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Gordon Institute
of Business Science
University of Pretoria

Aggressive transfer pricing as a means to increase multinationals' competitiveness.

Ingo Haig Tocknell
Student number: 23020416

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ABSTRACT

Aggressive transfer pricing is identified as a core competence that is required by multinationals to increase their competitiveness. The creation of a multinational is based on the evolution of corporate strategy, the culmination of which is encompassed by the internalisation theory. The main proponents of this theory is the efficient and effective management of internalised resources through the use of internal pricing. The purposes of this study was to establish if the possibility exists to use aggressive transfer pricing as a means to increase the competitiveness of multinationals. A deductive research approach was used to determine if the propositions set forth on the basis of the current literature would hold true when analysed based on data collected. A survey questionnaire was designed based on the literature review and submitted to respondents electronically. The results of the data analysis supported the propositions. The findings in this study enabled the researcher to deduce that the possibility indeed exists for aggressive transfer pricing to be used by multinationals as a means to increase their competitiveness.

KEYWORDS

Multinational, Transfer Pricing, Competitiveness, Corporate Strategy, Competencies

DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Ingo Haig Tocknell | Date

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1.1 INTRODUCTION

In a globalised world economy, there has been a significant rise in the number of Multinational enterprises (multinationals) with ever-increasing dimensions of complexity. Not only are these multinationals becoming more complex, the quest for innovation and competitiveness has increased with profit maximisation being a focal point for all multinationals. One of the approaches used to maximise group profits is transfer pricing and more specifically the use of aggressive tax planning. The lack of co-operation between tax authorities and their limited enforcement resources as well as harmful tax practises are often the main motives behind aggressive transfer pricing (Organisation for Economic Co-Operation and Development, 2015).

It is due to these harmful tax practises placing strain on the international tax framework under the disguise of transfer pricing that has led to the establishment of the 1979 Organisation for Economic Co-Operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereinafter TPG). The arm's length principle forms the backbone of the TPG and is continuously supported as the only realistic approximation of an open market by OECD member countries (Organisation for Economic Co-Operation and Development, 2010, p.36).

The OECD has revised the TPG on several occasions in order to stay abreast of global trends in transfer pricing as well as the evolution of corporate strategy and the continued expansion of globally networked multinationals. The increase in multinationals was due to the change in strategic management over the last four decades that increased the development of firm-specific advantages (FSA). FSA were initially developed in terms of core competencies as a means to attain a competitive advantage (Prahalad & Hamel, 1990).

The price at which group companies and divisions within a company transact for shared FSA is referred to as transfer pricing. When a multinational measures affiliates individually, through return on investment and operating profit, the distortion of individual entities' performance is curtailed through a transfer price for inter-company or inter-divisional sales of goods and services. Transfer pricing gained prevalence through the implementation of the above mentioned strategies that were influenced by Coase's transaction cost economics which emphasized the ability to reduce transaction cost by internalising external markets that could be managed more efficiently within an organisation through internal pricing (Rugman, 1980a).

The internalisation theory of a firm (Buckley & Casson, 2011; Rugman, 1980a, 1980b), a precursor to strategic intent (Hamel & Prahalad, 1989) and the resource based view (RBV) of a firm (Collis & Montgomery, 1995; Stalk, Evans, & Shulman, 1992; Wernerfelt, 1984) were instrumental in the creation of multinationals. This meant that multinationals moved away from licensing agreements for FSA, aiding in the protection of competitively distinct resources, by internalising these advantages. The implementation of these theories in an organisations strategy to create a competitive advantage informs the concept that aggressive transfer pricing could be a means to increase a multinationals' competitiveness.

With strategic fit as the main focus, a corporations' attention was concentrated on increasing shareholder wealth (Hamel & Prahalad, 1989) by using transfer pricing to minimise tax cost. This enables multinationals to successfully shift profits from high to low tax host countries. The only means in which to increase shareholder wealth with minimal effort in a steadily declining competitive multinational was the use of transfer pricing. The impact of the motives and methods used for transfer pricing was seen by affiliates reporting nearly twice the profit ratios of the multinational group (Organisation for Economic Co-Operation and Development, 2015).

The urgency with which the OECD established the Base Erosion and Profit Shifting (BEPS) package, a mere two years from the start of the project, signifies the turmoil in which the international tax framework found itself. The BEPS package aimed to restore confidence to the tax system as well as ensure profits are taxed where the economic activity took place (Organisation for Economic Co-Operation and Development, 2015). The BEPS package therefore signified that a change in terms of transfer pricing motives are needed. Deductively, the BEPS action points would increase the visibility of transfer pricing motives and should therefore reduce the use of aggressive transfer pricing methods that could arguably be seen as tax avoidance and in certain instances bordering on tax evasion.

Transfer pricing not only assists in minimising the group tax burden, it also enables multinationals to leverage their competitively distinct resources to create competitiveness as envisaged by the implementation of the internalisation theory. As with the evolution of corporate strategy from an external (Porter, 1980) to an internally (Prahalad & Hamel, 1990) focused strategy and eventually a combination thereof in the RBV of the firm (Collis & Montgomery, 1995), an evolution in transfer pricing motives and the methods are needed. This evolution should be one of aggressive transfer pricing with the aim at increased competitiveness as opposed to tax minimisation. This in and of itself would lead to increased profits, shareholder and stakeholder wealth.

The creation of the BEPS package as well as the Country-by-Country reporting necessitates the need for multinationals to evolve transfer pricing motives and methods. Greater competitiveness necessarily increases operational performance that would lead to greater financial performance. The effect on profits would therefore be in line with the current transfer pricing motives of increased group profits without the added risk of adjusting taxable income to compensate for profit shifting through aggressive transfer pricing.

1.2 RESEARCH SCOPE

The scope of this research is competitiveness. The pertinent literatures are within corporate strategy, competitiveness, multinational enterprises, and transfer pricing methodology, methods, and regulations.

1.3 RESEARCH MOTIVATION

The development of the BEPS package by the OECD places an additional burden on multinationals to not only substantiate the use of transfer pricing, but also justify the method used to calculate the transaction price between affiliates. Multinationals, as with all organisations, have a mandate to maximise profit through actively pursuing and leveraging their competitively distinct resources or FSA. A multinational passing these advantages onto an affiliate through aggressive transfer pricing, is merely performing the actions it was established for in the first place, that of reduced transactional cost through the internalisation of resources in order to attain increased performance (Kirca et al., 2011, p.64).

The fact that pricing between connected parties would, more often than not, not be comparable with that of non-connected parties increases the administrative burden and compliance costs of multinationals. It should also be noted that not all multinationals actively seek to minimize their tax burden, even though there are several cases where this has been the intention of multinationals such as Starbucks and Fiat (Chee & Blenkinsop, 2015), and Amazon and Apple (Bartunek, 2015). It is thus fair to say that the TPG, based on the arm's length principle, aims to reduce the advantages created through astute strategic management by nullifying the transfer of these advantages through aggressive transfer pricing.

1.4 RESEARCH PROBLEM

This study will attempt to determine if the use of aggressive transfer pricing could be a means to increased competitiveness for multinationals.

1.5 TABLE OF ABBREVIATIONS

Table 1 is a list of abbreviations used within this document and is included for ease of reference.

Table 1: Abbreviations used in this document

Abbreviation:	Meaning:	Abbreviation:	Meaning:
BEPS	Base Erosion and Profit Shifting	OECD	Organisation for Economic Co-operation and Development
CPM	Cost Plus Method	OEM	Original Equipment Manufacturer
CSA	Country-Specific Advantages	RBV	Resource Based View
CUP	Comparable Uncontrolled Price	RPM	Resale Price Method
FA	Formulary Apportionment	TNMM	Transactional Net Margin Method
FDI	Foreign Direct Investment	TPG	Transfer Pricing Guidelines
FSA	Firm-Specific Advantages	TPM	Transactional Profit Method
GM	General Manager	TPSM	Transactional Profit Split Method
LOF	Liabilities of Foreignness	TTM	Traditional Transaction Method

2 CHAPTER 2: LITERATURE REVIEW

2.1 CORPORATE STRATEGY AND COMPETITIVENESS

Drawing on the adaptation of Darwin's law, the corporations that thrive from one generation to the next are those that adapt best to their competitive environment (Henderson, 1989). With multinationals at the forefront of globalisation and internal pricing the key to their effective functioning, the necessity to adapt their transfer pricing motives is essential to their continued competitive advantage.

Corporate strategy and competitiveness has been an evolutionary topic for decades, with the most rapid evolution in the last four decades as evidenced by the excess of available literature. These changes were and still are affected by various aspects of the dominant business context of the time in which the change took place. The most notable context being that of globalisation and expansion of multinationals, alongside the evolution of neo-classical economics.

The starting point for the concept of transaction costs economics, and inadvertently internalisation and vertical integration of corporate strategy, can be connected to Ronald Coase's 1937 article *The Nature of the Firm*. Coase (1937) notes that, based on economic theory, the allocation of factors of production outside the firm is based on the price mechanism which refers to the manner in which the price for items affect the supply and demand for goods and services (Coase, 1937). Coase (1937) stated that "If a workman moves from department Y to department X, he does not go because of a change in relative prices, but because he is ordered to do so." (p.387). With specific reference to a firm, this signifies that the price mechanism, whilst valid, was not the only basis on which factors of production were allocated.

Based on Coase's inadvertent concept of transaction cost economics, the creation of the firm naturally evolved, whereby the price mechanism was superseded in order to negate the associated cost thereof (Coase, 1937, p.390). These associated costs, although not explicitly mentioned by Coase (Tadelis & Williamson, 2012), were transaction costs relating to negotiations, information collection, specialist consultants, marketing, and business contracts. Other costs include the acquisition and processing of information, legal costs, organisational costs, and the cost associated with inefficient markets (Joskow, 1985). These costs are lower within a firm, through the suppression of the price mechanism, and can be maintained due to the firm's ability to approach the market if the costs were to escalate (Coase, 1937, p.392).

In order to transcend the price mechanism, the natural evolution of resource integration into one firm, the internalisation of resources, and the subsequent creation of multinationals due to globalisation, can be attributed to Coase's seminal writing. Coase (1937) argued that the assumption that exchange transactions are homogenous when making use of the price mechanism was not correct and that the actual diversity of these transactions would mean that the costs of these transactions would vary considerably through not only the price mechanism, but also the internal organisation of these transactions (Coase, 1937; Tadelis & Williamson, 2012).

The internalisation of external resources should be done when it is the most cost effective decision based on the various resource choices available. Based on the variation in resource costs for the alternative choices of external resources, and the internalisation of these resources, Coase (1937) noted that the choice between these alternatives should be explained (Coase, 1937; Tadelis & Williamson, 2012). One such explanation is that the transactions that were not directly dependant on the price mechanism could be internalised (Coase, 1937).

Ronald Coase and Kenneth Arrow introduced the concept of positive transaction costs in the 1960's and quoted Kenneth Arrow's that the existence of vertical integration of firms is an indication that there is no such thing as zero transaction cost (Tadelis & Williamson, 2012). It is to this end that corporate strategy evolved to other avenues such as the development of core competences and the RBV so as to not place sole reliance on reduced transaction costs as a means to increase organisational competitiveness.

Cost-minimising relationships such as joint ventures that emerge due to the level on investment needed to create economies of scale for supply contracts, often led to an increase in transaction cost in the form of mediation costs between buyers and suppliers. This was generally caused by the emergence of unforeseen contingencies leading to opportunism from either party to the vertical relationship (Joskow, 1985). These contingencies led to the "hold-up" problem with one party to the relationship expropriating undue profits from the relationship (Joskow, 1985). On this basis, corporate strategy evolved to vertical firm integration, which inadvertently aided the subsequent evolution of corporate strategy. With this evolution came the emergence of conglomerates or diversification.

Corporate diversification was the strategy of choice in the 1960's and early 1970's and originated from the seminal work by Gort in 1962, and Ansoff in 1957 and 1965 (Ramanujam & Varadarajan, 1989). Diversification was a means to enter into new business streams that a firm could service by way of either an acquisition or leveraging the already developed economies of scale within the existing firm.

The key differentiator between integration and diversification was the change in administrative structures, systems, and other management processes required for diversification (Ramanujam & Varadarajan, 1989). The next evolution, away from diversification and into strategic fit grounded in Porter's five forces, was necessitated by the difficulties in measuring performance, growth, and risk reduction of diversification (Ramanujam & Varadarajan, 1989; Stalk et al., 1992).

In contrast to biological evolution, strategists accelerate the evolution of business competition through the use of their imagination, logic, and the understanding of natural competition (Henderson, 1989). A common context throughout this evolution is the rapidly changing competitive environment, in Hamel and Prahalad (1989) "And with the pace of change accelerating in most industries, the predictive horizon is becoming shorter and shorter." (p.66), and in Collis and Montgomery (1995) "the pace of global competition and technological change has left managers struggling to keep up" (p.118). Both these quotes indicate that if an organisation is an inch behind the competition, it may just as well be a mile behind.

The 1980's saw Michael Porter's five competitive forces dominate strategic and competitive thinking. These forces were aimed at creating a sustained competitive advantage by analysing the environment of the industry in which the organisation operates (Porter, 1980). The focus shifted from diversification of an organisation product offering to the differentiation of its products into diverse markets. This analysis was based on the preceding strategy of firm diversification and aimed at exploiting markets whereby an organisation attempted to differentiate its markets as opposed to its products.

Company strategy was formulated on the basis of strategic fit; i.e. does the industry we are in or attempting to enter "fit" the products and resources we have available currently. A diagnoses of an industries' five competitive forces would enable a company to determine its relative position within a new market. The strategic focus shifted from the differentiation of the organisations markets to the capabilities of the firm.

With focus on the capabilities of the firm, its core business, it is easier to first shift essential business processes to new geographical areas before shifting to a new business, providing the benefit of both focus and diversification (Stalk et al., 1992). Corporations could create a positioning strategy by taking the structure of the industry as a given and, by matching their strengths and weaknesses (their resources) thereto, could further establish defences against these forces or find a position where these forces were weakest (Porter, 1980).

As stated, the evolution of corporate strategy is led by the business context of the time. This was made evident by the RBV of a firm only being applied 20 years after it was first alluded to by Penrose in her 1959 book *The Theory of the Growth of the Firm* (Rugman & Verbeke, 2004; Wernerfelt, 1984). It has been argued that, even though Penrose had a substantial impact on the resource-based management approach, it was unintended (Rugman & Verbeke, 2002). This is the same for transaction cost economics coming to its pinnacle in the 1960's, 20 years after Coase first introduced the concept (Tadelis & Williamson, 2012).

The mid 1980's saw the "re-birth" of the RBV of the firm by using Porter's five competitive forces to analyse the fit of current resources an organisation possesses for an industry as opposed to only analysing the products (to be "forced" on customers) (Wernerfelt, 1984). The strategic aim was thus to go into product-markets where an organisations' current resources were adequate to exploit a gap within that industry. It was with this realisation that, to be or remain competitive, multinationals could no longer be content with the resources they have, but had to develop the resources they required for a competitive advantage.

This changed the vision of organisations from a value proposition to a winning proposition focussing on more than just the value of the product or service, but also the customer specific value creation. The value proposition was the point-of-parity with other competitors and the customer specific value creation was the point-of-difference that sets a producer apart from the rest.

Current resources versus building the required resources was the major shift in corporate strategy, and in the 1980's saw the evolution of strategy from strategic fit to strategic intent. This competitive advantage strategy stems from the customer-centric view that, in order to remain competitive, the organisation is required to supply the customer with the products they want and not the products the organisation is of the opinion the customer needs.

Strategic intent, as an Eastern business model, is far removed from the Western business model of strategic fit and was instrumental in the revitalisation of corporations' competitiveness (Hamel & Prahalad, 1989). It was due to this "fit" between resources and opportunities based on an externally focused analysis that led to the eventual decline of Western corporations' competitiveness. By focussing on competitors' current resources and likely threats on margin and market share erosion, little consideration was placed on the direction and intentions of potential competitors (Hamel & Prahalad, 1989).

Strategic intent comprised an intention of becoming an industry leader, whichever industry that may be, by improving current resources in the short term that would create the vehicle from which the leadership position would be obtained. Hamel and Prahalad (1989) stated that strategic intent provides both consistency in short term actions and leaves space for reinterpretation of future opportunities. Armed with intent or ambition, corporate strategy evolved from an external to internal focus. The internalisation started off with the development of an organisations core competencies to enable a competitive advantage (Prahalad & Hamel, 1990) which was based on the internalisation theory that originated from the work of Buckley and Casson, Rugman, and Hennart (Rugman et al., 2011, p.759).

The RBV was an amalgamation of the internal development of core competencies and the analysis of an industry, both applied previously on an individual basis to attain competitiveness. Corporations were now employing the RBV as a strategic management tool to compete on capabilities or resources (Collis & Montgomery, 1995; Stalk et al., 1992).

Stalk et al. (1992) linked capabilities to process improvements whereas Collis and Montgomery (1995) moved away from the often-narrow concepts of core competencies and capabilities to include both tangible (physical product) and intangible (brand name) resources. The RBV therefore required an analysis of the internal resources required to be successful in a competitive environment and subsequently develop these resources to be competitively distinct resources that leads to competitiveness (Collis & Montgomery, 1995).

The creation and evolution of firms or organisation into multinationals, go hand-in-hand with that of corporate strategy, not only as a means to internationalise and reduce transaction costs, but also to increase profitability and competitiveness by means other than cost management. Ronald Coase's 1937 paper on *The Nature of the Firm* has been labelled as the base from which the creation of corporations and more specifically multinationals stem (Rugman, 1980; Kapler, 2007; Buckley & Casson, 2011; Rugman, Verbeke, & Nguyen, 2011; Hashai & Buckley, 2014; Verbeke & Kano, 2015). The most substantial contribution from this book was that corporations could reduce transaction costs through internal pricing as opposed to coordinating economic activities externally (Rugman, 1980a).

The relevance of multinationals and the reason for their existence can be found in country-specific advantages (CSA), firm-specific advantages (FSA), the liabilities of foreignness (LOF), ownership and control over licensing and potential dissipation of FSA, exploitation of FSA through CSA built by foreign subsidiaries, knowledge transfers between multinationals, economies of scale, and internalisation theory (Rugman, 1980; Birkinshaw, Hood, & Jonsson, 1998; Kay, 2005; Rugman et al., 2011; Buckley & Casson, 2011; Rugman, Oh, & Lim, 2012; Chiang & Del Gaudio, 2013; Verbeke & Kano, 2015). All of these aspects or theories are evident in the evolution and formation of corporate strategies, e.g. FSA relating to the creation of core competencies.

The multinational has the ability to create efficiencies and consumer welfare which stem from its capacity to reduce transaction cost by replacing inefficient and non-feasible arm's length transactions in the market with internally established markets (Rugman et al., 2011). These are usually knowledge-based internal markets built on the basis of the RBV of the firm as well as FSA that were acquired by vertically integrating up- and downstream supply and distribution markets. The multinational is, therefore, able to maximise profits by internalising markets and coordinating these markets internally through hierarchical control, socialisation, knowledge flows and internal pricing (Rugman et al., 2011).

Internalisation theory encompasses all the above mentioned theories and strategies and offers a more reliable view of economic performance than the individual theories themselves (Buckley & Casson, 2011). As these theories and strategies evolved from the transaction cost approach, vertical relationships, vertical integration, diversification, industry analysis, competitive advantages, core competencies, RBV, and strategic fit to strategic intent, they all consolidated to form the base of multinational theory known as internalisation theory (Coase, 1937; Collis & Montgomery, 1995; Hamel & Prahalad, 1989; Joskow, 1985, 2010; Kapler, 2007; Porter, 1980, 2008; Prahalad & Hamel, 1990; Ramanujam & Varadarajan, 1989; Rugman, 1980b; Rugman et al., 2012, 2011; Stalk et al., 1992; Tadelis & Williamson, 2012; Verbeke & Kano, 2015).

Throughout the evolution of corporate strategy, as outlined in this section, the common theme was the creation of a competitive advantage. Whether the creation hinged on the development of core competencies, the diversification of the firm or its products, or the internalisation of resources the key was the internal transfer of these developments. This signifies that transfer pricing is an integral component of the multinationals' ability to be competitive.

2.2 TRANSFER PRICING

The evolution of corporate strategy and its culmination in the existence of multinationals has led to the frequent use and exploitation of transfer pricing to maximise profits through the reduction of tax costs to create the notion of multinational competitiveness. This brought about the establishment of the OECD TPG with the aim of ultimately stopping the exploitation of transfer pricing as a means to avoid or evade taxes in the multinationals' host countries.

The main focus of the TPG is the benchmarking of inter-group transactions in order to determine if these transactions are at an arm's length. The reason for this determination is due to the nature of inter-group transactions being controlled transactions in which the price can be manipulated to suit the needs of the multinational. The arm's length principle is established to reduce profit shifting between tax jurisdictions, which reduces the tax burden and increases group profits with minimal effort by multinationals.

The arm's length principle can be defined in several ways (Afik & Lahav, 2015; Choe & Matsushima, 2013; Keuschnigg & Devereux, 2013; Leng & Parlar, 2012; Yao, 2013):

- the fair distribution of firm-wide profits,
- the bargaining power of affiliates being on equal footing when dealing with related party transactions,
- the price at which a transaction would take place between independent firms,
- pricing of transactions between related parties being of such a nature that the price is comparable to pricing between unrelated parties, and
- the comparison of the conditions between related parties and unrelated parties for specific transactions.

Thus, the arm's length principle seeks to determine if the nature of controlled transactions is such that it would not have been agreed upon if the parties were unrelated. This creates a benchmark whereby the controlled transaction can be compared to similar transactions of an uncontrolled nature. If the arm's length principle is not met, the profits that would have otherwise accrued to one party, but due to these controllable conditions have not so accrued, will require the restating of the profit figure and levying of the appropriate tax charge for that party (Organisation for Economic Co-Operation and Development, 2010, p.33).

The inherent flaw of the arm's length principle, the separate entity approach not accounting for economies of scale and the interrelation of diverse activities within an integrated business (Organisation for Economic Co-Operation and Development, 2010, p.35), directly contradicts all the relevant theory surrounding the establishment of multinationals. The ability to leverage the reduced transaction cost of manufacturing facilities specifically set up to create economies of scale, as part of a multinationals strategic vision, is nullified by the acceptance of the arm's length principle.

Paragraph 1.8 of the TPG states the arm's length principle as being created to counter the creation of tax advantages or disadvantages that would distort the competitive positions of either associated or independent entities (Organisation for Economic Co-Operation and Development, 2010, p.34). This statement effectively says that a multinationals competitive advantage cannot be transferred to its affiliates through the use of transfer pricing. Multinationals have striven for decades to develop and establish FSA, as evidenced by the evolution of corporate strategy in Section 2.1, through the development of knowledge-based resources and core competencies such as continuous improvement and innovation and design. Leveraging or exploiting these core competencies as well as the reduction of transaction costs through internalisation of markets, has been the overarching reason for the existence of multinationals (Keller & Yeaple, 2016).

Paragraph 1.8 of the TPG goes on to say that the arm's length principle promotes growth and international trade and investment by removing these tax advantages or disadvantages (Organisation for Economic Co-Operation and Development, 2010, p.34), the counter argument the promotion of growth being the evolution of corporate strategy. This is based on the internalisation theory advocating the creation of FSA through the internalisation of individual markets that enables the creation of a competitive advantage and the ability the reduce costs by internally transferring expertise and knowledge which increases a multinationals' competitiveness (Birkinshaw et al., 1998; Buckley & Casson, 2011; Collis & Montgomery, 1995; Hamel & Prahalad, 1989; Kapler, 2007; Kay, 2005; Keller & Yeaple, 2016; Porter, 1980; Prahalad & Hamel, 1990; Rugman, 1980b; Rugman et al., 2012, 2011; Rugman & Verbeke, 2002; Verbeke & Kano, 2015; Wernerfelt, 1984).

Throughout the evolution of corporate strategy, the key focus points and drivers were that of creating competitive advantages and differences between organisations that would enable organisations to outperform their rivals. The attestation that the arm's length principle aims to remove tax advantages, created by the competitive advantages, defies the reason for the establishment of multinationals.

The researcher is not blind to the fact that, due to differences in tax rates and legislation granting various degrees of tax incentives to encourage foreign direct investment (FDI), multinationals have been developing their business interests in low tax jurisdictions and using transfer pricing to further minimise their tax costs. What should be noted is that although these differentials along with certain tax relief measures do not create competitiveness on their own (Prahalad & Hamel, 1990), previous research has shown it to be a key considerations for an investment decision (Lin & Chang, 2010). The average corporate tax rate percentages per country region are shown in Table 2 (KPMG, 2016).

Table 2: Average corporate tax rate percentages per country region

Country region	2010	2011	2012	2013	2014	2015
Africa	28.4	28.6	29.0	28.3	27.9	27.9
Latin America	27.5	28.8	28.3	28.0	27.5	26.9
North America	35.5	34.0	33.0	33.0	33.3	33.3
OECD	25.7	25.4	25.2	25.3	24.1	24.9
Asia	24.0	23.1	22.9	22.1	21.9	22.6
Europe	21.5	20.8	20.4	20.6	19.7	20.1
Global	24.7	24.5	24.4	23.7	23.6	23.9

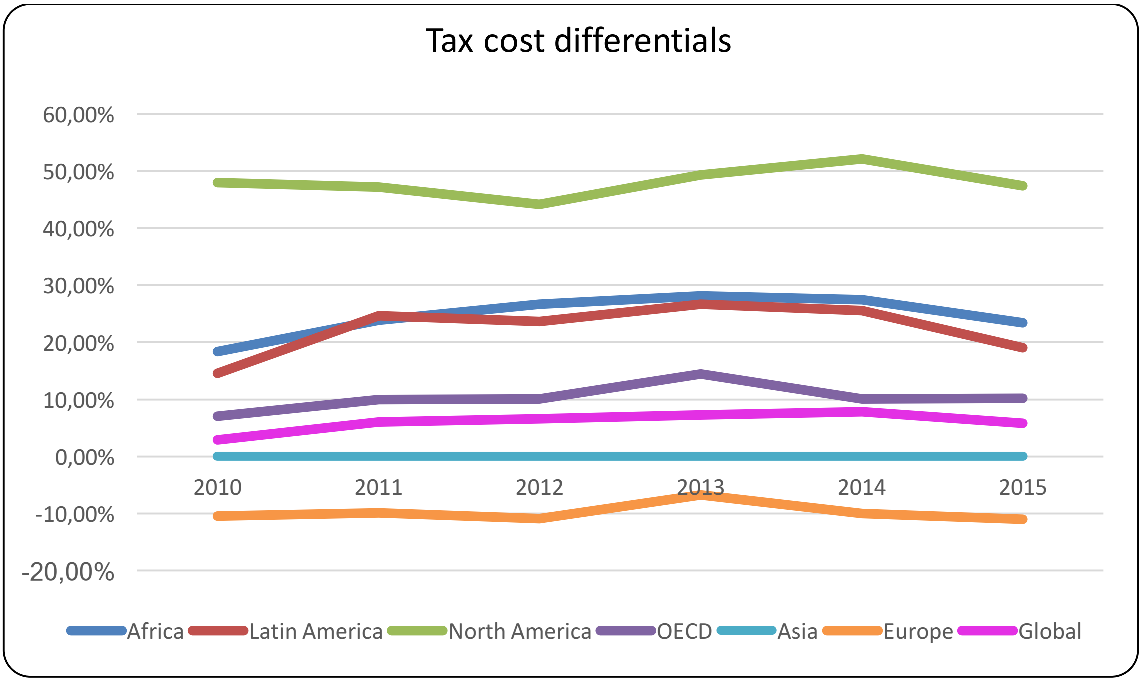
Applying the average corporate tax rates per region to a R1 billion taxable income for a multinational with affiliates in each of the regions, the tax costs differential shown in Figure 1, clearly indicates why a multinational would consider opening a manufacturing plant in Europe or Asia as opposed to North America. The researcher acknowledges that the tax rate and policies are not the only consideration as mentioned in paragraph Seven of Section 2.2, however, a tax percentage differential of 50% between North America and Asia equates to a R115 million tax cost differential based on R1 billion taxable income.

Lin & Chang (2010) indicates the main proponents and functions of transfer pricing as being enhanced market competitiveness, flexible transfer of internal funds, alleviation of the tax burden with reduced tariff costs and income tax, and reduced government control through trade restrictions, exchange control, and dividend export restrictions.

Even though their research has shown that there are several factors affecting transfer pricing motives, the most common factors being that of tax minimisation and group profit maximisation, it has also shown that a shift in these motives are taking place in Taiwanese multinationals and that these shifts are towards enhanced competitiveness and economic profit (Lin & Chang, 2010).

The changes in multinationals' transfer pricing motives are confirmed through research done by Munro (2013), whereby multinationals are no longer able to have profit maximisation, through tax minimisation as opposed to increased competitiveness, as their core transfer pricing motive (Munro, 2013).

Figure 1: Tax cost percentage differentials with the Asia region as the base



In conclusion, it is evident that a tax differential as mentioned above could have a direct effect on the transfer pricing motives. This effect is the main consequence of differences in tax rates and policies that the arm's length principle tries to negate. However, research has made it clear that there is a definite shift towards the creation of competitiveness through other means than tax minimisation.

2.3 TRANSFER PRICING METHODS

The TPG established the arm's length principle for inter-group transactions as an attempt to reducing tax evasion and avoidance enabled by the manipulation of transfer pricing that shifts the profits of multinationals to lower tax jurisdictions. However, this is in direct conflict with the business models and theories that informed the emergence and existence of multinationals.

Five acceptable transfer pricing methods are referred to in the TPG. These methods are the only accepted methods for calculating a transfer price between connected parties that meet the conditions of the arm's length principle. The methods are divided into two categories, the traditional transaction method (TTM) and the transactional profit method (TPM), for which the most appropriate method should be determined based on each relevant case (Organisation for Economic Co-Operation and Development, 2010, p.59).

Table 3 indicates the methods that can be applied for each category of transfer pricing method.

Table 3: Transfer pricing methods

Traditional Transaction Methods (TTM)	**Transactional Profit Methods (TPM)**
Comparable Uncontrolled Price (CUP)	Transactional Net Margin Method (TNMM)
Resale Price method (RPM)	Transactional Profit Split Method (TPSM)
Cost Plus method (CPM)	

Each of these methods have their own strengths and weaknesses and most appropriate situation for use. According to the OECD, international consensus has been reached on these five methods being the methods that best approximates the arm's length principle (Organisation for Economic Co-Operation and Development Secretariat, 2010).

The appropriate method should be determined through a functional analysis of a controlled transaction and its comparability with an uncontrolled transaction, often referred to as benchmarking. Each of the five methods are more suited to certain connected party transactions than others (Members of the UN Tax Committee's Subcommittee on Practical Transfer Pricing Issues, 2011, p.2). The functional analysis assists in gaining an understanding of the transaction, finding a basis for comparability, and determining the accuracy of the method selected (Members of the UN Tax Committee's Subcommittee on Practical Transfer Pricing Issues, 2011, p.3).

All the acceptable methods are in stark contrast with corporate strategy and theories such as FSA and internalisation (Rugman et al., 2011), on which the creation of corporations and more specifically multinationals were based. The notion of comparability between controlled and uncontrolled transactions in order to establish adherence to the arm's length principle is fallible. With internalisation theory, the base on which multinationals were established, seeks to minimise transaction costs by internalising markets in order to create both consumer and producer surplus. Therefore, the shortcomings are based not only on the fact that not one multinational is the same due to their functions or risks (Chiang & Del Gaudio, 2013), but also the effect of reducing consumer surplus (Behrens, Peralt, & Picard, 2014).

The determination of the comparability of a transaction has developed the need for a specialised skill and industry that adds to the cost of multinationals by way of additional administrative and financial burden for transfer pricing compliance purposes. As mentioned in the above paragraph as well as in Section 2.1 and paragraph seven of Section 2.2, multinationals specifically implement strategies that would differentiate them from other organisations therefore making it nearly impossible to accurately compare internal transactions of one multinational to those of other multinationals or independent organisations (Afik & Lahav, 2015; Bauer & Langenmayr, 2013; Keuschnigg & Devereux, 2013).

The adjustments that have to be made by multinationals in host countries whereby the FSA and CSA have to be recombined in order to ensure relevance and competitiveness in these host countries (Verbeke & Kano, 2015) is a further indication of the incomparable nature of multinationals. The TPG associates comparability to that of independent firms evaluating potential transactions, by comparing the alternatives realistically available and entering into those transactions that are clearly more attractive or at least on similar terms and conditions from another supplier at a lower price (Organisation for Economic Co-Operation and Development, 2010, p.42). Prior to becoming a multinational, organisations had the same “make or buy” considerations. The decision was made to “make” rather than “buy” by internalising and integrating these individual firms and markets based on the various corporate strategies as mentioned in Section 2.1.

A brief overview of the different transfer pricing methods will be discussed hereafter to establish how they attempt to simulate an arm’s length transaction. The TPG (2010) states, “The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case.” (p.59). The preferred methods when several methods can be applied in an equally dependable manner are the TTM instead of the TPM and the CUP method over another transfer pricing method (Organisation for Economic Co-Operation and Development, 2010, p.60). This indicates that the more intricate a multinationals’ business, the higher the costs could be in determining if the arm’s length principle has been adhered to when having to establish the reliability and appropriateness of the transfer pricing methods used.

2.3.1 Traditional Transaction Method TTM

2.3.1.1 *Comparable Uncontrolled Price (CUP)*

This method is as the name suggests. The CUP method compares the price charged between affiliated companies to the price charged between independent companies in comparable circumstances (Organisation for Economic Co-Operation and Development Secretariat, 2010). Transactions between affiliated companies are considered controlled, whereas transactions between independent companies are uncontrolled.

Comparability is obtained when either none of the differences between the transactions or the organisations could significantly affect the price in the open market, or reasonable accurate adjustments can eliminate the differences (Organisation for Economic Co-Operation and Development Secretariat, 2010).

Comparability can be obtained on the basis of transactions being internally comparable (i.e. taxpayer and independent companies) or externally comparable (i.e. independent companies only) which makes the CUP method better suited to transactions such as the sale of commodities traded on the open market, and common financial transactions such as the lending of money (Organisation for Economic Co-Operation and Development Secretariat, 2010).

A differences in the prices compared could indicate that the transactions in the controlled transaction are not at arm's length, and would then necessitate that the controlled transaction price be substituted with the uncontrolled transaction price (Organisation for Economic Co-Operation and Development Secretariat, 2010)

2.3.1.2 *Resale Price Method (RPM)*

This method is concerned with the gross margin made by the organisation reselling a product that was purchased from an affiliated company. An appropriate gross margin, based on an uncontrolled comparable transaction, is deducted from the resale price to determine an appropriate arm's length price for the original purchase price from an affiliated company (Organisation for Economic Co-Operation and Development Secretariat, 2010).

Thus, the gross margin made by the reseller is compared to that of gross margins made in uncontrolled comparable transactions. The gross margin that has been determined, represents the margins from which selling and administrative costs should be covered as well as making an appropriate profit after adjusting for other costs associated with the purchase of the product (Organisation for Economic Co-Operation and Development Secretariat, 2010). The RPM is most suited for sales and marketing operations such as distributors.

2.3.1.3 *Cost Plus Method (CPM)*

The CPM starts with the suppliers cost of products or services supplied to an affiliated company. An appropriate mark-up is then added to this cost to determine an arm's length selling price. The appropriate mark-up is determined in the same way as the gross margin in the RPM, by referring to uncontrolled comparable transactions. The mark-up is calculated after direct and indirect costs of production or supply, but before overhead expenses (Organisation for Economic Co-Operation and Development Secretariat, 2010).

In the same manner as the RPM, it is the mark-up of the seller in a controlled transaction that is compared to the mark-up in an uncontrolled comparable transaction. This method is best suited for transactions where the supplier of goods or services in a controlled transaction does not add any valuable unique intangible assets or assumes unusual risk (Organisation for Economic Co-Operation and Development Secretariat, 2010).

2.3.2 Transactional Profit Method (TPM)

2.3.2.1 *Transactional Net Margin Method (TNMM)*

The TNMM, being best suited to manufacturing and service activities, examines the net profit from controlled transactions and compares it to uncontrolled comparable transactions as a ratio to an appropriate base (Organisation for Economic Co-Operation and Development Secretariat, 2010). This base can be costs, sales, assets, or operating profits. The TNMM functions in a similar manner to that of the RPM and CPM, based on the cost or the sales respectively, but compares the net profit to these elements instead (Organisation for Economic Co-Operation and Development Secretariat, 2010).

2.3.2.2 *Transactional Profit Split Method (TPSM)*

The TPSM aims to split the total profit (loss) made between related parties to a controlled transaction in such a way that it approximates the division of profits that would have been made between independent parties in an uncontrolled comparable transaction (Organisation for Economic Co-Operation and Development Secretariat, 2010).

2.3.3 Formulary apportionment as an alternative

Formulary apportionment (FA) is an alternative method suggested for taxing global profits of multinationals (Behrens et al., 2014; Chiang & Del Gaudio, 2013; Martini, Niemann, & Simons, 2012). The FA method is not subject to the arm's length principle that requires each affiliate to be treated as a separate entity while essentially nullifying their cost advantages. This is mentioned previously as being an inherent flaw of the arm's length principle, exactly the opposite of what was intended by the creation of multinationals in the first place; requiring each affiliate entity to be treated separately from one another is counterproductive to customer welfare and the creation of consumer surplus.

This method suggests that the global profits of multinationals be allocated proportionally, e.g. affiliate turnover as a percentage of group turnover, among connected parties on the basis of a specific formula. This formula would take into account various aspects such as a combination of costs, assets, payroll, and sales (Organisation for Economic Co-Operation and Development, 2010, p.37). The researcher is of the opinion that an average tax rate should be used based on a multinationals global footprint, however, this is not within the ambit of this research proposal. Table 2 shows the global average tax rate with Figure 1 depicting that this is slightly higher than that of Asian countries and European countries being below that of Asian countries.

Removal of the arm's length principle will remove the incentive to change business processes in order to take advantage of profit shifting and reduce the litigation and compliance costs caused by a complicated arm's length standard (Chiang & Del Gaudio, 2013). This method has however been rejected by the OECD by stating that the OECD countries do not considering this method a realistic alternative to the arm's length principle due to the substantial international coordination and consensus required as well as agreement on a universal formula (Organisation for Economic Co-Operation and Development, 2010).

3 CHAPTER 3: RESEARCH PROPOSITIONS

This study will attempt to determine if the use of aggressive transfer pricing would add to the competitiveness of multinationals. Transfer pricing is instrumental in the functioning as well as the relevance of multinationals as depicted by the origin and development of corporate strategy and the subsequent emergence of multinationals through internalisation. As evidenced by the literature review, the creation of multinationals was based not only on transaction cost economics, but the evolution of corporate strategy from vertical integration through the RBV to innovation, design, and disruptive change.

The advantages of transfer pricing as a cost reduction mechanism as well as an enabler of competitiveness through the ability to transfer and protect competitively distinct resources within a multinational clearly indicates that it should be a core focus of all multinationals.

The researcher proposes the following findings based on the data collected form the survey questionnaire:

1. Multinational's competencies would be a reflection of the evolution of corporate strategy.
2. Senior management would be aware that transfer pricing is used and which method is implemented for transfer pricing calculations.
3. Senior management would not be directly involved in the selection of the transfer pricing method, or the calculation and deviation from the transfer pricing method selected would either be disallowed or allowed for reasons other than the creation of competitiveness.
4. Organisations do not have an internal transfer pricing department due to the cost associated with a specialised department of this nature and therefore, this function would be outsourced to a consulting firm.
5. Tax legislation and the relevant transfer pricing regulations would not be high on the list of considerations when entering a new market.
6. Transfer pricing would be deemed non-aggressive and that the key consideration for the use and calculation of the transfer price would be informed by the OECD recommendations.

7. Multinationals are different from one another, indicating that comparability testing is at best an exercise of discretion as opposed to a definitive measure of the arm's length principle.

4 CHAPTER 4: RESEARCH METHODOLOGY

4.1 INTRODUCTION

The overarching design that a research project can take is either exploratory, descriptive, or explanatory and is said to be the purpose of a project under which more detailed research strategies shelter (Saunders & Lewis, 2012). It is therefore critical in the design of a research methodology to be clear on the purpose of the research project.

The purpose of this research project was to gain insight by way of a descriptive study into the possibility that the use of aggressive transfer pricing could be a means to increase multinationals' competitiveness.

4.2 RESEARCH DESIGN

The initial research process was conducted as an exploratory study with the purpose of establishing the current methods that are allowed for the calculation of transfer pricing and the way in which theorists view competitiveness and the creation thereof. The use of transfer pricing was established inductively from the evolution of corporate strategy and creation of multinationals. The use of transfer pricing is intrinsic to multinationals and as such, a deductive approach was used to theorise that aggressive transfer pricing could be a means to increase competitiveness.

Competitiveness is a social phenomenon, therefore, a critical realism philosophy was adopted to conduct a descriptive study. A web-based survey questionnaire was used to gather qualitative data, both ordinal and nominal, to facilitate a descriptive study in an attempt to confirm the propositions set out in Chapter 3 by way of a deductive approach. An attempt was made to uncover the factors that affect transfer pricing motives and how aggressive transfer pricing could shape the strategic management of multinationals to attain a competitive advantage.

4.2.1 Rationale

When developing a research design, the researcher needs to consider the ontology (questions of meaning) and epistemology (questions of knowledge) of the philosophy of science (Kilduff, Mehra, & Dunn, 2011). Ontology deals with the researchers beliefs about what reality is, and whether theories represent a single reality or merely aids as an explanatory narrative (no single reality) to guide research within a reality (Kilduff et al., 2011). Epistemology is concerned with how access to knowledge is gained in order to determine whether theories are converging with actualities (Kilduff et al., 2011). There are four paradigms that underpin the philosophies of science namely positivism, realism, pragmatism, and interpretivism.

Positivism in its purist form seeks to find the relationships between measurable and observable variables in an assumed single reality in order to predict what the outcomes in certain controllable conditions would be based mainly on quantitative statistics (Saunders & Lewis, 2012). In direct contrast to this, interpretivism seeks to find the reality of things by describing why an outcome has occurred based on empirical evidence (Saunders & Lewis, 2012).

The literature review has shown that both the positivist and interpretivist paradigms have led to the belief that competitiveness is obtained through the establishment of multinationals, the reduction of transaction costs, and building of core competencies. More precisely, competitiveness is obtained as predicted by theories (positivism) such as transaction cost economics and internalisation or through the joint or separate implementation of the RBV and core competence building as evidenced through empirical studies of competitiveness (interpretivism).

Realism can be broken up into two forms, one being direct realism and the other critical realism (Saunders & Lewis, 2012). Direct realism is stated by Saunders & Lewis (2012) as “that what we experience through our senses is an accurate representation of the world” (p.105) and critical realism as “what we experience are sensations…, not the things directly” (p.105).

The literature review establishes the use of positivism and/or interpretivism as the paradigms leading to the creation of competitiveness, however, the effect transfer pricing has is vague albeit intrinsic. The direct realism is that competitiveness through the reduction in transaction costs is based on the use of transfer pricing. Critical realism is aimed at establishing the impact of transfer pricing in the current reality in order to determine the viability of aggressive transfer pricing as a means to increased competitiveness. This in and of itself leads to a measure of interpretivism.

A descriptive study is aimed at accurately describing the current reality (Saunders & Lewis, 2012). Combining a critical realism philosophy with a descriptive study is essential to knowledge building around a current reality, being that transfer pricing is used in multinationals. Survey questionnaires are typically used in descriptive studies and particularly suitable for probing questions such as "who?", "what?", "how?", and "how much?" (Saunders & Lewis, 2012). These types of questions are useful for knowledge building to create understanding of a current reality.

The inductive approach used in the initial exploratory study has informed the research propositions, leading to the use of a questionnaire to gather data that will inform knowledge of the current reality. A deductive approach is used to test a theoretical proposition in an attempt to determine if the data supports the theory proposed (Saunders & Lewis, 2012). Therefore, a deductive approach aimed at establishing the likelihood that a multinational could increase competitiveness through the use of aggressive transfer pricing, was used in this study.

With the aim to create action-orientated knowledge that would assist multinationals to increase competitiveness by applying aggressive transfer pricing, this study attempts to determine the possibility of aggressive transfer pricing as a means to increase competitiveness for a multinational.

4.3 POPULATION AND SAMPLING

4.3.1 Target population

The population for this study, being all the members within a specific group (Saunders & Lewis, 2012), were enterprises that use transfer pricing. The sample, being a subset of the population (Saunders & Lewis, 2012), are all the individuals within an enterprise that are willing to take part in the research. Multinationals and domestic enterprises that are vertically integrated are the key differentiator in determining if aggressive transfer pricing is a means to competitiveness.

Vertically integrated domestic enterprises, by the nature of being vertically integrated, make use of transfer pricing to its downstream enterprises to create price competitiveness. These enterprises however, do not have the restraints caused by transfer pricing regulations and would thus be competitive, in relation to pricing at least, without much forethought of the transfer pricing method used.

4.3.2 Sampling method

The sampling method the researcher decided on was that of non-probability sampling due to not having a full list of the population (Saunders & Lewis, 2012). The different non-probability sampling techniques to be used are (Saunders & Lewis, 2012):

- Purposive or Judgement sampling – the specificity of the enterprises required to take part in the survey questionnaire is crucial to addressing the research questions.
- Snowball sampling – the use of this sampling method would be to leverage off earlier respondent's business connections to gain access to the appropriate individuals within multinationals.

4.4 UNIT OF ANALYSIS

The unit of analysis for this study was multinationals. Multinationals are central to the research as both the use of transfer pricing and competitiveness are attributes thereof and is advisable to be at the same level as the sample being selected (Dolma, 2010).

4.5 DATA COLLECTION AND ANALYSIS

A self-administered web based survey questionnaire was utilised to gather the relevant categorical data allowing for a descriptive study using quantitative statistical methods. An alternative and complimentary strategy to a questionnaire would be semi-structured interviews conducted with the relevant people at different multinationals.

Epistemologically, a mixed strategy would lend itself to greater knowledge building in order to answer the research questions. However, due to the time constraints, sensitivity of the topic and therefore accessibility to relevant respondents, a questionnaire proved to be the most convenient for sampling.

4.5.1 Questionnaire design:

The aim of the questionnaire (Appendix 1) was to elicit information that creates knowledge on the current use of transfer pricing within multinationals in order to generate findings that can be generalised across the population in terms of the possibility of using aggressive transfer pricing to increase competitiveness.

In order to gain clarity on the respondent completing the questionnaire as well as the enterprises' relevance to the selected subject, various profiling questions were asked to gather nominal data for descriptive purposes. The first section of the questionnaire related to the respondent's type of organisation, core competences, industry, and considerations for entering a new market. These questions aimed to establish the respondent's relevance to the study and the deductively established link to corporate strategy.

In order to attain clarity on the organisations involvement in the selection of a transfer pricing method and calculation of the transfer price, the second section of the questionnaire related specifically to transfer pricing methods, organisations involvement in the selection of a method, and the calculations based on these methods. Further questions in this section related to the cost involved in calculating the transfer price and compliance to external transfer pricing legislation, as well as whether transfer pricing was outsourced or not.

The third section of the questionnaire attempted to gather information with regards to the organisations transfer pricing method used and if this was an OECD recommended methods or self-determined by the organisations' corporate strategy that still conformed to the arm's length principle.

To establish the motives behind the method/s selected and whether adjustments to the selected method/s and prices were allowed, the fourth section was added to the questionnaire. Insight into the aggressiveness of the transfer price and the use thereof for increased competitiveness would be deduced from the questions in this fourth section.

The fifth and sixth sections were added to determine if knowledge of FA, as a mitigation to tax avoidance and evasion through profit shifting by way of transfer pricing, is a possible alternative to the OECD recommended transfer pricing methods and arm's length principle.

4.5.2 Questionnaire pre-test:

A pre-test was done in order to check the quality of the questionnaire in terms of readability, ambiguity of questions, ease and time of completion, and logic flow of questions. Errors were highlighted and corrected before final data collection commenced. The errors found related to question ambiguity, readability, and logic flow of questions based on answers from respondents. Questionnaire testing is considered one of the factors that affect the validity and reliability of a questionnaire survey (Saunders & Lewis, 2012).

4.5.3 Data collection:

Data was collected using a questionnaire survey sent to relevant respondents using purposive and snowball sampling. The questionnaire was distributed in an electronic web based format. Respondents were informed of the topic and nature of the study and that participation was voluntary. The initial selection criteria for respondents were individuals known to work in a multinational enterprise.

The questionnaire was sent to 26 individuals using purposive sampling. Each individual was requested to forward the questionnaire to relevant respondents in order to leverage off their personal networks as a snowball sampling method. An additional 48 respondents were obtained. A total of 74 respondents accessed the questionnaire of which 34 did not start, 40 started, and 35 completed the questionnaire. This equated to a 47%, 88%, and 100% completion rate respectively.

4.5.4 Data analysis process:

The data collected from the survey questionnaire was edited where needed and presented using descriptive statistics. The nominal data was tabulated and the ordinal data was analysed using descriptive statistics (Wegner, 2012).

4.5.4.1 *Core competence*

The first section of the questionnaire asked respondents to indicate their organisations competences from a selection of 17 choices in order to determine the core competences of the organisation based on the respondent's opinion. The question allowed for multiple selections of competences. These choices were consolidated into four main categories in order to establish core competences as indicated in Table 4.

Table 4: Core competence consolidation

Core competence grouping:	Selection available for organisation competence:
Marketing	Product time to market
	Product Marketing
	Brand positioning
	Distribution
Change management	New firm integration
	Resource allocation
	Employee retention
Innovation and design	Market penetration
	Product pricing
	Product diversification
	Innovation
	Customer retention
	Value creation for customers
Continuous improvement	Quality control
	Product development
	Research and development
	Continuous improvement

4.5.4.2 *Management level of respondent*

In order to establish whether or not reliance could be placed on the data to ensure the validity of the conclusions drawn, respondents were asked to indicate their position within the organisation. Seven choices were given relating to executive management as well as the option to indicate other levels. The data was consolidated into six management levels to indicate the seniority of respondents as indicated in Table 5.

Table 5: Consolidation of positions into management levels

Management level:	Respondents position:
CEO	Managing Director
	Deputy Managing Director
	Chief Executive Officer
Finance Executive	Head of Internal Audit
	Shared Services Director: Finance
Marketing Executive	Marketing Director/GM
Operations Executive	Operations Director/GM
	General Manager Africa Operations
Other	SAP Specialist
	Investment banking Associate
	Account manager
Strategic	Manager
	Project manager
	Middle Management
	Senior Financial Manager
	Marketing Manager
	Manager Planning and Reporting
	Senior Manager National Warehousing and Logistics
	Financial Manager
	Internal Audit
	Group Financial Manager
	Departmental Head
	Aftermarket Manager
	Head Credit
	Strategy
	Operations Manager
	National sales manager
	Vice President Global Medical Affairs
	Chief Information Officer

4.6 CONCLUSION:

The researcher concluded that 35 responses were adequate to continue with the study based on the population, sensitivity and specialised nature of the topic, the position of the respondents within their organisation, and the footprint of the multinationals in the sample as depicted by Figure 7 in Section 5.5.2.

5 CHAPTER 5: RESULTS

5.1 INTRODUCTION

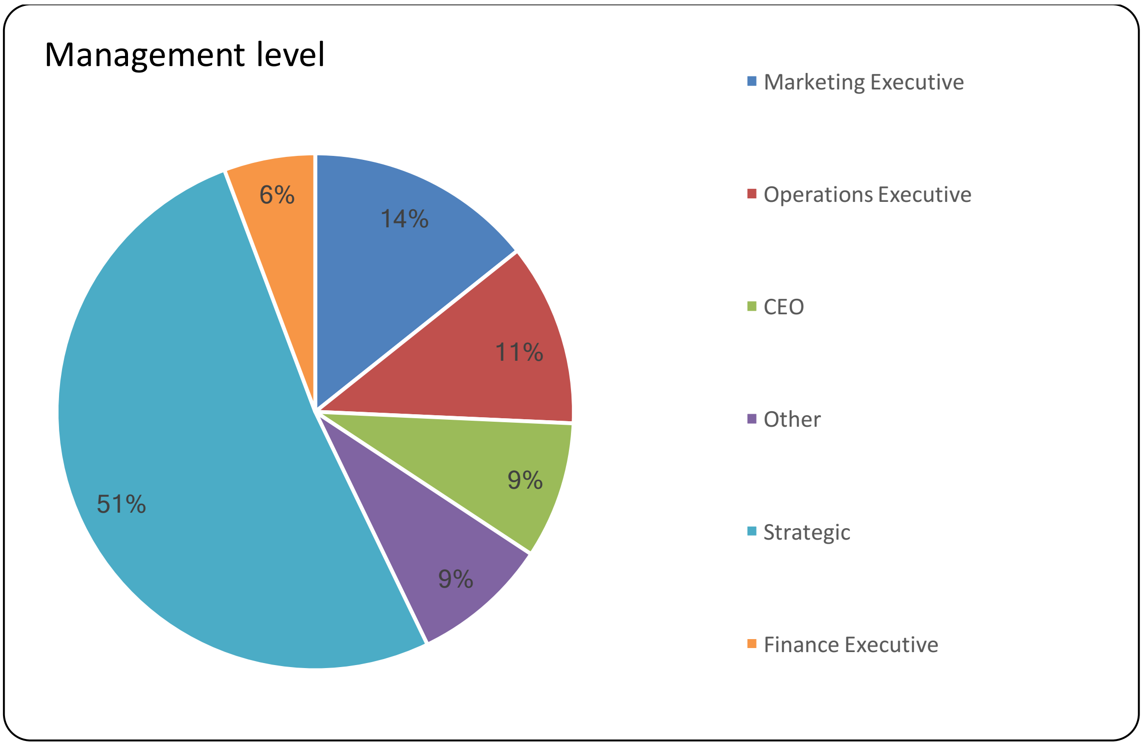
This chapter details the results from the survey questionnaire using descriptive statistics as well as non-parametric statistics.

5.2 DESCRIPTION OF SAMPLE

5.2.1 Management level of respondents

Figure 2 indicates the management level of respondents. This was used to establish the credibility of the conclusion based on the findings from the survey questionnaire. In total, only 9% of respondents were not on executives or strategic level within their organisation. The largest proportion of respondents were on strategic level, 51%, and marketing executives, 14%.

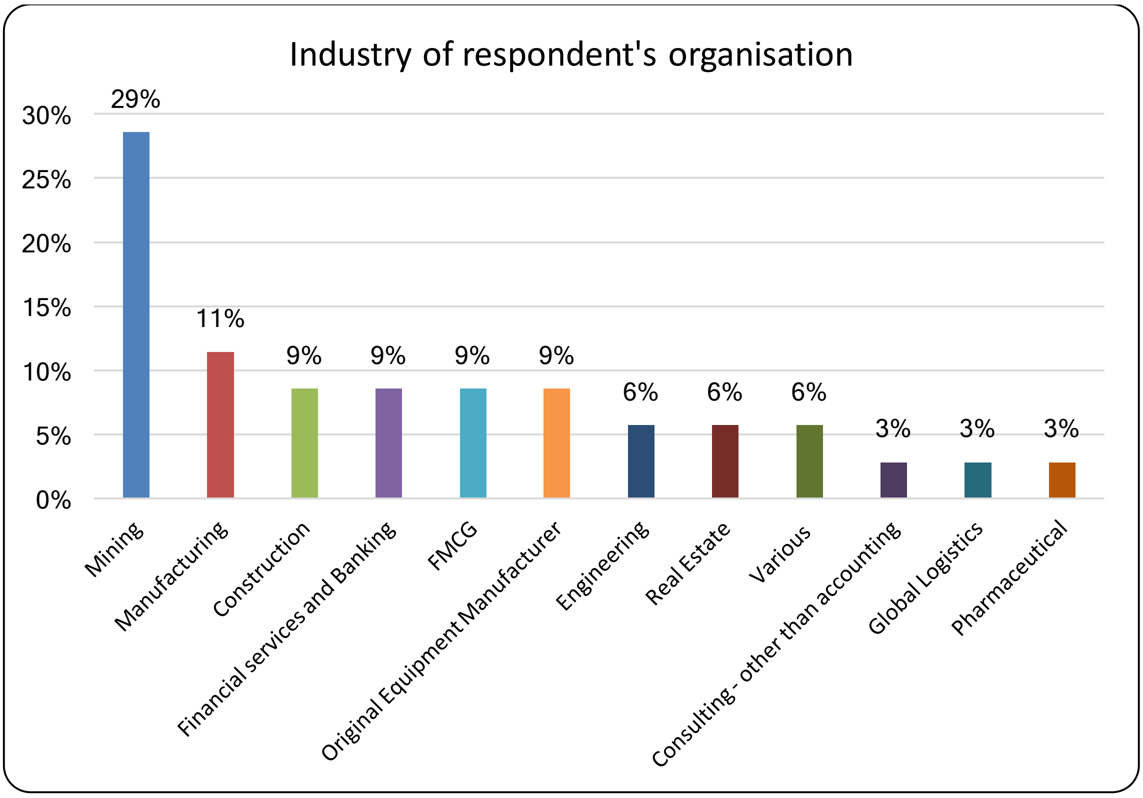
Figure 2: Consolidated management levels as a percentage of total respondents



5.2.2 Industry of respondent's organisation

Figure 3 indicates the industry spread of respondents that took part in the survey questionnaire. Ten of the 35 respondents (29%) indicated that they were in the mining industry with four respondents (11%) indicating that their organisation was in the manufacturing industry.

Figure 3: Industry of respondent's organisation



5.3 RELIABILITY AND VALIDITY OF DATA

In an attempt to establish the credibility of a conclusion based on the findings from a survey questionnaire, the researcher considered the factors that affect the validity and reliability thereof. Table 6 indicates the factors that affect the reliability and validity of research findings and conclusions and whether mitigation has been established (Saunders & Lewis, 2012).

Table 6: Factors affecting validity and reliability of research findings

<table>
<tr><th>Validity:</th><th>Mitigated:</th><th>Reliability:</th><th>Mitigated:</th></tr>
<tr><td>Subject selection</td><td>1. Yes</td><td>Subject error</td><td>6. Yes</td></tr>
<tr><td>History</td><td>2. N/A</td><td>Subject bias</td><td>7. Yes</td></tr>
<tr><td>Testing</td><td>3. Yes</td><td>Observer error</td><td>8. N/A</td></tr>
<tr><td>Morality</td><td>4. Yes</td><td rowspan="2">Observer bias</td><td rowspan="2">9. N/A</td></tr>
<tr><td>Ambiguity about causal direction</td><td>5. N/A</td></tr>
</table>

The mitigation of these factors were established as follows:

1. Through the selected research subject, transfer pricing, being representative of the sample,
2. There were no historical events after the sample was taken that affected the findings,
3. A pre-test was done to check for errors as mentioned in Section 4.5.2,
4. Mitigated with the use of a questionnaire and cross-sectional research (snapshot),
5. Categorical data gathered for new knowledge of the current reality,
6. Sampling method was aimed at specific respondents relevant to the research topic,
7. Mitigated through anonymity which was established by using a questionnaire with no company or individual identifiers being required,
8. Not applicable, and
9. Not applicable.

5.4 DATA CLEANSING

5.4.1 Transfer pricing methods

The third section of the questionnaire asked respondents to indicate the transfer pricing method used by their organisation. The five OECD recommended methods were included as possible choices and respondents were given the option to select “other” if a different method than the OECD recommended methods were used. Three respondents indicated that they were not sure and one indicated that a gross margin method was used. The gross margin method was added to the cost plus method based on the researcher’s opinion that this closely resembles the cost plus method.

5.4.2 Organisations industry

Selections made with regards to the industry in which the respondents' organisation functions, were cleaned where the core functions could be consolidated. These were for instances where separate respondents selected:

- Real estate and property related services – consolidated into real estate,
- All industries and various industries – consolidated into various,
- Mining and construction equipment, sell and support of mining and construction equipment, and supplier of OEM equipment and parts – consolidated into original equipment manufacturer (OEM).

5.4.3 Transfer pricing

The respondents that indicated their organisations as "not using" or "not sure" about the organisation using transfer pricing were not excluded from the analysis of:

- The use of a consulting firm, and
- Whether the organisation has an internal transfer pricing department.

Respondents would indicate "no" or "not sure" for the use of transfer pricing, but "yes" for an internal transfer pricing department or making use of a consulting firm for transfer pricing matters. These same respondents would also indicate the method used by their organisation. It was therefore concluded that the ambiguity regarding the question on the use of transfer pricing between business units had not been highlighted as having ambiguity by the questionnaire pre-test.

5.5 DATA ANALYSIS

5.5.1 Introduction

The data analysis was completed as per the propositions set out in Chapter 3 and all the results are presented hereafter.

5.5.2 Multinational's competencies would be a reflection of the evolution of corporate strategy.

Figure 4 indicates the percentage of respondents that selected a specific competency as an area of competence for their organisation. The data indicates that 46% of the organisations represented have an organisational competency in product development and that only 3% of organisations are competent in resource allocation.

Figure 4: Area of competence

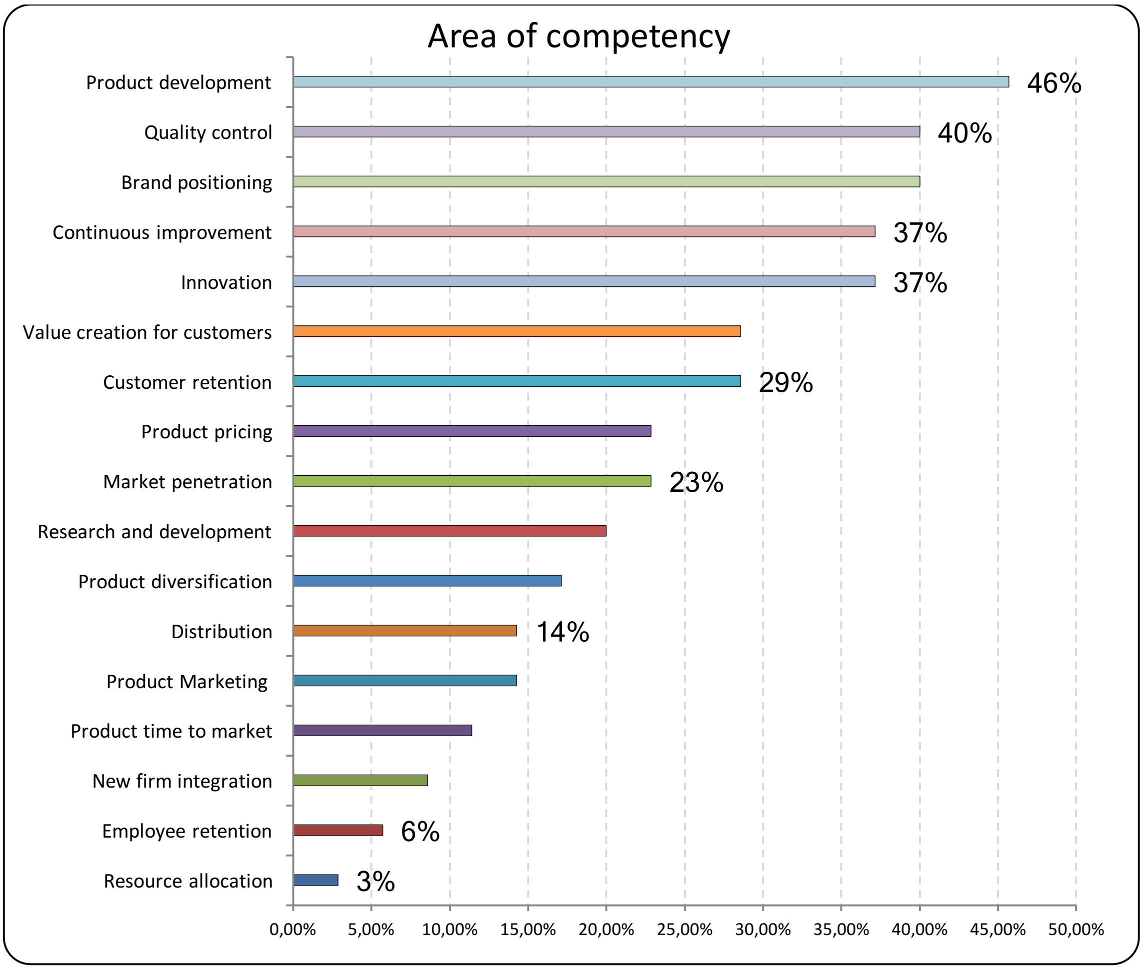


Figure 5 shows the frequency with which the area of competence was selected by the respondents in the sample. This is in contrast to Figure 4 that indicates the number of respondents that selected a specific competence.

Figure 5: Frequency of area of competence selection

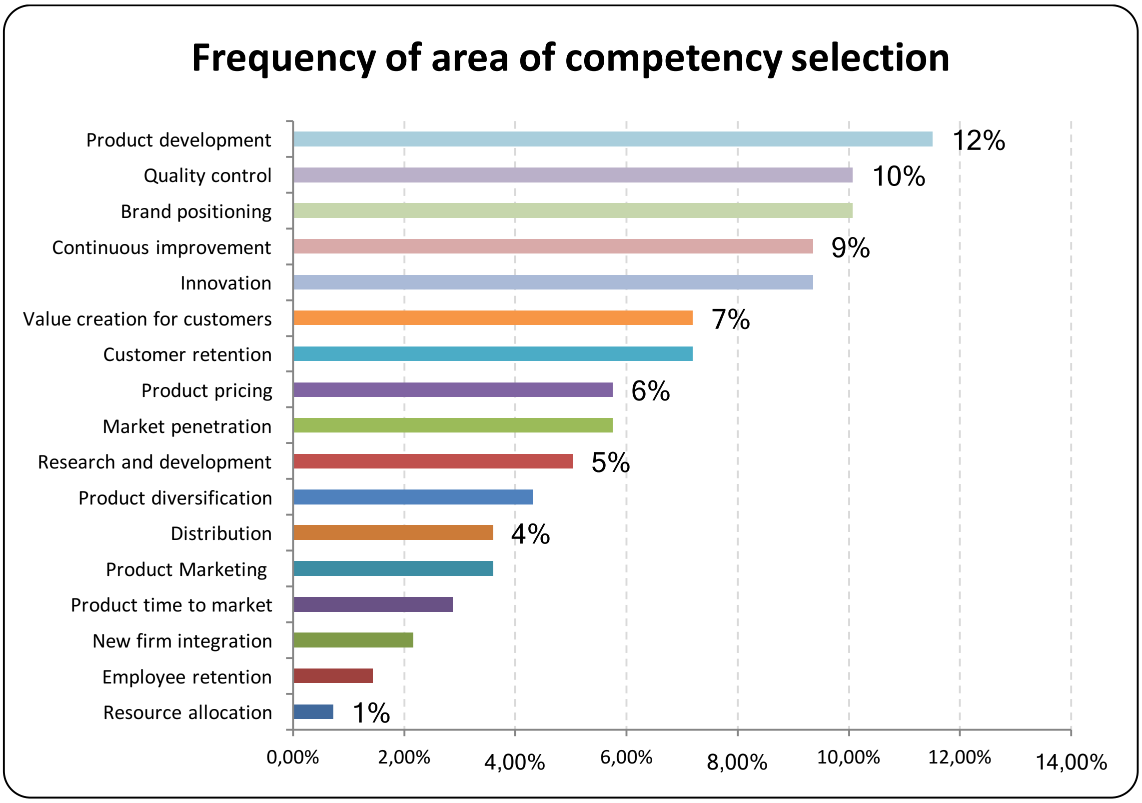


Figure 6 indicates the core competence as a percentage of the total responses received based on the consolidation of the individual competencies as per Table 3. This indicates that 40% of respondents are of the opinion that their organisations' core competence is innovation and design and 36% is continuous improvement.

Figure 22 in Section 5.5.7 indicates each area of competence as it relates to the level of transfer pricing aggressiveness as indicated by the respondents in the sample.

Figure 7 indicates the footprint of the multinationals in the sample. The size of the organisations is illustrated by 63% of multinationals doing business in more than ten countries, 37% of which have more than ten subsidiaries, and 23% more than ten strategic joint ventures.

Figure 6: Percentage of Core competencies

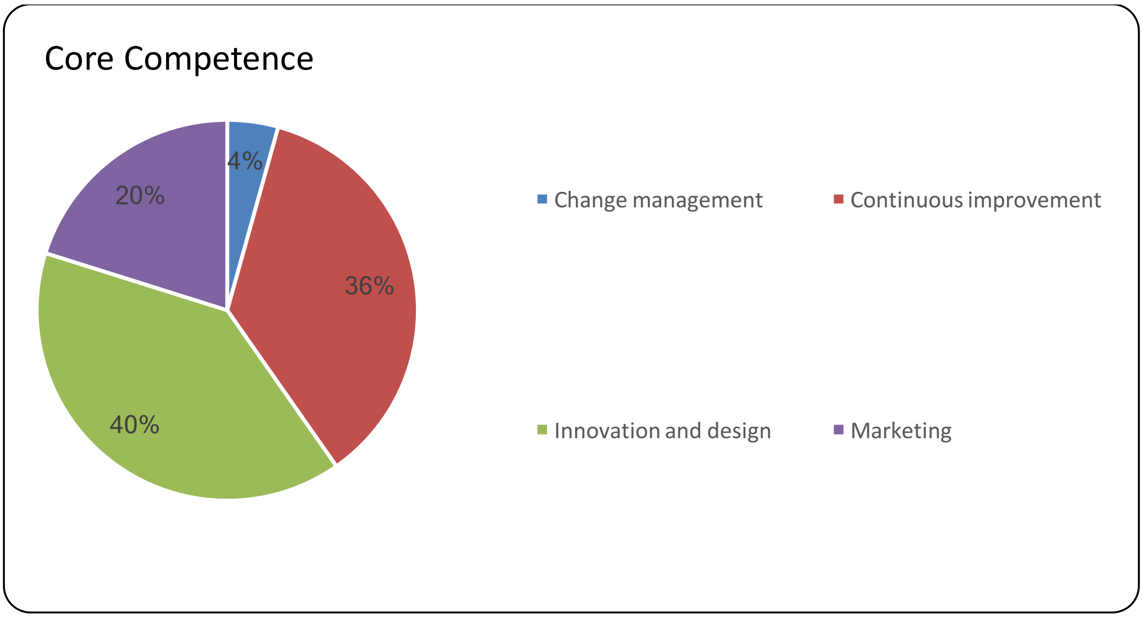
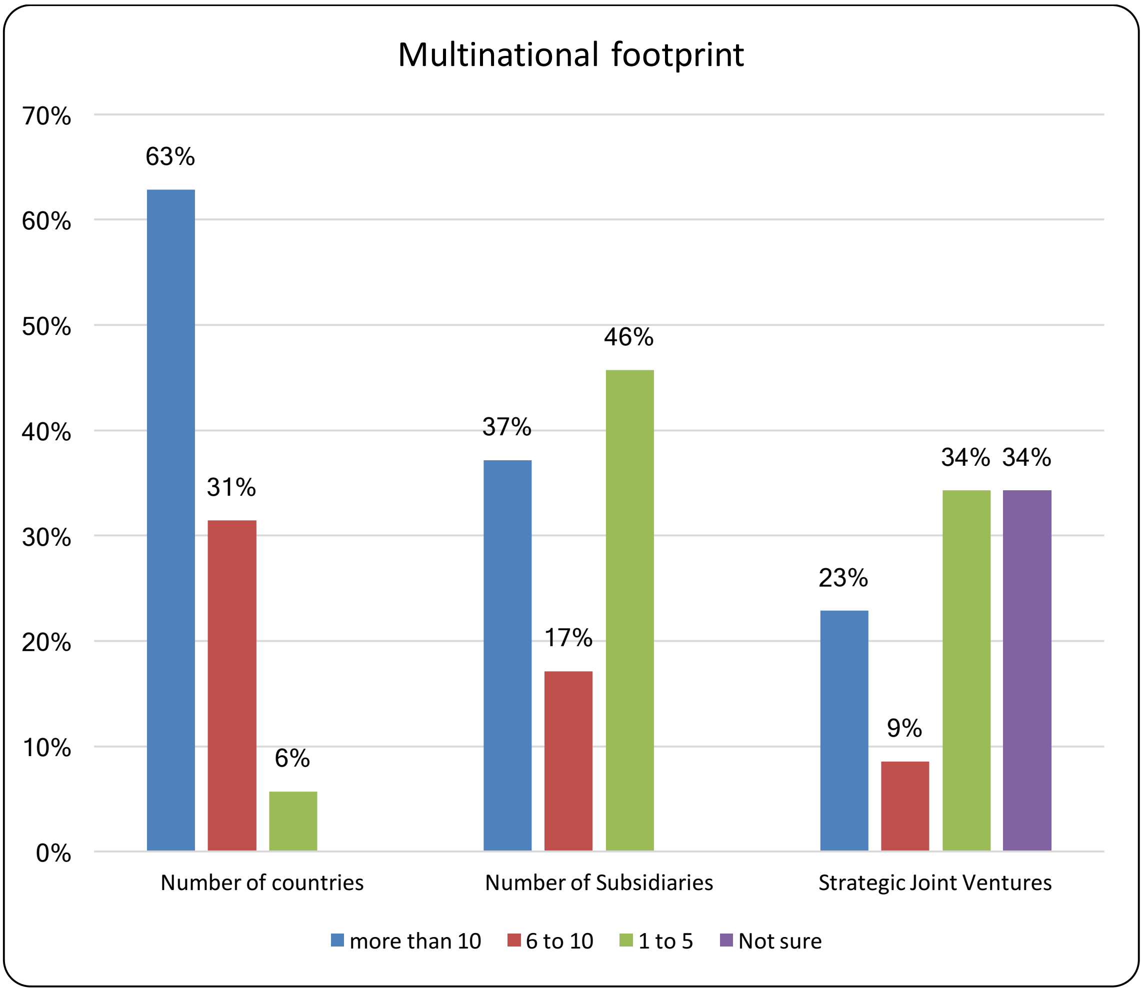


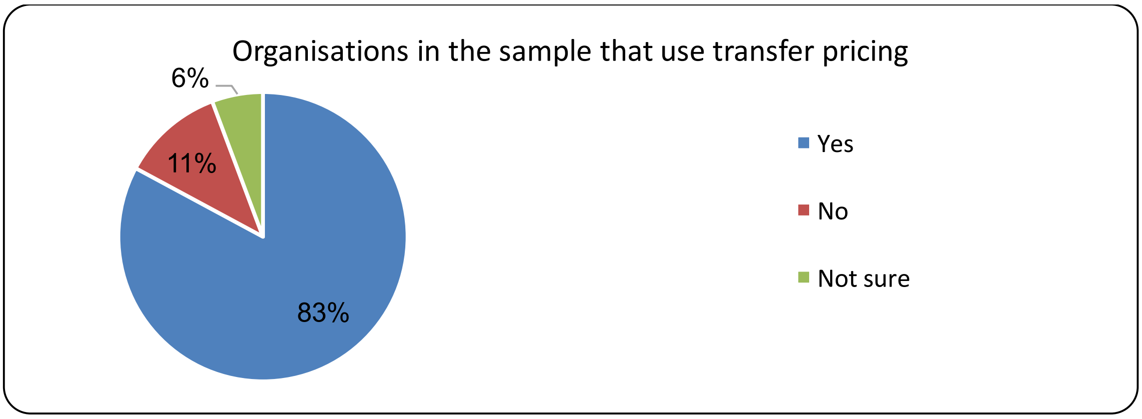
Figure 7: Multinational footprint



5.5.3 Senior management would be aware that transfer pricing is used and which method is implemented for transfer pricing calculations.

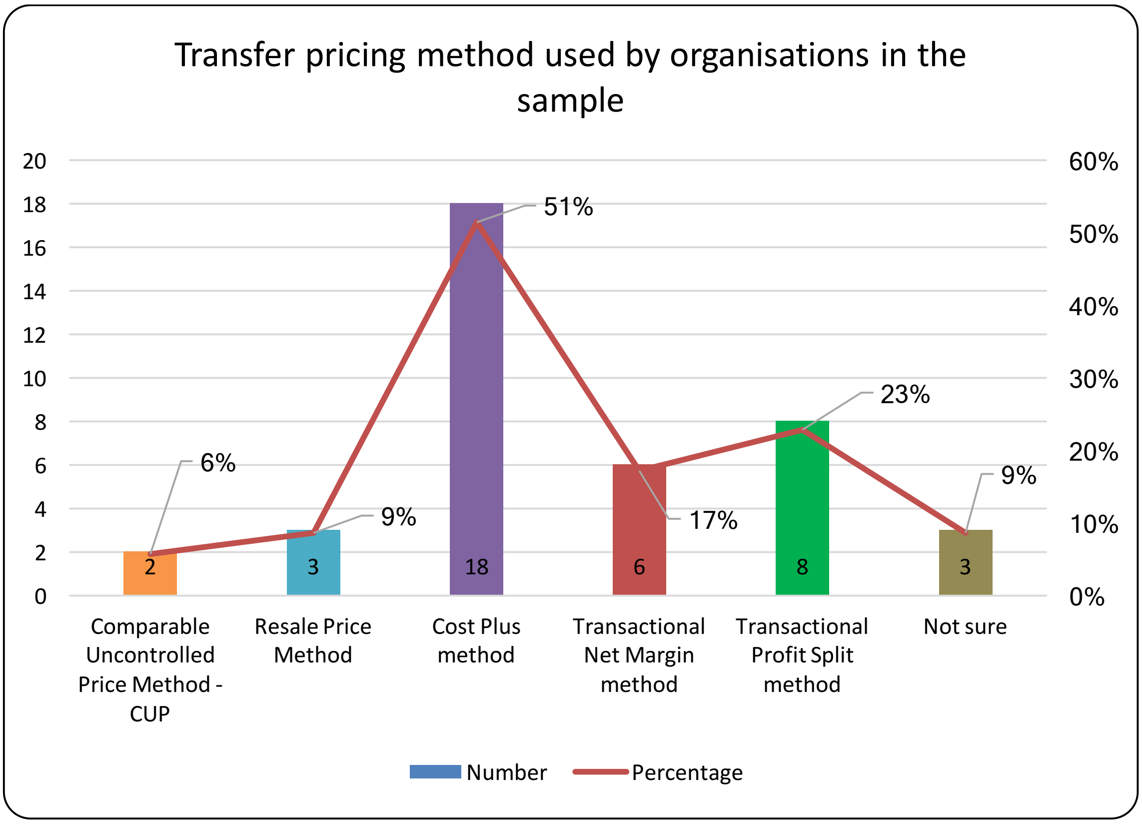
Figure 8 indicates that only 6% of the respondents were not sure of their organisations use of transfer pricing between business units, with 11% indicating their organisation does not make use of transfer pricing. These same respondents also indicated the use of an internal transfer pricing department and the use of a consulting firm which indicates that in total, 17% of respondents were not sure of the use of transfer pricing by their organisation.

Figure 8: Percentage of organisations making use of transfer pricing



The transfer pricing methods selected by the organisations in the sample are shown in Figure 9. Several respondents indicated that more than one method was used by their organisation and only 9% were not sure of the method used.

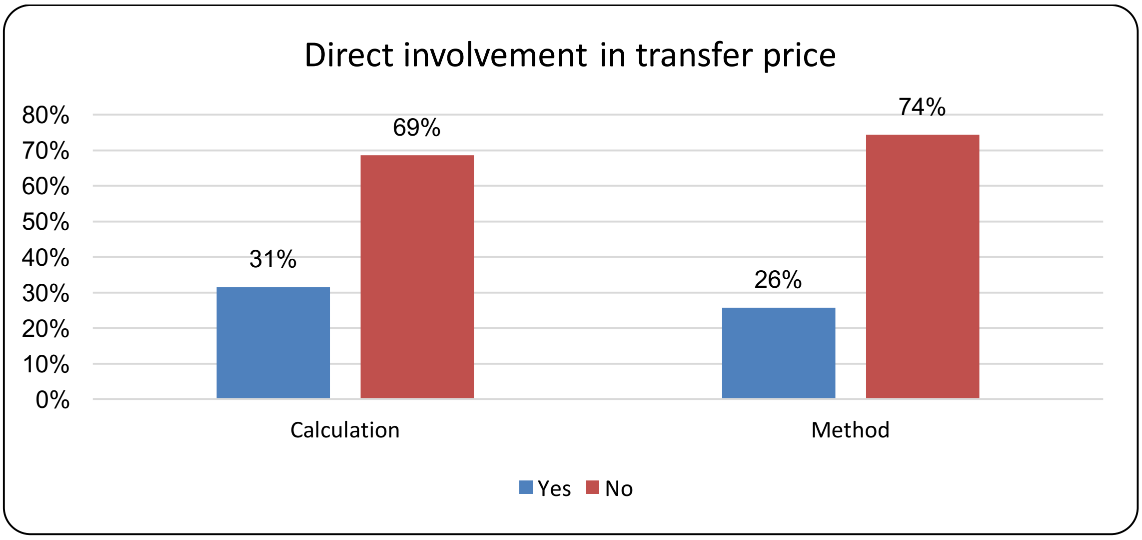
Figure 9: Transfer pricing methods used by organisation in the sample



5.5.4 Senior management would not be directly involved in the selection of the transfer pricing method or the calculation and deviation from the transfer pricing method selected would either be disallowed or allowed for reasons other than the creation of competitiveness.

As per Figure 10, senior management have indicated that they are neither directly involved in the selection of the transfer pricing method, nor the calculation of the transfer price in the majority of cases.

Figure 10: Direct involvement in the transfer pricing method selection and calculation



For this sample, respondents indicated that 63% of their organisation did not allow for deviation from the selected transfer pricing method, the reasons for which are indicated in Figure 11. The respondents that indicated the organisation allows for deviation from the method selected, supplied reasons as indicated in Figure 12.

As shown in Figure 11, 71% of respondents indicated that compliance with tax regulation was the main reason for not allowing deviation from the method selected. Of these respondents, 24% also indicated that profit maximisation was only a secondary consideration, that equated to 17% of all respondents which indicated that deviation was not allowed.

Figure 12 shows profit maximisation and market penetration as the main reasons for allowing deviation from the method selected. Fifteen percent of respondents that indicated profit maximisation also indicated either tax cost reduction, or market penetration. None of the respondents selected all three reasons.

Figure 11: Reasons for not allowing deviation from the transfer pricing methods selected

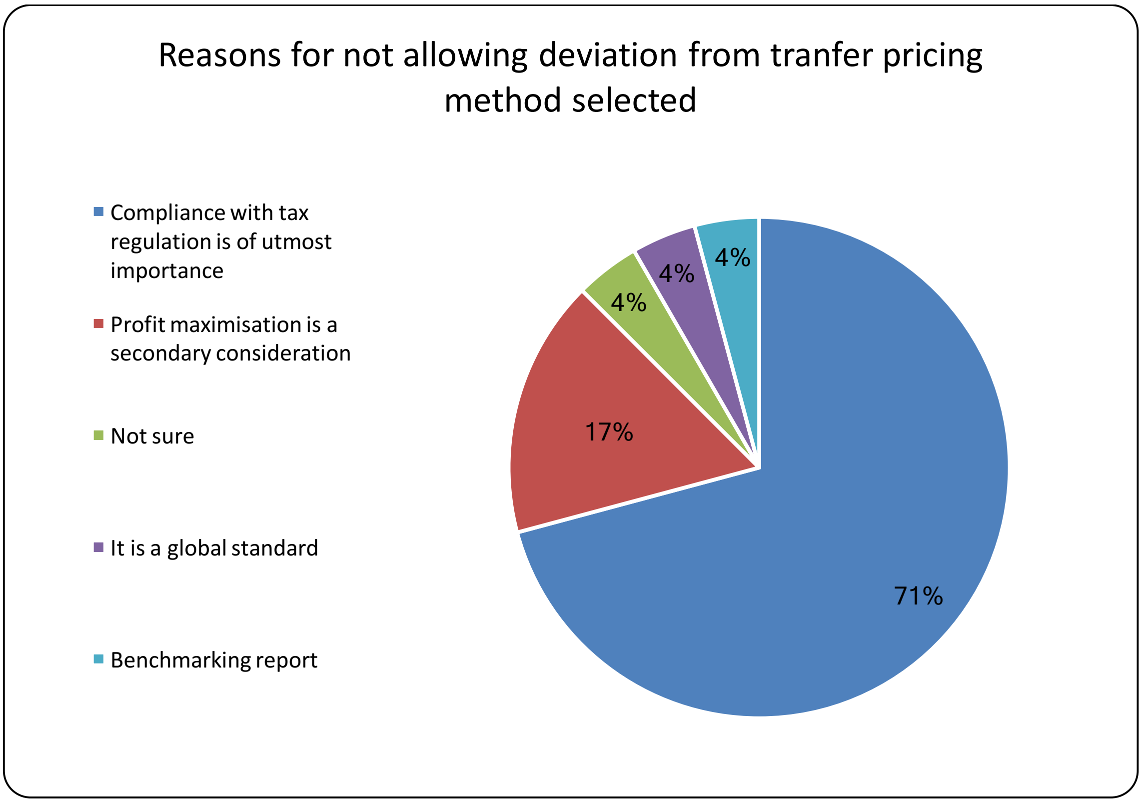
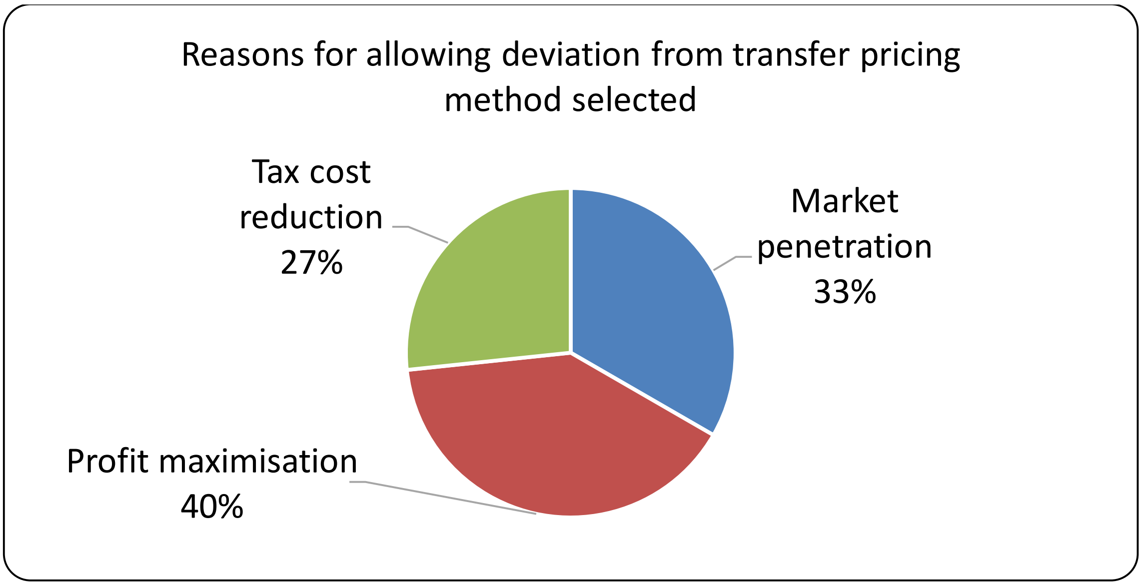


Figure 12: Reasons for allowing deviation from the transfer pricing methods selected



5.5.5 Organisations do not have an internal transfer pricing department due to the cost associated with a specialised department of this nature and, therefore, this function would be outsourced to a consulting firm.

Figure 13 shows the split of organisations in the sample that have and those who do not have an internal transfer pricing department.

The respondents that indicated their organisation as not having an internal transfer pricing department, gave reasons for this as illustrated in Figure 14. The majority of the reasons relate to the cost of an internal transfer pricing department, being 11% as too expensive, 21% the availability of specialised skills, and 26% the cost of such a department outweighing the benefit. The reasons grouped under "other" indicate there is no focus on transfer pricing and, as such, outsourced to a consulting firm, and that transfer pricing has been implemented only recently and still in the development stage.

Figure 13: Percentage of respondent that indicated an internal transfer pricing department

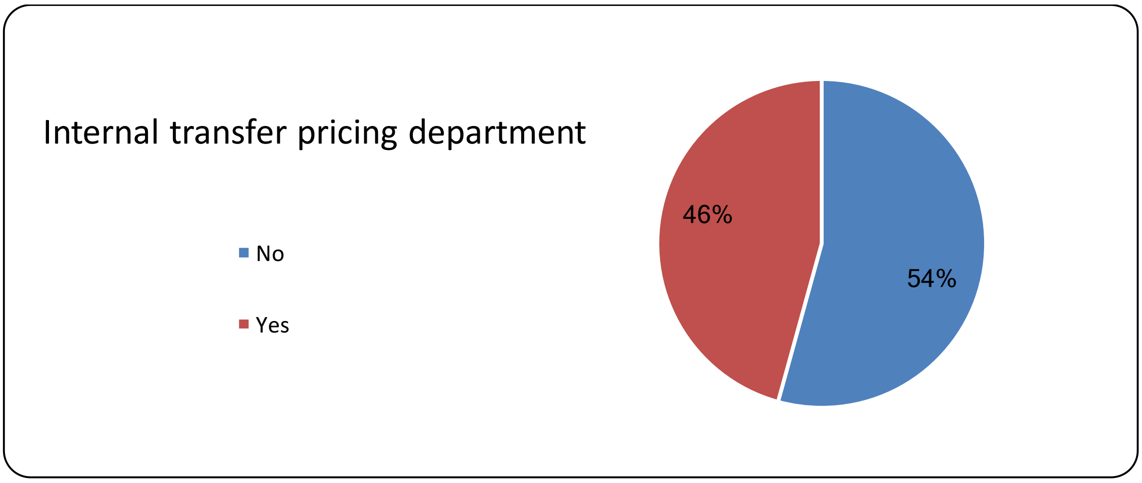


Table 7 shows the percentage of organisation that make use of a consulting firm for transfer pricing matters

Table 7: Percentage of organisation in the sample that use a consulting firm for transfer pricing matters

Organisation uses consulting firm	Percentage
Yes	29%
No	71%

Figure 15 indicates the percentage of respondents that make use of a consulting firm for transfer pricing matters in relation to having an internal transfer pricing department or not having one. For organisations in the sample that do not have an internal department, 63% do not make use of a consulting firm. For those with an internal department, 19% still require the use of an external consulting firm for assistance on transfer pricing.

Figure 14: Reasons for not having an internal transfer pricing department

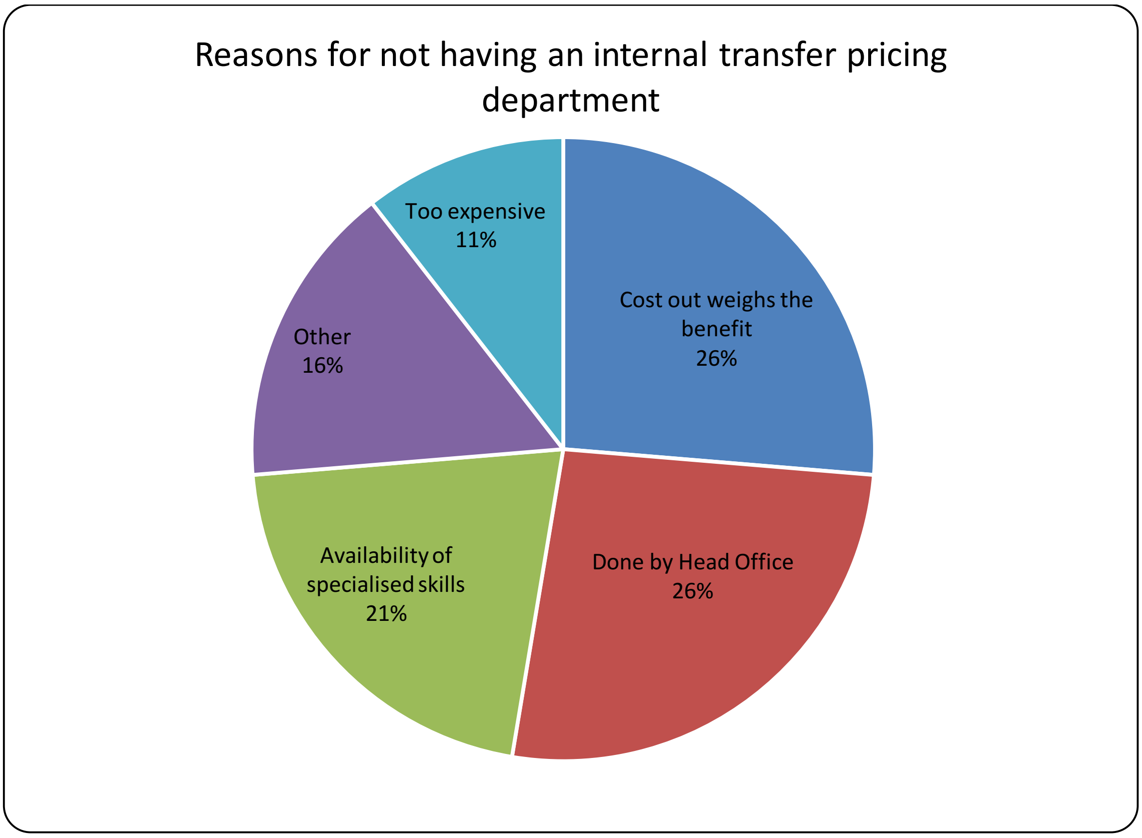
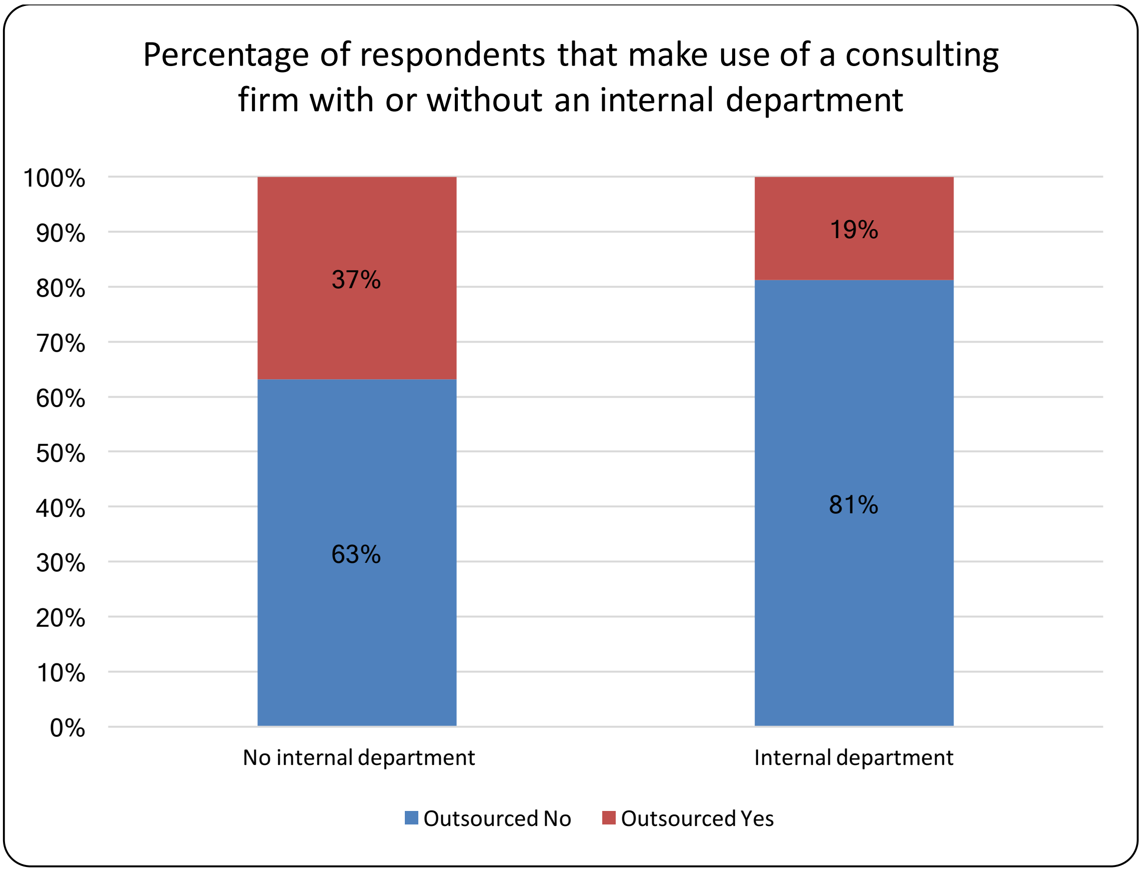


Figure 15: Percentage of respondents that make use of a consulting firm with or without an internal transfer pricing department



5.5.6 Tax policy and the relevant transfer pricing regulations would not be high on the list of considerations when entering a new market.

Figure 16 shows the criteria considered by organisations in the sample for entering a new market. The responses in others relate to the demand for the organisations' products within a market. Thus, the consideration of tax policy and transfer pricing regulation respectively ranked sixth and seventh out of the 11 criteria for entering a new market with only 34% of organisations considering the transfer pricing regulations.

Figure 17 shows the difference between organisations that use and do not use a consulting firm for transfer pricing matters when considering the criteria relating to tax policies and transfer pricing regulations of a new market. The difference is largest for the transfer pricing regulation criteria, with 83% of respondents considering the criteria when not using a consulting firm versus 17% of respondents that do use a consulting firm.

Figure 16: Criteria for entering a new market

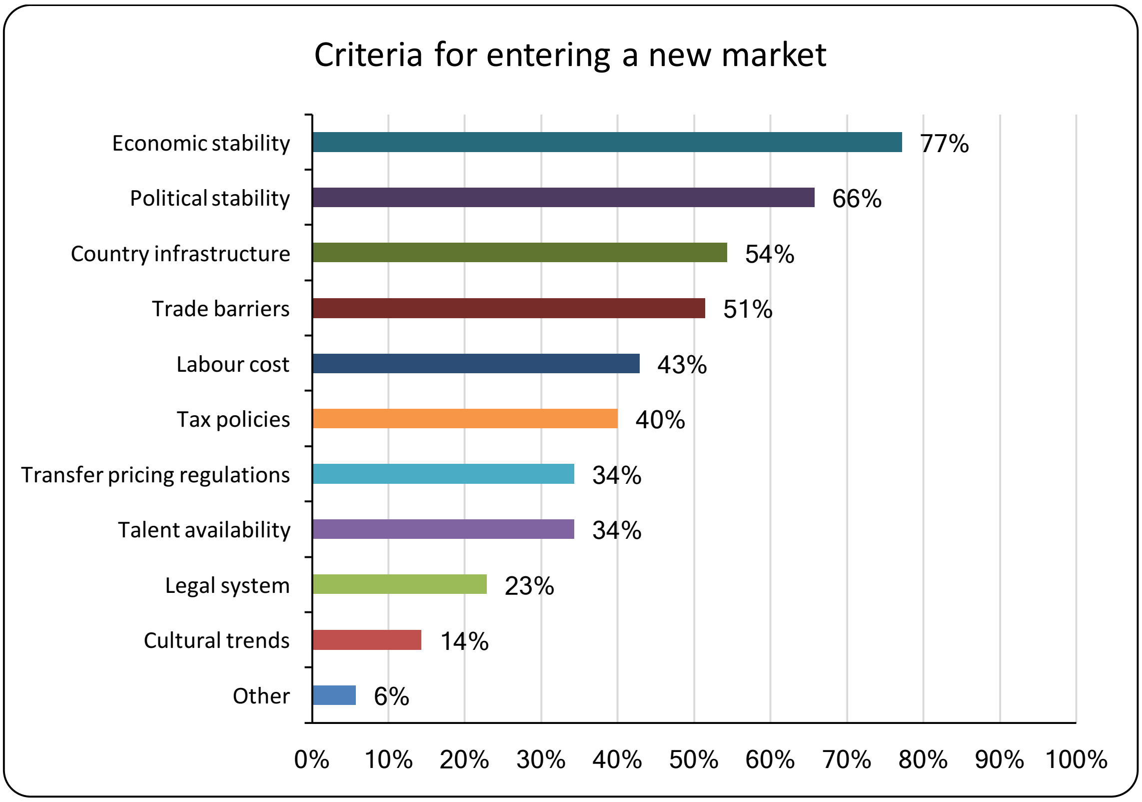
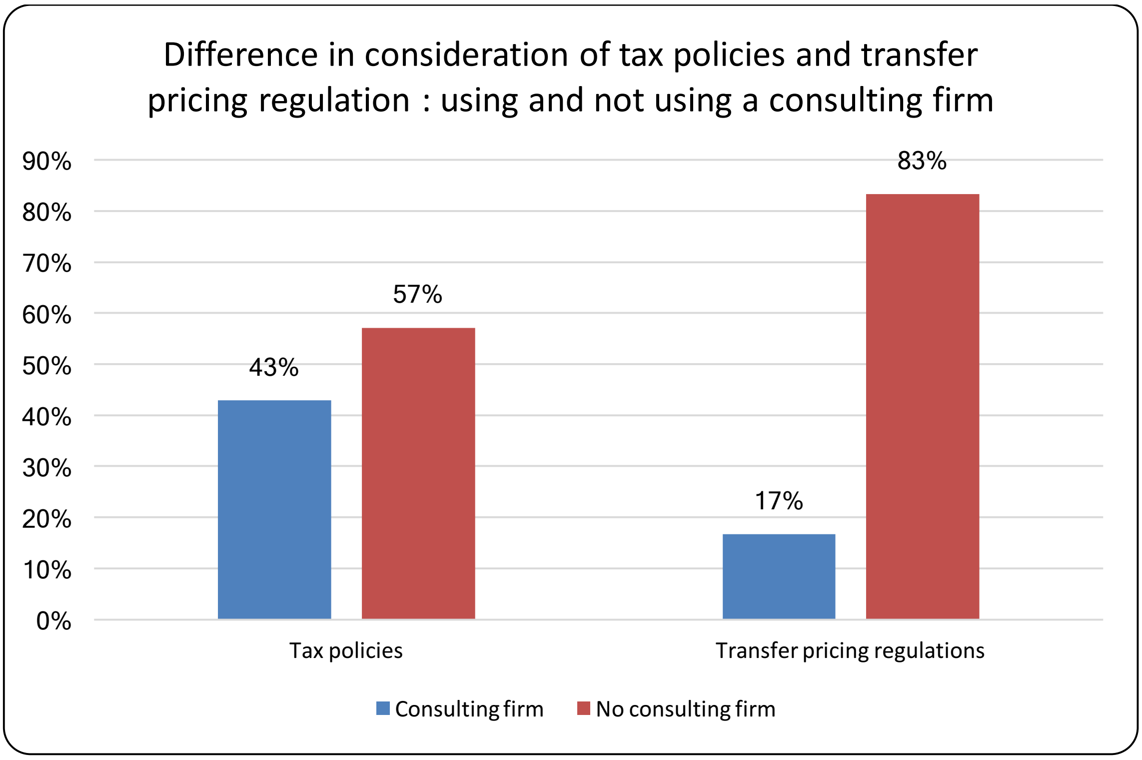


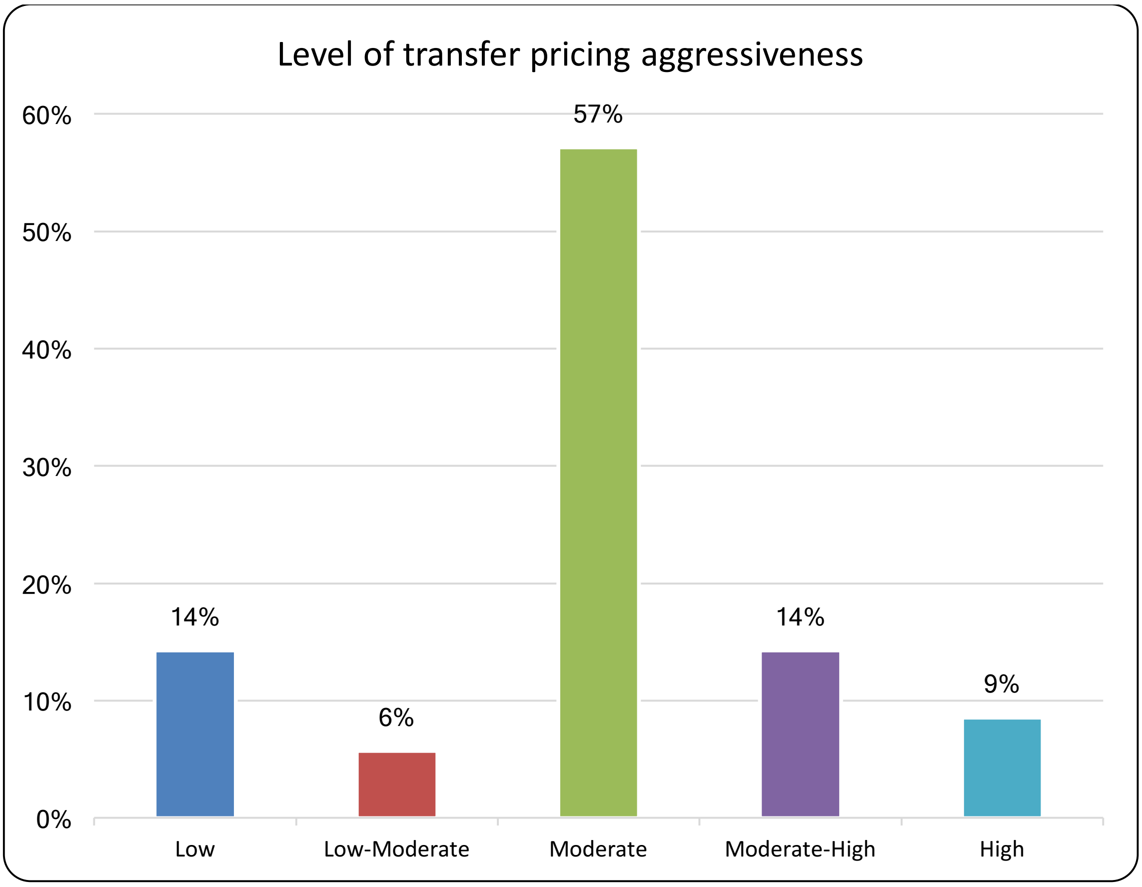
Figure 17: Difference in criteria considered when using a consulting firm for transfer pricing matters



5.5.7 Transfer pricing would be deemed non-aggressive and that the key consideration for the use and calculation of the transfer price would be informed by the OECD recommendations.

Figure 18 illustrates the level of transfer pricing aggressiveness as per the opinions of the respondents in this sample. The majority, 57% of respondents indicated that their transfer pricing is at a moderate level of aggressiveness.

Figure 18: Level of transfer pricing aggressiveness



In Figure 19 the OECD transfer pricing recommendations' effect on the ability of a multination to leverage its cost advantage is indicated, based on the respondent's opinion, in relation to the level of transfer pricing aggressiveness. A clear trend, in relation to the level aggressiveness, is that respondents were not sure of the effect the OECD transfer pricing recommendation had on their ability to leverage their cost advantage. This was indicated by 54% of respondents.

Figure 19: OECD transfer pricing recommendations' effect on ability to leverage cost advantage

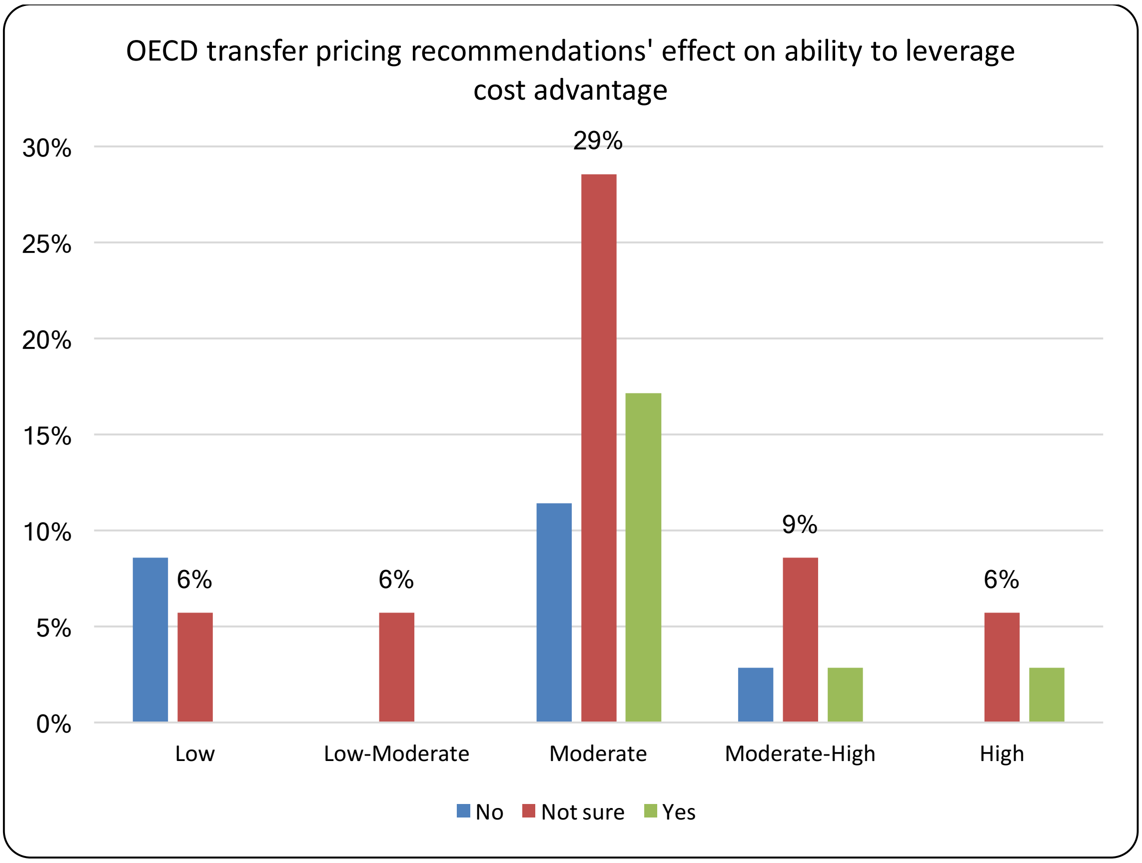


Figure 20 shows the OECD transfer pricing recommendations' effect on the ability of multinationals to increase their competitiveness in relation to the level of transfer pricing aggressiveness, based on the opinion of the respondents in the sample. In this instance, 49% of respondents were not sure of the effect the OECD had on their ability to increase their competitiveness.

Figure 21 indicates the reasons for the transfer pricing method selected. The major reasons being "ease of calculation" and "organisational strategy" at 43% for each of these reasons.

Figure 20: OECD effect on ability to increase competitiveness

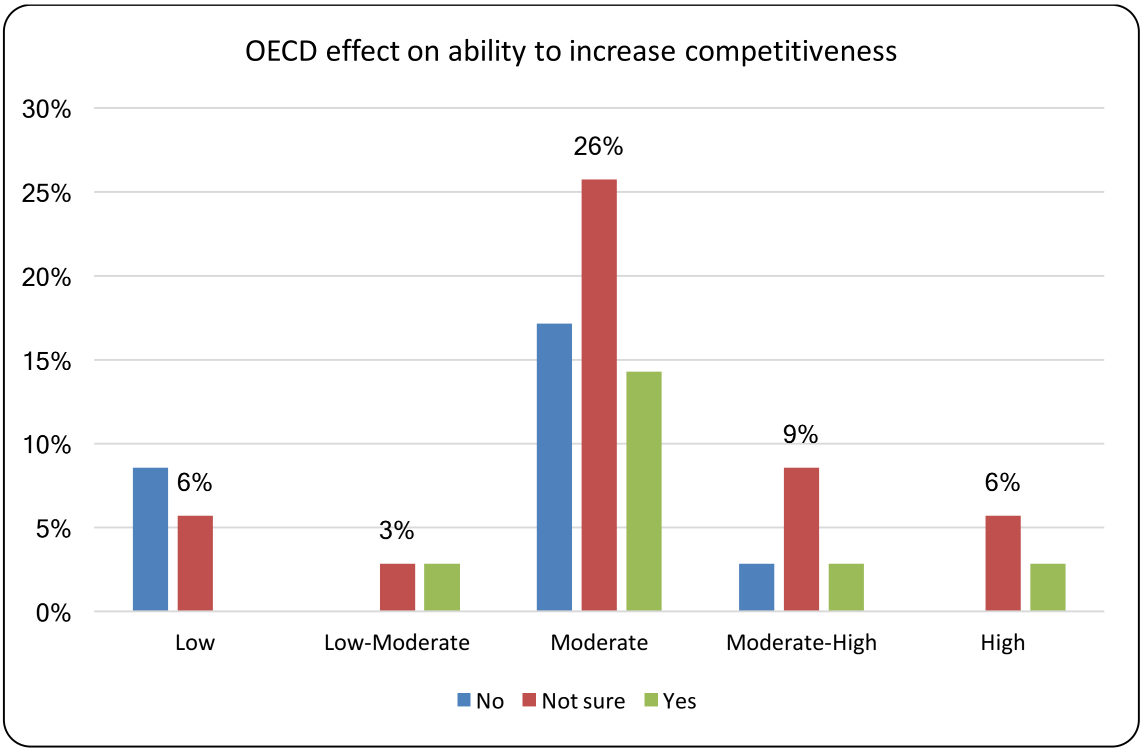


Figure 21: Reason for transfer pricing method selected

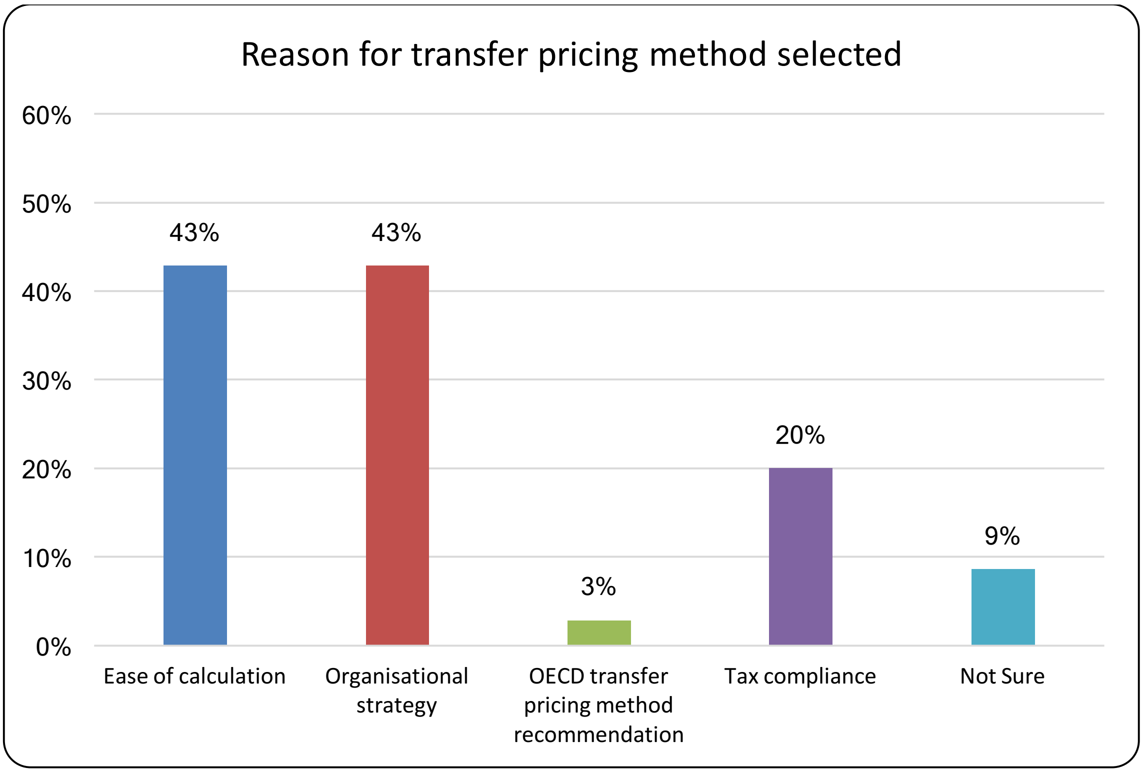
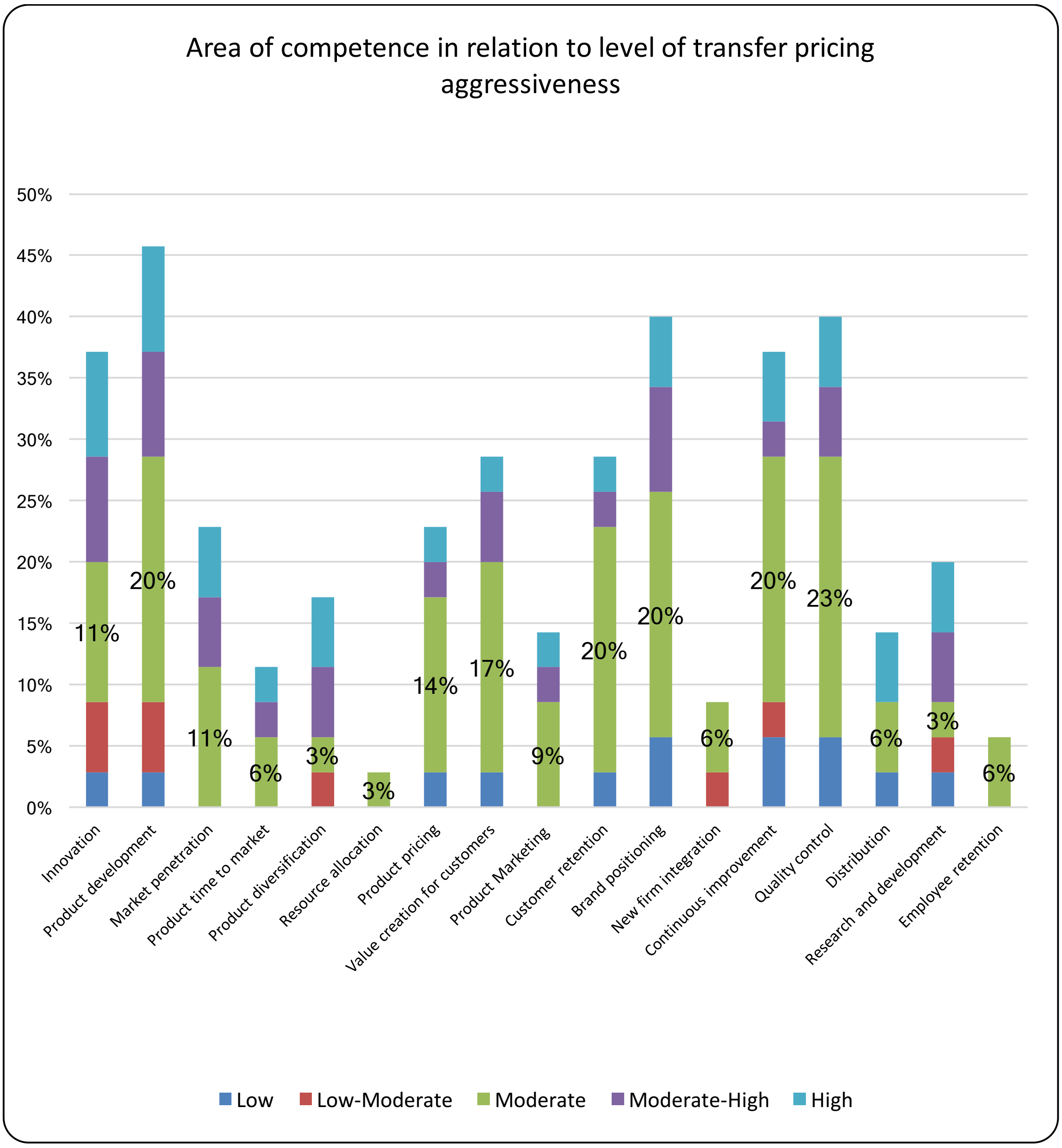


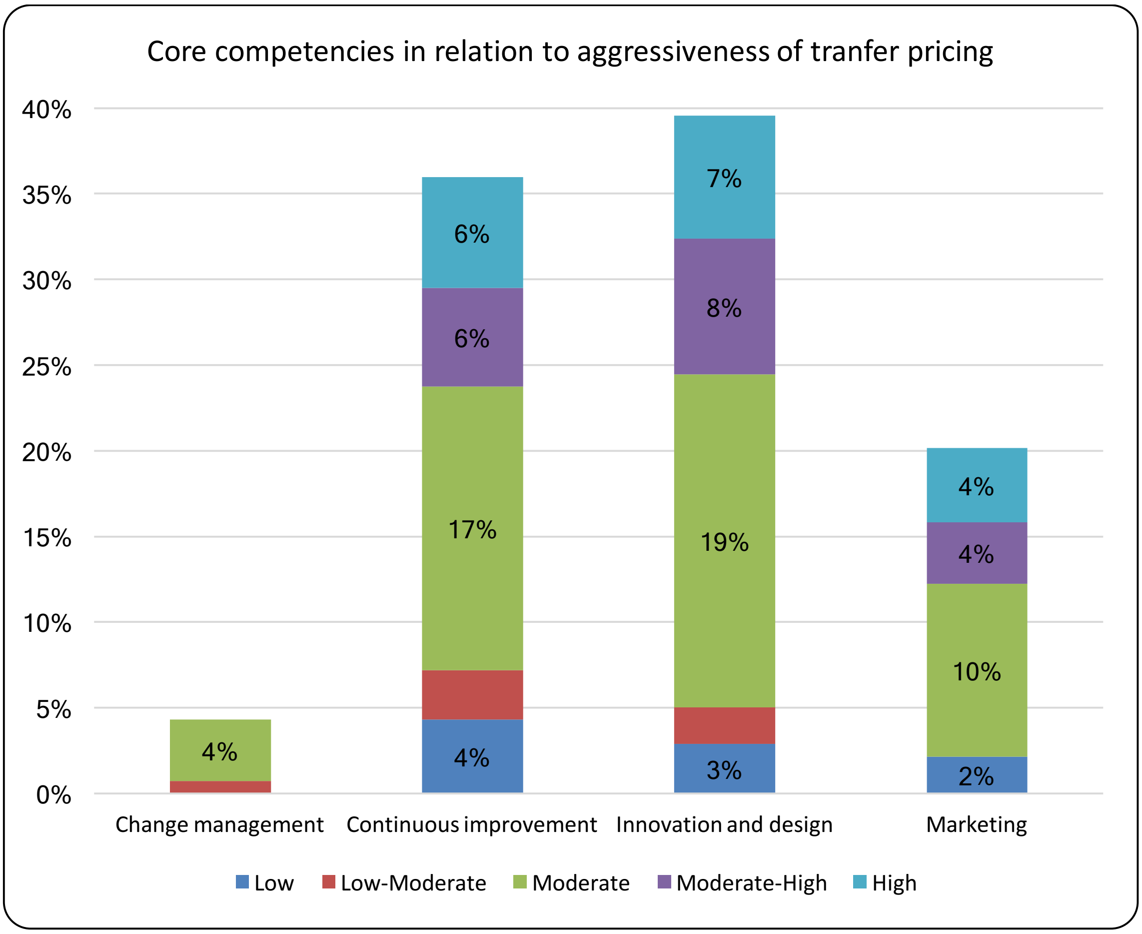
Figure 22 shows the relationship between the area of competence and the level of transfer pricing aggressiveness. In most instances, the highest area of competence also indicated the highest levels of moderate aggressiveness.

Figure 22: Area of competence in relation to level of transfer pricing aggressiveness



In Figure 23 the core competencies are depicted in relation to the level of transfer pricing aggressiveness and again indicates a moderate level of aggressiveness for the highest levels of competence.

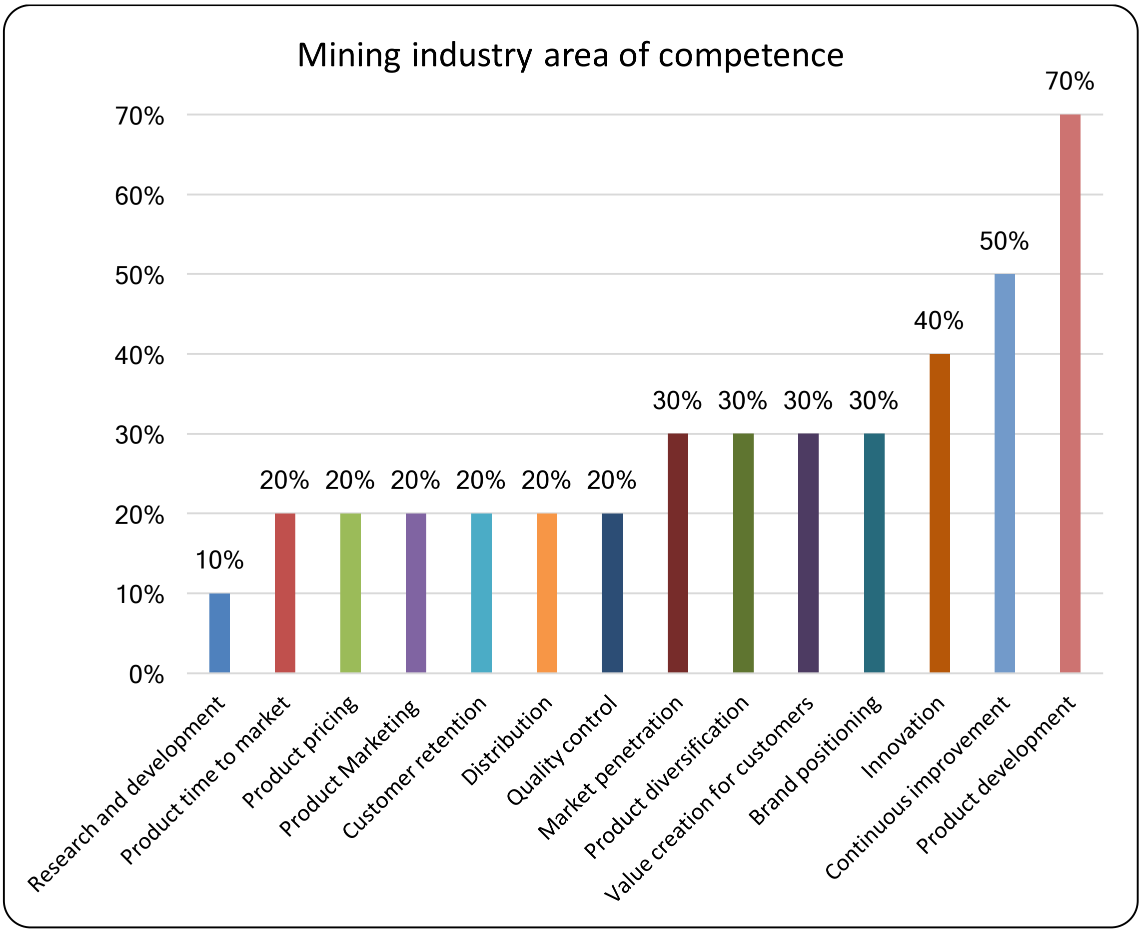
Figure 23: Core competencies in relation to the level of transfer pricing aggressiveness



5.5.8 Multinationals are different from one another, indicating that comparability testing is at best an exercise of discretion as opposed to a definitive measure of the arm's length principle.

As indicated in Figure 3, the sample covers a range of industries. In Figure 4 the diverse selection of competencies is illustrated. In this section, the researcher has combined these two variables for a single industry, in this case the mining industry. Figure 24 illustrates the number of times respondents within the mining industry selected a specific competency.

Figure 24: Mining industry area of competence



5.5.9 Summary table of propositions

Table 8 is a summary of the propositions as proposed in Chapter 3. Based on the data analysed in Chapter 5, Table 8 lists the proposition and states whether the findings supported the proposition or not. Chapter 6 will discuss these results in order to clarify the findings made in Chapter 5.

Table 8: Summary of propositions tested

Proposition number	Proposition	Proposition supported by findings
1	Multinational's competencies would be a reflection of the evolution of corporate strategy.	Yes
2	Senior management would be aware that transfer pricing is used and which method is implemented for transfer pricing calculations.	Yes
3	Senior management would not be directly involved in the selection of the transfer pricing method or the calculation and deviation from the transfer pricing method selected would either be disallowed or allowed for reasons other than the creation of competitiveness.	Yes
4	Organisations do not have an internal transfer pricing department due to the cost associated with a specialised department of this nature and, therefore, this function would be outsourced to a consulting firm.	Yes, and no for outsourcing to a consulting firm.
5	Tax legislation and the relevant transfer pricing regulations would not be high on the list of considerations when entering a new market.	Yes
6	Transfer pricing would be deemed non-aggressive and that the key consideration for the use and calculation of the transfer price would be informed by the OECD recommendations.	No
7	Multinationals are different from one another, indicating that comparability testing is at best an exercise of discretion as opposed to a definitive measure of the arm's length principle.	Yes

6 CHAPTER 6: DISCUSSION OF RESULTS

6.1 INTRODUCTION

This chapter provides an evaluation of the results presented in Chapter 5 with particular focus on the possibility of increasing the transfer pricing aggressiveness of multinationals as a means to increase their competiveness. The results are analysed and discussed as per the propositions of this study.

6.2 MULTINATIONAL'S COMPETENCIES WOULD BE A REFLECTION OF THE EVOLUTION OF CORPORATE STRATEGY.

Multinationals were shown to have distinct competencies in both a specific area of competence, and as a core competence. The core competencies clustered around innovation and design, and continuous improvement as illustrated by Figure 6. As mentioned previously, multinationals were not only created to reduce transaction costs, but also internalise resources that increase profitability and competitiveness by means other than cost management. This is an indication that multinationals implemented the RBV as a strategic management tool to compete on capabilities or resources (Collis & Montgomery, 1995; Stalk et al., 1992).

With the "re-birth" of the RBV, the strategic aim was thus to go into product markets where organisations' current resources were adequate to exploit a gap within that industry. It was with this realisation that, to be or remain competitive, multinationals could no longer be content with the resources they have, but had to develop the resources they required for a competitive advantage. This indicates that the competencies required for the multinationals' core business was internalised.

Competing on capabilities as well as the development of internal resources were evident in the selection of the area of competence. This is illustrated by Figure 24 where mining multinationals indicated their focus on innovation, continuous improvement, and product development. With only 6% of respondents shown to be in various industries, see Figure 3, the indication is that the majority of multinationals are focused on their core business, which provides the benefit of both focus and diversification as mentioned by Stalk et al. (1992).

Innovation, continuous improvement, and product development all link to the RBV of the firm and as mentioned, Stalk et al. (1992) linked capabilities to process improvements whereas, Collis and Montgomery (1995) included both tangible and intangible resources. The competencies selected are knowledge-based capabilities as well as intangible resources, both assisting with the improvement of processes. Combined, these lead to innovation, continuous improvement, and product development.

The number of joint ventures, as indicated by the respondents, reflects the internalisation of core competencies as a corporate strategy that enables a competitive advantage, as mentioned by Prahalad & Hamel (1990). The RBV required an analysis of the internal resources required to be successful in a competitive environment whereby these resources had to be developed to become competitively distinct resources that leads to competitiveness (Collis & Montgomery, 1995). Further linkages between competencies and the evolution of corporate strategy will be discussed in the sections that follow as well as the way in which aggressive transfer pricing could be a means to increased competitiveness.

6.3 SENIOR MANAGEMENT WOULD BE AWARE THAT TRANSFER PRICING IS USED AND WHICH METHOD IS IMPLEMENTED FOR TRANSFER PRICING CALCULATIONS.

Transfer pricing is an intrinsic part of the functioning of a multinational, not only as indicated by the literature, but also the respondent's indication of their awareness of its use and the methods implemented. With 83% aware of the use of transfer pricing, see Figure 6, and only 9% not sure of the transfer pricing method being used, see Figure 9. Transfer pricing stems from transaction costs economics, the RBV of the firm, internalisation theory, and ultimately the creation of the multinational (Rugman, 1980; Kapler, 2007; Buckley & Casson, 2011; Rugman, Verbeke, & Nguyen, 2011; Hashai & Buckley, 2014; Verbeke & Kano, 2015).

Transfer pricing is therefore instrumental as a means to transfer capabilities between affiliates and simultaneously reduce costs and increase competitiveness. The most substantial proponent of the use of transfer pricing was that of Coase (1937), which formed the base for all latter evolutions of corporate strategy, with the notion that corporations could reduce their transaction cost through internal pricing as opposed to externally coordinating transactions (Rugman, 1980a). As mentioned in Section 6.2, this is a further indication that multinationals followed the evolution of corporate strategy.

A concern with regards to the use of transfer pricing were the reasons specified for selecting the transfer pricing method as well as the deemed aggressiveness of the organisations transfer pricing. Figures 21 indicated the reason for selecting the transfer pricing method as "ease of calculation" being equal to that of "organisational strategy".

Figure 18 indicated the level of aggressiveness as being moderately aggressive. This indicates that the use of aggressive transfer pricing to increase competitiveness could be a possibility. Although an equal number of respondents indicated the selection of the method to be "organisational strategy", the deemed aggressiveness still leads to the conclusion that aggressive transfer pricing could be used to increase competitiveness.

Sections 1.1, 2.1, and 2.2 mentioned the instrumental nature of both the internalisation theory (Buckley & Casson, 2011; Rugman, 1980a, 1980b) and the RBV of a firm (Collis & Montgomery, 1995; Stalk et al., 1992; Wernerfelt, 1984) in the creation of multinationals. Focus on the creation of core competencies and the lack of consideration for the transfer pricing method, which is indicated in Section 6.2 and by the selection of "ease of calculation", signifies that multinationals could increase their competitiveness when transfer pricing receives the same focus as their other competencies.

6.4 SENIOR MANAGEMENT WOULD NOT BE DIRECTLY INVOLVED IN THE SELECTION OF THE TRANSFER PRICING METHOD OR THE CALCULATION AND DEVIATION FROM THE TRANSFER PRICING METHOD SELECTED WOULD EITHER BE DISALLOWED OR ALLOWED FOR REASONS OTHER THAN THE CREATION OF COMPETITIVENESS.

In Section 2.2, reference was made to Lin & Chang (2010), whom indicated the main proponents and functions effecting transfer pricing motives as well as the most common motives to be tax minimisation and group profit maximisation. This is confirmed by the responses, see Figure 12, that indeed tax cost reduction and profit maximisation were common factors for allowing the deviation.

However, market penetration being the second most common response, also indicates that competitiveness was a consideration for deviation from the normal transfer pricing method. This confirms the research by Munro (2013) whereby, multinationals are no longer able to have profit maximisation through tax minimisation as opposed to increased competitiveness, as their core transfer pricing motive. This is further evidenced by the reasons that organisations are not allowed to stray from their normal transfer pricing method in Figure 11.

Figure 11 indicates that multinationals are seeking alternative means by which competitiveness can be increased other than the manipulation of their transfer price. It was this manipulation of the transfer price that led to the creation of the TPG and the arm's length principle now plaguing multinationals' with compliance to transfer pricing regulation. The compliance to transfer pricing regulation and therefore, the arm's length principle, was clearly indicated by 63% of respondents indicating that their organisation did not allow for deviation from the selected transfer pricing method.

It was stated in Section 2.1 that the relevance of multinationals and the reason for their existence can be found in CSA, FSA, the LOF, ownership and control over licensing and the potential dissipation of FSA, the exploitation of FSA through CSA built by foreign subsidiaries, knowledge transfers between multinationals, economies of scale, and the internalisation theory (Rugman, 1980; Birkinshaw, Hood, & Jonsson, 1998; Kay, 2005; Rugman et al., 2011; Buckley & Casson, 2011; Rugman, Oh, & Lim, 2012; Chiang & Del Gaudio, 2013; Verbeke & Kano, 2015). Also mentioned in Section 2.1, was that these reasons are usually knowledge-based internal markets built on the basis of the RBV of the firm, and that FSA were acquired by vertically integrating up- and downstream supply and distribution markets. The multinational is therefore, able to maximise profits by internalising markets and coordinating these markets internally as indicated by Rugman et al. (2011).

Although disallowing deviation from the method selected definitely reducing and possible eliminates the manipulation of the transfer price from a compliance point of view, the limited involvement of local management creates both a concern and the opportunity to leverage off their CSA and knowledge. Figure 10 illustrated that senior management were not involved in the calculation of the transfer price or the selection of the transfer pricing method. Although FSA and CSA are focused when it comes to competencies, the reliance on CSA and local knowledge transfer when it comes to transfer pricing matters for the affiliates in their host countries are clearly not a primary consideration. It is therefore deduced that the deemed aggressiveness is an indication of the lack of involvement from local management who are seeking lower transfer prices from their internalised upstream markets to create market penetration opportunities and therefore, increased competitiveness in local markets.

Once again this leads the researcher to believe there is scope for the use of aggressive transfer pricing as a means to increase competitiveness. This follows the evolution of corporate strategies whereby multinationals have the ability to create efficiencies and consumer welfare, stemming from their capacity to reduce transaction cost by replacing inefficient and non-feasible arm's length transactions in the market through hierarchical control, socialisation, knowledge flows, and internal pricing as indicated by Rugman et al. (2011).

6.5 ORGANISATIONS DO NOT HAVE AN INTERNAL TRANSFER PRICING DEPARTMENT DUE TO THE COST ASSOCIATED WITH A SPECIALISED DEPARTMENT OF THIS NATURE AND, THEREFORE, THIS FUNCTION WOULD BE OUTSOURCED TO A CONSULTING FIRM.

Internalisation of external resources is a continuous theme throughout the evolution of corporate strategy. As mentioned in Sections 2.1, 6.2, 6.3, and again in this section, the internalisation should not only be considered, but implemented when it is the most cost effective decision based on the various resource choices available (Coase, 1937; Tadelis & Williamson, 2012). Prahalad & Hamel (1990) also indicates the enablement of a competitive advantage through the internalisation of core competencies. Section 6.4 further indicates the ability of multinationals to increase consumer welfare through internal pricing among other drivers.

Based on the theme of internalisation, the selection of "areas of competence" and the core competencies, in building the required competencies and resources into FSA that enabled multinationals to be competitive, it is clear that they were following the corporate strategies through their evolution. However, the area in which focus was lacking in this regard was the competencies around transfer pricing. This is illustrated by the number of organisation that do not have an internal transfer pricing department, see Figure 13. Of these, 58% indicated a reason for not having an internal department that relates to the cost related thereto. Another 16% indicated that there was no focus on transfer pricing and as such outsourced to a consulting firm. All these reasons are in direct contradiction of the internalisation theory and the building of FSA.

Of the 46% of respondents that indicated their organisation as having an internal department, 19% also said they use an external consultant to assist with their transfer pricing matters (as per Figures 13 and 15). Both these findings in terms of internalising external resources when it is the most cost effective decision to make, are in line with the evolution of corporate strategy.

In both cases, having an internal department or not having one, leaves room for increased competitiveness, initially by way of cost reduction when internalising the resources, and later on after further developing these resources by increasing the transfer pricing aggressiveness to create an additional competitive advantage.

6.6 TAX POLICY AND THE RELEVANT TRANSFER PRICING REGULATIONS WOULD NOT BE HIGH ON THE LIST OF CONSIDERATIONS WHEN ENTERING A NEW MARKET.

The data has shown the top five criteria for entering a new market, from high-to-low, as economic stability, political stability, country infrastructure, trade barriers, and labour cost (see Figure 16). These criteria relate to CSA from which multinationals could leverage FSA to enable competitiveness in a new market. This is once again in line with the evolution of corporate strategy whereby a multinational evaluates an industry (Porter, 1980, 1990, 2008) based on their available resources (Rugman, 1980a; Rugman et al., 2011; Stalk et al., 1992; Verbeke & Kano, 2015; Wernerfelt, 1984).

The consideration of tax policies and transfer pricing regulations are ranked at the sixth and seventh position respectively which simultaneously confirms and contradicts various findings by Lin & Chang (2010) and Munro (2013), as mentioned in Section 6.4. These findings also confirm that tax differentials along with certain tax relief measures do not create competitiveness on their own, as mentioned by Prahalad & Hamel (1990).

For those who did consider the tax policies and transfer pricing regulations, it was interesting to note the difference between those who use a consulting firm and those who do not. With 83% of respondents that considered the transfer pricing regulations not using a consulting firm, it indicates the need for internalising resources of this nature as mentioned in Section 6.3. What was not apparent in the data, by design of the questionnaire, is the time spent considering this criterion and the use of a consulting firm specifically for it. In any event, this indicates the possibility of not only saving time spent on researching this criterion, but also the reduction of costs by not using a consulting firm and freeing current resources.

As per Section 2.2, the application of the average corporate tax rates per region to a R1 billion taxable income for a multinational with affiliates in each of the regions, the tax costs differential shown in Figure 1, clearly indicates why a multinational would and definitely should consider the tax policies and transfer pricing regulations when entering a new market. For those considering the tax policies, the split between organisations were fairly equal. The researcher deduced that even though this was at a low level of consideration, it is done to determine the corporate tax rate of the new market.

This deduction is based on the reasons for allowing and not allowing deviation from the transfer pricing method, as well as the tax cost differential and possible savings based thereon. The researcher once again acknowledges that the tax rate and policies are not the only consideration as mentioned above and in paragraph Seven of Section 2.2. However, a tax percentage differential equates to a substantial tax cost reduction and would therefore be a likely consideration. These findings again lead to the belief that aggressive transfer pricing could add to the competitiveness of multinationals by way of increased focus on the transfer pricing regulations.

6.7 TRANSFER PRICING WOULD BE DEEMED NON-AGGRESSIVE AND THAT THE KEY CONSIDERATION FOR THE USE AND CALCULATION OF THE TRANSFER PRICE WOULD BE INFORMED BY THE OECD RECOMMENDATIONS.

The data collected and presented in Figure 18 illustrated that the level of transfer pricing aggressiveness was moderate for 57% of respondents and, in total, 77% of respondents indicated the level of aggressiveness being moderate or below. The suggestion is therefore, that the possibility exists for aggressive transfer pricing to lead to an increase in competitiveness.

The researcher did not foresee the key consideration for the selection of the transfer pricing method as being "ease of calculation" and "organisational strategy" (see Figures 21). The selection of "organisational strategy" was surprising, yet refreshing. However, the selection of "ease of calculation" was concerning. This was a further indicator of the necessity for much needed focus on the part of multinationals and introspection on the part of the OECD. The focus from multinationals is necessitated due to the fact that using the easiest calculation means there is potential for increasing competitiveness. Introspection from the OECD is required as this indicates that the establishment of comparability could be a hindering factor in compliance and increasing competitiveness.

Linking to the discussion in Section 6.4 that further consideration is needed with regards to transfer pricing, for CSA and the local knowledge-base of affiliates in host countries, this section discusses the creation of a competitive advantage in transfer pricing. By following the same logic used for the creation of other competencies, these competencies would lead to a better understanding of transfer pricing and the opportunity to use aggressive transfer pricing as a means to increase competitiveness. This logic would be the internalisation of markets, the RBV of the firm, and their building blocks, namely, integrations, focus, transaction cost reduction, industry analysis, and core competencies.

In Section 6.5 it was concluded that not having an internal transfer pricing department left room for improved competitiveness, and that increasing the transfer pricing aggressiveness would create an additional competitive advantage. Figures 22 and 23, showing the competencies of multinationals in relation to their transfer pricing aggressiveness, leads the researcher to believe that these competencies are potentially underutilised in the creation of the multinationals' competitiveness in those specific areas of competence.

The majority of respondents, at all levels of aggressiveness, indicated that they were not sure of the effect the OECD TPG recommendations had on their ability to leverage their cost advantage or increase their competitiveness in new and offshore markets. This indicates that the required resources for transfer pricing have not been internalised, as previously identified in Section 6.5, and if internalised, have not been developed sufficiently to establish a competitive advantage over competitors in the transfer pricing space.

Therefore, multinationals have fallen short in the area of transfer pricing, as compared to the development of other competencies, in following the corporate strategies that enabled their competitiveness in other areas. The possibility of using aggressive transfer pricing as a means to increase competitiveness is therefore, by no means out of a multinationals' reach.

6.8 ORGANISATIONS ARE DIFFERENT FROM ONE ANOTHER, INDICATING THAT COMPARABILITY TESTING IS AT BEST AN EXERCISE OF DISCRETION AS OPPOSED TO A DEFINITIVE MEASURE OF THE ARM'S LENGTH PRINCIPLE.

As mentioned in Section 2.2, the main focus of the TPG is the benchmarking of inter-group transactions in order to determine if these transactions are at an arm's length. The reason for this determination is due to the nature of inter-group transactions being controlled transactions in which the price can be manipulated to suit the needs of the multinational. The arm's length principle is established to reduce profit shifting between tax jurisdictions, effectively reducing the possibility of tax evasion and the "artificial" increase of group profits for multinationals.

The use of transfer pricing in this manner is made possible by the tax rate differential as indicated in Table 2 and Figure 1 in Section 2.2. The lure of manipulating the transfer price for profit shifting is made evident by the possible tax cost reduction of R115 million when shifting profits from North American to Asia.

As mentioned previously, the arm's length principle can be defined in several ways. These definitions include the fair distribution of firm-wide profits, the bargaining power of affiliates being on equal footing when dealing with related party transactions, the price at which a transaction would take place between independent firms, pricing of transactions between related parties being of such a nature that the price is comparable to pricing between unrelated parties, and the comparison of the conditions between related parties and unrelated parties for specific transactions (Afik & Lahav, 2015; Choe & Matsushima, 2013; Keuschnigg & Devereux, 2013; Leng & Parlar, 2012; Yao, 2013).

Thus, the arm's length principle is mainly concerned with the comparability of transaction between connected and non-connected parties to a transaction. This is made clear by the summaries of the transfer pricing methods in Section 2.3 whereby, all the methods make reference to the comparability of transaction between connected and non-connected parties. The appropriate method, as mentioned, should be determined through a functional analysis of a controlled transaction and its comparability with an uncontrolled transaction.

Also mentioned previously is that, if the arm's length principle is not met, the profits that would have otherwise accrued to one party, but due to these controllable conditions have not so accrued, will require the restating of the profit figure and levying of the appropriate tax charge for that party (Organisation for Economic Co-Operation and Development, 2010, p.33). This notion along with, the separate entity approach not accounting for economies of scale and the interrelation of diverse activities within an integrated business (Organisation for Economic Co-Operation and Development, 2010, p.35), signifies the inherent flaw of the arm's length principle.

This flaw relates to directly contradicting all the relevant theory surrounding the establishment of multinationals. The ability to leverage the reduced transaction cost of internalised markets, done specifically to create both customer and producer surplus and welfare, is nullified by the acceptance of the arm's length principle. As indicated in Figure 3, the sample covered a range of industries. In Figure 4 the diverse selection of competencies was illustrated. Both figures indicate that multinationals are vastly different and distinctly unique, even within the same industry. With the statement that the arm's length principle was created to counter the creation of tax advantages or disadvantages that would distort the competitive positions of either associated or independent entities (Organisation for Economic Co-Operation and Development, 2010, p.34), the base on which multinationals were built is summarily disregarded.

7 CHAPTER 7: CONCLUSION

7.1 INTRODUCTION

Throughout the evolution of corporate strategy, the key principle was the creation of differences between firms. From vertical relationships to vertical integration, the diversification of organisations' products and later their markets, to focussing on the core business of a multinational. This evolution ultimately led to the internalisation of markets because it could be better and more efficiently arranged from within the organisational structures of a firm, and the creation of FSA: a combination of internalisation and core competencies that constitute a multinational with a competitive advantage over its rivals.

The literature review has shown that both the positivist and interpretivist paradigms have led to the belief that competitiveness is obtained through the establishment of multinationals, the reduction of transaction costs, and the building of core competencies. More precisely, competitiveness is obtained as predicted by theories (positivism) such as transaction cost economics and internalisation, or through the joint or separate implementation of the RBV and the development of core competencies as evidenced through empirical studies of competitiveness (interpretivism).

This study leads the researcher to believe the arm's length principle, with comparability as its foundation, as an impracticable consideration for the promotion of growth and international trade as mentioned by the TPG. The removal of advantages, even when related to tax, created by multinationals as a differentiating factor will negatively affect their competitiveness and ultimately the welfare of their customers. This could possibly hinder the multinationals' drive for continuous improvement and innovation, yet another method of differentiating itself from competitors, when the prospect of future reward is removed.

This chapter provides an overview of the main findings as well as the aim of the study. It will go on to state the implications for business per the propositions outlined and make recommendations for future research. The aim of this research paper was to establish if the possibility to use aggressive transfer pricing as a means to increase multinationals' competitiveness exists. The research paper has met the outlined aim.

7.2 PRINCIPLE FINDINGS

The results supported five of the propositions, partially supported one, and contradicted one proposition outright. The summary of these propositions are represented in Table 8 of Section 5.5.9. This section will present the principle findings from these propositions.

The contradiction relates to proposition six whereby the results indicated that transfer pricing aggressiveness was deemed to be moderate instead of low, and that the key consideration for the calculation and use of a transfer price was “ease of calculation” and “organisational strategy”. The selection of “ease of calculation” indicates the difficulty in the determination of the comparability of transactions and strengthens the requirement that these resources have to be developed within the multinational. Alternatively, the use of the arm’s length principle and its comparability measure should be reconsidered and possibly replaced with FA.

The proposition that organisations would not have an internal transfer pricing department due to the costs associated with it, was supported by the results. Although the reasons intimated that this was mainly due to the costs related to a department of this nature, it could well be that multinationals consider the selection and calculation of the transfer price and method as a “tick box” exercise due to the complexity of multinationals in determining comparability of transactions.

The results did not support the proposition that this function would be outsourced to a consulting firm when a multinational did not have an internal department. When considering the results for this proposition collectively, they indicate an opportunity for developing these competencies and as such enable the use of aggressive transfer pricing to that could increase a multinationals’ competitiveness. The researcher believes this would create the necessary focus to overcome the comparability measure whereby the transfer pricing method and calculation could be justified for compliance purposes.

Viewing the results of various propositions collectively, the proposition that a multinational’s competencies would be a reflection of the evolution of corporate strategy was supported. The distinct industries, areas of competence, the core competencies, the footprint of multinationals, and the use of transfer pricing indicates that the encompassing internalisation theory was implemented by multinationals.

Senior managements knowledge of the use of transfer pricing as well as the method being used by their organisation, as such supports the proposition. Although only 11% of respondents indicated they were not sure if their organisation uses transfer pricing, the six percent that indicated “no” thereto, also indicated their organisation as using a consulting firm for transfer pricing matter as well as having an internal transfer pricing department.

The proposition that there would be no direct involvement in selecting the transfer pricing method or the calculation thereof by management, was supported by the findings, so too the reasons for allowing or disallowing the deviation from said method not being of a competitiveness-creating nature. Based on these findings, there is a clear opportunity to leverage-off local management knowledge of their market to allow deviation from the set transfer price to enable competitiveness.

The results also supported the proposition that tax policies and transfer pricing regulation would not be a “top five” criteria for entering a new market. This shows a reliance on the industry analysis as opposed to the RBV, although part of the internalisation theory indicates a narrow view of new market penetration. The low consideration of the tax policies and transfer pricing regulation, leads to the belief that confidence in the ability to transfer expertise and knowledge that enables the competitiveness of multinationals, is hindered by the arm’s length principle.

The proposition that multinationals are different from each other and that comparability testing is not a definitive measure of the arm’s length principle was not only confirmed by the results, but also the literature review and the preceding propositions. The reasoning for the arm’s length principle, although only for the reduction of tax evasion, is agreed upon in principle by the researcher. It is the implementation of comparability testing and benchmarking that is not embraced by the researcher. The counter argument for the use of the arm’s length principle, is that the evolution of corporate strategy based on the internalisation theory advocates the creation of FSA through the internalisation of individual markets. This enables the creation of a competitive advantage and the ability the reduce costs by internally transferring expertise and knowledge which increases a multinationals’ competitiveness

7.3 IMPLICATIONS FOR MANAGEMENT

The aim of the research paper was to establish the possibility that aggressive transfer pricing could be used in order to increase the competitiveness of multinationals. This aim has been met as outlined in this research study.

In order to move from possibility to actuality, management would be required to internalise the resources required for transfer pricing matters. By developing these competencies, the multinational would be able to effectively and efficiently manage their transfer pricing affairs in such a way that the increase in competitiveness would be a natural consequence. It is believed that command of the transfer pricing methods combined with internal expertise and company knowledge will lend itself to the use and justification of aggressive transfer pricing.

The involvement of local senior management should be a strategic necessity for decisions relating to transfer pricing. This will enable the sharing of localised knowledge with regards to industry and customer developments.

7.4 RESEARCH LIMITATIONS

The limitations to the research study are as follows:

1. Being a cross-sectional study that is done on a particular topic at a specific point in time it should therefore be noted that any changes in either the legislation or regulations governing transfer pricing would require the study to be conducted again in order to assess its validity.
2. Transfer pricing is of such a nature that not all respondents would have the same knowledge or experience with regards to the responses required by the questionnaire. This is partly due to the limited control of data collection intrinsic to snowball sampling and the sensitive nature of transfer pricing.
3. Responses in a web-based questionnaire are limited. This is due to the close-ended questions as well as the selections made available by the researcher.
4. The predisposition to dishonesty, intended or unintended, regarding the topic of transfer pricing as it relates to tax regulations and the possibility that it might be used as a mechanism for tax evasion or avoidance.
5. Deeper understanding of reasons for choices made are not supported by the close-ended questions the survey questionnaire.

7.5 SUGGESTIONS FOR FUTURE RESEARCH

Future research in this area is suggested for knowledge building in the area of transfer pricing and how this impacts on the ability of multinationals to increase their competitiveness.

FSA was mentioned as one of the key component to the emergence of multinationals and that its effective management was enabled with internalisation with the use of internal pricing (Rugman, 1980a). Research in the local market of multinationals is required to determine if there is correlation between a firms transfer pricing and market share. This could emphasise the level at which multinationals make use of their CSA and local knowledge base to leverage their FSA

An examination of the feasibility of FA, as opposed to the arm's length principle, should be done to determine if FA would be a pragmatic paradigm to increased competitiveness and possibly assist with the reduction of tax evasion and unethical tax practises. This would not only alleviate the need to remove the advantages, as per the arm's length principle, but reduce the compliance requirements of the TPG especially the comparability testing of transactions and the justification of transfer pricing methods used.

The likely impact for using an average tax rate should be determined in countries with high corporate tax rates as well as the impact on job creation and the unemployment rate of low tax jurisdictions. Multinationals decide to deploy their FDI based on criteria, such as the criteria mentioned in this study, and could therefore impact on job creation when deciding to deploy their FDI elsewhere.

A complimentary study to the one mentioned above, would be a study of the factor conditions that drive competitiveness to determine if a globalised tax rate would lead to multinationals relaxing their factor condition requirements for entering a new market. Alternatively, if an average tax rate that is based on a multinationals footprint would result in an increase of local organisations competitiveness when competing in the same industry.

Structured interviews should be done in order to gain deeper understanding of choices made in relation to the transfer pricing method selected and reasons for not having an internal transfer pricing department. This study mentions the development of an internal transfer pricing department that would be in line with the internalisation theory which advocates the internalisation of resources. Therefore, the suggestion is that a study be done to determine if multinationals that currently have an internal transfer pricing department are more competitive than others.

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9 APPENDICIES

9.1 APPENDIX 1: QUESTIONNAIRE

1 The following questions relate to your organisation.

a. What is your position within the organisation? *

- Chief Executive Officer
- Managing Director (MD)
- Deputy MD
- Chief Operations Officer
- Financial Director
- Chief Financial Officer
- Operations Director/GM
- Marketing Director/GM
- Other

b. Please specify your position within the organisation.

c. Is your organisation a multinational? *

Yes No

d. Where is the organisations head office located? *

e. In how many countries does your organisation do business? *

- 1 to 5
- 6 to 10
- more than 10
- not sure

f. Number of subsidiaries within your organisation. *

- 1 to 5
- 6 to 10
- 11 or more

g. Number of strategic Joint Ventures with key suppliers? *

- 1 to 5
- 6 to 10
- more than 10
- not sure

h. In which Industry is your organisation? *

- FMCG
- Financial services and Banking
- Consulting - other than accounting
- Accounting services
- Mining
- Engineering
- Information Technology
- Manufacturing
- Construction
- Other

i. Does your organisation make use of transfer pricing between business units? *

- Yes
- No
- Not sure

j. In your opinion, what is your organisation good at? *

- Innovation
- Product development
- Market penetration
- Product time to market
- Product diversification
- Product pricing
- New firm integration
- Research and development
- Continuous improvement
- Employee retention
- Product Marketing
- Customer retention
- Value creation for customers
- Resource allocation
- Brand positioning
- Distribution
- Quality control
- Other

k. What are the top 5 criteria for entering a new market? *

- Talent availability
- Labour cost
- Tax policies
- Political stability
- Economic stability
- Legal system
- Transfer pricing regulations
- Country infrastructure

- Cultural trends
- Trade barriers
- Other

2 The following questions relate specifically to transfer pricing within your organisation.

a. What is your head quarters involvement in local company decisions/operations? *
Low involvement indicates that they should be informed of decisions made and High involvement indicates that they need to agree to and sign off decisions made.

- Low
- Medium
- High

b. Are you directly involved with the calculation of the transfer price? *
Yes No

c. Are you directly involved in determining the transfer pricing method used? *
Yes No

d. Does your organisation have a dedicated department for transfer pricing matters? *
Internal transfer pricing matters relating to the calculation and determination of transfer pricing method to be used.
Yes No

e. Why does your organisation not have a transfer pricing department? *

- Availability of specialised skills
- Too expensive
- Cost outweighs the benefit
- Other

f. Where is the transfer pricing department located? *

- Head office
- Within each subsidiary
- In certain subsidiaries only
- Head office and each subsidiary
- Head office and certain subsidiaries
- Other

g. Does your organisation use a consulting firm for transfer pricing matters? *
Yes No

h. What is the estimated cost for internal transfer pricing consulting services? *

- R0 to R100 000

- R100 001 to R300 000
- R300 001 to R500 000
- R500 001 to R1 000 000
- More than R1 000 001

i. What is the estimated cost to comply with external transfer pricing regulations? *

For example, Country-by-Country reporting and benchmarking for comparability?

- R0 to R100 000
- R100 001 to R300 000
- R300 001 to R500 000
- R500 001 to R1 000 000
- More than R1 000 001

3 The following questions relate to the transfer pricing methods used by your organisation.

a. Which transfer pricing method does your company implement? *

- Comparable Uncontrolled Price Method - CUP
- Resale Price Method
- Cost Plus method
- Transactional Net Margin method
- Transactional Profit Split method
- Other

b. Please specify the method with a short description thereof. *

c. Does this method conform to the "arm's length" principle? *
Yes No

d. Is this method aligned with your organisations and/or country specific Corporate Strategy? *
Yes No

4 The following questions relate to the use of transfer pricing to create competitiveness for your organisation.

a. What is the reason for the transfer pricing method selected? *

- Ease of calculation
- Organisational strategy
- OECD transfer pricing method recommendation
- Tax compliance

b. Does your organisations transfer pricing policy allow for deviation from the transfer pricing method/s selected? *
Yes No

c. Please specify the reason for not allowing deviation from the transfer pricing method selected. *

- Revenue authority regulation is the only consideration
- Compliance with tax regulation is of utmost importance
- Profit maximisation is a secondary consideration
- Other

d. Please specify the strategic reason for allowing deviation from the transfer pricing method. *

- Market penetration
- Profit maximisation
- Tax cost reduction
- Other

In your opinion, how aggressive is your organisations transfer pricing? *

- 1
- 2
- 3
- 4
- 5

e. What forms the basis of the organisations transfer pricing method used? *

- OECD transfer pricing regulations
- Defined corporate strategy
- Not sure

f. In your opinion, does the OECD recommendations of transfer pricing methods reduce your organisations ability to leverage its cost advantage in the market? *

- Yes
- No
- Not sure

g. Does the OECD transfer pricing recommendations reduce your company's ability to increase its competitiveness in offshore markets? *

- Yes
- No
- Not sure

Formulary apportionment in essence, advocates the creation of an average tax rate to apply to all countries in which an organisation does business.

6 Are you aware of the Formulary apportionment method? *
Yes No

7 In your opinion, would this be a more realistic approach to transfer pricing regulations? *
Would you suggest formulary apportionment as an alternative to the existing transfer pricing methods that could possibly reduce tax evasion and increase organisational competitiveness through aggressive transfer pricing?
Yes No

8 If you have any thoughts or suggestions with regards to the use of transfer pricing, please feel free to comment below.

Submit

Review ...

9.2 APPENDIX 2: ETHICAL CLEARANCE

Dear Mr Ingo Tocknell

Protocol Number: **Temp2016-01450**

Title: **Transfer pricing as a means to increase multinational enterprises' competitiveness**

Please be advised that your application for Ethical Clearance has been APPROVED.

You are therefore allowed to continue collecting your data.

We wish you everything of the best for the rest of the project.

Kind Regards,

Adele Bekker