exchange risk. Consequently, we conclude that access to information-rich resources that take into consideration the needs of not-for-profit agencies in this area of foreign exchange would be welcome.

Of the NGOs interviewed, 55% percent disagreed with having a prescriptive policy on foreign currency from donors. However, almost all the organisations interviewed were keen to see donors involved in the process of increasing efficiency surrounding foreign exchange. One of the NGOs that thought a prescriptive policy would be useful questioned DFID on whether they felt including his organisation's policy on foreign currency procurement in grant applications would impact their application. DFID responded that although it would be of interest, they would take no position on whether it was a useful policy.

The FD of one of the larger NGOs felt that for organisations similar to her own leveraging their size as a means of gaining the best rates gave them an advantage over smaller organisations, therefore to use rates as a means of deciding what organisations to fund would leave smaller NGOs in a difficult position.

Concerns relating to foreign currency procurement were seen as an issue for NGOs and bodies such as the Charities Finance Directors Group (CFDG) and the Overseas Special Interest Group (OSIG). It was argued by one FD that, having a standardised policy as to how NGOs ensure the best rates for local currencies bought, which is created independently of donor organisations, would force donors to consider the impact the structure of their funding rounds had on buying currency efficiently. This issue was raised in light of the fact that there can be a substantial time difference between when a spot rate is quoted in grant applications and the day of which successful applicants would be sending funds to partners abroad, affecting budgets greatly, invariably impacting an NGOs ability to meet deliverables.

There are a variety of needs and concerns that should be recognised in developing policies on fx procurement. It is clear that the issue should not focus on what NGOs can

get the best rates – as discussed larger organisations moving larger volumes of funds can achieve rates that cannot be matched by the smaller organisations. Developing best practice guidelines that ensure the most cost-effective methods are used throughout the sector could see very large savings made for development and humanitarian NGOs, alongside their southern partners. DFID as an institution have an opportunity to take a lead in developing such guidelines without being prescriptive through initiating dialogue with individual NGOs and bodies such as MANGO, CFDG, and Bond.

The lack of coordination within the sector currently on this issue has meant that, although there are some NGOs (large and small) with very effective policies on how they achieve the best rate for the currencies they buy, other NGOs are not as proficient. It is clear that donors are yet to identify the potential cost savings associated with effective foreign currency procurement. This would explain why fx procurement has not been an area for consideration when allocating funds to development partners.

## 3.2 Hidden losses

The following analysis is a snapshot estimation of the potential losses NGOs could face from not procuring currency efficiently. The percentage volatilities for each country analysed are based on data received from a specialist exotic currency provider, INTL Global Currencies. Their findings are based on a five-year analysis of trends in prices they were quoted when purchasing the below-mentioned currencies. Their results are useful because they provide a conservative estimate of the likely price fluctuations seen on a given day when buying an exotic currency. Their ability to identify such fluctuations is due to the network they have established within developing countries. The following methodology was followed when accumulating and analysing data used to draw our conclusions. There are also a number of assumptions made which are outlined below.

### Assumptions

The analysis offers a snapshot estimation of the potential loss NGOs could make if they do not procure under competitive tender for spot rate prices. The scenario depicted is a conservative estimate in that the median average for each percentage variation has been taken, and therefore the results outlined are skewed downwards.

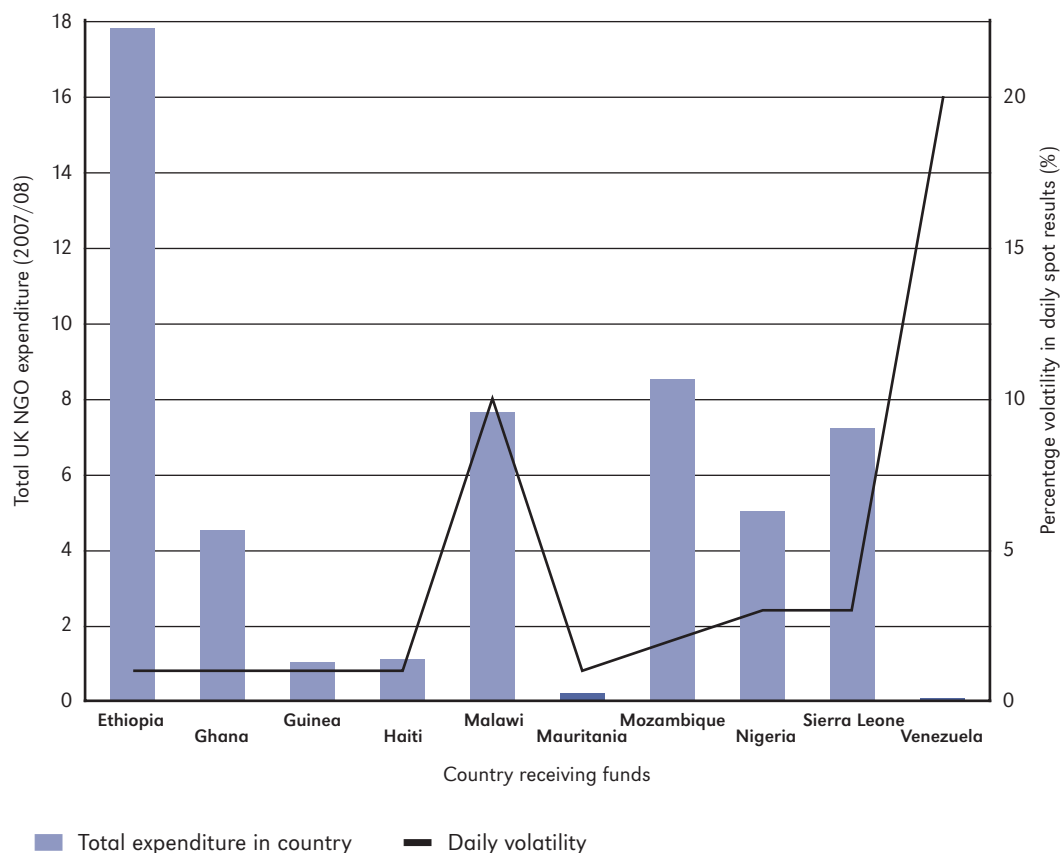
It is assumed that all funds transferred from each NGO into each country takes place through one transaction, as opposed to being spread out over the year. Given that the data used has been presented in a manner that provides a conservative estimate, it is likely that the loss would be greater than the figures presented here.

### Methodology

- The data used for NGO expenditure has come from the Statement of Financial Accounts (SOFA) of NGOs for the period 2007/2008. In some instances it was taken from the SOFA produced for the time period between 1st January and the 31st December 2007.
- The formula used to calculate the potential losses is as follows: total overseas spend per country multiplied by percentage volatility of country currency.

- The figures used to calculate the total overseas spend were listed in the SOFAs as either expenditure by country, or total grants to partner organisations in the relevant country. In a few cases, income for the respective countries was used as the total expenditure for that country was not available (it is assumed in this case, that the difference between the two is minimal).
- The figures are taken from data listed under restricted funding and are not broken down by funding organisation; in some cases they include funds from overseas donors. Totals given may be an underestimate as figures used are not exhaustive and only represent what was highlighted in the various SOFAs.
- The percentage volatility used to carry out this analysis relates to identifying the best price for hard currency in the country in question. With exotic currencies, the fact that they are traded at low volumes means identifying the spread on a given day requires seeking out the best price in country. Having an extensive network in country increases one's chances of identifying this best price. The volatility figures used here therefore, refer to the average variations in prices quoted on a given day for the currencies in question. This allows for a loss to be calculated on the basis of an organisation trading sterling for an exotic as a result of not undergoing a process that seeks out the most competitive rate on the day of exchange.

**FIGURE 3 Total sum of UK NGO funds exposed to currency volatility and the percentage volatility in daily spot rate for each country currency**



The bar chart of the graph represents an estimate of the total funds flowing from UK NGOs into the countries listed, whilst the line chart represents the percentage price volatility for a spot rate transaction. In 2007 Ethiopia was listed in the Statistics for International Development as the second highest receiver of Net Bilateral Official Development Assistance (ODA) after India. As outlined, Ethiopia was the largest receiver of aid across the ten-country portfolio used here. Although the volatility in the potential rates was not as high as other countries, the potential loss in funds going in is one of the greatest. Given the movement of funds from the UK to Ethiopia, we conclude that the potential loss is likely to be the highest. This is because unlike the assumption made here, UK NGOs buying Birr would do so in a number of transactions across a range of days. Although the percentage volatility is estimated at 1% for Ethiopia, this is an average, given the high volume of transfers to Ethiopian partners; the variation in the potential rates an NGO would receive throughout the year could be greater than the one percent calculated. This would increase the risk of trading sterling for birr consistently at an uncompetitive rate.

As discussed in **Section 1** the market for exotic currencies unlike the major currencies is demand driven, therefore the volatility in the price is heavily dependent on the demand seen for hard currency on that given day. Because this demand is not identifiable through an interconnected market system it may be missed, resulting in huge variations in the potential rate quoted on that day. It is important to note that the loss being calculated is the opportunity cost of not instituting better practice. It is a hidden cost because by not seeking out the best rate the potential saving is unseen.

**FIGURE 4 Potential total sum loss resulting from fluctuations in daily spot rate**

	Total NGO Expenditure 2007/08	Conservative Daily Volatility	Opportunity Cost
Ethiopia	£17,774,874.00	1%	£177,748.74
Ghana	£4,494,926.47	1%	£44,949.26
Guinea	£993,278.27	1%	£9,932.78
Haiti	£1,093,916.00	1%	£10,939.16
Malawi	£7,613,423.70	10%	£761,342.37
Mauritania	£193,848.00	1%	£1,938.48
Mozambique	£8,491,780.31	2%	£169,835.61
Nigeria	£4,999,206.32	3%	£124,980.16
Sierra Leone	£7,207,435.66	3%	£216,223.07
Venezuela	£41,439.50	20%	£8,287.90
<b>TOTAL</b>	<b>£52,904,128.23</b>	<b>TOTAL</b>	<b>£1,526,177.53</b>

The costs outlined as mentioned are based on figures taken from thirty NGOs of varying sizes. These organisations were used because their SOFAs for 2007/08 listed figures on expenditure by country, allowing the analysis to take place. The total loss over the ten-country portfolio provides a snapshot of what the total losses over the entire UK overseas spend could be.

Through collaborating with the Charity Commission and INTL Global Currencies we were able to utilize the same process used to calculate the opportunity cost of not instituting a competitive tender for the countries and organizations analysed in the above sample, to the entire UK sector. The Charity Commission calculated the total expenditure of UK registered charities working in Africa, Asia, South America and the Caribbean to be £6 billion for the year 2007/08. From a sample of UK charities we calculated the proportion of their total overseas expenditure used to purchase local currencies. From the data provided by INTL Global Currencies on volatilities in the daily spot rates of the ten most volatile currencies, we took the median volatility of 1%, and multiplied the proportion of total expenditure spent on foreign currency procurement by this percentage. From this we calculate a potential saving of £20–50 million for 2007/08 if UK charities instituted a process of competitive tender to buying foreign currency. This range reflects variations in the proportion of total expenditure spent by charities on foreign currency.

### 3.3 CASE STUDY 2 **fx procurement – a case of best practice**

Plan International is a ‘child centred community development organisation’, which works ‘with children, their families, communities, organisations and local governments to bring about positive change’.<sup>25</sup> Currently they work within 49 countries across the Americas, Asia and Africa carrying out development work in the following core areas:

- Education
- Health
- Water and sanitation
- Protection
- Economic security
- Emergencies
- Child participation
- Sexual health, including HIV.

As a large tNGO Plan originally decentralised their financial management system, which saw country offices managing fx procurement individually. Funds would be sent from the head office in the UK in hard currency (USD or euro), and the country offices would acquire currency locally.

On the surface it was thought that many of the country offices were gaining benefits from this system because there were often no bank charges placed upon them by the institutions they used and the remittance of funds to the countries was a relatively simple process (being only up to two currencies). However upon reviewing the rates they received

in comparison to the rates they could get under competitive tender in the UK they found that, generally, even with service charges they were losing money.

As a result of this, Plan International introduced a new foreign currency procurement procedure during 2008.

It is important to note that Plan's original procurement policy exhibited many of the problems outlined in **Section 1**. Firstly, they were sending hard currency to country offices, encountering a margin when converting Norwegian Kroner or Japanese Yen into either euro or US dollars, which would also have been the case when converting that hard currency into local.<sup>26</sup> Secondly, through originally focusing on the absence of service charge they were led to believe that a material saving was being made, whereas once the central point of consideration became the underlying unit cost of converting currency, it was clear that they were receiving uncompetitive rates.

### Plan International's new policy on fx procurement

Plan currently has an Approved Banking Arrangement (ABA) with six financial institutions. The banking arrangements are managed centrally from their international headquarters by the Treasury Department. Each banking arrangement ideally is reviewed every three to five years. In addition Plan engages the services of a currency remittance provider to supplement the foreign currency provision by the ABA.

Their approach to procuring foreign currency is to use organisations from the ABA to provide their spot rate for a given country or one organisation from the ABA and the Currency remittance provider. Organisations used for each transaction are dependant upon their historical record with Plan. This record assesses the competitiveness of the rate suppliers have provided in relation to the benchmark prices set. This takes place on a country basis and ensures the delivery of funds at competitive rates. Their positions are evaluated regularly through obtaining reference quotes from other providers on the ABA on operational currencies to ensure each institution remains competitive. Essentially no one supplier can assume that they will always be used to buy a given currency, this level of flexibility means Plan increase their likelihood of receiving the best rate on the day of purchase.

There have been a number of noticeable trends seen by Plan as a result of this system. Firstly, the variation in the rates they receive from organisations on the ABA has reduced considerably. At the outset of implementing their new procedure this difference was much higher. An example of the disparity between the prices was illustrated when Plan saw variances between providers of up to 10% during the first week of obtaining competitive pricing. As a result they implemented a 'no chance to improve' procedure, which was made clear at the outset of the new tender process. This meant that if a provider were to be outbid by a rival there would be no further opportunities to improve on the rate, meaning they lost out on that particular deal. It is clear that once all parties used to purchase currency are aware of this process they endeavour to offer their most competitive rates to obtain the trade.

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26 Some countries still receive € or USD as it is either their local currency (LC) or their LC is pegged to € or USD or for exchange control reasons it is not possible to purchase LC offshore.

Secondly, even though the margin of variation in the rates has decreased, they have not disappeared. The Treasury Department found that there are still material differences in the rates they receive and that no one organisation is able to provide the best rates over Plan's complete geographical focus. Their findings suggest that institutions would provide far less competitive rates if they knew their prices were not being compared or worse if they had an exclusivity agreement with them. For spot purchases Plan work with three institutions that have proven to be able to deliver funds that arrive in their field bank accounts on the value date of transaction or on the following day, which is also a very important factor for consideration.

The opportunity to develop such a comprehensive system seen in the case of Plan International is not necessarily available to all NGOs. Being a tNGO has meant that buying currency is less expensive as a result of the volume of money being moved between countries. Service providers are keen to work with them on an extended basis because of the volume of transactions their development work produces, and the resulting sustained business opportunity Plan's operations provide.

When discussing such a comprehensive procurement procedure it is important to consider the costs associated with the policy. For any development agency there are a number of banking requirements outside of currency procurement, therefore alongside centralising their foreign exchange procurement, Plan also managed their other banking needs using some of the same organisations. As a result the associated costs one could expect from running a consistent tender process are kept very low. Likewise, staffing costs were seen to only increase by the equivalent of a part-time finance officer annually.

It was estimated after conducting a study of ten country programmes that through obtaining currency from the UK, as opposed to in the field, Plan were making an fx margin saving of 0.5% of their local currency delivery turnover. This is in addition to an improvement on average percentage margins on transactions of 1% of the trade as a result of obtaining quotes under competitive tender. Given the modest cost to implement this new policy, it is clear that Plan are making real savings from this internal change, allowing for more of their funding to be focused on actual development work. For a more thorough explanation of the methodology for how these savings were calculated, please see **Appendix**.

The policy implemented by Plan offers great opportunities for lesson learning and best practice development, especially for similar sized organisations. Although the complete policy will not be appropriate for all NGOs, the attention given to foreign currency procurement and the subsequent reduction in rate variations demonstrates the real cost savings available through employing competitive tender in the procurement of local currencies. The cost savings available can undoubtedly increase the effectiveness of the work of NGOs, helping them to realise the objectives set by themselves and their donors in achieving sustainable development.

# Conclusion

The demand-driven market in which exotic currencies are bought and sold leads to most transactions being carried out on a spot rate basis. Through applying a process of competitive tender, best rates for local currency can be achieved by identifying the demand for hard currency in the country in question and encouraging competition between providers with the requisite geographical focus. This competition amongst currency specialists increases the chances of NGOs obtaining the best rate on the day of purchase. Finding suitable fx service providers within the UK reduces the number of transactions needed to obtain the desired currency, allowing NGOs to save money and increase the proportion of pledged funds going to development work. Moreover, it is highly important that NGOs focus on the rate quoted by fx providers, ensuring the costs associated with buying local currency are fully identified. This cannot be achieved if organisations associate the costs of currency procurement with service charge.

The UK funding landscape is divided up by size of organisation. TNGOs with substantial reserve income tend to also receive the largest amounts of funds from donors. Because the larger NGOs have the infrastructure to work across regions, they are seen as effective movers of money. For donors, organisations of this kind provide an opportunity to meet development objectives at the lowest possible cost. It is noteworthy that although being an effective mover of funds directs to some degree which organisations are funded, donors offer no policy prescriptions on how best to get those funds into the country in question. As **Case Study 2** demonstrates, the culture of competitive tender within the development sector ought to be extended to include currency procurement so as to increase efficiency and guarantee value for money. The sector has good lines of communication to see dialogue on this issue occurs.

The opportunity cost of not instituting better practice regarding currency procurement we calculate to be costing the UK development sector between £20–50 million a year. Although NGOs employ policies relating to how foreign currency is purchased, they are extremely varied. Plan International's fx procurement policy offers a useful model with which other similar sized organisations can compare their policies and procedures. We hope through increasing dialogue on this issue, lessons can be learnt, expertise can be shared and better practice can be achieved throughout the sector.

# Recommendations

A clear recommendation of this paper is that donors and NGOs should approach foreign exchange (fx) procurement in the same way as they approach any other procurement, rather than as a simple transfer of money abroad. Acquiring currency should not be viewed as different from the purchase of any other high-value item made by an organisation. Indeed, it is something of an anomaly that local currency procurement has not been treated in this way.

This situation where fx procurement is currently not competitively tendered in the UK's development sector can be overcome through constructive dialogue between donors and NGOs. The UK is fortunate in that open lines of communication already exist between these actors. This ought to allow guidelines of best practice to be developed without the need for overly prescriptive policy.

## Donors

DFID is well placed to take a lead in producing guidelines and information on sound fx procurement policy for its grantees, possibly through collaboration with other government departments to utilise their expertise in this field. We would hope that it would be possible for donors to work together to produce guidance of best practice on how to secure the most competitive rates when buying exotic currencies. A more unified position from institutional donors on this issue would potentially be of great use to grant recipients.

## NGOs

A key recommendation is that NGOs can ensure more money reaches projects on the ground through the use of a more flexible and proactive approach to purchasing fx, particularly through the employment of competitive tender. Organisations ought to research and make use of exotic currency specialists whose network of trading partners' in-country offers the greatest opportunities to identify the best rate on the day of purchase.

Historically some NGOs have obtained 'exclusivity agreements' with retail banks on the purchase of fx. This practice limits choice and encourages the misconception that foreign currency savings can be made through low transfer fees and not through the underlying currency unit price. A recommendation therefore is that NGOs adopt a more flexible approach to currency purchasing that allows various offers to be considered.

In order to address variances in prices between providers a 'no chance to improve' procedure can be introduced. This means that if a provider were to be outbid by a rival there is no further opportunity to improve on the rate, meaning they lose out on that

particular deal. Once all parties used to purchase currency are aware of this process they endeavour to offer their most competitive rates to obtain the trade.

For the smaller NGO that may be making an fx purchase of less than £10,000, the way to secure savings is not so clear-cut. Economies of scale are a principal driver of price. Especially below the threshold of £10,000 there is less possibility of achieving competitive prices. It is thus of particular importance that smaller players ask what spread they are being charged in order to secure best value whilst still maintaining a competitive tender process. Such an approach helps create price transparency and foster good practice. A further suggestion, although it carries with it certain logistical problems, is for smaller NGOs with a similar geographical focus to collaborate when buying exotic currencies, as their combined purchasing power will secure them better rates. A long term sector-wide objective could be a centralised semi-independent fx purchasing operation. This would see UK NGOs combining their fx procurement to increase their purchasing power to achieve better value for money.

Our research suggests that there is a lack of information about where organisations can buy exotic currency at competitive rates. NGO networks such as Bond, the Charity Finance Directors' Group (CFDG) and Management Accounting for non-governmental organisations (MANGO) are well placed to develop and disseminate information amongst their members on how best to procure currencies abroad.

The example of Plan International outlined in **Case Study 2** demonstrates how savings have been achieved and that the amount saved far outweighs the costs associated with institutional adoption of a competitive tender process. Savings equivalent to 0.5% across their local currency delivery were achieved for the salary cost of a part-time finance officer. This example could provide a benchmark for best practice for similar-sized organisations in the NGO sector.

# Closing remarks

In conclusion, our research indicates that tens of millions of pounds are being paid in charges and uncompetitively wide margins to the financial sector that could be being spent on people in need abroad. However, these are hidden costs only apparent when considering what might be possible if a better procurement approach for local currency was followed. The opportunity cost of not instituting better practice we calculate to be £20–50 million a year – such is the potential saving to the UK development sector.

Having highlighted this problem we believe it is beholden upon both donors and NGOs to work together to improve procedures relating to the procurement of foreign exchange so that every penny granted or donated by governments or individuals makes the maximum impact in the places in the world to which these funds are intended.

# Appendix

## CASE STUDY 2 – OUTLINE OF INTERNAL STUDY

The figures quoted in **Case study 2** were based on an internal study by the Treasury Department at Plan International. This was carried out for internal purposes only as a tool of analysis that aided their decision to centralise their foreign currency procurement processes, as well as demonstrating the effect of instituting competitive tender.

Their methodology and findings are useful and insightful, however are not quoted as a recommendation to other organisations as this was not its intended use. However they are used here as an example of an informal process that demonstrates Plan's reasons for policy changes relating to the purchase of foreign currency, alongside the benefits they identified from instituting a process of competitive tender.

In identifying the 0.5% saving across their local currency turnover the following methodology was used.

### Methodology re: 0.5% saving on local currency turnover

A screen-based benchmark was recorded at the same time as obtaining quotes from London parties. The margin was then measured using the following formula:

$$\begin{aligned} \text{USD sale amount} \times \text{benchmark rate} &= x \\ \text{USD sale amount} \times \text{quoted rate (bank)} &= y \\ x - y &= r \end{aligned}$$

A screen-based benchmark was recorded at the same time as obtaining quotes received by country offices. The margin was then measured using the following formula:

$$\text{USD sale amount} \times \text{quoted rate (local)} = z$$

From the margins calculated a comparison was made between rates received from local offices and those received from providers in the UK. This was done using the following formula:

$$\begin{aligned} x - z &= p \\ \frac{r - p}{\text{benchmark rate}} &= q \\ \frac{q}{\text{USD sale amount} \times 100} & \end{aligned}$$

## Results

The differences in margins varied by country between 0.29 and 3.00%. 0.5% was used as a conservative average margin for estimating the benefits of buying local currency centrally rather than in the field.

## Weaknesses in methodology and results

The comparison between London and country in some cases was not carried out on the same day and in others it was. This is why a benchmark was used as opposed to a direct comparison between country and London. However it is also important to note that weaknesses would always occur due to variations in factors such as liquidity and time zones.

There was an inherent weakness in using a benchmark as its reliability was not tested. However there were attempts to eliminate this weakness by carrying out the test over a 5–10 day spread over a number of weeks and spreading the currencies over the period.

## Methodology re: 1% saving as a result of competitive tender

The following method was used to calculate the 1% benefit of competition between providers when obtaining rates for local currency in the UK:

- An initial screen benchmark was used. The margin to benchmark was recorded to ensure that the rate obtained were market rates.
- The final deal rate was measured to the benchmark during an approximately ten-week period prior to moving to obtaining competitive quotes, as well as for ten weeks after.
- This comparison between rates received before and after obtaining competitive rates was taken on four currencies and then averaged across the four to come to 0.98%.

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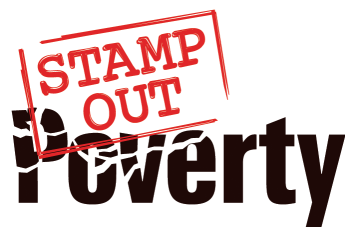
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