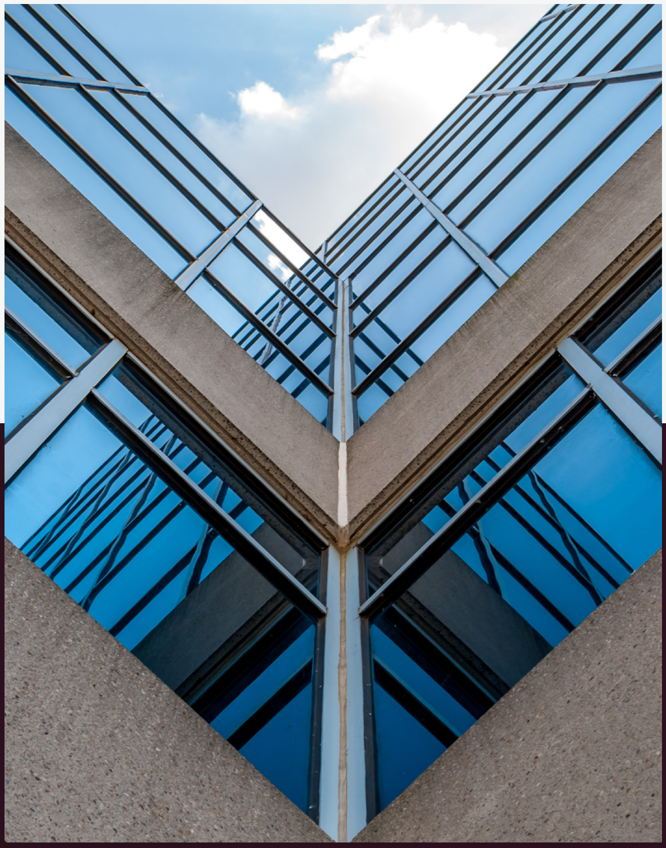
Currency Conversion and the Hidden Costs of Global Trade



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Currency conversion and the hidden costs of global trade

Every day, businesses send hundreds of billions of dollars in payments through the global banking system. But many organizations fail to recognize how inefficient – and costly – this process really is.

Transaction costs may be relatively small on a per-transaction basis. But when one considers the sheer number and value of payments that are made each year, the tally of fees can reach into the billions of dollars.

According to our recent proprietary study, the average global premium charged to send a payment across borders is 3.39%. Depending on the region, this may affect anywhere from 4% to 25%--fully a quarter-- of all transactions. Even when payments are made and received in a single currency, banks may charge significant administrative fees on each transaction.

This is quite clear to recipients, who see fees and exchange rate adjustments cutting into the amount ultimately received in domestic currency. To protect margins, many have no option other than to pass higher prices on to their customers – something that can hurt competitiveness and limit international growth.

The challenge is that many of these costs are not always visible to remitters. Businesses often don't appreciate the impact that a more efficient payment process could have in driving down costs – and improving trading relationships.

[2]Conducted from February 2021 through July 202i.using proprietary trade data from our platform. We analyzed a total of 70,000 transactions, of which 40,000 were US dollars sent to another jurisdiction and held as USD or converted to local currency by the recipient.

Understanding the Issue

To bring attention to this matter and understand the full impact of bank margins and fees on payments, we sifted through more than 40,000 US dollar transactions in which the money was sent from a bank in one country to a bank in another. We looked at transactions that required conversion from US dollars to a second currency, as well as USD to USD payments.

The aim was to produce a comprehensive picture of the cost of moving money across borders, especially on smaller transactions. To isolate the issue, we chose to focus on the 40,000 US dollar transactions where money was sent somewhere other than the US.

We found that the cost of these transfers varied widely, depending on FX conversion rates, administrative fees, geography and the size of the transaction. In many cases, trading partners were paying exorbitant transaction fees or premiums on the exchange rate.

On a broad level, the average bank margin is +3.39%, though the numbers change dramatically depending on the size of the transfer. While large transactions (over US$100,000) have an average bank margin of 0.90%, "micro" transactions (under US$1,000) pay an average margin of 5.67% (see figure 1). [2]

3.39% Average bank margin (USD to foreign transfer)

Methodology

For our study, we gathered and analyzed data on more than 70,000 transactions over 32 days between February and July 2021. To ensure we had a representative data sample, we concentrated on the middle and end dates of each month, when many of these payments are typically executed.

We looked at two types of transfers: one that required conversions to the local currency, and those that did not because the recipient had a USD account. We also compared rates and fees for those transactions completed by individuals and those by businesses.

To identify how costs vary from market to market, we broke our study into six regions: Africa, Asia & Pacific, Europe, Middle East, North America and South/Latin America.

Since the costs can vary greatly depending on the size of the transaction, our study also distilled the data according to US dollar size:

Large	Over $100,000
Medium	$10,000 to $99,999
Small	$1,000 to $9,999
Micro	Under $1,000

In the case of currency conversion, we calculated the average fee, as a percentage of the total sent, charged to the recipient for the service of converting US dollars to a local currency. The exchange rate of the transaction was compared against the daily rate posted here at Corpay for that currency pair on that same day.

In the case of US dollar to US dollar account transfers, using SWIFT GPI tracker data, we calculated the average fee charged to the recipient for the service of receiving the money and depositing it into the recipient's US dollar account.

Figure 1: Costs vary wildly for global payments

Aggregate USD to USD		Aggregate USD to Foreign	
	Average of Bank Fees		Average of Bank Margin
Large	$5.82	Large	0.90%
Medium	6.80	Medium	1.68%
Small	4.68	Small	2.23%
Micro	2.74	Micro	5.68%
Overall average	$4.57	Overall average	3.39%

Source: Data from Corpay Payment Solutions

How hidden charges accumulate

To understand where these fees come in, it helps to understand the steps involved in a typical payment. A transaction might begin with a buyer in the United States who wants to purchase an item from a vendor in the Philippines: the buyer transfers the amount of the purchase price in US dollars to the vendor's bank.

From there, one of two things happens, depending on the country and the financial institutions involved.

In some cases, the vendor's bank will convert those US dollars into the local currency – in this case, Philippine pesos – before depositing the funds into the vendor's account. In other instances, the bank deposits the money into a US dollar account held by the vendor.

When converting from dollars to pesos, the bank sets its own exchange rate, based on market rates, with some percentage of the total added as a profit margin. In cases where the money goes from one US dollar account to another, the bank adds an administrative charge, which can vary from a simple flat fee to a percentage of the sum transferred.

The scope of the issue

In total, our study considered payments worth $1.4 billion with an aveage value of $31,037. Notably, nearly 10% required currency conversion, meaning that they were impacted by both transaction fees and bank margin. The rest, we can assume, were trades made in the same currency (generally US dollars or Euros).

The proportion of transactions requiring conversion varied widely by region. Africa topped the list at over a quarter of the trades. In contrast, less than 5% of North American transactions involved currency conversion. It is important to remember that this data represents a sample of a much larger whole. Billions of cross-border payments are made annually.

Small payments comprised the majority of all transactions requiring currency conversions. This is important to note, as fees charged on smaller payments (e.g., to an online bookseller or clothing retailer) can add significantly to the vendor's costs, while those charged on larger transactions may be hardly noticed (see figure 2).

Figure 2: Conversion Rates by Region and Size

Region	Proportion of Total Converted
Africa	25.25%
Large	12.50%
Medium	20.90%
Small	25.89%
Micro	26.55%
Asia & Pacific	7.23%
Large	3.45%
Medium	4.40%
Small	8.62%
Micro	8.78%
Europe	11.91%
Large	3.01%
Medium	11.66%
Small	12.39%
Micro	12.17%

Region	Proportion of Total Converted
Middle East	12.32%
Large	0.00%
Medium	12.61%
Small	15.10%
Micro	7.03%
North America	4.15%
Large	0.76%
Medium	2.61%
Small	5.22%
Micro	4.54%
South/Latin America	12.88%
Large	4.63%
Medium	8.65%
Small	12.17%
Micro	14.50%

9.93% Overall average

Source: Data from Corpay Cross Border Study, February – July 2021

Bank margins vary greatly around the world

While the overall (or global) average for FX conversion is 3.39%, we found a large variance between regions (see figure 3). The most expensive transactions occur in Latin America, where banks charge an average premium of 5.77%. Relatively small amounts (under $1,000) distort this figure. These small amounts routinely experience higher costs, with an average bank margin of 8.05%. By contrast, those converting larger amounts (over $100,000) in this region have an average bank margin of 0.74%. This pattern generally holds across all regions, though the actual averages, region to region, vary widely. The least expensive average premium, for example, occurs in the Asia Pacific region, at 1.54%.

Figure 3: Average premium charged by region on currency conversion

USD to Foreign

Region	Bank Margins: Businesses	Bank Margins: Individuals
Africa	2.86%	3.31%
Asia & Pacific	1.51%	2.34%
Europe	2.06%	2.45%
Middle east	0.76%	0.68%
North America	4.55%	3.49%
South/Latin America	5.04%	5.74%
Average	2.50%	3.58%

Source: Data from Corpay Cross Border

Dollar-to-dollar transactions come with a cost

As mentioned, one tactic businesses use to avoid currency conversion premiums is by completing purchases in a single currency, in most cases the US dollar.

But this comes at a cost, even when one ignores regulatory constraints, banking costs, foreign exchange risk, and the fact that funds must eventually go through the conversion process. Figure 4 shows the average fee charged by a receiving bank to accept US dollars into a US dollar account. Once again, the range is wide, from a low of $3.72 for businesses in North America to a high of $14.22 in Africa.

Figure 4: Average bank fee charged on USD-to-USD transfers

Region	Businesses	Individuals
Africa	$14.22	$13.55
Asia & Pacific	5.08	5.44
Europe	4.18	4.47
Middle east	4.70	11.85
North America	3.72	6.30
South/Latin America	6.43	3.27
Average	$4.94	$4.77

Source: Data from Corpay Cross Border

Individuals pay significantly more than businesses

The data show that when the vendors are individuals with personal accounts, they pay more than vendors with business accounts: the average rate increases from 2.50% for business to 3.58% for individuals. These differences were consistent across regions and transaction sizes.

This can be especially important in today's gig economy when many individual accounts also serve as business accounts, with high volumes of relatively small transactions each year. Saving on these rate spreads and fees could result in a substantial increase in profit margin for workers.

A practical example

To illustrate the issue, here is a hypothetical scenario: A buyer in the US contracts to purchase equipment from a vendor in Mexico. The equipment might sell locally for the equivalent of US $10,000. However, because the vendor knows that the bank will charge a premium on the exchange to Mexican pesos of 6.87% (the average in Mexico on medium-sized deals), an additional 6.87% is added to the cost of the machinery bringing the selling price closer to $10,687.

When it comes to much smaller transactions, fees become a larger challenge. For a $100 transaction, for example, Mexican banks charge an average of $4.04, making the price to the buyer $104.04. While this is not a crippling increase on a single deal, the difference can represent a significant drag on profitability over the course of thousands of these small transactions.

Figure 5: Average conversion spreads on USD to foreign currency transactions

Business Account		Individual Account	
	Average Bank Margin		Average of Bank Margin
Africa	2.86%	Africa	3.31%
Asia & Pacific	1.51%	Asia & Pacific	2.34%
Europe	2.06%	Europe	2.45%
Middle east	0.76%	Middle east	0.68%
North America	4.55%	North America	3.49%
South/Latin America	5.04%	South/Latin America	5.74%
Average	2.50%	Average	3.58%

Source: Data from Corpay Payment Solutions

How you pay matters when making payments abroad

Ultimately, the cost of transacting internationally, whether from premiums on the exchange or from administrative fees, is passed on to end customers, often in the form of higher list prices. What's more, buyers are rarely made aware that part of the purchase price covers these expenses.

Where margins are particularly tight – especially for small and mid-sized businesses— this transaction burden can make the difference between profit and loss, between growth and stagnation.

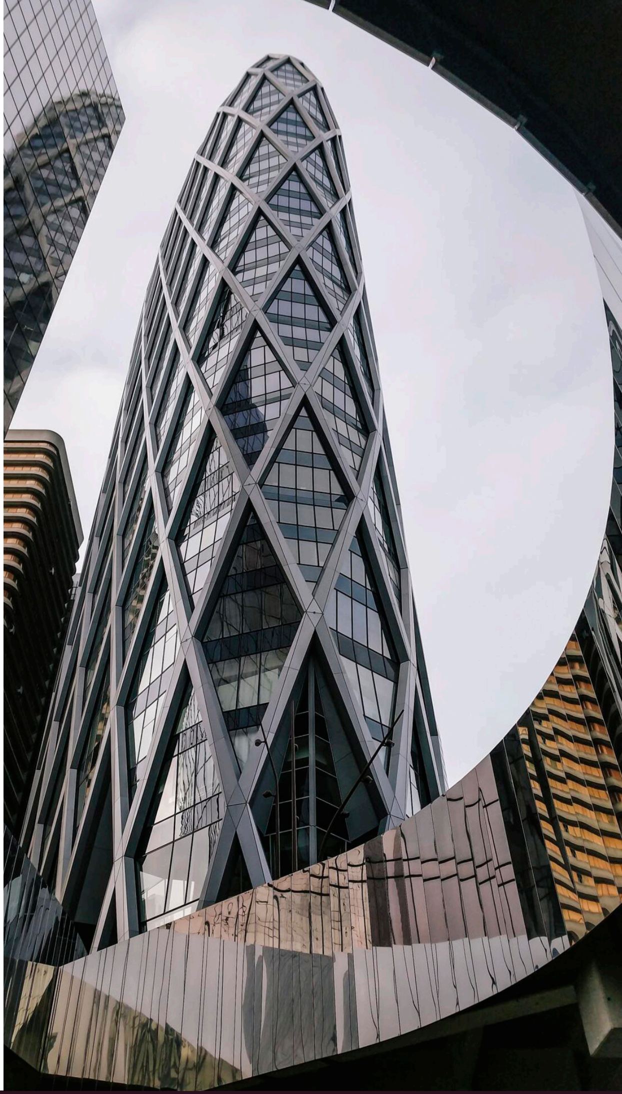
Identifying these hidden costs is the first step. A careful examination of administrative and transaction fees, plus an analysis of the cost of currency conversions, can be eye-opening. A conversation with banking partners and vendors could uncover areas to reduce costs and friction.

Contact Us

By leveraging our global banking footprint, Corpay Cross-Border can help reduce the number of intermediaries that a payment must go through, reducing fees and minimizing exchange rate spreads.

To learn more about this study and what it could mean for your business, we invite you to contact us for a complimentary consultation portfolio of foreign exchange and risk management solutions to each client's unique business goals. We help take the complexity out of foreign exchange so you can focus on your business.

To learn more, or to schedule a free, no-obligation risk consultation with one of our industry experts, please get in touch.



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