

Incoterms – What They Are And Why You Should Care!

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Incoterms are an essential subject to understand for companies who engage in cross border trade. Incoterms are a system of commercial terms created and updated periodically by the International Chamber of Commerce. Incoterms define various structure assignments of roles and responsibilities between seller and buyer. This does NOT include payment terms which can be as flexible and creative as two parties can negotiate. There are 13 different Incoterms definitions, each of which outline a different profile of commercial terms.

Each of the 13 different Incoterms designations are different, but on the two ends of the spectrum are:

Exworks (EXW): The Buyer takes title at the supplier's (Seller) dock, and the Buyer has direct responsibility for all activities and has risk of ownership from that point. All customs clearance, duty, taxes and insurance responsibility is the Buyer's. Since Sellers generally will charge some mark-up for these services (if they were to perform them), and sometimes have less scale to leverage favorable rates with international freight forwarders, Exworks is arguably the lowest cost approach. However, Exworks also requires the greatest involvement by the Western Company in the shipment, export and import logistics.

Delivery, Duty Paid (DDP): The Seller retains title through the entire chain that ends at the Buyer's dock and Seller retains direct responsibility for all activities and risk of ownership until that point. All customs clearance, duty, taxes and insurance are the responsibility of the Seller. Since Sellers generally will charge some mark-up for these services (if they were to perform them) and sometimes have less scale to leverage favorable rates with international freight forwarders, DDP is arguably the highest cost approach, but this also requires the lowest involvement by the Western Company in the shipment, export and import logistics.

Why are Incoterms Important?

Defined terms of title transfer are especially important because this issue links directly to insurance enforceability. Insurance companies only have the responsibility to pay claims that are properly submitted and documented. If the ownership of the goods is ambiguous at the time of a "claim event," the validity of any underlying claim could be at risk.

For example, a U.S. company has a PO document that has a fixed data block on the form entitled "F.O.B." Inside the block on a specific order is typed the word "Exworks." To those familiar with Incoterms, this might seem silly, but this is an actual case fact set. Innocently, this company has created an ambiguity that could very likely invalidate any insurance they think they have put in place. The reason is that F.O.B. is one of the 13 Incoterms and Exworks a completely different one. Their respective definitions conflict. Exworks says title transfers at the Seller. F.O.B. requires a location (most commonly a port) at which title transfers when the product is loaded on to a ship at that port. Neither term – F.O.B. or Exworks – has anything to do with timing of payment, but they mean very different things. This is one "real world" example of how a poorly defined PO can create unnecessary risk. There are many other innocently uninformed decisions within the Incoterms framework which can cause problems.

Did you know that as many as 10,000 shipping containers are lost at sea every year? Insuring material you own while in transit is a serious issue and having well-defined terms of ownership is equally important. That is one of the roles of the Incoterms system.

Incoterms are actually a simple way to avoid the kinds of problems outlined. The chart on the next page outlines the range of Incoterms options from which a company can select. Take the time to understand them, evaluate the cost, both financial and of human resources, and select the one that is best for your company. There is no right or wrong selection, or one Incoterms option that is inherently better than another. The only wrong choice is not understanding Incoterms and not managing this framework correctly to the benefit of your company.

INCOTERM CHART

	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAF	DES	DEQ	DDU	DDP
SERVICES	Ex Works	Free Carrier	Free Alongside Ship	Free Onboard Vessel	Cost & Freight	Cost Insurance & Freight	Carriage Paid To	Carriage Insurance Paid To	Delivered At Frontier	Delivered Ex Ship	Delivered Ex Quay Duty Unpaid	Delivered Duty Unpaid	Delivered Duty Paid
Warehouse Storage	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Warehouse Labor	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Export Packing	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading Charges	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Inland Freight	Buyer	Buyer/Seller*	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Terminal Charges	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Forwarder's Fees	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading On Vessel	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Ocean/Air Freight	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Charges On Arrival At Destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Buyer	Buyer	Seller	Seller	Seller
Duty, Taxes & Customs Clearance	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller
Delivery To Destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller

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HONG KONG

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