

# FOB Export Risks and Precautions

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**Abstract:** FOB price term is a commonly used trade term in foreign trade. In recent years, the proportion of FOB terms in China's export contracts has become increasingly large, and even some foreign trade companies use FOB for most of their export contracts. Export FOB transaction can make the seller in the charter booking, insurance and other links to save energy and cost. However, FOB contract makes our exporters face more and more trade risks. This paper analyzes the risks of export contracts under FOB trade terms from the aspects of insurance, cargo connection, forwarder, bill of lading and settlement method, and takes measures to avoid risks.

**Keywords:** Risk transfer; FOB; Terms

## 1. Introduction

More and more exporters have suffered a certain amount of fraud due to the irregular use of terminology. In terms of a complete trade process, the exporters may encounter many risks under the FOB trade terms, clarify these risks in the process of export trade, and take appropriate measures to have important practical significance for China's trade development. Under the background of the "One Belt, One Road" expansion of exports, China will have more foreign trade in the future. Under the new environment, it is of great significance to further discuss the risks and evasive measures under the FOB trade terminology. Based on the interpretation of FOB terminology, this paper explains and analyzes related risks. At the same time, it proposes to control the main risk factors under FOB according to relevant international trade standards, in order to reduce the trading risk under FOB terminology and make China's export trade more. Safety.

## 2. "Incoterms2010" Interpretation of FOB Terminology

The latest edition of Incoterms2010 was developed by the International Chamber of Commerce (ICC), which was modified on the version of Incoterms 2000. Incoterms 2010 modified the structure of the Group D in Incoterms 2000, the rules of trade terms, and Group C, Group E, The structure of Group F and its trade terms are still similar to the previous edition, with no revisions. Therefore, the FOB currently widely used in import and export is the Incoterms 2000 version. Now, my country recognizes and adopts this general rule. If the parties jointly agree to use the rule, the rule is binding on both parties to the trade; if the buyer and the seller do not agree on the trade term, the United Nations Convention on Contracts for the International Sale of Goods provides for this, Incoterms 2000 for this international Trade has a default effect. The FOB term is currently translated into

ship-to-ship on board in the country. That is to say, under the terminology, the seller only fulfills its obligations when loading the goods on the port of shipment. The goods are loaded before the ship at the port of shipment. The transportation, storage and storage are carried out by the exporter. The risk of the goods is also on the exporter's side. After the goods are loaded, all the obligations are transferred to other parties. The losses incurred after the goods are loaded are based on the specifics. The situation is borne by the buyer or the carrier.

## 3. The Significance of Studying the Risk of FOB Terminology

Since the beginning of this century, there have been more and more transactions in the world using FOB. According to the statistics of authoritative organizations, the adoption rate of FOB transactions in international trade contracts ranks first among the other 12 types of transactions, especially when trading in special goods such as bulk dry goods and oil. Before the 1980s, the CIF terminology was the absolute mainstream of China's export trade at that time. However, since China's accession to the WTO in 2001, China's export trade has become the world's largest trade country, and the main transaction methods have also changed. It is worth noting that the export of foreign-funded enterprises and the export of domestic apparel enterprises have reached more than 80% by FOB.

The FOB is delivered on board the ship. If the buyer is responsible for chartering and handling marine insurance, the seller shall install the goods on the ship designated by the buyer within the specified port of shipment and within the prescribed time limit, and promptly assign the ship to the buyer by means of shipping notice. The name, the place of shipment, the name and quantity of the delivery, and the time when the vessel is expected to sail and arrive at the port of destination shall notify the buyer in

time. According to the newly issued INCOTERMS in 2010, the seller fulfilled the delivery obligation when the goods were loaded onto the ship at the designated port of shipment. This also means that the buyer must bear all costs and the risk of loss or damage to the goods from the place of delivery. The FOB terminology transaction has become the mainstream of China's export trade.

#### **4. The Risk of Exporters Adopting FOB Trade Terms**

At first glance, it seems that the risk of exporting by the FOB transaction is small, but in terms of the trade term itself, any trade cannot be separated from the environment of the world economy. Now that the US financial crisis has not completely passed, the European financial system is in jeopardy, and the credit system is facing a severe test, which has brought many variables to the implementation of FOB contracts. Taking the data of China's credit insurance companies as an example, in recent years, export losses have increased, and bad debts have increased substantially. The large fluctuations in prices and exchange rates have caused the original integrity importers to tear off the veil of "integrity". To analyze the risk of exporters adopting FOB trade terms, there are several situations:

##### **4.1. Risk of cargo connection**

According to the usual practice, after the trade contract is signed, the seller prepares to produce the stock, and the buyer begins to apply for the opening of the letter of credit. Once the letter of credit is opened, the shipping period stipulated by the letter of credit is usually within 28 days after the issuance of the certificate. For the seller, the time is urgent and there must be no slack. If the special goods are not properly stocked or the licenses and other documents required for export cannot be opened on time, the normal shipping date will be delayed. Under the conditions of FOB trade terminology, if the buyer's scheduled ship arrives at the port of shipment on time and gives the seller an advance notice, and the seller is not ready for the goods or for other reasons, it may be possible to prepare all the goods in a few hours. The customs clearance procedure, which was originally easy to solve by other transaction methods, has become an intractable knot under the use of FOB, which will result in the failure of the goods to be loaded on the designated vessel, and the seller shall bear the consequences of failure to perform the contract. If the buyer delays the dispatch of the ship, the problem is from the buyer, but the trouble and risk are not small. The seller must increase the storage costs, increase the number of complicated procedures such as returning customs and returning the goods, and increase the time cost.

##### **4.2. The buyer specifies the risk of overseas freight forwarding agency**

Under the conditions of the FOB transaction, the buyer will definitely designate the freight forwarding agent of the exporting country to undertake services such as charter booking, customs clearance, distribution, and logistics. The freight forwarder designated by the buyer generally has a special relationship with the assigned shipping company. If the seller is not strict, the buyer wants to use the freight forwarding or the serial freight forwarding to defraud the seller's goods, which is very easy to do. Under the FOB transaction method, if the freight forwarder handles the charter booking, he will only issue the freight bill of lading to the seller, and the buyer himself will hold the shipping company ocean transport bill of lading. If the buyer intentionally defrauds, he can first guarantee the delivery, and then delay the payment after the goods arrive. And try to find excuses, such as quality flaws, inaccurate specifications, discrepancies in the system, etc., manufacturing troubles, delay until the letter of credit expires, or miss the prescribed delivery period. As a result, the seller can only ask the buyer to apply for the extension of the shipping period and validity period stipulated in the letter of credit, which inevitably increases the amount of expenses. For those who import untrustworthy, once the market conditions change, they may create various excuses to change the bank credit under the letter of credit to D/P, D/A and other commercial credit settlements. At this time, if the seller only holds the bill of lading for the settlement of foreign exchange, and there is no bill of lading for the shipping company, the buyer cannot go to the bank to redeem the bill, and the seller may be in a tragic situation of both goods and money.

##### **4.3. The risk of the buyer as the shipper**

Under the FOB transaction method, if the freight forwarder assigned by the buyer writes the shipper of the ocean bill of lading as the buyer, and the seller does not correct and change it in time, the risk is more difficult to control. At this point, the buyer designates a carrier with a good relationship and enters into a contract of carriage with the carrier. The buyer uses the shipper as the shipper in the chartering book, and there is no trace of the seller on the ocean freight bill of lading. . At this time, the buyer may instruct the carrier to deliver the goods to his designated consignee in the name of the bill of lading shipper. Then the seller is carrying the bill of lading to the shipping company to pick up the goods, and the shipping company will not reissue the goods bill of lading. If the seller sues the court for the indictment of the carrier, the court will also dismiss it on the grounds that it has no right to sue. Because the party written in the shipper column is the right holder and has the power to handle the

goods. The use of the buyer as the shipper of the ocean bill of lading is a huge risk. Similarly, the use of "registered bill of lading" and "instructed bill of lading" on ocean bills of lading is also highly vigilant. If the buyer is using the consignee of the bill of lading or such buyer to indicate the bill of lading "toorderofbuyer", it will directly lead to the buyer not having to pick up the goods. Such bills of lading hide huge risks and disputes. If the seller returns the goods, transships, or entrusts the third party to pick up the goods in the subsequent dispute handling, it will cause insurmountable obstacles. Under the "Borrower as the consignee's bill of lading" and "toorderofthebuyer" instructing the bill of lading, only the buyer has the right to dispose of the goods under the bill of lading, and the seller has no right to question the disposal of the goods.

#### **4.4. The risk that the buyer will not handle insurance**

In the export contract that is sold under FOB price conditions, the marine cargo insurance is handled by the buyer. If the FOB clause is adopted, and effective bank credit settlement and credit insurance are not adopted, if the buyer is not credited, or if the buyer is unfavorable when performing the contract, the buyer may not be insured. If the goods are damaged or the goods are lost in transit, the goods are not insured, and the seller's losses can be miserable. Analysis of the FOB or CFR price conditions in China's export contracts shows that countries in the Middle East, South Asia, Africa, and the Americas have the highest risks. They use China's freight insurance rates too high and insist on trading on FOB or CFR, but they often do not apply for cargo insurance to avoid insurance expenses. After the goods arrive in Hong Kong, the direct redemption order is delivered. Once the goods have any cargo damage in transit, the risk that should be borne by the insurance company is passed on to the exporter.

#### **4.5. Risk of choosing a commercial credit payment method**

In the case of a FOB contract, if the bank credit payment method and credit insurance are not used, the seller's risk of collecting foreign exchange is enormous. The letter of credit should be selected as much as possible, unless the buyer is willing to pay 100% advance payment. The risk of payment by letter of credit using bank credit is relatively small. The use of commercial credit for cash on delivery, T/T and collection settlement methods, if not linked to export credit insurance, export risks are inevitable.

### **5. Risk Prevention and Countermeasures Adopted by Exporters Using FOB**

The signing of the FOB clause should be based on the absolute trust and tacit cooperation between the buyer and the seller. Therefore, before signing the FOB trade contract, the exporter should fully prepare for the transaction, strengthen the credit investigation of foreign customers, and choose a reliable transaction partner.

#### **5.1. Selecting trading partners and strictly stipulate the contents of the contract**

Fully analyze and grasp the risks of FOB clauses, and carry out different levels of risk control for different customers. This is a compulsory course that exporters must carefully do in signing and implementing international trade contracts. For those customers who do not know the credibility of the bottom line, we must strictly abide by the operating regulations, try not to choose the FOB method or take corresponding risk control supporting measures such as export credit insurance. For old customers with good reputation, we should not be too lightly concerned. We must pay attention to his business changes at any time, and set up a risk control bottom line. Do not open the exposure too much to avoid falling into the mire of vicious circle. If it is necessary to use FOB conditions to deal with, it should be noted that the obligations and responsibilities of both parties to the contract are clearly stated in the contract, and the liability and loss for breach of contract are clearly specified. If the contract letter of credit is used for settlement, it is necessary to stipulate that the charter party bill of lading can be accepted and the seller has the right to use the warehouse receipt instead of the bill of lading to negotiate with the bank, so as to prevent the exporter from recovering the loss as much as possible when the situation is extremely unfavorable.

#### **5.2. Using risk control measures beforehand to avoid contract risks**

Pay attention to the use of international factoring or export credit insurance, two measures to control risks beforehand and the ex post compensation measures for entrusting the company to collect accounts. In the case of cost licensing, use third-party strength to strengthen risk management to eliminate commercial credit risk. Short-term export credit insurance is insured to circumvent and transform risks. The insurance company's relatively complete credit investigation system and risk recovery system are used to conduct investigations on buyer credit and recent capital turnover, so as to better strengthen the supervision and management of accounts receivable and avoid contract risks during the execution of contracts. The use of export credit insurance as a loss compensation mechanism can operate import and export business more steadily. When a risk accident occurs, the insurance company will pursue the responsible party from different channels through the transfer of subrogation rights.

### **5.3. Do a good job in communicating with the bank and consciously accept supervision and guidance from the bank.**

When choosing a payment method, try to use the T/T method or L/C method for prepayment. A safe and proactive payment method can eliminate or mitigate the risks brought by FOB price terms to a certain extent. Even so, it is still necessary to actively accept the guidance of the bank to avoid unexpected risks. For example, the payment method for the goods after receiving the money should be risk-free, but don't just ship the goods by fax on the so-called bank payment slip. When the bank payment slip is falsified, at least it must be verified by the bank. The payment is indeed paid to your account. L/C belongs to bank credit, adding a layer of bank insurance, but also to conduct a detailed investigation and tracking of the credit status of the payment bank at the importing side, so as to prevent the importer and the bank from joining hands to pick up the goods in the form of a letter of guarantee. If possible, you may even require a bank with a good third-party credit status to make a confirming bank or set a certain percentage of advance payment to ensure a smooth settlement in the case of a matching presentation. Under the L/C payment conditions, the quality of the documents must be strictly controlled, the document discrepancies should be eliminated, and the guarantee negotiation should be strictly controlled.

### **5.4. Strictly control the transportation risk, refuse to accept the bill of lading and the buyer's bill of lading**

Also refuse to accept the "buyer is the consignee's bill of lading" and limit the "toorder" to indicate the bill of lading, do not appear as the "toorderofbuyer" instructions bill of lading. Under the L/C payment conditions, it is acceptable to indicate "with the issuing bank or payment bank order" (Toorderofxxxbank) in the consignee of the

bill of lading. Under the settlement conditions of commercial credit, use the "Orderofxxxbank" in the consignee's column of the bill of lading carefully, because the bank is only an institution for collection and payment of goods at this time, and does not assume other obligations and responsibilities. . In addition, when the endorsement of the bill of lading is transferred, it is necessary to use the "blank endorsement" as much as possible. Otherwise, if there is a dispute between the two parties, the seller will have to face great difficulties in disposing of the goods stranded at the port of destination.

## **6. Conclusion**

In summary, FOB trade terms are currently used the most in export transactions, as exporters should fully understand the risks they pose and be flexible in dealing with the various issues that may arise under FOB terminology. Under the FOB clause, no matter what kind of precautions are taken, the risks faced cannot be completely avoided. For example, many times the two sides extend the content of international trade terms to suit the needs of the transaction, which will also change the nature of the FOB contract, and will not go into details here. The other provisions of IN-COTERMS should be used flexibly in different situations as much as possible to effectively avoid the above risks arising from FOB.

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