The Role of Risk in Trade Operations

➢ Specification of domestic and international risk in trade operations

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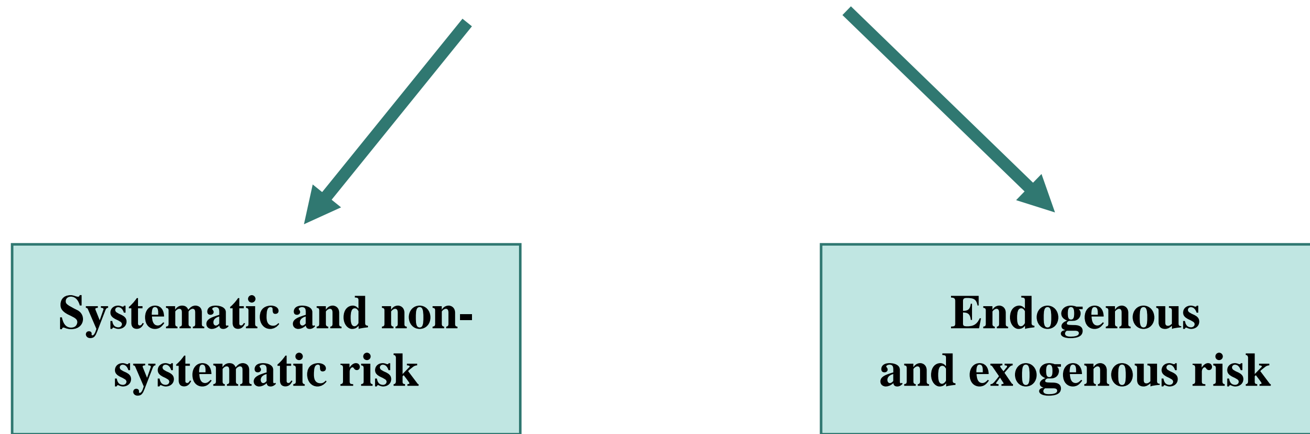
Risk, as a concept, is defined as **the probability of loss** (Merriam-Webster, 1984).

“***The impact*** *of a* ***currently unknown event*** *on* ***the business*** *and a potential problem*” (Sadgrove, 2015, s. 3).

The risk management standard ISO 31000 defines risk as *“**the effect** of **uncertainty** on **objectives**” (ISO 31000).*

There are generally **two basic classification of business risk** (Lambing and Kuehl, 2014; Miles, 2011):



The Risk Levels

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1. **Low risk** - the occurrence of a risk is unlikely, and no special or costly measures should be implemented other than standard company policies and procedures. A detailed risk management plan may not be necessary, and risk awareness training may be useful on a scheduled or annual basis.

2. **Medium risk** - it is possible that a risk will occur, and risk mitigation measures should reflect the costs and impacts on the company and the business activities, captured within a basic risk management plan. Annual low-level management training and the establishment of crisis management project groups will be beneficial to the company as part of contingency planning measures.

3. **High risk** - a risk is likely to occur. The company is advised to establish an appropriate budget to develop policies and procedures to counteract the probability of the risk and the subsequent impacts within a detailed risk management plan. Thorough, biannual management training will support the organization in responding to any crisis event more effectively.

4. **Extreme risk** - the risk is certain to occur at some stage of the project activity´s life span. The company should consider whether to continue with the activity or acknowledge the impacts and responses within a detailed risk management plan.

SPECIFICATION OF DOMESTIC AND INTERNATIONAL RISK IN TRADE OPERATIONS

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Domestic risk in trade operations

Domestic risk is low compared to the risk arising from the international environment. This is mainly related to area of operation which is **within the country**. Trade operations are mostly providing by **the same single currency**. The **business research can be conducted easily** and **capital investment are less**. The most known risks in domestic business are natural disasters risk, regulatory and legal risk, socio-political risk, start-up and operating risk, technological risk, market risk, financial risk, economic risk.

International risk in trade operations

International risk related to process of **trading around the whole world**, which brings some difficulties and more risks to companies. Trade operations are providing **in multiple currencies**. The **business research is difficult** to conduct and **customers are more heterogeneous**. Another specific factor influenced international business risk is **huge capital investment abroad**. The major risks in international business environment are financial risk, foreign exchange fluctuation risk, country risk and customer risk. There are also some others types of risk based on the changing global marketplace.

EXPLANATION OF INDIVIDUAL RISK TYPES
-domestic trade

1. **Economic risk –** the likelihood that macroeconomic conditions may affect an investment or a company´s prospects domestically or abroad. The economic risk include exchange rate fluctuations, a shift in government policy or regulations, political instability, or the introduction of economic sanctions.
2. **Financial risk –** the probability of loss of money due to investment transactions. Business research has examined the utility of accounting-based measures on risk evaluation and prediction. This type of risk include financial failure or bankruptcy risk, default risk, equity risk, market risk, inflation risk, interest rate risk, credit risk, liquidity risk, derivative risk and audit risk.
3. **Market risk –** market risk means the risk that an investment may face due to fluctuations in the market. The risk is that the investments´ value will decrease. The market risk include equity risk, commodity risk, currency risk, interest rate risk and inflation risk.
4. **Technological risk –** the potential for losses due to technology failures (website crashes, security incident, illogical trading algorithm, incorrectly chosen technology).
5. **Start-up and operating risk –** the risk of loss resulting from inadequate of failed internal procedures, systems or policies, or from external events (fraud by employees or third parties – fraud on bitcoin platforms, hacking, ransomware, employment risks, execution risks – failed reporting, wrong entries, etc.)
6. **Socio-political risk –** include risk that involves both social and political factors. An example of socio-political risk is "going green" trend.
7. **Regulatory and legal risk –** the risk that a change in law and regulatory will materially impact a security, business, sector, or market (change in interest rate).
8. **Natural disasters risk –** a threat of naturally occurring event will have a negative effect on business (earthquakes, volcanic eruptions, tsunami, landslides)

Risks of International Business Transactions

The numerous risks associated with international business transactions vary depending on the **method of transaction**, such as **trade, licensing, or direct investment**. They will also vary depending on what countries the business parties are **located** and in what country the **transaction is to be performed**. The country where a party is a citizen or national is its home county. If a party is transacting business in a foreign country, then that country is referred to as the host country. The types of risks that an international businessperson faces, and the methods utilized to minimize such risks, will vary from transaction depending on a number of variables. Two of the most fundamental variables are the **identity of the host country** and the **type of transaction**. (DiMatteo, 2016)

In general, the level of risk escalates in the three basic ways of conducting international business, **from exporting-importing to licensing, and from licensing to foreign direct investment**.

A successful international businessperson is sophisticated and able to **recognize risks and take the appropriate precautions.**

EXPLANATION OF INDIVIDUAL RISK TYPES
-international trade

Pricing Risk

- It is essential for a first-time exporter of goods to include in his price all additional costs of international trade.

Financial Risk

- One of the most important worries of the exporter in international trade is to obtain his payments from the importer. The exporter not only has to check the creditworthiness of the importer, but he also has to check the rules and regulation of foreign country buyers. Due to the problem of balance of payments, some countries may restrict payments in free foreign exchange only or in Asian dollars from the countries that are participating in the Asian Clearing Union. Professional agencies are available today, who provides useful information about the creditworthiness of foreign buyers. The period of trade cycle in international trade is longer as well as the degree of risk is higher in financial matters. Litigation in international trade is a costly process hence the exporter must take prudent decision in choosing the method of receiving payments from the foreign buyers.

Foreign Exchange Fluctuation Risk

- Another risk that requires the international trader´s/exporting company´s attention foreign exchange fluctuations. If the exporter is carrying on trade in Indian rupees and sales proceeds as per government policy comes in free foreign exchange such as dollars, euros or pounds, he has to be immensely careful in taking note of deprecation or appreciation of the Indian rupee. If the rupee appreciates, the exporter´s worry is that he will receive less Indian rupees for his trade transactions and if the rupee depreciates, exporters shall receive more Indian rupees due to the difference in the exchange rate with invoiced currency. → International traders can get their risk covered from authorized foreign currency dealers, through forward exchange cover and future exchange trading.

Country and Customer Risk

- There are risk associated not only with the importer/importing company, but also with the country where he or his business is located. The various risks associated with customer and countries are characterized on the next slide.

Country Risk

The various risks associated with countries are categorized as follows (Singh, 2009):

1. In case of economic turbulence of crisis, there may be **foreign exchange restrictions** that may prevent the outflow of funds from the importer´s country or release of payments to the exporters.
2. The country, where the buyer is located, may impose **import restrictions after the contract** between exporter and importer has been signed and such restrictions imposed may prevent the exporter to execute the contract due to such import restrictions.
3. Business suffers most in case of **breakdown in political and economic machinery** of any country. Such economic or political crisis/breakdown may prevent the transfer or release of payments to the exporter from the importing country.
4. There may be **collapse of banking systems or importer countries**. The exporter cannot receive his payments in time due to such collapse or inability of the banking system of the importer country to make payments
5. There may be **war, rebellion, battles, major terrorists or cyber attacks or civil unrest** in the importer country breaking down the country financial and banking system, thereby making it impossible for the time being to make payments.
6. There may be **natural disasters** in importer country such as tsunamis, earthquakes, volcanic eruptions, droughts or floods and it may take time to make payments by importer in such cases of natural disasters.

Customer (Importer) Risk

The various risks associated with customer are categorized as follows (Singh, 2009):

1. The **solvency of the importer** is major issue to be checked by the exporters. Some of the essential things to be checked are how long the importer has been into this business and what kind of business or businesses he has been doing in the past. Exporters shall check the relations of importer of the importing company with their suppliers, banks and government. The essential point to be checked is that whether the importer has regard for law, rules and regulations of his country and is honest and respectful to rules and regulations of other countries.
2. The **creditworthiness of the importer** is an important aspect to be checked by the exporter/exporting company. It has been observed that importer´s creditworthiness has nothing to do with the country´s creditworthiness as importer from low risks countries such as EU, US and Japan are also defrauding nowadays. Hence, exporter must check the creditworthiness either himself or through a professional agency.
3. Having checked the solvency and creditworthiness of the importer/importing company, the exporter/exporting company shall take necessary steps to cover risks through **insurance covers**, although being sound in solvency and creditworthiness may be exposed to risks that are beyond its control. The exporter shall ensure that managing payments from importer is most important event in international trade transactions.

Pricing Risk

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For a first time exporter of goods it is vital to **internalize all the additional costs of international trade within their price**. A domestic company cannot assume that the appropriate price of its goods in the domestic market is the appropriate price for a foreign market. Depending on the type of transaction and the trade term inserted into the contract there will be a **number of costs unique to international sales** that will need to be incorporated into the price charged for the goods. (DiMatteo, 2016)

Assume an example when an **exporter of goods has trade terms stated as CIF** (cost, insurance, freight). In a documentary credit transaction, the exporter must obtain a list of documents. Some of these documents will cost money to obtain, such as an **inspection certificate**, **standby letter of credit**, and a **certificate of origin**. The exporter also has to obtain an **export license**, meet all **marking and labelling requirements**, as well as any necessary product or marketing modifications needed to comply with the laws of the country of import. The CIF trade term allocates to the exporter the **costs of shipping the goods to a seaport** in the exporter´s country, the **loading of the ship**, and the **freight and insurance expanses** to the foreign port of destination. If the seller is being paid in foreign currency, it may want to buy a **hedge or insurance against a detrimental currency fluctuation**, such as a currency option. The cost of obtaining the option needs to be incorporated into the price. **These costs need to be internalized in the price if the exporter wants to maintain its profit margins.**

Pricing Risk

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A checklist of questions to be considered in setting the price of exports includes (DiMatteo, 2016):

- If the good being exported is **complete and ready to sell** to the ultimate purchaser
- The exporter must determine **whether the price for the product** (with all the internalized costs) **is marketable in the foreign country**. The price may make the product cost prohibitive in a country with a low per capita GDP.

The exporter would be left to **decide not to export** to that country, modify the product to make it less costly to produce or license the right **to produce the product to a company in the foreign country**. The foreign company may be able to produce the product more cheaply because of the lower costs of labour, regulatory compliance, and materials in its country. The exporter would then collect royalties as the licensor.

The **importer also has additional expenses** in an international transaction that need to be factored in determining the actual costs of the goods. Using the CIF trade term, the buyer is obligated to pay the costs of obtaining a letter of credit from a commercial bank, of unloading the ship, warehousing costs at the port, clearing goods through customs, paying import tariffs, and transporting the goods from the port to another location. If the payment is in the exporter´s currency, the costs of buying a currency option, future, or forward contract needs to be factored into costs.

Risk of Changing Global Marketplace

There is liberalization of international trade as there has been significant **reduction in non-tariff barriers.**

The **world is shrinking** but **markets are expanding** as trade barriers are coming down.

Regional trade blocks such as ASEAN, EU, MERCOSUR have **placed advantageous as well as challenging situations** before exporters as nations are giving preferential and free trade benefits to each other.

Following are the new challenges that an exporter has to keep in mind while planning to enter international trade in the rapidly changing global trade regime (Singh, 2009):

- Increase in global competition
- Increase in social and economic instability
- Change in buying trends

Specific Business Risks

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Looking more specifically at the risks that can arise in business operations and their initial impact on the business, **what risks can we mention**?

- **Quality problem** – product recall, customers defect
- **Supply and Demand Risk** – affects profitability, customers defect
- **Environmental pollution** – damage to the environment (plastic bags and accessories used for packing goods)
- **Fire** – harm to humans, loss of goods in warehouse
- **Computer Failure** – inability to take orders, process work or issue invoices; customer defect
- **Marketing risk** – market share falls, revenue drops
- **Fraud** – theft of money, theft of goods
- **Security** – theft of money, assets or plans
- **International trading** – foreign exchange losses, financial losses
- **Political risks** – foreign government appropriates assets; prevents repatriation of profits

RISK ANALYSIS AND RISK MANAGEMENT

Risk analysis of export business operations

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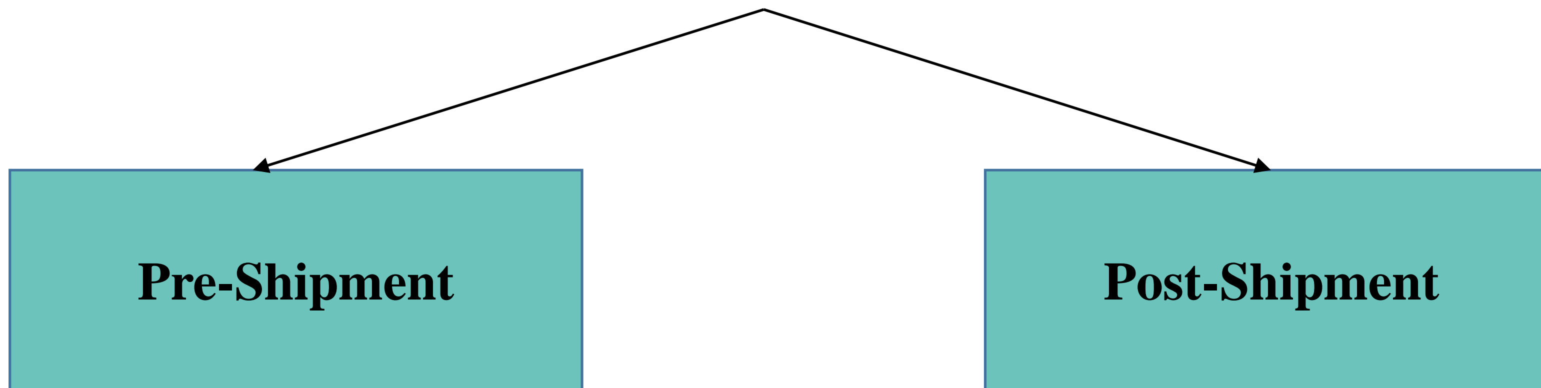
Foreign trade operations are characterized by an **increased level of risk**. Risk management is therefore one of the important tasks of a business company. It requires, in particular, **the creation of preventive measures to prevent losses** and, in particular, **the appearance of bad debts**. Preventive measures consist in **identifying risk factors** related to export or entering the foreign market (Svatoš et al., 2009).

The business risk analysis generally relates to two phases.



Risk management of export business operations

When managing business risks, we can proceed according to whether the risks are commercial or territorial. The so-called rating can then serve as a starting point for the analysis of territorial risks. The management of these risks can be specified as follows (Svatoš et al., 2009):

1. **Commercial risk management**
   - This refers to **manufacturing risks, non-removal risks and payment risk**. Based on the evaluation of these risks, **payment terms are formulated**. The most suitable option is a suitable **payment-hedging instrument** (documentary letter of credit) or hedging instruments (insurance, bank guarantees). These risks in foreign trade **can be passed on to a third party**. In particular, the participation of factoring and forfaiting institutions in export operations.
2. **Territorial risk management**
   - These risks relate primarily to the **economic, political, social and natural situation** in the country. Preventing or limiting large losses in the event of damage due to territorial risks is possible through appropriate **territorial diversification** of the exporter's commercial, credit and investment activities. The state plays an irreplaceable role in the transfer of territorial risks to another entity, through **state-supported export credit agencies** that insure the territorial risks.

The Specific Examples of Risks of Doing Business Internationally

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Type of Risk	Description	Mitigation of Risks
Foreign Country	Different countries have different risk characteristics	A risk assessment should be performed to determine a foreign country´s political and economic stability
Non-Delivery of Goods	Buyer makes payment, but never receives goods	On-Account transaction, documentary collection transaction, standby letter of credit
Non-Payment (Exporter)	Seller sends goods, but never receives payment	Cash in advance, letter of credit, retention of title, consignment
Language Risk	Misunderstanding of oral communications and written contract	Translation, contract in both languages
Cultural Risk	Risk of offending other party; different negotiation styles	Etiquette, building trust
Currency Risk	Fluctuation, convertibility, and repatriation risks	Payment in own currency, hedging, countertrade
Political Risk	Change in regulations	Political risk insurance, bilateral investment treaties, concession agreement
Legal Risk	Differences in law, enforcement of law, and legal remedies enforceability of judgments	Foreign lawyer, contract remedies, choice of law, arbitration clause
Special Import Laws	Local participation and content requirements, standards	Market selection, use of independent contractors
Transportation Risk	Damage of goods in transit and miss-delivery	Cargo insurance, trade term

-the task

THE WAYS OF ENSURING FULFILMENT OF BUSINESS OBLIGATIONS

The problems confronted by traders led to common rules for allocating risks associated with the loss of goods, the transfer of title, obligations to pay for freight and insurance, and the responsibility for other costs. Those rules in turn have served as the foundation for national rules (both judicial and legislative) and more recent international rules established both by the merchants themselves and by treaties among governments. (Brand, 2018)

The ways of ensuring fulfilment of business obligations can include:

- **Using price-delivery terms** to allocate risks and obligations
- **The United Nations Sales Convention** (Passage of Risk and Identification of the Goods to the Contract)
- **Bank guarantee** - is a special reinsurance institute applicable only to business obligations. The bank guarantee is based on a similar principle as the guarantee, but only the bank can be the guarantor of the bank guarantee.
- **Commercial means of security in purchasing contracts** (for example penalty, pledge contracts, securing obligations by transfer of law, assurance by assignment of the receivable).

In the case of risky transactions, the services of insurance companies can also be used.

RISK
INSURANCE

SPECIFICATION OF ECONOMIC IMPORTANCE AND LEGAL FRAMEWORK OF RISK INSURANCE

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Insurance is a financial service that is **based on the transfer of risk to a specialized institution**. This institution takes the risks for consideration and, as part of the infrastructure of the economy, ensures the financial elimination of the negative consequences of contingencies.

The **insurance stabilizes economic subjects**. It is based on the principle of the creation, distribution and use of an insurance fund managed by a special institution - an insurance company. An insurance fund is actually a money reserve fund, which is formed by the so-called insurance method. This means that all stakeholders are involved in its creation, but its distribution is for the benefit of those involved in the incident.

Insurance Forms and Groups

Basic insurance forms:

- **Statutory** (obligation to insure arises from the law)
- **Obligatory contractual** (the obligation to take out in the form of an insurance contract is imposed by a legal regulation in case the specified activity is to be performed)
- **Voluntary insurance**

Insurance classes are divided into three basic groups according to the basic subjects of insurance:

1. **Property insurance**
   - insurance of buildings or equipment of a business unit, motor insurance.
2. **Liability insurance**
   - insurance of liability for damage caused in the course of the occupation, statutory insurance of the employer's liability for damage in the case of work injury or occupational disease.
3. **Personal insurance**
   - life, accident, pension insurance.

SPECIFICATION OF INTERNATIONAL RISK INSURANCE TYPES

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Marine insurance

-overseas transporters usually assume no responsibility for the merchandise they carry unless the loss is caused by their carelessness. Marine insurance provides protection from loss during shipment of products. This insurance has two types of coverage:

1. **Ocean marine insurance** – protects goods during shipment overseas or while temporarily in port.
2. **Inland marine insurance** – covers the risk of shipping goods on inland waterways, railroad lines, truck lines, and airlines.

Marine insurance is usually sold in three forms with varied coverages (Dlabay and Scott, 2005):

- **Basic coverage** – provides protection from hazards such as sea damage, fires, jettisons, explosions, and hurricanes.
- **Broad coverage** – includes basic coverage plus theft, pilferage, non-delivery, breakage, and leakage.
- **All-risk coverage** – consists of any physical loss or damage due to an external cause, excluding risks associated with war.

As expected, an all-risk policy is the most expensive of the three types since the most coverage is provided. Some losses are not covered by all-risk policies – include improper packing, damage caused by natural properties of a product, and loss caused by delay (such as labour strike). The amount charged for marine insurance is affected by a variety of factors. Premium factors include **the value of the goods**, **the destination**, **the age of the ship**, **the storage location** (on deck or under deck), **the packaging**, and **the size of the shipment**.

Property insurance

Crimes such as burglary, theft, and arson disturb business activities throughout the world. Companies face three main risks as property owners (Dlabay and Scott, 2005):

1. **Loss of real property** – refers to structures permanently attached to land, such as factories, stores, garages, and office buildings. A company´s building and land represent a significant financial investment. Property insurance provides protection for damage or loss of real property. Buildings and structures are insured for loss or damage from fire, lightning, wind, hail, explosion, smoke, vandalism, and crashes or aircraft and motor vehicles.
2. **Loss of personal property** – refers to property not attached to the land. Loss or damage of office furniture, machinery, equipment, and supplies also can be covered by property insurance.
3. **Financial responsibility for injuries or damage** – liability is legal responsibility for the financial cost of someone else´s losses or injuries. Customers, company guests, employees, and others may be injured while on the premises of a business. Or a company representative may accidentally damage the property of others. When any of these occur, the company may be responsible for the financial loss that results from the incident. Quite often legal responsibility is the result of negligence, or failure to take ordinary or reasonable care. An employer may also be held financially responsible for the actions of an employee. Liability insurance protects a company from financial losses due to the actions of its employees.

SPECIFICATION OF INTERNATIONAL RISK INSURANCE TYPES

Political risk insurance

It covers political events, including the direct and indirect actions of host governments that negatively impact investments and are not properly compensated for. The following are the political risks commonly insured by the PRI industry (Dlabay and Scott, 2005):

- **Expropriation** – PRI protects against losses caused by host government actions that may reduce or eliminate ownership or control. It covers outright confiscations, expropriations, and nationalizations, as well as losses resulting from a series of acts that over time have an expropriator effect.
- **Currency inconvertibility and transfer restrictions** – protects against losses arising from an investor´s inability to convert local currency into foreign exchange and to transfer it out of the host country. It also covers excessive delays in acquiring foreign exchange. Typically, this coverage applies to the interruption of interest payments or repatriation of capital or dividends resulting from currency restrictions. It does not cover devaluation risk.
- **Political violence** (war, terrorism, and civil disturbance) – protects against losses resulting from the damage of tangible assets or business interruption caused by war, insurrection, rebellion, revolution, civil war, vandalism, sabotage, civil disturbance, strikes, riots, and terrorism. Coverage usually applies to politically motivated acts.

Credit risk insurance

One hazard of conducting business in other countries is not receiving payment. Credit risk insurance provides coverage for loss from non-payment of delivered goods. This protection helps reduce the risk of international business activities.

- Credit risk insurance is available through the **Foreign Credit Insurance Association (FCIA), a private association that insures U.S. exporters**. FCIA enables exporters to extend credit to overseas buyers. Credit insurance covers 100 percent of losses due to political reasons, such as war, asset seizure, and currency inconvertibility. This insurance covers up to 95 percent of commercial losses, such as non-payment due to insolvency or default. (Dlabay and Scott, 2005)
- In EU there is the private sector insurers offering short – term domestic and export credit insurance covering “marketable” risk which for them is synonymous with “re-insurable” risk. At the other, there are the **State-owned Export Credit Agencies (ECAs)** providing medium and long-term insurance for the account of the state within the terms of the OECD Arrangement on officially supported export credits.

Risk in Developing Countries

The level of risk in transacting business in many developing countries is considerably higher than in developed countries. Some countries are marked by arbitrary government actions, excessive taxation, ineffective legal and dispute resolution systems, and a high degree of corruption. These countries find it difficult to interest foreign investment. There fore the best and possibly the only way to conduct business in these countries is by exporting. (DiMatteo, 2016)

Some countries have passed laws to assure foreign investors and businesspersons by legally attempting to reduce the risks of doing business. Mexico passed the Foreign Investment Act of 1993 in order to attract and protect foreign investment. It opened large portions of the Mexican market to foreign ownership. In certain strategic economic industries, approval to the National Commission of Foreign Investments is needed for foreign ownership of greater than 49 percent, while some industries, such as oil, electricity, and railroads, remain reserved for Mexican nationals. The Foreign Investment Act provides expedited procedures to gain governmental approvals. For an extensive review of the risks of doing business in China. Some **examples of risk in developing countries** are introduced in the following slides.

Example 1: Sale of Goods to Nigeria and Canada

Nigeria has been rated at the top of the recent Corruption Index published by Transparency International, a non-governmental organization. It may be difficult to undertake business dealings in Nigeria without being asked to give a bribe. To best understand the risks of doing business witch such a country, it is prudent to order a political risk report from a professional risk assessment company. It is also advisable to contact state department for information. It is imperative to fully investigate the foreign party, including credit and reference checks. The Nigerian currency is not convertible to a hard currency like the U.S. dollar, European euro, or English pound. Payment in one of these hard currencies is unlikely because of government restrictions against the repatriation of such currencies from the country. Thus, the risk of doing business, even in the relatively risk-free method of exporting, may be too great a problem in a place like Nigeria.

Any exporting to such a county needs to be supported by a confirmed letter of credit from a reputable international bank. The currency convertibility and repatriation problems could be overcome through a countertrade transaction in which goods are exchanged for each other or an export transaction is linked to an import transaction. Another device to eliminate the risk to a company is to find an export trading company willing to perform the transaction on its own account. Finally, the costs and feasibility of obtaining political and credit risk insurance should be investigated. The Overseas Private Investment Corporation, Eximbank and the Multilateral Investment Guarantee Agency provide various types of insurance.

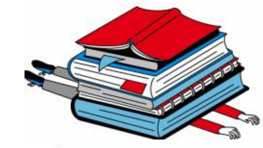
In contrast to exporting to Nigeria, **exporting to Canada** offers a low level of risk. Country and currency risks are minimal given that Canada is a stable, industrialized country and a member of the North American Free Trade Agreement (NAFTA). Although currency fluctuations are possible, the Canadian dollar is freely convertible into the U.S. dollar. Currency fluctuation risk may be a concern in a long-term transaction, and both parties may manage that risk through a variety of hedging techniques. In a one-shot export transaction, the risk of a dramatic currency rate change is unlikely. (DiMatteo, 2016)

Example 2: Licensing Technology to China and France

The licensing of technology and the transfer of intellectual property rights presents the next level of risk in international business transactions. Any time a company discloses confidential information and trade secrets to a third party, there is always a risk that the information may be further disclosed to unauthorized parties. The problem is confounded when that disclosure is made in a foreign country that is not protective or intellectual property.

China has acceded to numerous intellectual property rights 'conventions, such as the Berne Convention, but in the past the level of trademark, copyright, and patent infringement through piracy and counterfeiting has been relatively high. The cost and time of legal action to prevent the importation of illegal grey market goods has been the only effective countermeasure. It is hoped that Chinese membership in the World Trade Organization (WTO) will result in greater enforcement of intellectual property law. In the meantime, the licensor needs to negotiate a transfer agreement that includes contractual protections against the misuse of the licensed information. The problem remains whether such protections will be enforced. In order to reduce the cost of enforcement and increase the likelihood of success, the licensor should consider alternative dispute resolution methods such as mediation an arbitration. It is also important for the licensor to understand that, the licensing agreement may not be a totally private affair. The contract is likely to be reviewed and pro-licensor clauses modified.

In contrast to China, **France** has an established record of intellectual property protection. It is important for the intellectual property owner to register its rights under the patent, copyright, and trademark laws of France before entering any transfer agreement. The license or transfer agreement is generally enforced as written under French law, but superseding European Union Regulations dealing with licensing of patents and intellectual property must be addressed, and certain provisions that are legal under U.S. laws may be illegal under EU competition law. (DiMatteo, 2016)



Example 3: Purchasing a Company in the Russian Federation and Germany

The most risky of all international business transaction is foreign direct investment, which can range from opening a branch office to purchasing an existing company or building business facility. Foreign direct investment is risky primarily because it makes a company susceptible to a wide range of host country laws. These laws cover the areas of employment and labour, environmental, health and safety, product liability, and taxation. In considering FDI, the first decision is what type of legal vehicle should be chosen to operate the foreign business. The most popular way of doing business is to establish an independent subsidiary under the laws of the host country.

In purchasing an existing company in Russia, the greatest risk is the uncertainty in the meaning and enforcement of commercial laws. Most of the current Western-styled laws were enacted following the fall of communism in 1991. Supporting jurisprudence has yet to be developed by the Russian courts; in fact, the widespread ineffectiveness of the Russian legal system has been well chronicled. Russia is a country where the use of a joint venture with an established Russian partner might be advantageous. A joint partner can share the risks and provide a portion of the capital or offer necessary government contacts and distribution systems. Joint ventures have to be approved or registered with government agencies, and failure to register can lead to severe negative consequences such as the dissolution of the joint venture.

In contrast, purchasing a company **in Germany** is much easier. There is little likelihood of a government expropriation or nationalization in Germany. Germany´s pro-worker labour laws, however, prohibit an acquiring firm from ignoring existing collective bargaining agreements. The employment is viewed as a property right that must be respected. Any substantial changes in the workforce, such as layoffs or plant closings, must be submitted to a works council made up of employees. Finally, the corporation laws in both Russia and Germany should be researched. (DiMatteo, 2016)

Hedging Strategies and Instruments for Exchange Rate Fluctuations

The exporter in order to manage his risks properly used to take help of various instruments including derivatives, which is basically a financial contract and its value is evolved from the value of some other financial asset, such as securities, a commodity price, an exchange rate, an interest rate, or even an index of prices. Derivative helps the exporter in reallocating the risk among various financial market participants.

The following instruments of derivatives are used widely in today´s era to hedge against risks in order to manage the exchange rate fluctuations risk (Singh, 2009):

1. **Forwards Contract** – an agreement between two corporations or a corporation and a bank, generally **over-the-counter** (trading does not take place under the auspices of an official institution) or **privately negotiated "deals".**
2. **Futures Contract** – an agreement between two parties to buy (sell) something at a **pre-specified price**. Future contracts are **exchange-traded and regulated, standardized, market to market.**
3. **Options Contract** – is an agreement between a buyer and seller that gives the purchaser of the option the right to buy or sell a **particular asset at a later date at an agreed upon price**. Options contracts are often used in securities, commodities, and real estate transactions.
4. **Swaps Contract** - A swap is a forward-looking contract whereby two economic operators undertake to exchange either the agreed assets in question or cash flows under **pre-established conditions**.

The exporter should contact his authorized foreign exchange bank or dealer in order to use the above-mentioned hedging instruments to manage his risks.

SUMMARY

- The risk can be defined as **the impact of currently unknown event on the business and a potential problem.**
- Domestic risk in trade operations is mainly related to area of operation which is within the country, providing by the same single currency. The most known risk in domestic business are **natural disasters risk, regulatory and legal risk, socio-political risk, start-up and operating risk, technological risk, market risk, financial risk and economic risk.**
- International risk in trade operations is specific due to difficulties and more risky international environment. Trade operations are providing in multiple currencies. The major risks in international are **financial risk, foreign exchange fluctuation risk, country risk and customer risk.**
- The level of risk escalates from **exporting-importing to licensing, and from licensing to foreign direct investment.**
- The ways of ensuring fulfilment of business obligations can include various possibilities, e.g. **using price-delivery terms to allocate risks and obligations, bank guarantee, commercial means of security in purchasing contracts.**
- The insurance is another way of ensuring fulfilment of business obligations. Insurance classes are divided into three basic groups: **property insurance, liability insurance and personal insurance.**
- The major specific international risk insurance types are **marine insurance** (ocean and inland marine insurance), **property insurance** (loss of real property, loss of personal property and financial responsibility for injuries or damage), **political risk insurance** (expropriation, currency inconvertibility and transfer restrictions, political violence) and **credit risk insurance**.

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