

## **Risks in International Trade & Mitigating Measures**

### **What are the different types of risks in international trade?**

For buyers and sellers that are engaged in international trade, they may experience one or more of the following risks:

- Buyer's Insolvency/Credit Risk
- Buyer's Acceptance Risk
- Knowledge Inadequacy
- Seller's Performance Risk
- Documentation Risk
- Economic Risk
- Cultural Risk
- Legal Risk
- Foreign Exchange Risk
- Interest Rate Risk
- Political/Sovereign Risk
- Transit Risk

#### **Buyer's Insolvency/Credit Risk**

Buyer's insolvency or credit risk refers to the inability of the buyer to honour full payment for goods or services rendered on due date. This is a risk on seller associated with selling or supplying a product or service without collecting full payment or experienced late payment.

#### **Buyer's Acceptance Risk**

Buyer's acceptance risk refers to the buyer's non-acceptance of goods delivered or services rendered. Unaccepted goods or services may create difficulty for the seller to dispose the goods to another buyer or encounter working capital problem.

#### **Knowledge Inadequacy**

A buyer or seller who intends to expand his business into another product/service/industry/country may not have adequate knowledge on the risk of the new product/service, local market situation or goods' fashion. The lack of knowledge increases the chances of business failure.

#### **Seller's Performance Risk**

A seller may fail to carry out his obligations in a sales contract due to one or more reasons, and such non-performance by the seller may have adverse consequential impacts on the buyer's business. It could be expensive for the buyer to take legal actions against the seller in his country.

#### **Documentation Risk**

Documentation risk is the risk of non-conformance to specific documentation requirements under a sales contract or documentary credit. Failure in fulfilling documentation requirements may result in seller's inability or delay in obtaining payment for goods delivered or service rendered.

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**Economic Risk**

Economic risk refers to unfavourable economic conditions in buyer or seller's country which may affect both parties in fulfilling their obligations. On the buyer side, economic risk may result in buyer's insolvency or inability to accept the goods or services. On the other hand, the seller may experience difficulty in producing or shipping the goods per se.

**Cultural Risk**

Different countries have their unique language and culture. The inability to appreciate/accept cultural differences and/or language barrier may result in conflicts and non-completion of the sales contract.

**Legal Risk**

Legal risk is the potential for financial loss arising from uncertainty of legal proceeding or change in legislation, such as a foreign exchange control policy. A sales contract could be frustrated due to changes in laws and regulations.

**Foreign Exchange Risk**

A buyer or seller may deal with foreign currencies in their daily course of business. This implies that they are exposed to fluctuations in foreign exchange market which may result in paying more (by the buyer) or receiving less (from the buyer) in terms of the local currency.

**Interest Rate Risk**

Interest rate risk is the risk borne by an interest-bearing asset, such as a floating rate loan. An increase in interest rate will result in buyer or seller paying more interest for their floating rate loan.

**Political/Sovereign Risk**

Political/sovereign risk refers to the complications that buyer or seller may expose due to unfavourable political decisions or political changes that may vary the expected outcome of an outstanding contract. Examples of political/sovereign risk are changes in fiscal/monetary policy, war, riots, terrorism, trade embargoes, etc.

**Transit Risk**

Transit risk is the risk of goods being damaged during shipment from the place of origin to the place of destination. Failure in addressing transit risk may result in heavy replacement cost or performance risk.

## How to Mitigate Risks in International Trade

### For the Buyer

- Deal with seller with sound reputation or established track record.
- Request for performance guarantee to avoid non-performance risk.
- Agree on more secure methods of payment such as documentary credit or open account.
- Acknowledge and respect cultural differences with the seller.
- Buy and sell in same currency to minimise foreign exchange risk. Alternatively, the buyer can hedge against foreign exchange risk by entering a forward or option foreign exchange contract with a bank.
- If financing is needed, enter into a fixed interest rate loan or interest rate swap agreement to mitigate against interest rate risk.
- Ensure sufficient insurance coverage against transit risk.
- Always have a contingency plan against unfavourable events.

### For the Seller

- Deal with buyer with sound reputation or established track records.
- Engage a reputable credit agency or credit insurer to minimise buyer's insolvency or credit risk.
- Engage on more secured methods of payment such as documentary credit or advance payment.
- Avoid granting excessive credit period or limit to the buyer.
- Ensure that the sales contract or documentary credit does not contain ambiguous or erroneous terms and conditions that are subject to future disputes.
- Acquire sufficient knowledge in document preparation to mitigate against documentation risk.
- Acknowledge and respect cultural differences with the buyer.
- Buy and sell in same currency to minimise foreign exchange risk. Alternatively, the buyer can hedge against foreign exchange risk by entering a forward or option foreign exchange contract with a bank.
- If financing is needed, enter into a fixed interest rate loan or interest rate swap agreement to mitigate against interest rate risk.
- Ensure sufficient insurance coverage against transit risk.
- Engage a representative in the buyer's country to deal with the goods or relevant parties in case of non-payment or non-acceptance by the buyer.
- Always have a contingency plan against unfavourable event.