

Risks in international trade

Risks in international trade are broadly classified as country/political/sovereign risks and commercial risks. It is important for the parties to understand risks involved in international trade and also the options available and techniques to be adopted for mitigation and managing those risks. Accordingly, parties may choose a particular payment method as part of the risk mitigation.

Country Risks	Commercial Risks
Wars	Counterparty risks <ul style="list-style-type: none">• Credit risk• Performance risk
Acts of terrorism	Market fluctuations (Commodity prices, Freight rates, foreign exchange rates)
Civil unrest / Political instability	Transportation risks
Imposition of economic sanctions	Contract structuring (non inclusion of penalty clauses, legal jurisdiction, dispute resolution etc.
Shortage of foreign exchange (conversion risk)	Language & Cultural risks
Changes in EXIM policies	Frauds

Risk mitigation and management:

Country Risks :

Most of the country risks can be mitigated by obtaining appropriate credit insurance policies on the buyer's country. However, It is important that the parties must carefully review the nature and extent of risks covered under these policies, as certain risks may not be covered or are excluded from the coverage. If the payment method is LC, the seller may obtain credit insurance on the country of the issuing bank or get the LC confirmed by a local bank in the seller's country.

Commercial Risks :

Counterparty Risks:

- Credit Risk

The seller is exposed to payment risk in all payment methods other than advance payment. This risk may be mitigated by obtaining credit insurance or if the payment method is LC, the seller may get the LC confirmed by a local bank. By getting confirmation, the seller can mitigate both commercial and political risks of the issuing bank. In this case, the seller is exposed to documentary risk, so the seller must ensure that complying presentation is made to the confirming bank.

- **Performance Risk**

Buyer is exposed to risk of non performance by the seller, especially in case of advance payment. Buyer may demand the seller to arrange a performance bond / advance payment guarantee / standby LC from the seller's bank.

Market Risks :

Commodity prices, freight rates and foreign exchange rates are always subject to change. Fluctuations in the market may take away all the anticipated profits, sometimes parties may even end up with the losses due high volatility. As market risks cannot be mitigated through any external agencies, the parties must closely monitor markets and manage risks with well defined risk management policies including stop gain/ stop loss limits.

The risks on account of fluctuations in freight rates may be mitigated by booking freight with carriers at the time of entering into the sales contract as per freight rates considered for costing.

Similarly, parties may enter into forward contracts with their banks for sale or purchase of foreign currency to mitigate risks on account of fluctuations in foreign exchange rates.

Transportation Risk :

Goods may be damaged, lost, or stolen during the transportation between the seller's place and the place of destination, due to various reasons such as accidents, theft, strikes, civil unrest, riots, acts of wars & terrorism or due to any natural calamities etc . The parties may consider taking appropriate insurance policy to mitigate these losses.

Contract structuring risk :

This risk arises due to inadequate or poorly structured contracts. Sales contracts must include penalty clauses for non performance of obligations by the parties, force majeure clauses, legal jurisdiction, applicable laws and dispute resolution procedures in case parties prefer out of court settlement through Alternative Dispute Resolution (ADR). When parties do not have expertise in drafting a well structured contract, they may seek professional assistance from a trade expert or an experienced legal counsel.

Language & Cultural Risks :

Parties dealing with international trade may quite often use a foreign language for verbal and written communication that may lead to understanding / interpretational issues which may lead to unwanted disputes. Apart from that there could be some significant cultural differences between the parties hailing from different regions of the world. People

involved in international trade operations may be trained on cross cultures to sensitize their behavior while dealing with people of different cultural backgrounds.

Frauds :

Due to involvement of many parties in the entire international trade supply chain process, such as sellers, buyers, brokers, transport operators, surveyors, insurance companies, bankers etc, there could be a lot of scope for frauds if KYC is not done against a counterparty at a each stage of supply chain. Robust due diligence processes, background checks on supply chain partners and utilizing secure payment mechanisms are few key techniques to manage such risks.