

INCOTERMS: OPPORTUNITIES AND THREATS FOR COMPANIES

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Abstract: The paper demonstrates the definitions of Incoterms rules including when they should be applied, when risk is shifted, how expenses are distributed between the seller and the buyer. The paper analyses main mistakes and consequences of wrong choice of Incoterms rules for companies and shows some useful decisions of this problems.

Key words: Incoterms, international trade, trade agreement, export, import

The Russian entities are more and more actively involved in the international activities with the influence of the world internationalization factors, and because of processes which occur within the country. First of all, it should be noted a tendency of freedom of the entities' foreign-economic activity which gave the chance them to enter the international market. Apart from that, backwardness and lagging of the market relations in Russia, low solvent demand of the population the entities paid attention to possibilities of the foreign markets more often.

However, along with it, the companies have to face certain problems of goods transportation abroad, as in each country there are special designations for commercial conditions reflection of the transaction. As a result, there can be some misunderstanding between the seller and the buyer which, eventually, pass into additional costs of the entities. In order to avoid similar situations there were created special international rules of most often used trade terms interpretation which are called the Incoterms.

International Commercial Terms are internationally accepted terms defining the responsibilities of exporters and importers in the arrangement of shipments and the transfer of liability involved at various stages of the transaction. Incoterms rules provide internationally accepted definitions and rules of interpretation for most common commercial terms.

The Incoterms were first conceived by the International Chamber of Commerce (ICC) in 1921, and brought to fruition with the first Incoterms rules in 1936.

The rules have been developed and maintained by experts and practitioners brought together by ICC and have become the standard in international business rules setting. Launched in mid-September 2010, Incoterms® 2010 came into effect on 1 January 2011. The 11 Incoterms 2010 rules are presented in two distinct classes (The Incoterms rules [сайт]. URL : <http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/>).

The **first class** includes the seven Incoterms 2010 rules that can be used irrespective of the mode of transport selected and irrespective of whether one or more than one mode of transport is employed. **EXW, FCA, CPT, CIP, DAT, DAP** and **DDP** belong to this class. They can be used even when there is no maritime transport at all. It is important to remember, however, that these rules can be used in cases where a ship is used for part of the carriage. For understanding of a difference between rules it is necessary to consider highlights according to each term of Incoterms: when they should be applied, when risk is shifted, how expenses are distributed between the seller and the buyer.

- **EXW** (Ex Works) means that the seller delivers (without loading) the goods at disposal of buyer at seller's premises. Long held as the most preferable term for those new-to-export because it represents the minimum liability to the seller. On these routed transactions, the buyer has limited obligation to provide export information to the seller.

- **FCA** (Free Carrier) is used when the seller delivers the goods to the carrier and may be responsible for clearing the goods for export (filing the EEI). More realistic than EXW because it

includes loading at pick-up, which is commonly expected, and sellers are more concerned about export violations.

- CPT (Carriage Paid To) is applied when the seller delivers goods to the carrier at an agreed place, shifting risk to the buyer, but seller must pay cost of carriage to the named place of destination.

- CIP (Carriage And Insurance Paid To) means that the seller delivers goods to the carrier at an agreed place, shifting risk to the buyer, but the seller pays carriage and insurance to the named place of destination. The buyer should note that under CIP the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the seller or to make its own extra insurance arrangements.

- DAT (Delivered At Terminal) means that the seller bears cost, risk and responsibility until goods are unloaded (delivered) at named quay, warehouse, yard, or terminal at destination. Demurrage or detention charges may apply to seller. The seller clears goods for export, not import.

- DAP (Delivered At Place) is used when the seller bears cost, risk and responsibility for goods until made available to the buyer at named place of destination. The seller clears goods for export, not import.

- DDP (Delivered Duty Paid) is applied when seller bears cost, risk and responsibility for cleared goods at named place of destination at buyer's disposal. The buyer is responsible for unloading. The seller is responsible for import clearance, duties and taxes so buyer is not "importer of record" (The Incoterms rules [сайт]. URL : <http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/>).

In the second class of Incoterms 2010 rules, the point of delivery and the place to which the goods are carried to the buyer are both ports, hence the label "sea and inland waterway" rules. **FAS, FOB, CFR** and **CIF** belong to this class.

- FAS (Free Alongside Ship) is used when the seller delivers when the goods are placed alongside the vessel (e.g., on a quay or a barge) nominated by the buyer at the named port of shipment. Risk passes to the buyer, including payment of all transportation and insurance costs, once delivered alongside the ship (realistically at named port terminal) by the seller. The export clearance obligation rests with the seller.

- FOB (Free On Board) means that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. Risk passes to the buyer, including payment of all transportation and insurance costs, once delivered on board the ship by the seller. A step further than FAS.

- CFR (Cost and Freight) is applied when the seller delivers goods and risk passes to buyer when on board the vessel. The seller arranges and pays cost and freight to the named destination port. A step further than FOB.

- CIF (Cost, Insurance and Freight) means that the seller delivers the goods on board the vessel or procures the goods already so delivered. Risk passes to the buyer when delivered on board the ship. The seller arranges and pays cost, freight and insurance to destination port. The seller also contracts for insurance cover against the buyer's risk of loss of or damage to the goods during the carriage. The buyer should note that under CIF the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the seller or to make its own extra insurance arrangements (The Incoterms rules [сайт]. URL : <http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/>).

Proceeded explanations are not a part of the existing rules Incoterms 2010, but their purpose is to help a user in an accurate effective choice of the corresponding international trade term for the specific transaction.

It is also necessary to remember that Incoterms rules do not determine ownership or transfer title to the goods, nor evoke payment terms, they do not apply to service contracts, nor define contractual rights or obligations (except for delivery) or breach of contract remedies. Apart from that, Incoterms do not protect parties from their own risk or loss, nor cover the goods before or after delivery. They are not law and that is why they can not specify details of the transfer, transport, and delivery of the goods.

In trading of primary goods, in compare with trading of finished goods, freight is often sold several times during transportation. If it takes place, the seller in the middle of a chain "does not

perform shipment" of goods because goods are already shipped by the first seller in this chain. Therefore the seller in the middle of a chain carries out the obligations concerning the buyer, performing not goods shipment, but shipped goods provision. For the purpose of refining there is included an obligation on "shipped goods provision" as alternative of an obligation on goods shipment in the corresponding terms Incoterms.

Incoterms rules have traditionally been used in international sale contracts where goods pass across national borders. In various areas of the world, however, trade blocs, like the European Union, have made border formalities between different countries less significant. Consequently, the subtitle of the Incoterms 2010 rules formally recognises that they are available for application to both international and domestic sale contracts. As a result, the Incoterms® 2010 rules clearly state in a number of places that the obligation to comply with export/import formalities exists only where applicable (The Incoterms rules [сайт]. URL : <http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/the-incoterms-rules/>).

Despite on such extensive application of the Incoterms rules many entrepreneurs often make mistakes in a choice of this or that term in case of the making the transaction with the buyer. They have to pay additional costs, but such mistakes are reparable: the companies choose over time the best terms of transaction for themselves saving up experience. However, sometimes the entities do not note changes of the Incoterms rules and continue to use obsolete rules, and again they pay additional costs.

The brightest example is using of FOB which is one of the oldest and has been used for many years, although international trade has been constantly evolving and the International Chamber of Commerce has progressively modified its regulations. Nevertheless, companies continue to apply it now.

On the one hand, these users may be right but they are not aware of what could potentially happen. In actual fact, international trade is conditioned by the goodwill of both parties, the buyer wants to buy and the seller wants to sell and in the majority of cases, minor differences are smoothed out with goodwill. But if the operation goes wrong, the costs of a bad pact and a bad choice of Incoterms can escalate to great heights. Not just that, but a good choice of Incoterms rule provides improved efficiency, lower cost and better risk control of the operation.

The reason can be in a lack of knowledge. Training in Incoterms and international trade in general is not great. The majority of individuals who work within companies that operate in other markets obtain their knowledge through experience and daily practice. Today many companies prefer FOB to sell and CIF to buy. Moreover, they make a special effort to reduce production costs wherever possible, but subsequently disregard important aspects and generate enormous costs in logistical transport processes. It is evident that knowledge can help us to conduct operations better and reduce costs and risks.

To reduce costs with an FOB, the seller must take charge of the manipulation expenses in the port of origin which concern the port load and stowage manipulation. These expenses are named differently depending on the country, THC, RAC, etc. With term FOB it is the buyer who takes charge of the freight and, in many occasions this includes both load and stowage. These operations are already included in the THC paid by the vendor. It is easy to note that the same operations are paid for twice, one by the buyer and one by the seller.

Apart from that, misuse of Incoterms rules will carry a great amount of risks in an international transaction. So in the first place the seller assume the risk of robbery, risk of a contract breach, risk of costs such as the cost for the stay of a container in an exit port terminal in case the ship is delayed etc.

According to world trade specialist J. Coetzee, there is still no certainty on the legal position concerning delivery and risk under FOB variants. For these reasons, it is important that parties clarify whether the seller is to undertake the responsibilities for loading and stowage operations at his cost or whether this also entails an assumption of risk until the loading and stowage obligations are completed, for example, by adding a phrase such as "FOB stowed, costs and risks in connection with loading on the seller" (Incoterms variants: greater precision or more uncertainty? [сайт]. URL: <http://www.dejure.up.ac.za/index.php/volumes/46-vol-2-2013/20-volumes/46-volume-2-2013/173-notes1/>).

If it counts all potential costs which the seller can pay with the wrong choice of the Incoterms, it will appear that such transactions are not so profitable for the company. In the future, these expenses will be strongly able to affect the goods price, the product demand will decrease, and the entity will have losses though, firstly, the exit to the international market seemed very perspective.

Proceeding from the aspects stated above, it is possible to draw a conclusion that the entities should not rely on the settled principles of Incoterms rules using. The major role is played by professionalism; it is the main reason why it is necessary to correctly apply the Incoterms in general. It means that to be the professional of International trade, it needs to use these tools in reach properly.

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