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RISK TRANSFER BETWEEN BUYERS AND SELLERS IN INTERNATIONAL TRADE

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Abstract: In international trade, the allocation of responsibilities, costs, and risks between buyers and sellers is essential for smooth and efficient transactions. The International Commercial Terms, widely known as **Incoterms**, are standardized trade terms published by the International Chamber of Commerce (ICC) that define the roles of trading partners. This paper evaluates the Incoterms 2020 rules with a specific focus on cost obligations and the transfer of risk between buyers and sellers during the delivery of goods.

The analysis covers how different Incoterms allocate transportation costs, insurance, and customs duties, while also determining the precise point at which the risk of loss or damage to goods transfers from seller to buyer. By comparing commonly used terms such as EXW (Ex Works), FOB (Free on Board), CIF (Cost, Insurance and Freight), and DDP (Delivered Duty Paid), the study reveals how the choice of Incoterm can significantly impact financial planning, legal liability, and logistics coordination.

Furthermore, the paper discusses how misunderstandings or misapplications of Incoterms can lead to disputes, delays, and unforeseen expenses in global trade. As supply chains become increasingly complex, understanding and applying the correct Incoterm is vital for risk mitigation and operational clarity.

Keywords: Incoterms, risk transfer, international trade, cost obligations, delivery terms

I. INTRODUCTION

In the globalized world of today, the shipping industry plays a pivotal role in connecting markets, bridging continents, and facilitating international trade. At the heart of this complex network lies the concept of cargo consolidation, a strategic and increasingly important aspect of maritime logistics. This paper aims to delve deep into the intricacies of cargo consolidation, its significance, methodologies, and the evolving trends that are shaping its future within the shipping industry.

8 facts about Incoterms you should know

1. The international regulations all started way back over 200 years ago: In 1812, British Courts established Free on Board (FOB) shipment terms indicating who is liable for damage in shipping were established. These established rules were the seeds that would eventually grow into Incoterms® we know today!
2. Booming Trade: Up until 1936, the original FOB rules were updated only once. It was in this year that the ICC would publish 6 rules, making these the first truly global standardization for worldwide trade.
3. World War II: After the second world war, lots of international trade standards and agreements had to be mended, re-written, and new rules established.
4. New Modes = New Rules: As new forms and methods of transportation emerged, Incoterms had to evolve as well. In 1953, 3 new rules were added to include Trains, Trucks, and specific costs.
5. FOB: The first air freight was officially delivered in 1910, but it took until 1976 to include air FOB rules into Incoterms®!
6. Electronification: in 1990, Incoterms® underwent a massive re-build, as more and more electronic services became available.
7. Ever-changing landscape: In 2010, with so many changes and increases with international shipping, Incoterms® had to adjust as well. In 2010, 4 Incoterms were done away with, and 3 all-new Incoterms were added.
8. Incoterms® 2020 were released!

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II. STATEMENT OF THE PROBLEM

In international trade, managing the transfer of risks and costs between buyers and sellers is essential for completing transactions successfully. Incoterms (International Commercial Terms) provide internationally accepted regulations that outline the duties of every party engaged in the transaction. These regulations aid in ensuring that both buyers and sellers are aware of their responsibilities, including who assumes the costs and risks during each phase of the shipping process. However, the varying interpretations and application of Incoterms can lead to disputes, unclear responsibilities, and financial or logistical complications. The lack of clarity on who is responsible for what in terms of costs (e.g., transportation, insurance, taxes, customs duties) and risk (e.g., loss or damage to goods) can significantly affect the success and cost-effectiveness of international transactions.

III. REVIEW OF LITERATURE

Eddie (2018), Incoterms serve as an essential framework that ensures both parties
Incoterms are critical to simplifying and standardizing the complexities of international trade. According to Eddie (2018), Incoterms serve as an essential framework that ensures both parties—buyers and sellers—understand their respective responsibilities, thus reducing misunderstandings and potential disputes. Incoterms define the delivery point, specify who is responsible for transportation and insurance, and outline the precise moment the risk is transferred from one party to the other.

Chandra & Chawla (2016) note that the use of Incoterms provides transparency and predictability
The authors argue that clear definitions of risk transfer, such as when the seller's obligation ends and the buyers begins, contribute to a smoother flow of goods and services across borders.

Tan & Ng (2019), illustrate that different Incoterms affect the seller's and buyer's cost obligations
A substantial body of literature has explored how Incoterms determine the division of costs between buyers and sellers. In a study by Tan & Ng (2019), the authors illustrate that different Incoterms affect the seller's and buyer's cost obligations, especially when considering freight, insurance, and customs duties. Incoterms such as FOB (Free on Board) and CIF (Cost, Insurance, and Freight) clarify which party bears the responsibility for transportation costs and related charges. The study also highlights how terms like EXW (Ex Works) and FCA (Free Carrier) place a greater burden on the buyer for handling transport and customs processes, which may lead to higher logistical costs for the buyer, especially in less developed regions.

Jin & Li (2020) argue that selecting an appropriate Incoterm is essential for optimizing cost efficiency
For instance, while the CIF term might be advantageous for a buyer who lacks logistics experience, it could result in higher costs due to the seller's potential markup on freight and insurance. On the other hand, EXW could be more beneficial for a buyer who has strong control over transportation and logistics but places more responsibility on them for managing shipping costs.

IV. OBJECTIVES OF THE STUDY

Primary Objectives:
To evaluate the application and relevance of Incoterms in governing international trade agreements.
To examine how Incoterms determine the distribution of costs between buyers and sellers.
To analyze the points at which risk is transferred from the seller to the buyer under different Incoterms.
To assess the impact of Incoterm selection on trade contract outcomes and stakeholder responsibilities.

Secondary Objectives:
To compare various Incoterms (e.g., EXW, FOB, CIF, DDP) in terms of risk, cost, and responsibility allocation.
To explore the challenges and common errors in the interpretation or use of Incoterms in international contracts.
To understand the role of Incoterms in improving supply chain efficiency and reducing logistical uncertainties.
To evaluate the legal implications of incorrect or ambiguous Incoterm usage in trade documentation.

V. RESEARCH METHODOLOGY

In my research on Incoterms, I used a theoretical approach alongside a detailed literature review to explore their historical development, principles, and practical applications in international trade. By analyzing various sources, I identified key concepts and gaps in existing knowledge, providing a comprehensive understanding of Incoterms.

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The research also included real-world case studies to highlight their impact on trade operations and the challenges businesses face when applying them. This methodology allowed for a critical evaluation of the advantages, limitations, and best practices surrounding Incoterms, contributing valuable insights to the field of international trade.

Methodology Summary

1. Data Collection: Gather data from various sources such as trade documents, shipping records, and interviews with industry experts to gain insights on the application of Incoterms rules and the challenges faced.
2. Case Studies: Select and analyze representative case studies to understand the practical implications of different Incoterms rules and their impact on tasks, costs, and risks.
3. Comparative Analysis: Evaluate and compare the tasks, costs, and risks associated with various Incoterms rules to identify the most efficient and effective options for different types of transactions.
4. Expert Interviews: Conduct interviews with logistics managers, legal advisors, and trade consultants to gather insights on practical challenges and best practices for applying Incoterms rules.
5. Data Analysis: Use statistical and qualitative analysis techniques to identify patterns, trends, and key factors that influence the effectiveness of Incoterms rules.
6. Reporting: Document the findings and conclusions in a comprehensive report, including detailed analysis, recommendations, and practical guidelines for buyers and sellers.

RESEARCH DESIGN

This study adopts a **combined Exploratory and Descriptive Research Design**:

- **Exploratory Research Design** is used to gain a deeper understanding of the interpretation and practical application of Incoterms by various international trade actors. It helps in identifying the challenges and ambiguities in the application of these rules.
- **Descriptive Research Design** is used to systematically describe how Incoterms allocate cost responsibilities and risk between buyers and sellers. It involves quantifying stakeholders' awareness, understanding, and usage of Incoterms.

SAMPLING TECHNIQUE

The study will use a purposive (judgmental) sampling technique, a non-probability method ideal for reaching out to experienced professionals who are directly involved with international trade contracts and logistics. This ensures that the respondents possess the required knowledge of Incoterms and can provide meaningful insights.

DATA COLLECTION

Primary Data

Primary data refers to information gathered firsthand by the researcher for the specific purpose of the study. It is crude information without understanding and speaks to the individual or authority conclusion or position. Essential sources are most legitimate since the data isn't separated or altered. Information accumulation from people can be made through surveys.

Secondary Data

The information collected from the company magazines, various books and from internet.

HYPOTHESIS FORMULATION

To help you formulate hypotheses for evaluating Incoterms rules, especially regarding cost obligations and risk transfer between buyers and sellers in international trade, you'll want to ensure that each hypothesis is:

Hypothesis 1: Cost Obligation
H1: Buyers incur significantly higher total logistics costs under EXW (Ex Works) terms compared to CIF (Cost, Insurance, and Freight) terms.
Hypothesis 2: Risk Transfer
H2: Under FOB (Free on Board) terms, risk is transferred to the buyer at an earlier point compared to DDP (Delivered Duty Paid) terms, leading to higher exposure to in-transit losses.
Hypothesis 3: Incoterm Familiarity and Misallocation
H3: Companies with limited knowledge of Incoterms are more likely to misallocate cost responsibilities, resulting in unexpected expenses.
Hypothesis 4: Seller Strategy
H4: Sellers prefer Incoterms that minimize their exposure to delivery risk, even at the expense of reducing overall sales competitiveness.

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Hypothesis 5: Impact on Buyer Satisfaction
H5: Buyers are more satisfied with trade outcomes when Incoterms used clearly allocate risk and cost in a balanced manner.

VI. SIGNIFICANCE OF THE STUDY

The study of risk transfer between buyers and sellers in international trade is important because it clarifies when responsibility for goods shifts from one party to another, reducing disputes and financial losses. It helps businesses draft clearer contracts, comply with international regulations, and make informed decisions about shipping, insurance, and pricing. Understanding risk allocation also strengthens negotiation power and promotes trust between trading partners, ultimately ensuring smoother and more secure global trade transactions.

Statistical Tool

ANOVA

		Sum of Squares	Df	Mean Square	F	Sig.
Role of respondent	Between Groups	7.417	7	1.060	.723	.656
	Within Groups	17.583	12	1.465		
	Total	25.000	19			
How clear are the responsibilities defined for the buyer and seller under the Incoterms you use most often?	Between Groups	48.617	7	6.945	2.916	.050
	Within Groups	28.583	12	2.382		
	Total	77.200	19			
Do you feel confident in understanding the Incoterms used in your transactions?	Between Groups	6.000	7	.857	1.029	.460
	Within Groups	10.000	12	.833		
	Total	16.000	19			
Are there any aspects of risk (such as damage, loss, or theft) that you feel are not adequately addressed by the chosen Incoterms?	Between Groups	9.467	7	1.352	1.464	.268
	Within Groups	11.083	12	.924		
	Total	20.550	19			
To what extent do Incoterms clarify the tasks of the buyer and seller in terms of documentation, customs procedures and delivery procedures?	Between Groups	37.217	7	5.317	13.920	.000
	Within Groups	4.583	12	.382		
	Total	41.800	19			
Overall, how satisfied are you with the role that Incoterms play in clarifying tasks, costs and risks in international trade?	Between Groups	45.117	7	6.445	6.536	.002
	Within Groups	11.833	12	.986		
	Total	56.950	19			

Interpretation

1. Role of Respondent - There is no statistically significant difference between groups in terms of how the role of the respondent affects perceptions. The p-value (0.656) is much higher than the typical threshold of 0.05, so we fail to reject the null hypothesis.

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2. Clarity of Responsibilities Under Incoterms - The p-value is exactly 0.050, which is right at the conventional cutoff for significance. This suggests there *may* be a significant difference in how different groups perceive the clarity of buyer and seller responsibilities under commonly used Incoterms.

3. Confidence in Understanding Incoterms - There is no significant difference in confidence levels across groups. The high p-value (0.460) suggests respondents largely share a common level of confidence regardless of group.

4. Risk Coverage by Incoterms - The p-value indicates no statistically significant difference in perception across groups regarding how well Incoterms address risks such as damage, loss, or theft.

5. Clarity of Tasks (Documentation, Customs, Delivery) - Highly significant difference across groups. The very low p-value (< 0.001) suggests that perceptions of how well Incoterms clarify procedural tasks differ notably among groups.

6. Overall Satisfaction with Incoterms - There is a significant difference in satisfaction levels across groups regarding the overall role of Incoterms in clarifying tasks, costs, and risks in international trade.

VII. DISCUSSION

Risk transfer between buyers and sellers in international trade is a vital concept that defines when responsibility for goods moves from the seller to the buyer. This transfer usually depends on the agreed Incoterms, which outline who bears the risk at each stage of the shipping process. Understanding risk allocation helps both parties avoid disputes and financial losses due to damage, theft, or delays during transit. It also ensures that proper insurance coverage is arranged by the party bearing the risk. Clear knowledge of risk transfer leads to well-structured contracts and better legal protection. It allows businesses to make informed decisions on pricing, delivery, and payment terms. Moreover, it supports compliance with international trade regulations. Fair and transparent risk sharing strengthens trust between trading partners. It enhances negotiation power by allowing each party to assess their responsibilities. Ultimately, understanding risk transfer ensures smoother, safer, and more efficient global trade transactions.

VIII. CONCLUSION

Incoterms rules play a pivotal role in clearly defining the responsibilities, cost obligations, and risk transfer points between buyers and sellers in international trade. By standardizing terms across global markets, Incoterms reduce the likelihood of disputes, enhance transparency, and ensure smoother logistical coordination. Each Incoterm—from EXW to DDP—allocates costs and risks differently, allowing parties to choose terms that best fit their commercial objectives and logistical capabilities. For example, while EXW places the maximum responsibility on the buyer, DDP shifts nearly all obligations to the seller. Understanding these nuances is essential for effective contract negotiation and risk management. Therefore, careful selection and accurate interpretation of Incoterms can significantly influence the success of international transactions, reducing costs, mitigating risks, and fostering trust between trading partners. Businesses must stay updated on revisions and seek legal or logistics expertise when necessary to ensure their international trade practices remain compliant and efficient.

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