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TRANSFER PRICING AS AN ELEMENT OF TRANSNATIONAL COMPANIES' MANAGEMENT POLICY

ANNOTATION

The article explores the essence of transfer pricing and the main features of its use as a management policy tool at transnational companies. The critical analysis of transfer pricing methods is accomplished. Suggestions of different methods implementation possibilities are provided based on the company's objectives and indicators of market conditions.

Key words: transfer price, transfer pricing, management policy, transfer pricing calculation methods, transnational companies.

АНОТАЦІЯ

У статті досліджено сутність трансфертного ціноутворення та визначено особливості його застосування як інструмента управлінської політики транснаціональної компанії. Здійснено критичний аналіз методів трансферного ціноутворення та надано пропозиції щодо можливостей їх застосування залежно від цілей компанії та показників ринкової кон'юнктури.

Ключові слова: трансфертне ціноутворення, трансфертні ціни, управлінська політика, методи розрахунку трансфертних цін, транснаціональна компанія.

АННОТАЦИЯ

В статье исследована сущность трансфертного ценообразования и определены особенности его применения в качестве инструмента управленческой политики предприятия. Осуществлен критический анализ методов трансфертного ценообразования и даны предложения о возможностях их применения в зависимости от целей компании и показателей рыночной конъюнктуры.

Ключевые слова: трансфертное ценообразование, трансфертные цены, управленческая политика, методы расчета трансфертных цен, транснациональная компания.

Formulation of the problem. The processes of integration and globalization in the world economy, politics and socio-cultural field are becoming increasingly valuable nowadays. The most significant impact of such processes can be noticed in the economy. An indicator of these processes is continually growing up the volume of transnational companies (TNCs) that operate in the world and particularly in Ukraine.

Integration processes have an essential impact on the management policy of business entities. Enterprises interested in expanding the geographical boundaries of their activity, sharing knowledge and technologies, removing barriers to the exchange of goods and services can feel the biggest impact of integration. Transfer pricing is one of the tools used by companies to optimize business activity and increase its efficiency in terms of integration processes.

Analysis of recent research and publications. The development of the theory of transfer pricing has been reflected in the works of domestic and foreign scientists like E. Shmalenbach [1], J. Dearden, R. Anthony [2], L.V. Zherdetska [3], K.S. Vasina [4], T.G. Savchenko [5] etc. Nevertheless, the issue of the influence of transfer pricing on the management policy of the enterprise and the problem of choosing the method of setting transfer prices remained unsolved.

Formulating the goals of the article. The purpose of the article is to analyse the essence of transfer pricing as a management policy tool and to provide suggestions regarding its implementation depending on the objectives of the enterprise and indicators of market conditions. In order to achieve the goal, the following tasks were set:

– generalization of the theoretical basis of the transfer pricing tool through the disclosure of the concepts of "transfer price" and "transfer pricing";

– a critical analysis of the methods of calculating transfer prices, defining its pros and cons;

– providing methodological recommendations on choosing an optimal method of transfer pricing that depends on a number of factors, namely: market system, market saturation, type of goods, type of competition, the degree of decentralization of management in the company, etc.

Presenting the main material. In the domestic and foreign scientific-practical literature, the concept of "transfer price" has no general definition. The concept of transfer prices is often replaced by the notion of estimated, management or internal prices. However, each of these types of prices can be considered as a separate type of transfer prices. E. Schmalenbach uses the notion of internal estimated price and notes that this is "a peculiar price, which is formed as a result of the evaluation of mutual services provided by separate parts of the enterprise, which have settlement relationship" [1, p. 167]. Domestic scientists, in particular, S.V. Voytko and V.H. Herasymchuk give the following definition: transfer prices are the prices of internally-corporate trade between subdivisions located in different countries of one TNC, used for transfer of profits and reduction of taxes paid to the state budgets of partner countries [2, p. 107]. Current legislation doesn't give the exact definition of transfer prices. There is only indicated that these are prices used in the process of controlled transactions.

Taking into account above noticed definitions, transfer prices can be interpreted as the prices on any internally-corporate trading objects between subdivisions of the same company or affiliated companies that are used to optimize cost management at an enterprise, recalculate profits, neutralize conflicts of interests of participants and reduce taxes, paid to the state budget. The main advantage of transfer pricing is the possibility of diversion transfer prices from market prices.

The main characteristics of transfer prices [2, p. 107]:

– regulation, which can become a guarantee of stability unlike market pricing;

– transfer prices level is set according to certain needs of the company (minimization of tax obligations, customs expenses, transfer of financial resources, accumulation of assets, etc.);

– positive influence on the formation of the profit rate by minimizing costs and redistributing financial resources;

– have an impact on the main macroeconomic indicators (GDP, exports, etc.).

Management accounting and transfer pricing are interdependent processes. As long as management accounting is an information base for calculations of transfer prices, and for management accounting and management policy, the transfer pricing tool can be a risk management method, an assessment of the efficiency of an activity, a step towards optimizing costs, etc.

American scientists R. Anthony and J. Dearden [3, p. 203] include the following main tasks of transfer pricing as a management tool:

– stimulation of the management system of the company's structural divisions, encouragement of the acceptance of effective decisions and their justification in order to maximize the company's profits;

– transfer prices serve as a criterion for assessing the effectiveness of subordinate subdivisions;

– transfer prices are used in the system of production and economic relations of decentralized subdivisions of the company and, therefore, the mechanism should not violate the autonomy of these components.

Prerequisites of transfer pricing implementation can be grouped into four main groups [4, p. 122]:

– functional need;
– economic need;
– organizational reasons;
– strategic planning.

The functional need is reduced to the company's division into responsibility centres, which leads to a separate assessment of their activities and individual approaches to motivating managers of such subdivisions. The economic reason is the need for an efficient allocation of limited resources among the divisions to achieve the strategic goals of the organization. Organizational component occurs when in a company with a divisional management structure the transfer pricing system is an integration and differentiation tool. On a global level, a transfer pricing system is used to create and develop optimal strategic decisions.

Depending on the market situation, the type of enterprise and its management policy, different methods of calculating transfer prices are used. The main ones are: on the basis of market prices, expense and contractual [5, p. 15].

The method of calculating the transfer price based on market prices means that current or averaged market prices for similar (or interchangeable) goods are taken as the basis. Taking into account, there is a practice of using market prices with discounts. This method is used mainly in market economies. The market transfer price is, in fact, the price of demand for which the products can be sold to external buyers, but it is reduced by the amount of sales costs. However, for the effective use of this method, a developed competitive environment and a rich market of similar goods or substitute products are needed. Also, such a method leads to a more even distribution of profits among the divisions of the company, which is especially beneficial for enterprises with a decentralized type of management.

Another method is the method of calculating the transfer price based on expenses. The general formula for this method is as follows:

Transfer price = cost + profit rate

The rate of return is determined on the basis of the main objectives of the relevant subdivision. This method involves several subspecies that depend on the type of expenses. Thus, transfer prices can be calculated on the basis of full actual costs, normative, variables and marginal. The method is particularly effective for enterprises with a high degree of centralization and vertical integration, as each subdivision is interested in reducing expenses in order to maximize profits. In addition, the method of the transfer price determined by the expenses method applies to novelty products or non-analogous goods, since in this case there is no need to take into account competitors' prices. The advantage of the method is that the transfer price is calculated on the basis of the company's accounting and management, meaning it does not require any additional information from the outside.

The contractual method for calculating transfer prices is used under conditions of imperfect market mechanisms or at a rapid pace of market change (rapid price changes, growth in the number of competitors) or in some cases when the leader (monopolist) on the market sets his own conditions. The advantage of this method is that the divisions of the company have information and can take part in the negotiations. However, subjectivity takes place this approach since the choice of price may depend on personal qualities or the views of managers. In addition, there may

Table 1

The matrix of choosing the method for calculating transfer prices

Management centralization level	Market saturation	
	High competition (market is saturated with similar goods)	Monopoly (novelty product)
Decentralized type	Based on market prices	Contractual
High level of centralization	Contractual or mixed (expense method taking into account certain indicators of market prices)	Based on expenses

Source: developed by the author

be problems in the case, when the contract specifies a condition, prohibiting the purchase of products from external suppliers. Then, the company may have losses when the market price descents.

Generalizing all the factors that influence the choice of a transfer pricing method, the main ones can be determined by the situation on the market and the degree of centralization of the company's management. The decision of choosing the method of transfer pricing can be systematized in the form of the following matrix (Table 1).

When using the mechanism of transfer pricing, the key role is played by separate subdivisions, which are called centres of responsibility. We allocate the following types of centres of responsibility [4, p. 122]:

– Centres of income – the activities of such centres are assessed on the basis of their profits, their goal may be to increase the market share or the number of orders;

– Expense centres – subdivisions that control only their expenses, do not have direct access to the market, their goal is to minimize expenses at the established production volumes;

– Centres of expenditure – subdivisions, which expenses are difficult to link with the results (management expenses, research expenses);

– Investment centres – are responsible for using own and borrowed capital;

– Revenue centres – are responsible for the amount of revenue.

It's believed that the selection of the above-mentioned centres of responsibility allows solving the following tasks:

– reducing the time needed for decision making and thus accelerating the process of responding to customer needs;

– keeping an accurate account of expenses for products and processes;

– taking into account the income of each centre;

– evaluating the performance of each individual subdivision.

In addition, for the effective functioning of the transfer pricing system, the following requirements must be provided:

1) creation of a single network database, which operates in real time and provides centralized and simultaneous access to information for all subdivisions;

2) managers must receive in a timely manner all the necessary information about changes in the system of internal accounting;

3) the operation of special tools for information analysis and forecasting in order to develop appropriate and effective management policy objectives.

Conclusions. As a result of the research, a theoretical generalization of the existing interpretations of the concept of "transfer price" was conducted and a new, in our opinion, the more complete definition was proposed.

Having analysed the existing methods of calculating transfer prices at the enterprise, the main advantages and disadvantages of each of them were determined.

Recommendations on choosing the method for calculating transfer prices and their generalization in the matrix of the choice of method depending on the level of centralization of company management and the competitive situation on the market were developed.

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The article explores the essence of transfer prices in the context of integration and globalization processes. The above-noticed processes in the world economy, politics, and socio-cultural field are becoming increasingly valuable nowadays. The most significant impact of such processes can be noticed in the economy. An indicator of these processes is continually growing up the volume of transnational companies (TNCs) that operate in the world and particularly in Ukraine.

Integration processes have an essential impact on the management policy of business entities. Enterprises interested in expanding the geographical boundaries of their activity, sharing knowledge and technologies, removing barriers to the exchange of goods and services can feel the biggest impact of integration. Transfer pricing is one of the tools used by companies to optimize business activity and increase its efficiency in terms of integration processes.

There was provided a theoretical generalization of the existing interpretations of the concept of "transfer price" and a new, more complete definition was proposed in the article. The existing methods of calculating transfer prices at the enterprise as based on market prices, on expenses and contractual method were analysed. Taking into account the results of the analysis, the main advantages and disadvantages of each of the methods were determined.

Recommendations on choosing the method for calculating transfer prices and their generalization in the matrix of the choice of method depending on the level of centralization of company management and the competitive situation in the market were developed. The mechanism of transfer pricing methods implementations in the TNC was explored and some suggestions on its reasonable use were added.