INCOTERMS 2020

International Commercial Terms - Guidelines for Industrial Development

A Comprehensive Guidelines Document for Industrial Development Officers, SMEs, and Export-Oriented Enterprises

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Reference: Incoterms 2020 - International Chamber of Commerce (ICC)

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1. EXECUTIVE SUMMARY

Incoterms 2020 (International Commercial Terms) are a standardized set of rules published by the International Chamber of Commerce (ICC) to define the responsibilities, risks, and costs between buyers and sellers in international trade transactions.

Key Points:

• Updated every 10 years (last updated January 1, 2020)

• Comprise 11 distinct trade terms applicable to international commerce

• Divided into two categories: Any Mode of Transport (7 terms) and Sea/Inland Waterway (4 terms)

• Are NOT automatic - must be explicitly specified in the sales contract

• Provide guidance only, NOT enforceable law

2. INTRODUCTION TO INCOTERMS 2020

Historical Context

The ICC first published Incoterms in 1936. Over eight decades, these terms have evolved to reflect changes in international commerce, technology, and logistics practices. The Incoterms 2020 update introduced significant changes, particularly regarding the division of costs and responsibilities.

Importance for Industrial Development

For SMEs and industrial enterprises in Sri Lanka, particularly in the North Western Province, understanding Incoterms is crucial for:

- Reducing uncertainty in cross-border transactions
- Simplifying complex international negotiations
- Ensuring clear allocation of responsibilities between trading partners
- Mitigating financial and operational risks
- Enabling standardized, internationally recognized trade practices

3. WHAT ARE INCOTERMS?

Definition

Incoterms stands for "International Commercial Terms." They are a set of universally recognized rules that interpret the terms of delivery in contracts for the sale and purchase of goods. Each term defines:

- Who is responsible for arranging transportation
- Who bears the cost of transportation and insurance
- At what point responsibility and risk transfer from seller to buyer
- Who must secure export and import clearances

Critical Characteristics

Incoterms are NOT automatic. They must be explicitly stated in the contract of sale, typically as: "FOB Port of Colombo, Incoterms 2020."

Incoterms are NOT law. They provide guidance and standardized interpretation to facilitate international commerce. They do not override national laws or regulations.

Incoterms do NOT constitute a complete contract of sale. They address only delivery terms and leave other contractual elements (e.g., payment terms, warranty, liability) to be negotiated separately.

4. WHAT INCOTERMS COVER AND DO NOT COVER

What Incoterms COVER:

✓ Carriage (transportation) of goods from seller to buyer

✓ Export and import clearance responsibilities

✓ Allocation of costs between parties

✓ Allocation of risks (loss or damage) between parties

✓ Delivery point and timing

✓ Insurance obligations (where applicable)

What Incoterms DO NOT COVER:

✗ Ownership or title to the goods

✗ Payment terms or methods (e.g., L/C, TT, D/A, D/P)

✗ Detailed vessel or carrier requirements

✗ Force majeure or unforeseen circumstances

✗ Contract termination or breach remedies

✗ Insolvency or credit risks

✗ Unloading costs (except under DPU)

5. THE 11 INCOTERMS 2020 - DETAILED BREAKDOWN

Incoterms 2020 are categorized into two main groups:

GROUP A: RULES FOR ANY MODE OR MODES OF TRANSPORT (7 Terms)

1. EXW - Ex Works (Named Place)

Seller's Obligations:

• Make goods available at the warehouse or named place
• Provide packing in usual manner
• Bear all costs until buyer collects goods
• Responsibility ends when buyer takes possession

Buyer's Obligations:

• Pay for the goods as agreed
• Bear ALL costs and risks from point of collection
• Arrange all transportation and insurance
• Obtain all export and import licenses

Use Case: Bulk agricultural products, raw materials, commodities purchased from warehouses

2. FCA - Free Carrier (Named Place)

Seller's Obligations:

• Deliver goods to carrier at named place
• Obtain export clearance and licenses
• Provide transport documents (may include "on board" notation if buyer requests)
• Bear costs and risks until goods handed to carrier

Buyer's Obligations:

• Contract with carrier
• Bear costs and risks from delivery to carrier onwards
• Obtain import clearance
• Arrange insurance (if desired)

Use Case: Multimodal transport, containerized goods, inland delivery points

3. CPT - Carriage Paid To (Named Place of Destination)

Seller's Obligations:

• Deliver goods to carrier
• Pay freight to destination
• Obtain export clearance
• Provide transport documents

Buyer's Obligations:

• Bear all risks after goods delivered to carrier
• Arrange import clearance
• Arrange insurance (if desired)

Use Case: When seller wants to control transport arrangements; air freight; multimodal transport to inland destinations

4. CIP - Carriage and Insurance Paid To (Named Place of Destination)

Seller's Obligations:

- Deliver goods to carrier
- Pay freight and insurance to destination
- Obtain export clearance
- Provide transport and insurance documents

Buyer's Obligations:

- Bear all risks after goods delivered to carrier
- Arrange import clearance

Use Case: When comprehensive protection is required; valuable goods; multimodal transport

5. DAP - Delivered At Place (Named Place of Destination)

Seller's Obligations:

- Deliver goods at buyer's location (ready for unloading)
- Bear all costs and risks until delivery
- Obtain export and import clearances

Buyer's Obligations:

- Bear unloading costs
- Accept delivery at named place

Use Case: Door-to-door delivery; high seller responsibility; landlocked destinations

6. DPU - Delivered at Place Unloaded (Named Place of Destination)

Seller's Obligations:

- Deliver goods and UNLOAD at buyer's location
- Bear ALL costs including unloading
- Bear all risks until unloaded and ready for use
- Obtain import clearance

Buyer's Obligations:

- Accept delivery when unloaded

Use Case: Maximum seller responsibility; goods requiring special handling; buyer wants minimal involvement

7. DDP - Delivered Duty Paid (Named Place of Destination)

Seller's Obligations:

- MAXIMUM seller obligations
- Deliver goods at buyer's location
- Bear all costs including duties, taxes, and customs clearance
- Bear all risks until delivery

Buyer's Obligations:

- MINIMUM buyer obligations
- Receive goods
- Pay contract price

Use Case: Seller assumes complete responsibility; buyer is passive; imported to end destination

GROUP B: RULES FOR SEA AND INLAND WATERWAY TRANSPORT (4 Terms)

8. FAS - Free Alongside Ship (Named Port of Shipment)

Seller's Obligations:

• Deliver goods alongside the vessel at named port
• Obtain export clearance
• Bear costs and risks until goods placed alongside vessel

Buyer's Obligations:

• Nominate the vessel
• Load goods onto vessel and pay loading costs
• Arrange sea freight and insurance
• Obtain import clearance

Use Case: Non-containerized cargo; traditional breakbulk shipping; when buyer controls loading

9. FOB - Free on Board (Named Port of Shipment)

Seller's Obligations:

• Deliver goods on board the vessel nominated by buyer
• Obtain export clearance
• Bear costs and risks until goods on board
• Provide clean on-board bill of lading

Buyer's Obligations:

• Nominate vessel and arrange freight
• Bear all costs and risks after goods on board
• Arrange insurance
• Obtain import clearance

Use Case: Traditional sea trade; break bulk cargo; shipments where buyer controls vessel selection and main freight

10. CFR - Cost and Freight (Named Port of Destination)

Seller's Obligations:

• Deliver goods on board vessel
• Pay freight to destination port
• Obtain export clearance
• Provide bill of lading

Buyer's Obligations:

• Bear risk after goods on board at origin
• Arrange insurance
• Obtain import clearance and pay unloading costs

Use Case: Seller controls freight; traditional sea cargo; when seller wants to manage shipping

11. CIF - Cost, Insurance, and Freight (Named Port of Destination)

Seller's Obligations:

• Deliver goods on board vessel
• Pay freight to destination port
• Obtain and pay for insurance (minimum cover)
• Obtain export clearance
• Provide bill of lading and insurance certificate

Buyer's Obligations:

• Bear risk after goods on board
• Pay additional insurance if more coverage desired
• Obtain import clearance and pay unloading costs

Use Case: Maritime trade with insured shipments; traditional sea cargo; maximum seller comfort

6. RISK AND COST ALLOCATION MATRIX

The following table illustrates how risk and cost allocation varies across the 11 Incoterms:

Incoterm	Seller Arranges Carriage	Seller Pays Freight	Seller Arranges Insurance	Risk Transfers at
EXW	No	No	No	Collection
FCA	No	No	No	Handover to Carrier
CPT	Yes	Yes	No	Handover to Carrier
CIP	Yes	Yes	Yes	Handover to Carrier
DAP	Yes	Yes	No	At Destination
DPU	Yes	Yes	No	After Unloading
DDP	Yes	Yes	No	At Destination
FAS	No	No	No	Alongside Ship
FOB	No	No	No	On Board
CFR	Yes	Yes	No	On Board/Origin
CIF	Yes	Yes	Yes	On Board/Origin

Legend: YES = Seller's responsibility; NO = Buyer's responsibility

7. GLOBAL LOGISTICS STEPS AND INCOTERMS

International shipment involves 11 key logistics steps. Understanding where Incoterms allocate responsibility is critical:

1. Packing & Handling (Outbound)

Seller's responsibility in virtually all Incoterms to pack goods properly

2. Preliminary Transportation

Seller responsible under DDP, DAP, DPU, CPT, CIP; Buyer under EXW, FCA, FAS, FOB, CFR, CIF

3. Export Customs Clearance

Seller responsible under all Incoterms (except EXW and partially FCA)

4. Loading onto Vessel

Critical point. Buyer loads under FAS and FOB; Seller loads under other terms

5. Main International Transportation

Arranged by Seller for: CPT, CIP, CFR, CIF, DAP, DPU, DDP; by Buyer for: EXW, FCA, FAS, FOB

6. Insurance During Transit

Seller arranges only under CIP and CIF; optional/buyer arranged for others

7. Unloading at Destination

Only seller pays/arranges unloading under DPU; buyer responsible for others

8. Import Customs Clearance

Buyer responsible under most terms; Seller only under DDP

9. Final Transportation to Buyer

Buyer responsible except under DAP, DPU, DDP

8. BEST PRACTICES AND RECOMMENDATIONS FOR SMEs AND INDUSTRIAL ENTERPRISES

A. For EXPORTERS (Sri Lankan SMEs)

1. Choose EXW or FCA for Maximum Control

If you are a manufacturer or producer, EXW shifts all responsibility to the buyer. However, FCA is more practical for most SMEs as it allows you to prepare goods and hand to a freight forwarder, then your responsibility ends.

2. Use CPT/CIP for Strategic Partnerships

If you have a long-term buyer and want to strengthen the relationship, CPT (or CIP for high-value goods) shows willingness to manage logistics while buyer focuses on receiving goods.

3. Avoid DDP Unless Absolutely Necessary

DDP is risky for exporters because you bear all costs including import duties, which vary unpredictably. Use only if buyer insists and you understand the destination's import regime.

4. For Sea Exports: Use FOB or CIF

FOB gives buyer control over shipping while you deliver goods on board. CIF is safer because you purchase insurance and have documentation control. Avoid FAS—it is antiquated for containerized cargo.

5. Always Specify the Exact Place/Port

Example: "FOB Port of Colombo, Incoterms 2020" is clear. Ambiguous terms lead to disputes.

B. For IMPORTERS (Buying from Suppliers)

1. EXW for Bulk Purchases and Price Negotiation

If you buy in volume and have logistics relationships, EXW gives you the lowest quoted price and maximum control.

2. FOB/CIF for Traditional Sea Trade

FOB is common for liquid bulk and breakbulk cargoes. CIF is preferred if seller is creditworthy—insurance protects you in transit.

3. CPT/CIP for Air Freight and Multimodal

If goods arrive by air or mixed transport, CPT/CIP ensures seller controls routing and you avoid logistics coordination headaches.

4. DAP/DPU for Convenience and Risk Transfer

If you want goods delivered to your warehouse with minimal involvement, DAP/DPU shift responsibility to seller until arrival. DPU is even better because seller pays unloading.

5. Use DDP Only from Trusted Suppliers

DDP gives you zero logistics responsibility, but only negotiate if the supplier is experienced with your country's import regime.

C. General Recommendations for ALL Parties

✓ Always specify Incoterms 2020 explicitly in all contracts

✓ Combine Incoterms with clear payment terms (e.g., "FOB Port of Colombo, Incoterms 2020, Payment: 50% L/C at sight, 50% TT on delivery")

✓ Insurance is NOT mandatory under most Incoterms (except CIP, CIF). Negotiate insurance arrangements separately.

✓ Incoterms 2020 supersedes older versions (2010, 2000). Make sure all parties agree on the 2020 version.

✓ Understand your country's laws regarding export/import. Incoterms do NOT override national regulations.

9. FREQUENTLY ASKED QUESTIONS AND COMMON PITFALLS

Q1: Do I HAVE to use Incoterms?

A: No. Incoterms are optional and must be explicitly agreed. However, they are internationally recognized and recommended to avoid misunderstandings. Most professional international trade contracts reference Incoterms.

Q2: What's the difference between FOB and CIF?

A: Under FOB, the seller delivers goods on board the vessel at the port of shipment and your risk transfers there. The buyer arranges sea freight. Under CIF, the seller pays freight and purchases insurance on your behalf. Both work for sea cargo, but CIF is "heavier" on the seller (more cost and responsibility).

Q3: Is insurance mandatory?

A: Only under CIP (Carriage and Insurance Paid) and CIF (Cost, Insurance, and Freight). For all other Incoterms, insurance is NOT included unless separately negotiated.

Q4: What does "risk transfer" mean?

A: Risk transfer means the point at which if goods are lost, damaged, or destroyed, the buyer (not the seller) becomes responsible. It is independent of cost. For example, under FOB, risk transfers when goods are on board, even though the seller may have already paid for preliminary transportation.

Q5: Can I negotiate who arranges insurance?

A: Yes. Incoterms define the default. But parties can negotiate. For example, you can use "FOB with seller-arranged insurance" or "CIP with additional buyer insurance." Always document these changes in the contract.

Q6: Which Incoterm is best for a startup exporter?

A: FCA (Free Carrier) or CPT (Carriage Paid To). FCA lets you hand goods to a freight forwarder and step back. CPT is safer if you want to ensure goods reach the buyer's region—you arrange it, buyer pays freight implicitly via a higher price. Avoid DDP as a startup.

Q7: Are there risks with FOB?

A: Yes. Under FOB with a Letter of Credit, you need a bill of lading marked "on board" before payment. Some buyers or freight forwarders place goods in containers before vessel loading, making an "on board" notation impossible. Use FCA in such cases—buyer can instruct the carrier to issue an on-board bill.

Q8: What is DPU and when should I use it?

A: DPU (Delivered at Place Unloaded) is new to Incoterms 2020. It replaces the old DAF/DES/DEQ terms. Use DPU when you (seller) want maximum control: you deliver, unload, and bear risks until unloaded at buyer's location. It is common for heavy equipment and industrial machinery.

Q9: Can Incoterms be used for domestic (Sri Lankan) trade?

A: Yes, but they are designed for international trade. For domestic sales, simpler terms like "FOB Factory" or "CIF Warehouse" work, but formal Incoterms 2020 are overkill. Use them only if your domestic buyer requests them.

Q10: What happens if goods are damaged after risk transfers?

A: The buyer bears the financial loss (unless they have insurance). This is why insurance is critical. Under CIP/CIF, the seller arranges insurance on the buyer's behalf. Under other terms, the buyer should arrange their own insurance to protect against loss.

COMMON PITFALLS TO AVOID:

✗ Not specifying which Incoterm applies → leads to disputes and legal confusion

✗ Not specifying the place/port clearly (e.g., just "FOB" without port name) → ambiguous and unenforceable

✗ Mixing old Incoterms (2010, 2000) with Incoterms 2020 → rules have changed; confusion can arise

✗ Assuming Incoterms cover payment, ownership, or quality → they do NOT; these are separate contract terms

✗ Using FOB for containerized cargo without understanding modern port practices → goods may be loaded before on-board notation is possible

✗ Neglecting to arrange or document insurance → high risk of uninsured loss

✗ Not understanding local customs/duties under DDP → can lead to unexpected cost overruns

CONCLUSION

Incoterms 2020 are essential tools for international trade. They provide a common language and framework for defining responsibilities, risks, and costs between trading partners. By understanding the 11 Incoterms and selecting the one that best suits your transaction, you can:

- Reduce uncertainty and prevent disputes
- Allocate risks and costs fairly
- Facilitate Letters of Credit and payment negotiations
- Operate professionally in the global marketplace

For SMEs and industrial enterprises in the North Western Province of Sri Lanka, mastery of Incoterms is a competitive advantage in export markets and a safeguard against costly misunderstandings.

For more information, visit the International Chamber of Commerce website:

www.iccwbo.org/incoterms

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