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CHOOSING OF FOB OR DDP FROM BUYER PERSPECTIVE IN INDIRECT IMPORT OF THE PRODUCTION EQUIPMENT

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Abstract

Most enterprises in various industries have the brand or manufacturer list of items allowed to be used in their production activities. Refers to the manufacturing or brand list, the means of production in the industrial world still has a country of origin mostly from Europe, America and East Asia. Large manufacturers whose products are vastly used should ideally have a representative office in a region and considers cooperation with third party, domestic company in the country to become a distributor for its products. One of the determining variables in a quotation price given by distributors is the delivery cost. The amount of delivery cost depends on the delivery point or INCOTERM used. Both FOB & DDP are popular INCOTERM in the process of importing production equipment in Indonesia. FOB term is when the goods pass the ship's rail, at the port of export (origin), and DDP term is when the goods are placed at the disposal of the buyer. Gap responsibilities between FOB and DDP term consists of: carriage charges, insurance, destination terminal charges, delivery to destination, and import duty & taxes. By built up of the FOB price with approach to the gap responsibilities above, based on some references for various production equipment with various prices are obtained reasonable percentage of differences between the DDP price against FOB price, within range 13.65% - 36.04% for DDP price above FOB price.

Keywords: INCOTERM, FOB, DDP, Carriage Charges, Duty & Taxes.

1. Approved Manufacturer List

Most enterprises in various industries have the brand or manufacturer list of items allowed to be used in their production activities. It is an effort to guarantee the quality and safety because generally, brand lists are made after examining the certification and experience of the products. Commonly, certificates can only be held by a product after it has passed through the test against a standard rule agreed by a recognized institution.

For developing countries such as Indonesia, the means of production in the industrial world are still largely imported from abroad. Whether parts then carried out in domestic assembly, or imported under conditions complete assembly. This refers to manufacturing or brand list of each company that still has country of origin, mostly from Europe, America and East Asia.

Large manufacturers whose products have widespread usage should ideally have a representative office in a region. By looking at regulations and locations, representative offices of manufacturing European and American countries for the Southeast Asian region or ASEAN are mostly located in Singapore. However, by seeing the level of demand from a country, manufacturers certainly consider need cooperation with third parties, domestic companies in the country to become distributors for its products. As a sign that a third-party or local company has been being distributor for a certain brand, proven by a letter issued from the ministry of trade.

As an end user, how do we get the best prices from a distributor? One of determining variables in a quotation is delivery cost. The amount of delivery cost depends on the delivery point or INCOTERM used. Many considerations between the buyer and seller in deciding used INCOTERM. In this practical research, the author intends to compare between FOB (Free on Board) & DDP (Delivery Duty Paid) which are popular used in the process of importing production equipment in Indonesia.

Material or goods shipped via sea freight is a material with a large size & weight which should not be lifted via air freight. In other words, the goods exceed the recommended capacity of air freight, or small material which its requested estimation time arrive (ETA) site are not in the near future, and the distribution process travel time can be waited for. As for DDP, end users don't have to think about the freight is by sea or air, what they know is the goods received at the handover end place. However, as a competent buyer, they are supposed to ask the distributor whether shipping is done via sea or air as a reference to predict the freight cost composition in purchase order prices (PO) and in making a comparison of commercial bid analysis and estimate of the time wasted in the transportation process.

1.1. Introduction of INCOTERM 2010

To avoid conflicts and difficulties, importers and exporters or buyers and sellers, must have a common understanding of the terms and conditions under which they trade. The Incoterms (International Commercial Terms) also known as terms of delivery, are an essential part of any export-import transaction and standard trade definitions most commonly used in international sales contracts.

International Commercial Term (INCOTERM) were developed and administered by International Chamber of Commerce (ICC) in Paris. The Incoterms is a set of rules issued by private commercial institutions. Thus, the position of the incoterms is independent, because it is not a government product from any country. Though the last several updates to INCOTERM (*i.e.* 1980, 1990, 2000, and 2010) have been coincidentally one decade apart, meaning we will await upcoming updates INCOTERM on next year. In the 2010 version of incoterms, there are 11 terms can be chosen by traders, namely: Ex-works (EXW), Free Carrier (FCA), Carriage Paid to (CPT), Carriage Insurance Paid To (CIP), Delivered at Terminal (DAT), Delivered at Place (DAP), Delivered Duty Paid (DDP), Free Alongside Ship (FAS), Free On Board (FOB), Cost & Freight (CFR),and Cost Insurance & Freight (CIF).

INCOTERMS 2010 are compressed and now presented in two groups. The new classification makes it easier for shippers to discern between INCOTERMS that are to be used only for ocean and inland waterway, and those that should be used for multi-modal contracts. The new INCOTERMS, or Rules, are separated as follows:

1. Rules for use in relation to any mode or modes of transport, which can be used where there is no maritime transport at all, or for transportation transactions in which maritime transport is used for only part of the carriage.
2. Rules for ocean and inland waterway transport, where the point of dispatch and delivery are both ports.

Thus, FAS, FOB, CFR, and CIF belong to the latter class of Rules; while EXW, FCA, CPT, CIP, DAP, DAT, and DDP belong to the former.

Incoterms not only describe seller's and the buyer's obligations and specify the point when the responsibilities for the transportation costs shift from the seller to the buyer, it also determines the point when the risks associated with transportation transfer from the seller to the buyer. FOB is when the goods pass the ship's rail, at the port of export (origin), and DDP is when the goods are placed at the disposal of the buyer.

1.2. Introduction of FOB (Free on Board)

Under FOB, the risk point is when the goods have been loaded aboard an ocean carrier. Accordingly, if a container is dispatched from the seller's place of business, the risk does not pass until it is loaded aboard the ship. However, many sellers wrongfully believe that since the container is now in the hands of the carrier, the risk has already transferred to the buyer. It has not. Any accidents do happen like trucks crash, port warehouses catch fire, cranes topple during loading, goods are stolen from containers on piers etc. In all such circumstances, if FOB is the designated INCOTERM, these mishaps are at the risk of the seller. Most of Indonesian logistics companies run the business under FOB (free on board).

Free on Board (FOB) named Port of Shipment means that the seller delivers when the goods pass the ship's rail at the named port of shipment. This means that the buyer has to bear all costs and risks of loss or damage to the goods from that point. The FOB term requires the seller to clear the goods for export. This term can be used only for sea or inland waterway transport.

1.3. Introduction of DDP (Delivered Duty Paid)

If we purchase directly from the manufacturer that do not have domestic distributors, rarely to find any manufacturer who is interested in using the DDP term because of concerns in payment and regulatory issues in the import process in Indonesia.

The responsibility is transferred to the buyer when the goods have been placed at the buyer's arrangement at the stated destination, in a condition ready to be dismantled. It means that the seller bears the entire cost of shipping to the placement of goods at the destination specified. DDP services are commonly known as door to door service. Appropriate writing as per Incoterms 2010: DDP (insert the named place of destination).The seller clears the goods for export and is responsible for making the goods available (usually in the buyer's country) at the named point and place and on the date or period specified in the sales contract, but not unloaded from any arriving means of transport. The seller may not invoice the buyer until delivery at the final destination has taken place.

Obligations of the seller:

1. The seller shall at his own expense take care of the licenses and formality of exports and imports.
2. The seller opens Contracts of carriage of goods to the destination specified.
3. The seller must deliver the goods at the disposal of the buyer on the means of transport arrangements that arrived ready to unload at the point / destination stated on the date agreed (on location of the buyer).

Obligations of the buyer:

1. The buyer should provide assistance to the seller, upon request, risk, and expense of the seller in obtaining permits.
2. The buyer must bear any risk when the goods have been delivered to the destination.
3. The buyer must bear all expenses related to the goods after the destination point, unloading costs, and additional costs in case of late taken care of.

2. Incoterm Chart of Responsibilities

Table 1: Incoterms 2010 Rules

	ANY TRANSPORT MODE		SEA/INLAND WATERWAY TRANSPORT				ANY TRANSPORT MODE				
	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAT	DAP	DDP
Charges/Fees	Ex Works	Free Carrier	Free Alongside Ship	Free On Board	Cost & Freight	Cost Insurance & Freight	Carriage Paid To	Carriage Insurance Paid To	Delivered at Terminal	Delivery at Place	Delivered Duty Paid
Packaging	BUYER OR SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Loading Charges	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Delivery to Port/Place	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Export Duty & Taxes	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Origin Terminal Charges	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Loading on Carriage	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Carriage Charges	BUYER	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Insurance						SELLER		SELLER			
Destination Terminal Charges	BUYER	BUYER	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER	SELLER	SELLER	SELLER
Delivery to Destination	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	SELLER	SELLER	SELLER
Import Duty & Taxes	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	BUYER	SELLER

Source: Quanterm Logistics (quanterm.com)

As stated in the chart of various INCOTERM responsibilities above, the gap between the FOB and DDP responsibilities consists of: carriage charges, insurance, destination terminal charges, delivery to destination, and import duty & taxes. In this paper, the author intends to find the ideal cost approximation for the responsibilities gap, afterwards it can be a consideration of the buyer when getting quote from domestic distributor, which Incoterm should be chosen between FOB and DDP.

There are several modes of transportation by sea freight:

1. Containerized -> Full Container Load (FCL) / Less-than-full Container Load (LCL)
2. Conventional (general cargo)
3. Charter Shipping (bulk)
4. Roll on (RO)/Roll off (RO) Vessels and LASHING.

Considered in weight metric and the cubical, production equipment is generally dispatched with containerized mode, and general cargo mode for support, auxiliary, and the miscellaneous goods.

Carriage Charges

Freight cost of imported goods is the actual transportation costs paid according to those listed in bill of lading (B/L) or air waybill (AWB). If the transportation costs listed in B/L or AWB are not transportation costs that should be paid, transportation costs are actual transportation costs or should be paid as long as the importer can show real evidence of the transportation costs. If the importer cannot show concrete evidence in question, the cost of transportation for sea transport is defined as follows: 15% of the FOB price of goods originating from Europe, America and Africa; 10% of FOB prices for goods originating from Asia-non-ASEAN and Australia; 5% of the FOB price for goods originating from ASEAN countries. We assume the FOB price plus the freight cost as CFR (cost & freight) price.

Insurance

Insurance is an agreement between two parties, namely an insurance company and policy holder, which became the basis for acceptance of premiums by insurance company in exchange for providing compensation to the insured or policy holders for losses, damages, costs incurred, loss of profits, or legal responsibility to third parties which may be suffered by the insured or the policyholder due to occurrence of an uncertain accident. It is a common practice in the commercial world to insure goods in transit. Briefly, the following reasons compel traders to contract transport insurance:

1. Protection against financial losses resulting from damage, pilferage, theft and non-receipt of entire or part of a consignment
2. Protection against financial claims that can be made against the owner of goods on board a vessel in case of a "declared general average" (the goods themselves being undamaged)

Insurance premiums in the distribution process may vary. The premium is determined by the insurance company, depending on the used insurance company's services and the scope of insured coverage. This insurance premium can start from 0.1% to 0.5% of the total price of goods and shipping costs. It is rare for an insurance company which provides premium under 0.1%. The premium determination is influenced by several factors i.e. type of goods (general cargo, engine, etc), type of packing (container or non-container), types of Ships (steel, barges, etc), shipping routes (domestic or worldwide), and type of guarantee.

Table 2: Percentages of Insurance Value from CFR Price

Freight Modes	ASEAN	Asia/Australia	Afrika/Timur Tengah	Eropa	Amerika
Sea	0,1951	0,205	0,215	0,205	0,225
Air	0,16	0,17	0,175	0,17	0,185
Inland	0,0383	0,064	-	-	-

Source: Ministry of Trade of the Republic of Indonesia*(PMK No 07/M-DAG/PER/1/2014)*

Planners generally use the approach 0.5% for insurance estimation, duly actually insurance premiums are often found around 0.2%. Strengthened by data from Ministry of Trade above, figures 0.2% becomes the author's approach in estimating the value that must be issued for insurance premiums during dispatch over sea. The calculation of the insurance premium is based on CFR price. But for the process of sending to delivery point of the buyer or final destination from end users after going through the terminal and exiting customs and clearance, we need to append insurance premiums again if using this number. We assume the CFR price plus the insurance premium as CIF (cost insurance & freight) price.

Destination Terminal Charges

Many factors influence the amount of terminal charge rate, one of them is the size of the transport container that represents the cubical size of the imported goods, which then affects the amount of lift-on costs. As for other tariff lists referred to Jakarta International Container Terminal (JICT), in Indonesia, administrative costs in the current terminal is the same for each container various sizes, which consists of note fees, pass truck fees, and stamp duty, as amount Rp 127,000.00 ribu (eq USD 9.02). The total lift-on costs and subsequent administration fees are subject to 10% for VAT tax.

The terminal charge price range based on JICT for conditions full container load (FCL) is started from Rp 345,750.00 (eq USD 24.55) for container size 20ft, and Rp 6.514.387,00 (eq USD 462.47) for container size 45ft. The rates are applied if there is no examination upon the goods. In case the inspection is carried out and even the red line is affected, the costs incurred will be much greater.

Delivery to Destination

The average operational cost of inland freight transport in Indonesia is Rp. 3,093 per kilometer, or around USD 34 cents per kilometer. This figure is higher than the average for Asia which amounted to USD 22 cents per kilometer. This operational costs are very varies, depending on the route. The highest costs occur on the route Rantau Parapat - Medan, in North Sumatra, and on the route Sumbawa - Mataram, in West Nusa Tenggara. The lowest operational costs occur in East Java, namely the Malang - Surabaya route. In addition, spending on roads include official and unofficial levies amounted more than 10% of total operating costs of the vehicle.

Giving a proportion of 3% of the total price of FOB price and freight costs before being subject to import duties for the entrance fee terminal to the destination is a fairly safe figure in estimating, as well as cover the insurance premiums during a trip to the field or final destination.

Import Duty & Taxes

The amount of import duty imposed by Indonesian Customs as contained in PMK 2017 ranges within from 0% to 50%. Most of production equipment as per the Harmonized System (HS) Code is in the range of 5-15% duty fee. Harmonized System classify the goods in a nomenclature which governed by some principles.

Custom duty is a tax imposed on imports and exports of goods based on the value of goods. Either using Incoterms FOB or DDP is not a differentiator for imported goods to be subject to VAT and holding tax. The difference is in the customs location. Author does not approach the two types of taxes for this comparative method.

Henceforth, Indonesian Customs has his own foreign exchange rate different from the central bank, though of course there are only a few differences. In the price built up process, the difference in exchange rates affects the percentage of DDP prices against FOB prices. But the difference is not significant; it only affects the decimal point. Hence author ignores it, and using foreign exchange rates of USD against IDR prevailing at the time of writing in progress.

Conclusion

By built up the FOB price with approach to the gap responsibilities which have been described above, for various production equipment with various prices are obtained reasonable percentage of differences between DDP price against FOB price within range 13.65% - 36.04% for DDP price above of FOB price. This approach is conditional if goods do not enter the red line when the customs clearance, and do not need to enter the examination zone. The number does not include bank provisions or fees shall be spent while payment transaction.

This approximation could be used while considering or choosing INCOTERM whether FOB or DDP in order to find the lowest and efficient cost before issuance purchase order, under condition the travel time of distribution not being a major consideration and the goods are not in a tight requested schedule. By known FOB price, buyer should choose the term DDP if the distributor gave DDP price only 10% above its FOB price. However, if the distributor gives significant price difference with DDP price 40% higher than the FOB price, it is better for buyers to direct their own forwarder services by choosing FOB term.

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Appendix

Foreign Exchange Selling Rate Bank Central of Indonesia, dated 18 April 2019
USD 1 = IDR 14,086.00
Foreign Exchange Rate Ministry of Finance of Indonesia (KMK Nomor 19/MK.10/2019)
USD 1 = IDR 14,137.00