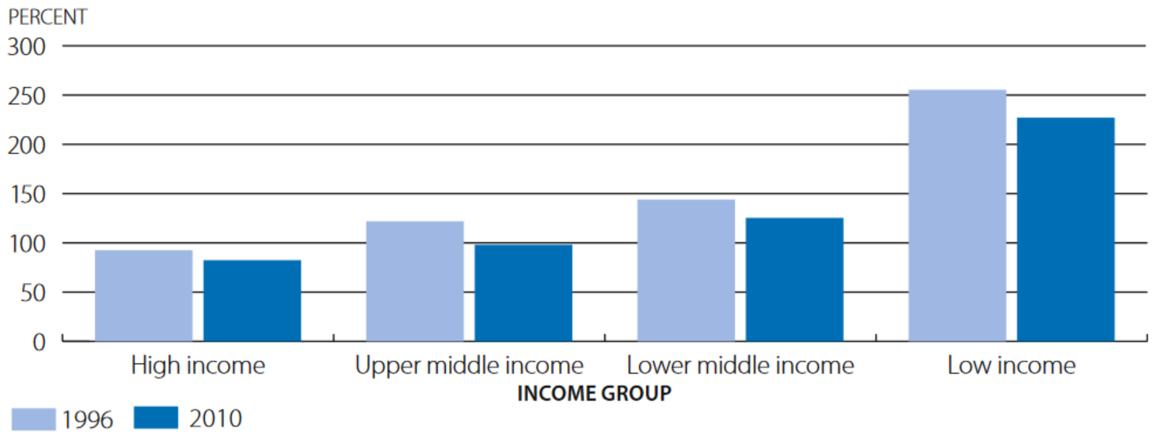
Global Trade is the lifeblood that fuels economies around the world. Total merchandise trade in 2015 amounted to USD 16 trillion, with the G20 countries accounting for about 80% of that. Trade in services was USD 4.7 trillion in the same year.

Over time, many  impediments to trade have been eliminated or reduced, but high transactions costs continue to affect trade volumes and profit margins. Here is a breakdown of the primary financial costs (excluding tariffs or shipping charges) involved in international trade.

**Foreign exchange conversion costs**

This is usually the single biggest cost factor. The actual "spread" between the spot rate and what the bank charges depends on a lot of factors affecting the currency pairs - things like liquidity, volatility, convertibility and so on. It's easier to get good rate on a popular currency pair like USD/EUR (less than 2%), but you might have to pay a lot more for an obscure pair like the Mongolian tögrög/ Brazilian real. Given the total quantum of global trading, the FX conversion cost alone for traders could be north of USD 400 billion annually. Small businesses and retail users bear a disproportionately high portion of this cost as compared to large corporate houses.

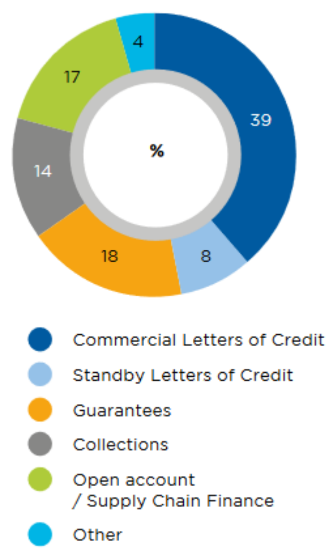
According to World Bank data, total trade costs can be as high as 80% of producer price in developed economies.




*Source:* UNESCAP-World Bank trade costs database

**Trade Finance**

Trade is not always open account. Most of the larger trade deals utilize documentary credit instruments - things like Letters of Credit (defined by internationally accepted rules like UCP600), Guarantees or SBLC etc. Here is a quick summary of how imports are financed worldwide:




Source: ICC Global Survey on
Trade Finance 2016

Customers have to pay for these instruments and the price can be anywhere from a few basis points to over 10% of the deal value depending on the country of origin/ destination and the client's risk profile. Hedging against future foreign exchange movements can also add significantly to this.

As per data by Accenture, USD 1 spent on trade finance is likely to be accompanied by USD 1.7 spent on FX and cross border payments and USD 2.2 spent on other transaction banking revenue items explained below.

**Payment delays and other costs**

Float is the term used to describe money "floating" around within a bank as it moves from one client account to another. The bank  earns money of this float on a daily basis. For example, if you send the money across on Monday and your supplier receives it only on Wednesday, the bank has earned some interest on that money for two days. This is interest that the supplier could have earned instead. Additionally, a delay in payment can also lead to supply chain issues, demurrage charges and so on. As per WEF data, if countries were to improve their border administration and transport and communications infrastructure halfway to global standards, an estimated USD 1.6 trillion in additional exports could be achieved.

Banks also charge a fixed wire transfer fee, low account activity fee, document handling charges, cash management service charges and other administration fees. These costs can add up for smaller traders.

**About the Author**

Gaurav Sharma is an independent financial and business consultant and strategist. He works with fintech startups, wealth management firms, international banks, consulting companies and multi strategy investment funds.

Gaurav previously worked with banks like Standard Chartered, Citi and Yes Bank in International Trade Finance, Supply Chain Finance, and other corporate banking and corporate finance functions.

**Main sources**


- ESCAP-World Bank Trade Cost Database
- Worldwide Currency Usage and Trends,. SWIFT Institute
- Statistics on payment, clearing and settlement systems in the CPMI countries.
- ICC Global Trade and Finance Survey 2016
- Trade finance: The landscape is changing— are you?, Accenture
- Enabling Trade Valuing Growth Opportunities, WEF