

Incoterms – What They Are and Why You Should Care

Incoterms are a critical subject that must be understood and managed by companies that engage in cross border trade. Incoterms is the name of a system of commercial terms created and updated periodically by the International Chamber of Commerce which define structural assignments of roles and responsibilities between seller and buyer. Incoterms do not define payment terms which are separate and can be as flexible as two parties can negotiate. There are 13 Incoterms definitions, each of which outline a 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?

Defining the point of title transfer is 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. client company has a PO document with a fixed data block on the form entitled "F.O.B." Inside the block on one specific order is typed the word "Exworks." To those familiar with Incoterms, this might seem silly, but this is an actual case. Innocently, the U.S. company created an ambiguity that could invalidate any insurance they have put in place. The reason is that F.O.B. and Exworks are both Incoterms, and their respective definitions conflict. Exworks says title transfers at the Seller's shipping dock. 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. This is one "real world" example of how a poorly defined PO can create unnecessary risk.

Did you know that thousands of shipping containers are lost at sea each 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; 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

SHANGHAI

ZHUHAI

HONG KONG

TAIPEI