

# MISSING MILLIONS



## EXECUTIVE SUMMARY

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.

### Hidden losses

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.

### 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

<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.

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.

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.