Managing Risks in International Trade

Malaysia exported US Dollar 299 billion worth of goods internationally in 2021[1]. In 2022, the total trade reached record levels, rising by 27.8% to RM2.85 trillion[2]. Export for the year under review also rose by 25% to RM1.55 trillion, exceeding the 12th Malaysia Plan projections for 2025[3]. The imports of goods and services of GDP is 55.03% and 61.47% for exports of goods and services.[4]

MITI reported that there had been a significant rise in exports which was due to the robust exports of electrical and electronics, petroleum products, liquefied natural gas (LNG), palm oil and palm-oil based agricultural products, crude petroleum and machinery, equipment and parts, each contributed more than RM10 billion increase.[5] Based on the Economic Outlook 2023 by the Finance Ministry, Malaysia's trade is expecting to grow by 1.3%, exports are estimated to increase by 2.2% and imports by 0.2%.[6] Thus, many businesses in Malaysia are involved in International Trade.

Where International Sales run smoothly, the buyer will receive the transacted goods and the seller will receive payment. Such smooth trading is achievable if sufficient due diligence is done to avoid any potential risks. But there are, however, many potential risks involved in international trading. The most common being trading fraud, country risks, country requirements, damaged cargo and insurance. This article aims to provide an understanding of some of these risks which can arise in international trade and how they should be managed.

Trading Fraud

One of the risks in international trading risk is fraud. A fraudulent buyer can open a documentary letter of credit for payment of cargo shipped with terms in the credit that an unwary seller cannot obtain payment due to list of presentation documents which cannot be obtained at the time of shipment.

This was what occurred on the facts of **The Istana VI**[7], the inaugural reported decision of the Malaysian Admiralty Court. In this case, the fraudulent buyer was also the charterer of the vessel.

Photo source: https://claimar.com/wp-content/uploads/2022/04/risk-management.png

The shipment was diverted pursuant to a letter of indemnity that the fraudulent buyer gave the shipowner. The seller managed to arrest the shipowner's vessel because the cargo was delivered against the original bill of lading (still in the seller's hands as the letter of credit was not fulfilled) and the seller managed to obtain recourse.

The presentation documents to achieve shipment should be kept simple so that the seller can safely receive payment upon loading the cargo at the load port. If the list becomes longer the seller may find that they cannot fulfil the complete presentation of documents to call upon payment, for example, if a landing report at the port of discharge.

Country Risk and/or Requirement(s)

Country risk and/or requirement(s) are risks relating to non-tariff trade barriers, central bank exchange regulations or bans on the sale of specific products imported from a particular country.[8] It relates to the country's laws and regulations that are relevant and applicable to the importing and exporting of goods or international trade in general. Understanding the laws of the importing country is important.

One good example is the Top Glove controversy. Several rubber glove manufacturers from Malaysia found that the world's largest manufacturer of rubber gloves, Top Glove, has been banned for one year from exporting its products from Malaysia to the United States ("the US") after the US Customs and Border Protection ("CBP") made a finding that its products are made using forced and indentured labour. This means that rubber medical gloves from a Malaysian manufacturer will be seized if they enter the US due to "reasonable but not conclusive evidence" that they are being made by workers under conditions of modern slavery as per the CBP.

Country risks also involve war risks. The country with higher war risks includes but are not limited to Afghanistan, Iraq, Palestine and so on[9]. One recent example is the conflict between Russia and Ukraine. Where these risks are in the Country of export there will be an inability to produce and ship. Much of international trade is conducted by commercial traders who in turn obtain from suppliers from the affected countries. The trading contracts are also entered for advance delivery.

Where war breaks out and interrupts the supply chain and performance of the delivery contracts, the seller will want to raise the outbreak of war to excuse performance. They will rely on force majeure clauses. However, the effectiveness of these clauses depends on their wording. Marine or transit insurance, does not cover these war risks. For that, separate insurance is required to cover loss and damages caused by war or conflict.

Damaged Cargo and Insurance

Transit damage to cargo may sometimes be encountered. Such risk can be minimised through proper marine cargo insurance. Parties need to understand adequately where property or risk in the cargo lies and who is to insure. If there is no insurance, the buyer who finds that the goods are already damaged before arrival will not want to pay. Insurance cover should not be assumed before shipment. Insurance can either be bought by the seller or the buyer depending on the trade terms.

Trade terms such as CIF and FOB are commonly used in international trade. CIF, meaning "cost, insurance, freight" is where the seller discharges delivery obligations by tendering the bill of lading, the insurance policy and the invoice for the costs of freight. FOB, on the other hand, is "free on board" where the seller undertakes to place cargo on board a ship nominated by the buyer and the delivery is completed once the cargo is across the ship's rail.

The buyer in this case is responsible for arranging the insurance and freight. These trade terms are known as International Chamber of Commerce standard trade terms ("INCOTERMS"), which purpose is to ensure parties are clear about respective obligations under the sales contract and to minimise any misunderstanding between international traders.

Additionally, the facility of the documentary letter of credit ("LC") reduces much of the trade risks. A LC is an trade finance facility given by the buyer's bank to assure that payment will be made, indicating that the buyer is able to pay for the goods.[10] With a LC, it reduces many trade risks, especially when it involve international transactions. It generally reduces financial risk as a LC as explained, it guarantees payment for the seller.[11] This is beneficial for exporters, which allows them to deliver the goods as it creates an ease of mind that payment will be made to their account.[12] For importers, a LC can ensure the company only pay for the goods after the supplier had provided evidence that the goods had been shipped.[13]

This preserves the cash flow of the importers since there will not be any advance payment required. As mentioned earlier the seller asking for payment through a LC should ensure that he has the full documents to make the presentation once cargo is loaded on board and he obtains the 'shipped' bill of lading.

Photo source: https://d3njjcbhbojbot.cloudfront.net/api/utilities/v1/imageproxy/https://coursera-course-photos.s3.amazonaws.com/51/dddae273984f13abbdf9aa1f0cf429/Intro-to-RM-LOGO.png?auto=format%2Ccompress&dpr=1

That would mean that he can make full presentation to obtain payment once cargo is loaded on board at the load port.

CONCLUSION

Malaysia being the export hub, exports various goods, especially machinery and electronics at USD 127.94 billion in 2021,[14] keeping a good record and reputation may be a challenge if risks are not properly managed. The deliveries of goods affected due to the lack of risk management not only would lead to the traders facing a certain amount of loss but also likely to cause losses to subsequent customers of the traders. One should start managing risks from the beginning through appropriate contract terms and should continue with risk management throughout.

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2 Daniel Khoo, 'Total Trade at Record High', (*The Star*, 19 January 2023), <https://www.thestar.com.my/business/business-news/2023/01/19/total-trade-----------at record-high#:~:text=It%20has%20climbed%20by%2020.7,by%2017.5%25%20y%2Do%2Dy%20to%20RM167.> accessed 25 January 2023.

3 Ibid.

4 World Integrated Trade Solution, 'Malaysia Trade Statistic', (*WITS*, n.d.), <https://wits.worldbank.org/CountryProfile/en/MYS>

5 Daniel Khoo, (n 2).

6 Ibid.

7 [2011] 7 MLJ 145, the Author, Philip Teoh, acted for the Plaintiff in this case.

8 Jared Vineyard, '6 Risks in International Trade & How to Manage Them', (*Universal Cargo*, 3 September 2019), <https://www.universalcargo.com/6-risks-in-international-trade-how-to-manage-them/> accessed 18 January 2023.

9 CPP, '2021 – 2022 High Hazardous War Risk Countries Listing', (*CPP*, n.d.),<https://www.cpp.edu/international/study-abroad/docs/21-22-hazard-list.pdf> accessed 14 January 2023.

10 Interlog USA, 'Reducing Shipping Risk with a Letter of Credit', (*InterlogUSA*, n.d.), <https://www.interlogusa.com/answers/blog/reducing-international-buying-risk-letter-credit/> accessed 25 January 2023.

11 Ibid.

12 Bdc, 'What is a letter of credit?', (*BDC*, n.d.), < https://www.bdc.ca/en/articles-tools/marketing-sales-export/export/what-is-a-letter-of-credit#:~:text=Letters%20of%20credit%20are%20used,that%20they%20have%20been%20shipped.> accessed 25 January 2023.

13 Ibid.

14 Axis Group, 'Malaysia Proves Its Strength As An Export Hub', (*Axis Group International*, 29 July 2022), <https://axisgroupinternational.com/2022/07/29/malaysia-proves-its-strength-as-an-export-hub/> accessed 18 January 2023.

Philip Teoh
Partner