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RISK TYPES IN INTERNATIONAL TRADE

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Abstract *Exporting and importing activity leads to more occasions for companies, but also involves higher risks. Although the environment for international trade has changed significantly over the years, the risks that firms deal when vending their merchandises and services in other countries remain basically the same. Before a company is expanding overseas, must be aware of the additional risks of the foreign trade market. Generally, the risks of conducting global business can be segmented into four main categories: country, financial, commercial and cross-cultural.*

Key words:
International, trade, risk, business

JEL Codes:
G3

1. Introduction

The importance of international trade can be the providing of goods and services from one country to another provides employment, controls the cost of goods and services in the international market.

Therefore, a simple and clear definition of international trade can be: the exchange of goods and services among states, which leads to a global economy, where supply and demand or prices, affect and are affected by international events.

We may say that any business activity involves many risks of several types. Some risks can be more important for one kind of business than another. Because of these risks, firms are starting to ask some questions related to the threats that may affect their activity. The most important questions are: What is the commercial risk in international business? How do commercial risks arise in export import trade of international business? What are the factors caused for commercial risk under import export activity?

One of the main risks in exporting or importing is the absence of information about the global market. If a company which does not have accurate information about the region of sales where it fairs its merchandise, without doubt, it may fail in international business. So, the companies should study carefully about a foreign market.

Adaptability of your export product in foreign market plays a vital role in international market. Means, if your product can not have adaptability to change to the conditions of foreign market requirements, you may fail in exporting such product. With a simple example, I can explain about this commercial risk under international business. Suppose you are a mobile manufacturer. As you know, the models and application features are changed daily basis globally. So, if you fail to update features of your product, your market to sell such mobile comes down. So taste and preference of end users of your product plays an important role in any business market especially in export import trade.

Commercial risks can be reduced by using forecasting methods and keeping a careful watch on the changing business conditions in the concerned country, in particular, and also keeping a track of the changes in the world economy. Exporters have to be prepared to face any eventuality and wisdom lies in forecasting and anticipating.

2. The four major risk types in international trade

Any business transaction implicates a degree of risk. The risks in the global trade vary from those in national trade, and it is essential to treat worldwide trade with an extra degree of care and proper risk management and while all big organizations have extensive risk management departments, smaller businesses tend not to look at this issue in such a systematic way.

There are four types of risks that any organization should be aware when it is decided to operate in the international market.

Figure 1. The four major risks of international trade

Source: the author

a) *Commercial risk* refers to probable losses arising from the market or the transaction partners. An important measure is to secure that the trading partners are reliable. It is also important to take into account the partner's possible bankruptcy or indisposition to pay.

• weak partner, operational problems, competitive intensity, poor execution of strategy;

b) *Financial risk* is risk that contains financial loss to organizations. This type of risk usually appears as a result of instability and losses in the financial market produced by changes in interest rates, currencies, stock prices, and much more.

• currency exposure, asset valuation, foreign taxation, inflationary, transfer pricing;

c) *Country risk* refers to the possibility that fluctuations in the business environment in another country where companies are doing business may impact badly their operations or payment for imports resulting in a financial loss. It includes sovereign risk, which is a subdivision of risk generally connected to the government or one of its agencies refusing to comply with the terms of a credit agreement.

• government intervention, protectionism and barriers to trade and investment, red tape, lack of safeguards for intellectual propriety rights, legislation unfavorable to foreign firms, economic failures, social and political instability;

d) *Cross-cultural risk* – a situation or occurrence where a cultural miscommunication puts human value at stake.

• cultural differences, negotiation patterns, decision making styles, ethical practices.

3. Methods to mitigate risks in international trade

The first step in managing export risks is an evident one – but one which occasionally needs to be spelled out: firstly the companies must identifying the source of any possible risks, and then they must manage and decrease the arising risks to a minimum.

Managing export risks is a process of thinking systematically about all possible undesirable outcomes before they happen and then setting up procedures that will either avoid or minimize these risks, or help you to cope with their impact.

There are six basic elements in the risk management process:

- creating the background of the risks;
- detecting the risks;
- evaluating probability and probable consequences of the risks;
- developing strategies to mitigate these risks;
- monitoring and evaluation the consequences;
- communicating and consult with all the involved partners.

All the organizations must keep their risk management analysis simple and clear, and ensure it is understood by every company's employee who is involved in the exporting activity.

Mitigation methods for the buyer[1]

- requesting for performance guarantee to avoid non-performance risk;
- agreeing on more secure means of payment, like documentary credit or open account;
- respecting and acknowledging cultural differences with the seller;
- buying and selling in same currency to minimize foreign exchange risk;
- incoming into a fixed interest rate credit or interest rate swap agreement to moderate against interest rate risk, in case of financing requirement;
- ensuring adequate insurance exposure against transit risk;
- having all the time a contingency plan against critical events.

Mitigation methods for the seller[2]

- engaging a trustworthy credit agency or credit insurer to reduce buyer's indebtedness or credit risk;
- engaging on additional secured techniques of payment such as documentary credit or advance payment;

- evading granting unnecessary credit period or limit to the buyer;
- guarantee that the sales contract or documentary credit does not contain unclear or inaccurate expressions and circumstances that are subject to future disagreements;
- obtaining adequate information in document preparation to mitigate against documentation risk
- admitting and respecting cultural differences with the buyer;
- buying and selling in same currency to reduce foreign exchange risk;
- guaranteeing adequate insurance against transit risk;
- engaging a company's representative in the buyer's state to verify the merchandises or relevant parties in case of the buyers non-acceptance or non-payment;
- having all the time contingency plan against hostile events.

4. Conclusions

Risk mitigation means understanding those risks that can impact the objectives of the business, and taking the suitable stages to decrease the risks to an suitable level.

As soon as a company has identified weaknesses to their security program, the essential risk mitigation measures will be put in place to generate multiple layers of safety. These integrated security controls are designed to neutralize, evade, or reduce the firm's risks.

The risk identification framework alongside the establishment of risk evaluation indicator system will allow organizations to have an apprehensive understanding of the risks involved in trade and provide firms with timely risk alert and control.

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