

The Side Effects of Transfer Pricing

A case study on a Swedish MNE

This paper aims to investigate how transfer pricing (TP) impacts the major management control functions: organizing, planning, evaluating and rewarding (Chow et al., 1999) and if there is any difference in the perceived impact between sub-units in a TP tax compliant multinational enterprise (MNE). Further, we also examine how these impacts, if any, are managed with regards to coercive and enabling uses of management control within these three major functions (Ahrens & Chapman, 2004). This was investigated through an in-depth case study at ManuCo, a Swedish multinational manufacturing company. We found that TP was in general not regarded as an issue and its perceived impact was only marginal within the major management control functions according to the headquarters (HQ). However, moving one level down in the organization; different perception gaps were revealed in the sub-units (Birkinshaw et al., 2000). At the factories there was a low perception gap with regards to the TP impact. However, the sales companies experienced a TP impact in all management control functions and had TP on the top of their mind on a daily basis. Thus, the TP policy was revealed as giving rise to a tension between the HQ and the sales companies that needed attention and management in order to align the corporate goals with the goals of the sub-unit in a satisfactory way. Our main finding of why TP caused this impact was the absence of a common enterprise resource planning (ERP) system resulting in a lack of internal transparency of the TP policy. In addition, the TP impact was perceived and managed differently both between sub-units and between sectors due to an uneven distribution of designated corporate resources. Hence, we encourage future research to examine the importance and role of ERP systems in managing tensions that TP tax compliant MNEs are encountered with.

Key words: Transfer pricing, Transfer pricing impact, HQ-Sub-unit relationship, Management control, Coercive versus Enabling

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1 Introduction

“The point is that transfer pricing should be neutral in a perfect world. But it is not.”

(VP Controller A-sector ManuCo, 2013)

Today, multinational enterprises (MNEs) are increasingly making use of different countries’ comparative advantages in order to win market share and grow revenues while reducing costs. The rising international flows of goods and services within an MNE have amplified the focus on international transfer pricing¹ (TP) – both in terms of regulation and challenges for management control.

One of the core issues in the study of MNEs engaged in TP is how to structure and manage the relationship between the headquarters (HQ) and its foreign sub-units (Birkinshaw et al., 2000). Management control systems (MCSs) help MNEs to increase goal alignment, i.e. that employees make decisions and take actions that are in the MNEs’ best interest as a whole (Birkinshaw et al., 2000; Chow et al., 1999). The case study by Cools et al. (2008) confirms that the use of transfer prices will affect the MCS in an organization and Plesner Rossing and Rohde (2010) show how transfer prices affect the overhead cost allocation system design. However, the majority of previous studies have focused on the company-wide perspective of TP, even though TP decisions have a greater impact on sub-unit levels since they have a more operational role (Boyns et al., 1999). Furthermore, Chenhall (2003) argues that firms will adapt to both their external and internal environment since the HQ and the sub-unit have different roles and answer to different external environments. One could expect the TP impact on the MCS to appear differently on different hierarchical levels in the organization. Therefore, we aim to investigate the relationship between the HQ and its sub-units in a TP tax compliant MNE by focusing on the variables organizing, planning, evaluating and rewarding. These variables incorporate the major management control functions that are affected by the tension of goal alignment (Chow et al., 1999; Cools et al., 2008; Cools & Slagmulder, 2009). This leads us to our proposed research question being formulated as:

1. *How does transfer pricing impact the major management control functions; organizing, planning, evaluating & rewarding, and is there any difference in perceived impact between sub-units in a tax compliant MNE?*

Studying the role of novel MCSs within contemporary settings is necessary to ensure that the management control research is relevant (Chenhall, 2003). With regards to the enhanced speed of globalization, where more companies engage in TP we deem it relevant and important to investigate how a MCS appears in practice in a TP context. By adopting a HQ-Sub-unit relationship view, we aim to further investigate the MCS through the coercive and enabling uses for control and cooperation by applying the principles of Ahrens and Chapman (2004). This leads us to our second research question being formulated as:

¹ Transfer pricing is the price one legal entity charges for a product, service, intangible or financial transaction delivered to another foreign legal entity within the same corporate group (Emmanuel & Mehafdi, 1994).

2. *How are these transfer pricing impacts, if any, managed with regards to coercive and enabling uses of management control within the functions organizing, planning, evaluating & rewarding?*

The purpose of this study is to contribute to current empirical research through a single case study at a Swedish manufacturing company, which we will call ManuCo throughout the paper. Through a contingency based in-depth single case study, we intend to respond to the call made by Cools et al. (2008) for more conceptualized investigations of how theory appears in practice by mapping ManuCo's TP process and MCS, its perceived tensions and its practical implications in the HQ-Sub-unit relationship(s).

1.1 Scope & Limitation

To explore the research questions outlined above we conduct a single case study on the TP system within the European principal structure of ManuCo. ManuCo is a decentralized manufacturing company with operations worldwide that uses tax compliant transfer prices for their organization which encompasses the entire value chain from manufacturing to sales. In 2012, ManuCo had a turnover of 110 billion SEK and employed 61 000 people (ManuCo Annual Report, 2012). ManuCo has operations in Asia, Europe, North America and South America, but due to practical constraints we will only focus on the European market. We will take the internal and organizational perspective of the TP impact in the HQ-Sub-unit relationship, hence excluding the external stakeholder perspective from the study. More precisely this implies that we will take tax compliance as a given, and therefore not investigate whether ManuCo is tax compliant or not.

1.2 Outline

The remainder of this paper is organized into five sections. The next section provides an overview of the foundation of TP theory, a review of the current research literature in the field of TP, and management control, supplemented with an elaboration of vertical dyadic settings and concludes by deriving our theoretical framework for further analysis. Section 3 outlines the methodological approach employed and its implications for the quality, reliability, and validity of the study. Section 4 describes the case company and the empirical findings with regards to MCS, TP, and tensions arising in their use. Section 5 contains the analysis, which combines the presentation of the empirical findings with the analysis by employing frameworks and theories discussed in the literature review. The final section concludes the relevant findings of the study, acknowledges its limitations, and suggests areas for future research.

2 Previous literature & Theoretical framework

2.1 Previous literature

Economists and business managers have for decades analyzed theories regarding how to achieve the best transfer pricing (TP) system for a rational multinational trying to fulfill several organizational goals and objectives. First, the focus was on setting the optimal transfer price (Cook, 1955; Hirshleifer, 1956), then determining the correct TP method and later, how to use TP as a strategic tool (Abdallah, 1989; Cravens, 1997; Eccles, 1985). General conclusions of most academic literature of that time were that no optimal transfer price, method, or strategy exists (Eccles, 1985; Spicer, 1988). Nevertheless, to understand the foundation of TP, we also need to consider the underlying economic theory that gives rise to implications with regards to TP.

2.1.1 Economic theory – the foundation of transfer pricing

Traditional economic theory has laid the foundation for the early work on TP. Within this arena, theory has assumed that companies rely on the pricing mechanism to determine the optimal transfer price and product mix that maximizes profits (Ezzamel, 1995). If an intermediate product can be traded in an external market, then the optimal transfer price will be the market price (Hirschleifer, 1956; Williamsson, 1975). Transfer prices help in valuing and coordinating the workflows of interdependent sub-units that each are held accountable for their financial performance (Simons, 2000). A common tradition in the management control literature is that TP should provide economic information with the aim of both corporate and managerial goal congruence and should aid in the evaluation of divisional managers performance (Abdallah 1989; Emmanuel & Mehafti, 1994; Watson & Baumler, 1975). Economic theory assumes that sub-units should be permitted maximum autonomy in setting their activity level, i.e. optimizing price or product mixes (Ezzamel, 1995). In other words, economic theory assumes sub-units to act and behave like selfish profit-maximizers. However, a TP tax compliant MNE desires sub-units to behave as if they all constitute one entity whose aim is to maximize corporate profits (Ezzamel, 1995).

The divisionalized organization is in essence a dynamic and interactive web of interdependent sub-units seeking to attain pre-set goals (Ezzamel, 1995). With the economic theory model in TP, there is an overriding priority of attaining corporate goals and optimality resulting in significant reductions of sub-unit autonomy (Baumol & Fabian, 1964; Ezzamel, 1995). TP does not only impact the degrees of cooperation and integration that takes place between sub-units and headquarters (HQ), it also influences the extent of decision-making enjoyed by sub-unit managers (Spicer, 1988). Sub-unit managers may feel alienated if top management imposes constraints on the way in which they run their units, which can induce them to behave in a manner inconsistent with corporate interest. The trade-off between corporate optimality and sub-unit autonomy is an issue of major importance and it is not entirely clear when in conflict, which one should be sacrificed in favor for the other (Ezzamel, 1995).

The economic theory method presented contains two limitations: it oversimplifies economic reality and does not take behavioral issues into account. The success of a TP system in facilitating the

allocation of resources and evaluating sub-unit performance depends largely on capturing the relevant economic and organizational characteristics of a company (Watson & Baumler, 1975). Complex interdependencies between sub-units are ignored and the TP problem is reduced to a simple microeconomic model with supply and demand. There is no explicit linkage of TP to the firms' organizational and behavioral context, such as diversification strategy, organizational structure, and intra-firm transactions (Spicer, 1988). According to Spicer (1988) TP is as much a behavioral issue as it is an economic issue, as explicit considerations of the contexts is needed in order to understand TP techniques and implications.

One major organizational issue is differentiation and integration (Swieringa & Waterhouse, 1982). Differentiation can be defined as the segmentation of the company into sub-units and the differences in behavior caused by this segmentation. Integration refers to the extent of collaboration between sub-units. TP enhances differentiation as it helps to illuminate responsibility and to separate stages of production (Ezzamel, 1995; Swieringa & Waterhouse, 1982). In addition, if the TP method is cost-plus, which is cost plus a pre-set mark-up, it helps to achieve the required integration in situations where standard operating rules and procedures are relied upon frequently (Ezzamel, 1995). However, Ezzamel (1995) has not elaborated on other TP methods contribution to enhanced integration or differentiation.

Under the influence of organizational behavior literature, management control research started to recognize the importance of “processes” and “dynamics” when studying TP. Watson & Baumler (1975) were the first in the organizational TP literature to not only take economical reasoning into account but also the organizational and social context. They also pinpointed the role of TP in increasing differentiation through decentralization, and simultaneously integrating the organization. Following them, Swieringa & Waterhouse (1982) demonstrated and stressed that dynamics and processes, also recognizing pressures for organizational learning and adaptation, cannot be neglected when studying TP.

Swieringa & Waterhouse (1982) argue that organizations are viewed as going through processes of “organizational learning” in which they display adaptive behavior. This implies that organizations are undergoing constant change, rather than being rigid and static. The “process” enables learning within the organization as a whole (Swieringa & Waterhouse, 1982). Shared understandings of situations and agreements on future actions can be attained by encouraging interaction between managers. Moreover, Swieringa and Waterhouse (1982) elaborates on the fact that through the processes of dealing with problems, individuals and the environment of the organization can learn and create a common ground. This in turn can contribute in creating the basis for structuring and controlling. Further, the process of creating TP rules and procedures may enable an opportunity for structuring and controlling. Viewing the TP process as an enabler of structure and control will in turn allow for attention on organizational learning and adaptation (Swieringa & Waterhouse, 1982). Swieringa and Waterhouse (1982) demonstrate in their study the complexity of TP in an organizational context and warn for not considering internal as well as external factors in combination when analyzing TP in order to get a more comprehensive view. These early authors

laid the foundation for frameworks of TP processes and choice later developed by Eccles (1983; 1985) and Spicer (1988).

2.1.2 Transfer pricing in practice and management control

The ultimate goal of an MNE must be to compete in a global economy, through creating or maintaining a competitive market position (Cravens, 1997). An MNE's choice of a TP method can thus be motivated by changes in the MNE's strategic, organizational, and transactional circumstances (Abdallah, 1989; Spicer, 1988). The focus should lie on why that particular TP method is used based on what strategic objective the MNE is trying to achieve (Cravens, 1997). TP systems fulfill a variety of goals and objectives in MNEs such as; profit maximization, tax management, currency fluctuations or host country relations to name a few examples (Cravens, 1997; Spicer, 1988).

Most covered in previous management control literature with regards TP is the tax perspective, guiding how companies can manage or minimize their tax burden (Anctil & Dutta 1998; Baldenius et al., 2004; Bartelsman & Beetsma, 2001; Borkowski, 1990; 1992a; 1992b; 1996; 2012; Choudhury, 1990; Clausing, 2001; 2003; Cravens & Shearon, 1996; Cravens & Yancey, 2008; Sikka & Willmott, 2010). Since tax authorities around the world have raised their awareness and focus on TP and its effect on income shifting and tax allocation, these global trends have made the tax compliance objective of vital importance in the design and use of MNEs' TP system and have led to an additional goal and objective to emerge, tax compliant TP. This in turn has led to more recent literature in management control having a greater focus on the TP policy's effect on the management control system (MCS) (Cools et al., 2008; Cools & Slagmulder, 2009; Plesner Rossing & Rohde, 2010).

Cools et al. (2008) conducted a case study on how tax compliance impacts the design and use of the MCS. From this study they concluded that there are three major effects on the design of the MCS and one major effect on the use of the MCS within the MNE. They formulated four propositions for predicting the consequence of tax compliant TP on the MCS design and use. The first proposition suggests an increase in centralization and an increase in the formal structuring of organizational activities. The second proposition suggests an increased use of universally applied internal and external benchmarks and a reduction in participation by lower level management in setting standards and targets. The third proposition suggests an increased recognition of self-selected, non-financial metrics for evaluating and rewarding. The fourth proposition refers to the use of the MCS. It suggests that an adoption of a single tax compliant TP policy causes an increase in the controlling use of an MNE's MCS which is identified by an increase in internal and global transparency at the expense of flexibility and repair mechanisms.

While the TP policy plays an important role in an MNE's tax management, it creates a theoretical conflict between tax compliance and the goals and objectives of the organization as a whole. The case studies by Cools et al. (2008) and Plesner Rossing and Rohde (2010) show that the goal of having tax compliant transfer prices has an effect on the management control practices in a MNE. This conflict could be interpreted as a tension in the organization since the optimal solution for tax purposes might not create the best incentives for internal management. In addition, neither Cools et

al. (2008) nor Plesner Rossing and Rohde (2010) provide any specific guidance for how to manage this tension. One suggestion discussed in literature is to keep different transfer prices for these two objectives. This separation is referred to in literature as keeping two sets of books, one for tax purposes and one for internal management purposes (Durst, 2002). Separated accounting systems for different purposes are only one way of avoiding conflicts between internal management control and TP. However, due to the high audit risk and the fact that keeping two books is illegal, Durst's (2002) proposal is not used in practice. Instead, MNEs use one set of books, i.e. a single set of transfer prices (Baldenius et al., 2004; Durst, 2002).

Studying the trade-offs of different TP objectives, some previous researchers indicate that MCS objectives could be taken into account when MNEs establish their TP policies. Yunker (1982) found that MNEs that used TP to increase overall profits placed less emphasis on profit measures in sub-unit performance evaluation. He concludes that large MNEs tend to use market-based transfer prices and profit-oriented measures in the evaluation of sub-unit performance, while cost-based companies are more concerned with budgetary and goal oriented criteria for performance. Further, Smith (2002b) studies the use of performance measures independent of the transfer price, when relaxing the common assumption that the aggregate profit is being used as the performance measure. He found that by attaching different weights to performance versus other effort measures the firm could eliminate tax and incentive trade-offs when using a single transfer price.

The organizational set-up of a TP system also contains a tension between centralization versus decentralization (Emmanuel & Mehafdi, 1994). Efficient operational structures can be used for tax saving purposes, while decentralization allows for more local adaption. A centralized company has the decision-making on a higher level compared to a decentralized company. There is a trade-off between leveraging synergies and the need for flexibility and local adaptation (Emmanuel & Mehafdi, 1994). Cools et al. (2008) observed that the goal of being tax compliant had a visible effect on all management control functions in their study on one sub-division. These effects restricted the entrepreneurial activities in the MNE and to mitigate the effect of standardization, the performance measurement system was adjusted to also include non-financial measures. Further, Plesner Rossing and Rohde (2010) studied overhead cost allocation in a MNE as another aspect of TP. The investigated MNE moved towards a more centralized structure where the allocation of overhead cost is carried out at the HQ. They also observed a rise in standardization and formalization of the overhead cost allocation process parallel to the more centralized process.

Busco et al. (2008) investigates when different actors on different hierarchical levels within one organization fight for different goals and tensions arise. He concludes that in centralized organizations, which have strong HQ-sub-unit relations, the HQ facilitates coordination and all communication and information flows are mainly transferred vertically. However, in decentralized organizations, authority and power are more distributed and information does not flow exclusively through the HQ. Busco et al. (2008) emphasize, that this relationship context does not only depend on the form of organization, it also affects the processes of convergence towards standardization of a set of global practices and the possibilities for local divergence and adaptation.

2.1.3 Isolating the HQ-Sub-unit relationship

The majority of studies have taken a company-wide perspective of TP (Boyns et al., 1999; Cravens, 1997; Eccles, 1985; Spicer, 1988), although TP decisions are assumed to have a greater impact on the sub-unit levels since they have a more operational role (Boyns et al., 1999). Previous research within management control tend to focus on the management control role of TP on profit centers, reflecting the lack of TP research and management control in other types of responsibility centers, such as the HQ or cost centers (Cools & Slagmulder, 2009). Therefore, we have chosen to cover the whole value chain by investigating the HQ and its sub-units such as factories and sales companies.

An MNE could be described as a geographically dispersed business with value-adding sub-units. Each unit can be viewed as a semi-autonomous entity with ownership ties, meaning they have certain obligations to the HQ (Birkinshaw et al., 2000). As sub-units are organized through interdependent exchange with the HQ, the relationship becomes a crucial one with corresponding issues such as control and cooperation (Ghoshal & Bartlett, 1988).

When the HQ and sub-units are not aligned in their motives, the relationship can be classified as a “mixed motive dyad” (Ghoshal & Nohria, 1989). Birkinshaw et al. (2000) conducted a multiple case study to investigate the relationship between sub-units and their HQ. They wanted to map the gap between the perceptions to enable an analysis of how these different perceptions affect the MCS. They define the perception gap as the extent to which sub-unit managers overestimate the strategic role of their sub-unit vis-à-vis HQ managers. Birkinshaw et al. (2000) identifies three situations of mixed motives in the relationship. The first is when the sub-unit desires local autonomy, and the HQ requires control. The second is when sub-unit managers engage in entrepreneurial behavior, and the HQ sees opportunism. The third is when the sub-unit is acting in the prime interest of the local division, and the HQ is more concerned about global or corporate profitability in the MNE. These elements exemplifies that there are different perceptions between the sub-units and the HQ, however there have been very little research covering this issue in a TP context. There seems to be an implicit assumption in previous research that HQ and sub-unit managers’ perceptions *should* converge to each other but the outstanding question is if that is the case (e.g. Birkinshaw, 1997; Ghoshal & Nohria, 1989).

On the contrary, Birkinshaw et al. (2000) argue that these mixed motives, or perception gaps exist between HQ and sub-units in all business areas. The reasons for the existence of the perception gaps are different experiences, reference points and world views. This, he argues, will most likely have an impact and consequence on the management of the HQ-sub-unit relationship. Thus, when the HQ and the sub-unit managers have different perceptions about the role of the sub-unit in the MNE, these gaps will create implications for the MCS. Different perceptions of the MCS will make the organization adapt in a certain way. We therefore extend Birkinshaw et al.’s (2000) reasoning to include the different perceptions of the TP impact on the MCS at the sub-unit and HQ level. Birkinshaw et al. (2000) conclude that the sub-units perception of their own role and the MCS will affect how the HQ behaves and how it controls the sub-unit. However, in this study we define the perception gap as the differing perceptions of the TP impact on the MCS in the HQ-sub-unit relationship.

Despite keeping one single set of transfer prices, the structural implications, and the tension of goal alignment and performance evaluation - the perception of these impacts on different hierarchical organizational levels have still not been sufficiently investigated. Since sub-units may have a more operational purpose and higher levels of the organization may have a more strategic role, we could expect these tensions to appear differently on different levels in the organization (Birkinshaw et al., 2000; Busco et al., 2008). The external environment has a great impact on the MNE's reaction, this in turn will affect how the firm both manages and perceives these tensions.

The contingency approach focuses on the environmental perspective and on TP as a managerial concern (Chenhall, 2003). The main assumption of contingency theory in accounting is that there is not one universally appropriate accounting system that can be applied to all organizations in all circumstances (Otley, 1980). The appropriateness of an accounting system depends more on the distinct situation of an organization and is measured by both external factors such as the environment and technology and internal factors, such as the organizational design (Otley, 1980). Management control is therefore a key activity for all organizations as it provides the focus for all those activities designed to help ensure that overall operating coherence is maintained and that the organization retains a capability to survive in its uncertain environment (Otley, 1980).

The contingency approach is relevant as MNEs are affected daily by different environmental factors while simultaneously striving to be both TP tax compliant and efficiency-seeking in its operations (Covaleski et al., 2003). Contingency theory in management control research has proven to produce generalizable findings and to provide helpful frameworks (Chenhall, 2003). Managers adapt their internal MCSs to fit the circumstances of the contingencies in the MNEs external environment (Chenhall, 2003; Plesner Rossing, 2013). Since the external environment is undergoing constant changes, contingency research will always be necessary to understand companies' adaptation to the external environment (Chenhall, 2003).

2.2 Deriving the theoretical framework

2.2.1 Mapping the transfer pricing process

Some studies have focused on classifying company structures into different categories (see e.g. Hedlund, 1986; Ghemawat, 2005), but there has been a lack of studies relating the company structure to the TP process. Eccles (1985) postulates that "strategy" and "administrative processes" are the two primary determinants of TP practices. According to Eccles (1985), both corporate strategy and sub-unit strategy affect the TP policy. Strategy determines what an organization does and administrative processes how it does it (Eccles, 1985). In order to analyze the impacts of the TP policy we will use Eccles (1985) to map the TP process and determine the organizational type. We aim to answer our first research question with the help of Eccles (1985) framework to guide and illustrate the TP process in ManuCo.

Eccles (1985) uses five questions to map and determine the TP process in order to facilitate a comprehensive view for later analysis. The first question regards how transfer prices are set, through the use of established corporate rules or procedures. The second question seeks to determine which

individuals are involved in the TP process, if it is for example different managers on different hierarchical levels. The third question aims at answering what information is used to determine the transfer price and can entail data on costs, or comparisons with internal and/or external transactions. The fourth questions establishes when transfer prices are set or if they change. Thus, the frequency of changing transfer prices and under what conditions the change is desirable. Lastly, the fifth question entails how conflict is managed by narrowing who is involved in conflict resolution and what tools are used to avoid conflict. These five questions are relevant to use for determining the TP process in an organization.

Moreover, Eccles (1985) provides a matrix for classifying the MNE according to its TP method, resulting in four different organizational types shown in figure 1 below. We choose to classify the investigated relationships in isolation into Eccles (1985) organizational types. We motivate our choice of dyad classification into an organizational type as the dyads can entail strokes of Birkinshaw et al.'s (2000) "mixed motives", i.e. parallel uses of cooperation and competition, which further emphasizes the need for management. Vertical integration refers to the activities that could be obtained externally, such as make-or-buy decisions, and creates interdependencies between functions. Diversification refers to the number of different businesses in which the MNE competes and how diversified these businesses are from each other.

Figure 1. *Matrix of Eccles (1985) four organizational types*

Degree of vertical integration	High	Cooperative (Full cost)	Collaborative (Market based less discount)
	Low	Collective (No transfer pricing)	Competitive (Market based)
		Low	High
		Degree of diversification	

The collective organization is typically a small firm with one or a few products. The term collective means that there is a lack of formal management and the strategy in this company is implicit in the vision of the owner/entrepreneur, and usually operates domestic with no engagement in TP.

The cooperative organization is often found in mature or capital-intensive industries. The term cooperative means that all managers cooperate to maximize total company performance. Sub-units are interdependent and top management exercise control through the organizational structure on the actions of lower level managers. Because of the high degree of interdependence, lower level managers are rewarded in terms of their contribution to the performance of the company as a whole, and usually apply a full cost-plus TP method.

The competitive organization is based on many different businesses that have little or no sharing of resources such as manufacturing facilities or TP forces. Examples include conglomerates or holding companies. The term competitive means that sub-units are profit centers and compete with each other for resources and capital on the basis of performance, which is comparable across all sub-units. The TP method is usually market based, since profit centers seek to maximize their own results.

The collaborative organization has a number of profit center interdependencies and a number of related businesses with functional interdependencies. It is a mix between cooperative and competitive organizations and these types are found in project-based industries such as aerospace and construction. The term collaborative means that sub-unit managers must both cooperate for the cooperate goals and compete for resources and results. The transfer price employed in this field is the resale price method or market based price less a discount.

2.2.2 Three types of management control functions

Within the management control literature, several studies focus on how managers while pursuing their personal goals, also can be motivated to contribute to the corporate organizational goals (Simons, 2000). TP should provide economic information that encourages goal congruence and at the same time have positive motivational effects for evaluating and measuring divisional managers' performance (Simons, 2000; Watson & Baumler, 1975). Chow et al. (1999) focus on the three control functions organizing, planning, evaluating, and rewarding, that they argue provide a relatively complete coverage when analyzing management control and performance management systems (Chow et al., 1999). We will use these three variables to analyze the MCS of the investigated company as they incorporate the major management control functions in an integrated manner.

Organizing controls entails “decentralization” and the “structuring of activities”. Decentralization refers to the amount of decision-making that is delegated to lower levels in a vertical hierarchy. Written policies, rules, standards, and manuals make up the structuring of activities and specifies how to and not to perform activities (Chow et al., 1999). The tension between centralization and decentralization is examined by Busco et al. (2008). Decentralized decision-making is beneficial as sub-units are closer to the local market while centralized instructions of how to perform activities can instruct and navigate subordinates in a formal manner, increasing the chance for internal consistency between the HQ and sub-units and aid in goal congruence (Mundy, 2010).

Planning controls entails “participative budgeting” and “stretched targets”. The former, refers to the extent to which subordinates can participate in the development of the budget and selection of the targets for which their superiors will hold them responsible for achieving. The latter, refers to the probability that the subordinate can attain to the budget and target plan (Chow et al., 1999). Also within this control function, the ability for subordinates to set their own budgets and targets can be motivated by better internal knowledge of what the unit is capable of producing or achieving. A lack of participation in a budget process combined with unrealistic targets can decrease the internal motivation and induce subordinates to engage in unethical practices in order to attain central agendas (Ezzamel et al., 2008).

Evaluating and rewarding controls focus on “participative performance evaluation” and refers to the amount of input subordinates have in the evaluation of their own performance and “performance contingent financial rewards” is the financial compensation received, determined through comparison of budgeted and actual performance (Chow et al., 1999).

Combining Eccles (1985) and Chow et al. (1999) we believe that we can strengthen our analysis of the perceived and managed impact of the TP policy in ManuCo.

2.2.3 The coercive and enabling use of management control

To be able to answer and analyze our second research question regarding the coercive and enabling uses of the MCS, we will use the concepts of Ahrens and Chapman (2004). In order to encourage goal congruence and at the same time retain control over the sub-units activity levels, another aspect of management control literature acknowledge that HQ’s can pursue a control strategy that is either enabling or controlling (Adler & Borys, 1996, Ahrens & Chapman, 2004; Merchant & Van der Stede, 2007; Mundy, 2010; Simons, 1995). Enabling uses seeks to put subordinates in positions where they deal inevitably with the contingencies in their daily work and encourage employees to search for new opportunities and potential improvements (Mundy, 2010). On the contrary, controlling or coercive uses of management control refers to the classical top-down approach that emphasizes centralization and pre-planning (Adler & Borys, 1996). The exertion of control force to ensure that organizational goals are achieved (Merchant & Van der Stede, 2007; Simons, 1995).

A potential mix of enabling and coercive uses are not feasible as the two aims for steering are in conflict with each other and could hence not be employed simultaneously (Mundy, 2010). Simons (1995) is one of the prominent researchers within the field of MCS arguing that contradictory uses of MCS give rise to tensions that need management attention in order to not create an imbalance between the enabling and coercive uses. However, Mundy (2010) challenges Simons (1995) by arguing that the tensions can be dynamic which can create a competitive advantage if balanced properly. On the other hand, enabling use is potentially harmful to organizations operating in stable environments as their control processes require stable and effective ways of operating (Mundy, 2010). However, an organization’s inability to balance different uses of the MCS is associated with slower decision-making, inefficient use of resources, instability, insecurity and eventually lower organizational performance (Mundy, 2010).

Mundy (2010) studies how organizations balance between enabling and controlling uses of MCS in order to simultaneously direct and empower employees. She finds four factors that impact an organization’s ability to impact different uses of MCS. One of the factors is internal consistency, which means that employees receive a clear and coherent message about the importance of particular organizational priorities. In our study, this would correspond to the TP policy. If internal consistency is lacking, there is a risk of misalignment and that the MCS is perceived differently, although an MCS should communicate the same message of what to prioritize (Mundy, 2010).

Another framework that analyses the more processual uses of MCSs is Ahrens and Chapman’s (2004) field study of a division in a restaurant management chain. Their findings illustrate how management can pursue their objectives of efficiency and flexibility by using enabling MCSs (Ahrens

& Chapman, 2004). They suggest four design principles of enabling use. These are repair, internal transparency, global transparency and flexibility.

Repair entails the breakdown of control processes and provides opportunities for fixing these processes. This mechanism requires however both internal transparency, which refers to the visibility of local processes, and global transparency, which refers to the visibility of how the local processes fit into the organization as a whole. Finally, flexibility is also a characteristic required for enabling formalization, and refers to the choice and use of control systems and to which extent they can turn them off. Through these design principles researchers can analyze the ways companies simultaneously employ efficiency and flexibility in their MCS (Ahrens & Chapman, 2004). By applying Ahrens and Chapman's (2004) principles of coercive and enabling controls we believe that we can deepen our analysis of the TP impact for the relationships in place and see how managers handle the balance between the two.

2.3 Mapping the research process within the theoretical framework

The previous literature review has shown gaps in the research on TP, management control and its appearance on different hierarchical levels. There are only a few contemporary published papers on TP that conduct in-depth case studies (e.g. Cools et al., 2008, Cools & Slagmulder, 2009; Plesner Rossing & Rohde, 2010; Plesner Rossing, 2013), however these do not include a comparison between HQ and sub-units when evaluating goal alignment with tax and managerial objectives. From the described theories we derive a framework for analyzing the effect the TP policy has on the three management control functions between different hierarchical levels, and how the balance between the coercive and enabling management control forces are managed. The analytical framework results in a stepwise process, consisting of four stages. First, we take a starting point in the framework of Eccles (1985) by identifying the TP process and classifying the HQ-sub-unit relationships with the help of Eccles' (1985) four different organizational types. Second, we map the MCS in place by using the framework of Chow et al.'s (1999) and structure the empirics accordingly. Third, we analyze the perceived impact of the TP on the MCS through Chow et al.'s (1999) framework. Finally, we investigate the dynamics between coercive and enabling control for the relationships in place and see how managers handle the balance between the two, by applying the concepts of Ahrens and Chapman (2004). Following these steps we believe that we can map the TP process and understand how the TP impact is perceived and managed on different hierarchical levels.

3 Methodology

In this section we will motivate and present the research method applied for conducting our research. The objective of this section is to enable a clearly defined procedure and traceability of the research process, which in turn is essential to ensure the validity of the research. Alternative approaches, potential drawbacks and practical implications will also be reflected upon where applicable.

3.1 A qualitative empirical method with an abductive scientific approach

To answer our overarching research question, of how transfer pricing (TP) impacts the major management control functions and if there is any difference in perceived impact between the HQ and its sub-units, we will conduct a qualitative, in-depth, single case study. Qualitative research allows researchers to experience and understand how meanings are shaped by interviewing or observing participants in a real life context, with the possibility to discover variables rather than to test those (Corbin & Strauss, 2008). It enables a deeper understanding of the problem complexity, fulfilling our aim of investigating and describing the parallel systems of TP and management control (Merriam, 1994). A quantitative research would have implied a collection of numerical data in order to answer our research question, while disregarding important details and nuances captured by a qualitative approach. The main drawback with qualitative research is its inability to generalize main findings, compared to a quantitative one (Eisenhardt, 1989).

In our qualitative investigation we used the abductive approach which is considered to be highly suitable for case studies, because it aims to provide understanding of the underlying patterns in a specific setting that targets a particular phenomenon (Alvesson & Skoldberg, 2008). As the study seeks to comprehend the relationship between HQ and sub-units MCS within a TP context, we find the abduction approach to be in line with our thesis objective. Induction begins with empirics and deduction derives from theory. Abduction starts off by processing empirical facts, as induction does, but does not neglect theoretical frameworks and is therefore also related to deduction (Alvesson & Skoldberg, 2008). Our study is based on the acquired empirical data, however we allow for theory and empirics to be developed and revised parallel to each other throughout the research process and we apply available theory to broaden and explain our perspective on the investigated phenomena (Alvesson & Skoldberg, 2008). The analysis of the empirical material will not only be adjusted and refined by implementing the abductive approach, but will moreover include and be combined with theory and previous research in order to provide a foundation for understanding the underlying patterns which will lead to answering our research questions.

3.2 Selecting a single, revelatory, and exploratory case study

Scapens (1990) argues that case studies are especially appropriate in areas where the theory is not well-developed. Some case studies have addressed the organizational effects of tax compliance in an MNE (Cools et al., 2008; Cools & Slagmulder, 2009; Plesner Rossing & Rohde, 2010). Within TP research there is a lack of empirical evidence taking recent developments within management

control into account. With the scarce amount of studies made that combines management control theory with TP, the empirical method chosen for this study is a qualitative single case study.

The suitability of a case study for our research derives from two parameters identified by Yin (2009): when the researcher has (1) little or no control over events; and (2) the focus is on a contemporary phenomenon within a real life context. In addition, the research questions investigated in this study are “how” questions. “How” or “why” research questions are most effectively answered through case-based research according to Yin (2009), as they can help in generating and modifying theory when existing theories are incomplete or only partially explain the studied phenomenon. Since our study focuses on the appearance of a MCS in a real life context, where we have no control over the events and elements in the studied setting, we have selected a case study design.

The nature of case studies can be explanatory, exploratory or descriptive. This study we define as exploratory, as we aim to describe the TP impact on the MCS in ManuCo and its appearance and perception on different hierarchical levels and form a foundation for further research. The type of questions being raised falls under process theory. Process theory focuses on *how* things happen, i.e. *how* a particular phenomenon occurs. The questions address: “the *meaning* of the events to people involved”, i.e. people at sub-units and HQ, “the influence of behavioral and social *context* on these events” and “the *processes* by which these events and their outcomes occurred”, i.e. the TP policy and methods (Maxwell, 2013). Maxwell (2013) further argues that, for studies based on process theory, a qualitative single case study approach is preferred.

Dubois and Gadde (2002) argue that researchers should go deeper into a single case instead of increasing the number of cases when the research problem concerns different variables in complex structures, which is why we have chosen to do a single case study rather than using multiple cases. Choosing a multiple case design would however increase the possibility of generalization, but the pressure of finding appropriate cases increases, as the cases must either represent contrasts or similarities (Yin, 2009).

The single revelatory case can confirm, challenge or extend theory (Yin, 2009). The revelatory case is a situation where researchers have the opportunity to observe and analyze a phenomenon. Our case represents the revelatory case, as our objective is to study to what extent the MCS is affected by TP on different hierarchical levels. The trade-off between gaining deep understanding of the studied phenomenon and the width in terms of broader conclusions is always a researcher’s dilemma. Preferably, one would like to have both the deep understanding of a particular social setting and the ability to generalize main findings. However, due to practical limitations within the scope of this thesis we choose to conduct a single case study in order to reach an in-depth elucidation of the studied phenomenon rather than being able to draw broader conclusions across industries or settings.

3.3 Selecting the case company, ManuCo

Since the TP function tends to be centralized in companies' HQ we decided to focus on a company with their global HQ in Sweden. The selection was made through theoretical sampling (Eisenhardt, 1989). We approached a Swedish MNE that was considered to be tax compliance oriented in their TP practices. The company was first contacted by telephone and asked to participate and then an email was sent with the outlines and goals of the study. After the initial telephone call, where the study was presented, a pilot interview was conducted, where the company declared its willingness to participate in the study and access was granted for further investigation. Hence, the case company was chosen due to its relevant nature as well as the opportunity for access (Yin, 2009). The choice of an MNE with HQ in Sweden would also enable us to conduct interviews in person rather than by telephone. At the company we focused on getting interviews with personnel directly involved in the case company's TP system. This function was mostly part of the global tax department but also controllers at the different sub-units. Further, we conducted interviews with management control functions, business controllers, financial functions, sales departments and production units located abroad.

3.3.1 Selecting the HQ-Sub-unit relationship

The relationship between the HQ and sub-units in ManuCo were chosen due to previous research having a company-wide view, disregarding that multiple relationships can exist within a company. When studying the TP impact on ManuCo's management control, we are of the opinion that it is necessary to investigate different hierarchical levels, as sub-units are legal entities but still part of a group control perspective. The appearance and management of potential tensions are therefore deemed to be most apparent within this relationship.

3.3.2 Focusing on the three management control functions

We have chosen to focus on the three major management control functions provided by Chow et al. (1999), as they are according to their argumentation the functions that provide a complete coverage when analyzing MCSs as well as performance systems. Organizing, planning, evaluating and rewarding controls will therefore be focused on in order to analyze the impact of TP and management control on the sub-unit and HQ level.

3.4 Data collection primary through semi-structured interviews

In this case study transfer prices and management control are dependent on the information provided by professionals who work within this area. In-depth interviews have therefore been the primary source of qualitative data in line with Merriam (1994), Rowley (2012) and Yin's (2009) recommendations for case studies. The interviews contained questions based on different perspectives of our research question and were performed with representatives from both the HQ and the sub-units. The sample objects for our interviews were chosen based on their positions within ManuCo. Our primary aim was to conduct personal interviews face to face, and where it proved unfeasible, we used alternative interview channels such as telephone and e-mail.

The employed interview technique was semi-structured. When the interviews are said to be semi-structured, it means that the questions are open-ended (Silverman, 2010; 2011). A semi-structured interview technique allows for discovery as its open-questions element allowed us to follow up the interesting side tracks which derived from interviewees' statements (Gillham, 2005). Semi-structured interviews are the most common interview method used in case study research and therefore this was used in our study to gain a deeper insight into the topic (Rowley, 2012). Following the recommendation by Eisenhardt (1989) and Rowley (2012), a well-defined focus and systematic approach for data collection is crucial for successful research. However, all pre-determined structures should be tentative to be able to adapt to the findings, which is fulfilled by a semi-structured interview approach.

All data was gathered in the period from September to December 2013. We have conducted 16 interviews in total, 10 face-to-face interviews and 6 telephone interviews. The number of relevant people in ManuCo that are affected by the TP policy is very limited, thus, these 16 interviews were able to provide us with both depth and objective views. A list of interviews can be found in Appendix A. Moreover, we used e-mail for posing follow-up questions. The interviews were conducted with both researchers present at the workplace of the interviewed for their convenience and for enabling us to absorb the setting. We asked all interviewees to forward us to the next person of interest (Merriam, 1994). Thereby, we obtained different perspectives in the interviews originating from being part of different levels in the organization, national cultures as well as employee positions, which enabled data triangulation (Yin, 2009). The interviews had an approximate duration of 1 hour. Follow-up interviews were conducted with a few selected respondents which lasted approximately 30 minutes. In the course of the interviews, the questions became more detailed and targeted to uncover the specificities of the TP policy and MCSs in ManuCo.

Secondary data has been collected from material provided by ManuCo, articles from online databases, literature from the Stockholm School of Economics Library and the Internet.

3.4.1 Interview design and process following Gillham's (2005) guidelines

Since the data regarding TP might be considered to be quite a sensitive subject for a company to talk about to an external party, an interview might be preferred over other data gathering tools, as the interviewees can retain control over the information they provide. The interview setting allows them to determine what they want to share with the researchers or not. In our study, a pragmatic approach was used, meaning that almost all interviews were conducted face-to-face. This approach can help to reduce potential reluctance from our interview persons with regards of talking about TP. Because certain questions were of sensitive nature and could be potentially wrongly interpreted we chose to receive spontaneous answers rather than well prepared in advance and therefore decided not to distribute interview questions in advance.

We have used Gillham's (2005) guidelines for the overall process of conducting interviews. In the first preparation phase we informed the interview object with the aim of our thesis and our objectives with the interview. We further explained that the purpose is not to evaluate whether the organization is TP tax compliant or not, rather how this context affects the internal MCS. The

second, initial contact phase involves starting the interview with small talk or social questions. We initiated our interviews by asking the interviewees to introduce themselves, their background and how long they have been working for ManuCo. In this phase we also asked for permission to record the interviews and offered interviewee anonymization so that they were able to talk freely and thereby we reduced the presence of politically guided answers (Alvesson, 2003). One of the risks with interviews is that the interviewee replies politically correct in accordance with his interests or fear of that certain facts may harm him or her or the organization (Alvesson, 2003). Afterwards we moved on to the orientation phase, where we started off by asking questions that pointed in the direction more relevant to our research question such as: *“Are you involved in the decision-making regarding TP? If so, do you have the ability to affect the outcome?”*. This phase somewhat overlapped with the next phase, the substantive phase, as the previously asked open questions led us to posing follow-up questions to certain statements that would eventually contribute to our main empirical focus for the analysis such as: *“In what area (organizing, planning, evaluating and rewarding) do you think that TP has a large impact or no impact?”*. Follow-up questions were an important tool which enabled us to reach depth in our study, by examining central themes or events, or asking for elaboration of core interviewee’s statements. We finished the interviews with Gillham’s (2005) closure phase where we made sure to summarize the main points of important discussions regarding the appearance and tension of TP and management control and to double-check any hesitations, both from our point of view and if the interview objects had any questions. By ending the interviews with asking questions of the character *“Do you think there is anything else we need to know or anything we have missed out?”* or *“Do you have any other comments you would like to add?”* we reassured that we did not miss out on any valuable material. An interview protocol is enclosed in Appendix B.

Often in case studies, the interviews are the researchers’ primary source of data. Interviewees’ statements are often accepted without criticism, as they are used as the only source of evidence (Alvesson & Sköldbberg, 2008). The use of a multi-method approach when collecting data would support the evidence of the interviews and allow the researchers to address a broader range of historical and behavioral issues (Yin, 2009). Thus, any findings or conclusions from the case study are more likely to be convincing and solid if based on multiple sources. Moreover, we acknowledge the fact that our study would have benefited from more interviewees. On the other hand, we felt a sense of saturation in the interview series when approached individuals first started to forward us to individuals we had already interviewed and second, declined participation due to them not being affected by TP in their positions *“I am clearly not the right person to talk to, or anyone else at Group Control for that matter”* (Group Control). Hence, although the sample of interview is less than recommended, we believe the key individuals have provided depth and objective views covering their current positions but also reflecting views encountered in their previous positions within the company. Some of the key individuals at ManuCo have also been used for follow-up interviews, as we would like to point out that the amount of key individuals that in fact are affected and concerned with TP are limited.

3.4.2 Telephone

Some of the interviews were conducted by telephone, partly because geographical distance hindered physical meetings, but also due to the interviewees preferred to engage in a telephone interview since they found it more convenient and compatible with their work schedules. The primary advantage of a telephone interview over other distance methods is that it allows for the interviewer to be reactive, as you are talking 'live' to the respondent (Gillham, 2005). During the telephone interview, we were also able to clarify misunderstandings and pick up cues from the tone of voice of the respondent. Moreover, we recorded and transcribed all telephone interviews. The disadvantage of this interview channel is the opposite of its main advantage. Even if the interview is live, we are still not able to see the other person. This leads to missing out on the visual cues of what the interviewee is saying (Gillham, 2005). If deemed necessary we also used telephone for further clarifications or follow-up questions.

3.4.3 E-mail

E-mail is a fast and flexible medium of communication and provides access to people that feel too busy to set time aside for an interview (Gillham, 2005). We have used e-mail to clarify minor factual details or for follow-up questions based on our previous proactive interviews. The advantage with this medium is that the response rate is fast; however the interview object is remote and has time to reflect on the potential appropriateness of answers. This could potentially endanger the trustworthiness of the answers to more sensitive questions posed.

3.5 Coding of gathered data and approach to analysis

The first step in the data analysis is organizing the data from the different sources. Coding is thus used in the analysis to categorize the data. This facilitates the comparison of the data and should be grounded in the data (Maxwell, 2013). When coding and analyzing data we followed the recommendations of Miles and Huberman (1998) and summarized our main impressions and insights after each conducted interview to identify patterns and differences to guide further data collection and to relate them to the allocated theory. Common themes that arose from the comparison of the interviews were used as bases for codes (Miles & Huberman, 1998). Different characteristics of the TP system and MCS were identified from the literature review and used as codes if appropriate in the context of the findings. We coded the data more formally with guidance from our theoretical framework; identifying the TP process, mapping the MCS, and analyzing the perceived impacts within the functions organizing, planning, evaluating and rewarding.

3.6 Reliability and validity signals the quality of the study

The quality of findings is evaluated through the reliability and validity of the study (e.g. Bryman & Bell, 2010; Merriam, 1994; Yin, 2009). External reliability refers to the extent to which a study can be replicated, i.e. high reliability would lead to the same identical results and conclusions being reached if a researcher followed the same procedures as described in the research on the same case. The goal hereby is to eliminate errors and biases as far as possible (Yin, 2009). Internal reliability refers to

whether the researchers agree on what they see and hear (Flick, 2009). In order to increase the internal reliability, we have used Gillham's (2005) interview design when performing our interviews and consider therefore our internal reliability to be high. By discussing and transcribing the interviews, we shared views and interpretations in order to minimize the internal bias and ensure mutual coherence of the interview material. Since this study's research process and methods used have been well documented, we believe that external reliability and transparency will provide future research replication. It is however impossible for case studies to achieve a complete reliability as the conditions for them constantly change (Fidel, 1984). Especially, semi-structured interviews with open-ended questions will be different as human behavior changes and the reliability can be lacking if the study is replicated at a later point in time (Merriam, 1994). Also, changing the interview persons may alter the answers given and also lead to subjective interpretation, which decreases the replication potential of the study (Alvesson, 2003; Fidel, 1984).

3.6.1 Internal validity

Internal validity refers to the interpretation of the study and correctness of the conclusions, i.e. whether there is a good match between researchers' observations and the theoretical ideas. To ensure the correct description of the problem, recordings of the interviews should be conducted if possible (Maxwell, 2013). In our study, all interviews have been recorded and transcribed in connection of each interview, thus enhancing the internal validity of the study. Moreover, to facilitate the inner validity of our research we interviewed people from different hierarchical levels in ManuCo, from production to sales, to enable data triangulation by asking them the same types of questions to confirm our results by repetition. If contradicting perspectives that could not be explained by Alvesson's (2003) social and cultural factors were identified, interviews were sent back to the interviewee for clarification.

3.6.2 External validity

External validity is the degree to which findings can be generalized across social settings (Merriam, 1994; Yin, 2009). The general problem with case studies is the external validity. Critics typically say that single case studies are insufficient for generalization (Maxwell, 2013; Otley & Berry, 1994). It is difficult to generalize findings of case studies for a greater population than the sample selected and in our single case study the findings apply for ManuCo, not necessarily for similar firms in the same or different industries. Thus, assumptions about TP systems and its impact on the internal management control should be done with care. A way of being able to generalize findings is to increase the sample size to include more companies and thus conduct a multi-case study (Silverman, 2010; 2011). We are fully aware and encourage future research to prove whether our study has external validity by examining whether our conclusions hold true for other MNEs. Hence, we state that our generalization of the main findings is low, as the research design of the study is not suitable for generalization across social settings.

However, as case studies are conducted to gain understanding of the already known, generalizability is not needed to the same extent as in quantitative studies with hypothesis testing (Merriam, 1994). Rather, case studies often aim at analytical generalization instead of statistical in trying to generalize and gain in-depth insights from a particular set of results applied to a broader theory (Yin, 2009).

Thereby, by letting our theoretical framework guide the analysis and interpretation of the empirical findings, it enables improvement in the external validity. Despite this, in single case studies there is always a risk that theories are developed that can only be used for the specific case investigated, and can thus not be used beyond the case itself (Eisenhardt, 1989; Merriam, 1994; Yin, 2009).

3.6.3 Some alternative views on the quality of the study

Corbin (2008) depreciates the use of the terms “validity” and “reliability” when discussing qualitative research, as she believes that the terms are more associated with quantitative research. Corbin (2008) suggests the use of the term “credibility” instead. Credibility should indicate that the findings are believable and trustworthy and that the explanations and findings put forward by the researchers are only one of many possible interpretations from data. An illustrative example can be the quality of answers to interview questions: they are most likely to vary on interviewee’s mood, personal and work situation, the time of the day, etc. Hence, the quality as well as the content of answers is impossible to replicate in detail. Therefore, researchers like Rubin and Rubin (1995) suggests that credibility of qualitative work should be judged through its transparency, consistency-coherence and communicability.

Transparency refers to the process of data collection. We consider our study to be transparent, as we have documented our methodological research approach, data collection process, transcribed our interviews and presented the empirics in detail. This should allow the reader to see the intellectual strengths and weaknesses, biases and conscientiousness of the researchers (Rubin & Rubin, 1995).

The goal with a qualitative research is not to eliminate any eventual inconsistencies, but rather to present contradictory responses and gain understanding on why they occurred and seek to provide explanation of why the inconsistencies occurred. The credibility of the report increases when one can provide elaboration on the inconsistencies (Rubin & Rubin, 1995). We have received contradictory answers from several respondents, and chose to return to our collected empirical material and theory in order to provide clarification for the discrepancies in the analysis.

If a report communicates well, people reading the report should feel comfortable in the research setting the researches are describing. By providing richness of details, we help the readers gain confidence about our text, and make them feel as if they were present in the research arena (Rubin & Rubin, 1995). We hope that the readers of our report will find it comprehensive and well communicated, as we have tried to be as vivid in our descriptions as possible. We motivate our choice of including quotations in our research as providing the reader with the feeling of the setting and the emotions involved in the perception of TP impacts on the internal MCS at different hierarchical levels.

4 Empirical findings from the case

In this section we first provide an overview of ManuCo and its tax regulatory environment. Second, the transfer pricing (TP) process is described through the use of Eccles (1985) guiding questions. Then, the two vertical relationships between the HQ-Factory and the HQ-Sales Company (SC) are presented. Lastly, we have organized the empirics for each level in the organizational hierarchy covering Chow's (1999) management control functions for the description of the perceived impact of TP.

4.1 Introducing ManuCo and the tax regulatory environment

ManuCo is a listed decentralized manufacturing firm with operations worldwide. ManuCo is headquartered in Stockholm, Sweden, and has a yearly turnover of 110 billion SEK, 61 000 employees worldwide and is listed on the NASDAQ OMX Nordic Stock Exchange (Annual Report ManuCo, 2012). Despite their global presence, we have narrowed our selection for investigating ManuCo to only focus on the European sub-units and the HQ in Stockholm.

ManuCo is organized into sectors, representing their major and supplying product lines on different geographical markets. These sectors are operating globally, i.e. cross-nations. Tax Manager 1 described the Tax department's role as a mechanism to eliminate the borders between the countries. The major product category in Europe, the A-sector, has a turnover of 35 million SEK, 14 factories and employs 25 000 people (VP Controller A). The smaller product category, the B-sector, has a yearly turnover of almost 4 million representing roughly 10 % of the total group, four factories and employs around 3 000 people (VP Controller B).

ManuCo uses tax compliant transfer prices for their organization which encompasses the entire value chain from manufacturing to sales. This means that ManuCo has organized their operations around a tax paying structure, and not in a tax avoidance structure. We take the issue of tax compliance as a given variable, meaning that our aim and focus is not to investigate whether ManuCo is tax compliant or not. Having the European market as a geographical limitation, we have investigated the A-sector and the B-sector as they have the strongest market share and presence. Since ManuCo is a manufacturing company encompassing the entire value chain representatives from factories, intermediate levels, the HQ and sales companies (SCs) have been interviewed.

To understand the process, policy and principles of TP we need to understand the tax regulatory environment to which the MNE needs to comply. International regulation of TP is provided by the Organisation for Economic Co-operation and Development (OECD) and based on the TP Guidelines (OECD, 2010). It is intended to provide guidance on the application of the arm's length principle. The arm's length principle is the transfer price between a company and its foreign divisions and requires that transactions should be valued as if they had been carried out between unrelated third parties, each party acting in his own best interest in a comparable transaction (OECD, 2010). The OECD guidelines prescribe five different methods which fulfill the arm's length principle. Within all methods, comparability with a market transaction should be achieved to ensure the validity of the chosen transfer price. The tax authorities then take a "separate entity approach" to

investigate multinationals adherence to the arm's length principle (Cools & Slagmulder, 2009). The penalties for not being able to demonstrate that intercompany prices are in line with an unrelated transaction can result in double taxation and in potential reputational consequences. The risk of financial damage if found non-tax compliant, motivate MNE's to give high priority to TP tax compliance (Cools & Slagmulder, 2009).

4.2 The transfer pricing policy and process

To be able to analyze decision-making and structure in ManuCo we will map the TP process following five guiding questions provided by Eccles (1985).

ManuCo has a centralized tax department at the HQ that is responsible for all tax related questions as well as any TP issues. The Tax department is the body that decides the TP principles and policies used for all the flows in the organization. The general guidelines are that the cost-plus method is used for transfers of products from the factories to the HQ, which is the actual cost plus a fixed mark-up. The resale price minus method is used for transfers of products between the HQ and the SCs, which is the resale price to an independent party reduced by an appropriate gross margin. These TP principles are the same regardless of which sector the products belong too (Tax Manager 1 & 2). However, the margins are set with the help of external benchmarking and on internal functional analysis². "We decide on the cost-plus margin of 2.5 % and the resale price minus margin of 1 %. These numbers refer to both our internal calculations and on benchmarked numbers for industry peers. Basically, the Tax department decides, other managers are not involved in the TP revision discussion. However, it is our job to make sure that they follow the [transfer] prices and reach the margins" (Tax Manager 2).

Further, Tax Manager 1 emphasized the fact that not everyone is acquainted with transfer prices: "Generally, you should not expect that everyone knows what TP is about. People get it, but they do not care about it since it is not their area of practice. Not even the management cares, it is basically only we [Tax department] and Audit who care about the correctness of the transfer prices". In sum, the workgroup of individuals who are involved in the TP policy process and review are allocated to the HQ and consist of members at the Tax and Audit department. However, there is some involvement from the regional controllers since the transfer prices must be adapted to local regulations, but not from any other lower levels in the organization.

Tax Manager 2 described the formal TP document in place which postulates how the TP policy and process works. The consequence of following pre-set practices for setting TP is that cost allocation and budgeting process becomes easier, and "implicitly it means that the end-result is predetermined" (Tax Manager 2). Therefore, for all manufacturing activities a transfer price based on budgeted cost-plus and the same fixed margin is applied. The SCs pay the HQ a resale price minus a fixed, predetermined profit margin (Tax Manager 1 & 2, VP Controller A & B, Factory Controller B, Regional Controller 1B). Further, Tax Manager 1 exemplified the importance of a correct cost calculation:

² A functional analysis is conducted to validate and check the appropriateness of the chosen TP method.

“We collect information on cost and external comparables, benchmarks. Benchmarks, of course we use them; but if you have seen one you have seen them all. Some tax authorities have realized that it is not so relevant to chase after small percentages. In the end it is all about: if you have a cost base of 100, then it does not matter if you add a mark-up of 2.5 % or 3 %. Then it is more relevant to look at the 100. Is it correctly calculated? Here you have to be cautious when calculating the cost base. If you make a mistake it will be visible in your transfer prices”.

The transfer prices are based on budgeted costs and budgeted sales for management control reasons and adjusted at year-end to match the actual costs and sales. The SCs in both sectors in ManuCo use frozen transfer prices, i.e. the budget sets the transfer prices in the beginning of the year and at year-end they do a transfer price adjustment. This implies that the HQ either sends a credit note or an invoice depending on whether the transfer price has been too high or too low during the year. Moreover, the SCs do not adjust the transfer prices during the year due to both administrative and comparative reasons (VP Controller B). Another reason was to keep it simple and provide clarity both for internal management and tax compliance purposes. “If you change your transfer prices every quarter you lose track. Because it means that you have new assumptions of your transfer prices every quarter” (VP Controller B). However, this was not the case for the factories in the A-sector where they change the transfer prices to meet the EBIT target every quarter (Factory Controller A).

Furthermore, the biggest challenge that the Regional Controller 1B experiences is to coordinate the complex organization and the different products. No transfer of a product can be made without the transfer price being registered in the enterprise resource planning (ERP) system by the HQ. If a transfer price is missing, it will cause lag in the operations, and conflict and frustration may arise at the sub-unit. This issue was described by Regional Controller 1B:

“We are not the ones who are calculating the transfer prices and we are not the ones who are putting it into the [ERP] system. Now we are facing thousands of issues on a daily basis that one product is missing and as long as it is not set up in the system we are able to make any transfer of this product. We are not able to sell any products. Then, each day at least 20 emails are going to the HQ saying “please enter the transfer price in the system for that and that country, for that and that product”. This is also a kind of waste of time. But as long as it is not in the system you are not able to do any stock movements, so it is necessary”.

The TP process and policy in ManuCo can be summarized as follows, following Eccles (1985) guiding questions for determining the TP process:

1. How are transfer prices set?

For all manufacturing activities a transfer price is based on budgeted cost-plus and the same fixed margin is applied of +2.5 %, while the SCs pays the HQ a resale price minus a fixed, predetermined, profit margin of 1 %.

2. Which individuals are involved?

The workgroup of individuals who are involved in the TP review are allocated to the HQ and consist of members at the Tax and Audit department. However, there is some involvement from the regional controllers since the transfer prices must be adapted to the local regulations and guidelines.

3. What information is used to determine the transfer prices?

Through the use of information on cost, established corporate rules and formal documents that give guidance on how the transfer prices are to be calculated and set. Existing TP practice is based on the physical flow of products and services and the internally calculated transfer price is validated against external benchmarks.

4. When are transfer prices set or do they ever change?

In ManuCo transfer prices are calculated once a year. Prices are set on January 1st and kept frozen until year-end. For the following year, they are re-calculated and if necessary changed or they remain unchanged. Transfer prices are not recalculated during the year or adjusted due to administrative, comparative, transparency and tax compliance reasons. However, there is one exception which is the transfer price for the factories in the A-sector.

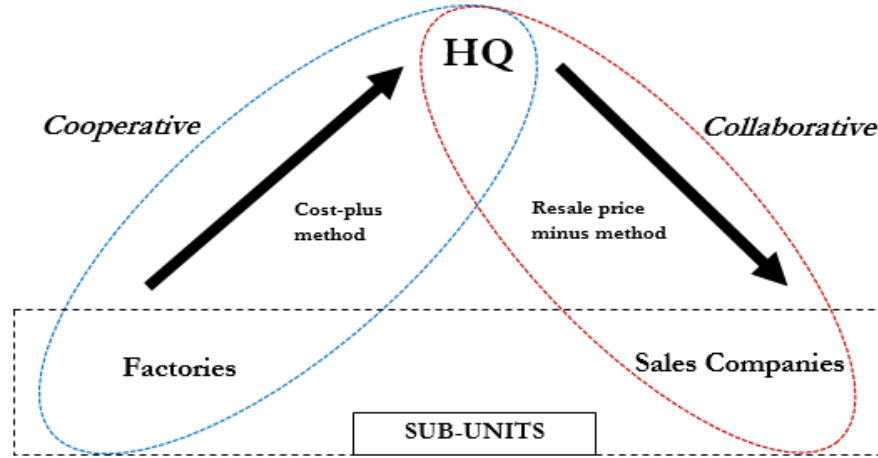
5. How is conflict managed?

The TP policy and principles are determined centrally and managed by the tax department and no operational managers are involved in setting the transfer price, the conflict is then managed through the centralization of the TP decision. If a conflict arises due to different perceptions about how the transfer price should be set a dialogue is held, however, the Tax department will have the final say. The consequences for not having a system in place to handle conflict results in a negative effect on operations due to missing transfer prices in the reporting system.

4.3 Organizational types and relationships

The HQ has the coordinating and overarching responsibility for all the sub-units operations. From a TP perspective, all transfers from factories to SCs must pass through the HQ. The factories both have an A to Z production but also an assembly function. If it is an assembly factory, parts are sourced from different original equipment manufacturers (OEM) (Tax Manager 1). The SCs are represented in almost every European country. In markets where ManuCo does not have their own sales organization they use agents for their products (Regional Controller 2B). In a simplified view, the transfer price between the factory and the HQ can be viewed as one relationship in a TP context, whilst the HQ in turn have another transfer price exchange with the SCs. To be able to analyze why there may be a difference in the relationship between the HQ-Factories and the HQ-SCs we need to classify the relationship with regards to the TP method used in accordance with Eccles (1985). Below is a simplified illustration of the relationships between the HQ and the sub-units:

Figure 2. *Illustration of TP methods in the headquarter-sub-unit relationships*



4.3.1.1 *The HQ-Factories – A cooperative organizational type*

The relationship between the HQ and the factories with regards to the TP method used results in a cooperative organizational type according to Eccles (1985). The factories apply a cost-plus TP method and the HQ exercise control over the sub-units by integrating the results and rewarding the factory management for contribution to corporate goals. With top-down formal action instructions, budgets and targets, the HQ can exercise effective control over lower level managers. In line with Ezzamel (1995), the routine based cost-plus TP method helps integrating the sub-unit to the required level, as the factories rely on standard operating rules and procedures.

4.3.1.2 *The HQ-Sales Companies – A collaborative organizational type*

Based on the TP method “resale price minus” between the HQ and the SCs, the relationship is classified as a collaborative organizational type according to Eccles (1985). The reason for this relationship fitting to this description is not only contingent on the choice of TP method, but also on the characteristics in the relationship. With a high degree of both diversification and integration, SCs must both cooperate for reaching corporate goals and simultaneously compete for results and resources from the HQ.

4.4 The Headquarters

4.4.1 Organizing

Previously, ManuCo used a profit-split method for their transfer prices, 80 % to the factories and 20 % to the SCs. However, the problem was that ManuCo never had an 80/20 split (VP Controller B). Therefore, a revision of the TP policies was made to better match ManuCo’s operations. A centralization was made with an installment of a global tax department, as well as a change in TP methods to cost-plus and resale minus. The uniform cost-plus policy governed the transfers from the factories and the SCs using an identical profit percentage. VP Controller B described this restructuring as something that not only the strategy benefited from, but also the tax compliance objective within the group. According to the HQ, the overall simplification integrated the large and divisionalized manufacturing company and made the TP policies more transparent and easier to

understand internally. Therefore, compared to before, the current TP policy has led to an increased centralization by installing a tax department and a top-down approach for TP management. This has resulted in a better alignment of ManuCo's operations and TP policy (VP Controller B). With regards to the structuring of activities, the interviewees did not express any difficulties in following the routines, rules and procedures for implementing or using transfer prices.

4.4.2 Planning

The transfer price is calculated on the basis of budgeted costs and sales. Annual top-line budgets are set in December for the coming year and rolling forecasts of the sales are then made every quarter, however, the transfer price is not revised. The budget allows the HQ to apply the same targets to similar factories and SCs. Both regional targets as well as sector targets are used. We observe that lower level managers in sub-units are restricted from participating in the budgeting process and setting targets. The VP Controller B described the budgeting process as centrally managed: "We have moved to a more centrally controlled budget process. It is top-down, but also a bottom-up. Or at least there is a discussion. [...] This usually results in a perception gap that we are open with, as it is hard to reach the targets".

4.4.3 Evaluating & Rewarding

ManuCo evaluates the performance of individual managers and legal entities in relation to predetermined targets, which are set in the budget. In addition, there are also sector, regional and global targets that the sub-units need to reach. "We do not evaluate our entities based on their local results. For TP reasons, we take an integrated view. However, it is a daily challenge to keep consistency between targets, both local and integrated" (VP Controller A). VP Controller B also had a similar view: "It's a bit strange how we evaluate, because all our reporting is based on transfer prices but our evaluation is based on the integrated results." Several of the interviewees expressed that it was tiresome to look at two results all the time, both local EBIT and integrated EBIT (VP Controller B, Regional Controller 2B). Tax Manager 1 emphasized that the sub-units are evaluated on integrated EBIT. Further, EBIT was viewed as the single most important bonus target. Interviewees also stressed that financial reward measures received the primary focus and was the primary source of rewards.

Table 1. *Summary of TP impacts on the MCS with regards to the HQ*

Organizing
• Increased centralization through installment of Global Tax Department • Uniform TP methods: Cost-plus 2.5% and Resale Price Minus 1%
Planning
• HQ sets annual budgets and targets • Top-line annual targets for regions and sectors set by the HQ
Evaluating & Rewarding
• Evaluation and rewards on integrated results for the sectors and regions • No evaluation on local results • Financial reward measures primary source of rewards

4.5 The Factories

4.5.1 Organizing

In the factories of ManuCo, the controller is the one entrusted with establishing all the different control functions that need to be in place as described by Factory Controller B: “I built up all these different systems, all the calculation methods, how we follow up cost, manufacturing variances etc., but also all the things like integrating the factory in the TP flow”.

In the past, there were quarterly transfer price adjustments to absorb or to adjust for the variances the factories had. The TP margins were cost +2.5 % for deliveries in Europe and a cost +5 % for deliveries outside Europe. During this time there was a lot of discussion going on between the tax people and the sub-unit controllers on how to unify the system. At the factories, the different documentations used in determining the transfer price, the cost data, the volume data, have all been locally developed but approved by the HQ.

“We had 2.5 % for Europe in the past and 5 % for the others [outside Europe]. So I tried to get that aligned. Right now we only have 2.5 %, I do not really decide about the margin, this was just a push on how to get it more aligned. This is a little bit of a struggle, how you can do your management reporting with transfer prices and how you properly can do a follow-up on your performance of the different regions and that is why it makes it easier if you know what percentage is being used for all the flows, it makes it really easy to understand where you are” (Factory Controller B).

The TP principles at ManuCo are set in not a too difficult way. The mark-ups are the same for all products. Further, it was emphasized that the cost-plus 2.5 % was very useful, the Factory Controller B contrasted this to having different mark-ups on different products: “I mean if we had 10 different mark-ups on 10 different product groups, then it would be very difficult. But if it is easily organized when it is a percentage on all the flows or something and then there is not a problem to eliminate this effect”.

In the beginning a big problem area in the TP process was that rules and procedures were not properly set. The organization within ManuCo’s sectors and the TP policy was going against the management reporting, in the way that factories and HQ looked at the statutory numbers and interpreted them differently. Factory Controller B exemplified this:

“What I want to say is that the bottom-line is that the TP and the management follow-up were actually going against each other. So we had to break it up a little bit to make it more transparent. I work in operations and have my own targets and then we have the tax people and they have of course other targets, they do not care so much about the management reporting. For me TP is more...we have to do it, but it is a little bit disturbing to do it”.

In the business reviews nobody really wants to see the transfer prices, so it is necessary for the factories to find a way to separate and eliminate this effect completely. A good organizational

structure and clear rules and procedures were deemed important by factory management in order to satisfy individual, unit and corporate goals.

4.5.2 Planning

Budgets are set using a top-down approach for the factories, and the 2.5 % cost-plus mark-up is identified in the beginning of the year by the Tax department, which is based on the standard product cost (STC) in accordance with the budget. However, it was emphasized that there will always be deviations from the budget. “But then, in reality there exists deviations from that, and what we need to make sure, or what the tax people want to make sure, is that at the end of the year we have exactly 2.5 %” (Factory Controller A).

Furthermore, one of the factory controllers from the B-sector mentioned that the quarterly adjustments of transfer prices have been cumbersome due to seasonality in the factories. The change from quarterly adjusted transfer prices to frozen, with adjustments at year-end, was therefore made this year in the B-sector. The same controller also highlighted the administrative process involved and how the frozen transfer price have contributed to less discussion between the HQ and the different factories. Thus, the planning process for TP has been simplified through the change to “frozen” transfer prices, in the B-sector, leading to less administration.

“We have also seen that, for example after the first quarter our forecast shows that we have had too many positive variances, so we had to take down the profit, by reducing the prices. And then three months later we did the next rolling forecast and calculation, then we saw that our profit was too low due to currency or volume changes or whatever. Then, we had to increase the price again...So we had to do a lot of adjustments and they were not necessarily in the same direction. We found out that we can actually avoid it if we do adjustments a little bit less, and the other thing you can do is of course to have a right cost calculation from the beginning. If you are more precise on that side as well then you can avoid a lot of variances afterwards” (Factory Controller B).

However, in the A-sector they are still using the quarterly adjustments of the transfer prices. When talking to Factory Controller A, he emphasized the issue of them having different ERP systems. In an MNE pursuing an acquisition strategy for growth, it is not unusual with 50 different ERP systems operating simultaneously. When sub-units and HQ do not even have the same reporting system, there is always an overhanging risk of important financials getting lost in the transfers between the systems. Further, he did not see the quarterly adjustments as problematic: “I came here to implement a common ERP system in the factories, however when we received the invoice from them [the ERP providers] we had to cancel the project of rolling it out in the whole organization indefinitely. But I have it already up and running, so a transfer price adjustment is something that only takes 20 minutes to do”. Nevertheless, the A-sector also uses a single mark-up for all products from the factories, no matter what market the products are shipped to.

The bill of materials is the cost base which is used for the transfer price. It consist of six items, direct material, direct labor, fixed overheads, variable overheads, tooling and research and development. All

of these items are assigned a cost target and clear instructions on how they should be allocated and calculated. Together they build up the so called STC which is the real standard product cost. This number is then used as the standard product cost for the next years forecast and is kept unchanged. Factory Controller B exemplified this: “We use a frozen STC for every single product where we add 2.5 % on top – this is then our fixed transfer price throughout the whole next year to the different sales divisions, or in this case from the factories in Europe to the HQ” (Factory Controller B).

The budget is a top-down budget with targets on the bill of materials that the factories are expected to deliver. The perception gap between what is a stretched target or not can be brought to discussion, but no “penalties” are received for not reaching a target, other than that the personal financial reward might be lower.

4.5.3 Evaluating & Rewarding

There are very clear instructions with targets related to the product cost in all the six different items. If the factory manager believes that there will be some issues in reaching those targets there is an opportunity for discussion, however if the HQ does not believe there is something reasonable behind the adjustments, the instruction and targets stands. One of the factory controllers described his view on the stretched cost targets in the budget: “We have removed a lot of the “safe-margins” to be much more precise in what we have, and this will also lead to less variances” (Factory Controller B). However, other interviewees stressed that targets felt stretched, but the ability to adjust them was very little leading to a consensus of acceptance. Further, interviewees acknowledged that not every single target was achieved. Moreover, Factory Controller B described the importance of having the right cost calculation:

“Probably they do not achieve every single target, but in the end, if you look at the whole picture together it looks okay. We want to avoid transfer price adjustments and we want to avoid to suddenly positive or negative variances. We want to have a reliable delivery of the numbers from here. Because this is expected as well from our side and from the sector and from the management, that we have precise numbers. So it is only in our interest to have the right numbers”.

Therefore, there is a standard procedure on how the six items on the bill of materials should be achieved or targeted within, in order to minimize the transfer price adjustment at the end of the year as much as possible. Despite the general feeling of stretched targets and lack of participation in setting them, the targets were accepted without any further discussion from the factory side.

Within the B-sector on the factory side, a slightly different financial rewarding system was set up. On the controller level, as well as on the factory management level a common system was set up, with the same targets for everyone. The Factory Controller B described this overlapping accountability: “So the factory guy has not only his target in his factory, but there is also an overall target. And what we want to achieve is the best overall profit”. Moving one level down in the factory, the key performance indicators (KPIs) change focus. In the production which is much more efficiency related, there is a translation of the targets to more operational targets, such as efficiency, scrap rate, quality achievement, warranty claims to name a few. Interviewees believed that there are

different things to incentivize in order to reach the overall corporate targets. The KPIs on the floor level are set by the factory management and financial rewards are allocated depending on level of achievement, without any effect of transfer prices. Further, it was emphasized that KPIs can differ between plants depending on what type of production that factory is engaged in, if its assembly, production of add-on supplies, or an OEM plant.

The way the transfer prices have been eliminated at the factory level when evaluating and rewarding have been by never looking at the local results, but rather at the STC, and that is where the follow-up is made. The transfer price is then just a percentage on top of the STC, but the transfer price percentage is ignored as it is deemed insignificant. Moreover, in the management reporting system ManuCo have found a way to completely eliminate the TP effect, as described by one of the factory controllers:

“For example, Factory X is delivering to all the four different markets in our sector, and we do not want to penalize our internal products against the external products, so all the profit we do in Factory X related to Europe are reported in a special way in the system, so this profit is shown in the European P/L. We eliminate the transfer price because, transfer prices are required from a legal and from a tax point of view, but for us who wants to follow-up the business we do not need it. We do that for all the different factories, we eliminate roughly 80-90 MSEK like this in transfer prices every year. What we really look at is the STC”.

The evaluation is thus made on the integrated result and for the factories the cost base is the standard cost. Thus, the transfer prices are not affecting the evaluation metrics in the factory.

All of the legal entities have an interest of driving integrated EBIT, as that is the metric the units are evaluated on affecting their financial reward. However, for the B-sector, they can only observe the integrated result at the end of each month. This is in contrast to the A-sector where they only look at the integrated result on a daily basis. The Tax department decides the transfer prices for all products in all sectors and the controllers' daily task is to make sure that the transfer prices are followed. Any deviation from the cost-plus 2.5 % is adjusted for at year-end for the B-sector and at each quarter for the A-sector.

By using integrated EBIT as an evaluation metric, the HQ are of the opinion that the taxes and any effect of TP is eliminated from the way the sub-units are evaluated and rewarded for their performance. In addition, by disregarding the local statutory results and instead focusing on integrating the result for the sector, the divisional goals are aligned with the corporate goals. This goal alignment was described by Tax Manager 1: “It is good if your factory is cost efficient and we trust the factories that they are self-sufficient and follow our budgets, guidelines and targets. Everyone is aware of what to do, so we do not view transfer prices as an issue affecting their operations [...] We have a continuous exchange of information with the factories”.

Furthermore, to incentivize a factory, by definition you have two ways. This was described by Factory Controller A:

“Either you say: Hey guys, you should have a zero-profit and the only profit that we see in the statutory income statement is the mark-up related to what you sell. The other way is by making sure that they have control on their cost variances in the bill of materials [...] in the factory it is essential for the cost targets to be reached as 60 % of the price on the product to the final customer is made up of production costs. With increasing competition, it is therefore crucial to work with your bill of materials to ensure future survival of the entity, and the company as a whole”.

Table 2. *Summary of TP impacts on the MCS with regards to the Factories*

Organizing
• Centralized decision making • Centrally pre-set TP method and margin (cost-plus 2.5%)
Planning
• HQ sets annual budget and targets • Transfer prices adjusted quarterly in A, frozen in B
Evaluating & Rewarding
• Evaluation on integrated results for the sector and region • Financial rewards on six items in Bill of Materials • Non-financial local measures for efficiency, quality and warranty claims

4.6 Perception of transfer pricing in the Factories

Even though the flows and percentages are uniform, some interviewees on the factory side had different perceptions and view on their interaction with transfer prices in their daily work. This was explained by both the Factory Controller and the Factory Manager in the B-sector:

“I actually have a lot of contact with tax, there is not a week that goes by where I do not think of tax or some transfer price somewhere...but for us in operations it is more a hustle than a benefit...But we get along” (Factory Controller B).

“I just make sure that my local result is what is expected, 2.5 % in this case. A result worse than that will lead to an increase of the transfer price and vice versa, in other words a move of results in and out the HQ” (Factory Manager B).

The HQ is not trying to emphasize the importance of transfer prices in the organization in an active way, however they would like everyone to be aware of what transfer prices are and what is expected from them with regards to transfer prices. With the prevailing different perceptions of what is important and not, interviewees on the factory side experienced that the Tax department’s focus is more in the theoretical details instead of focusing on the real magnitude and effect of money the transfer price corresponds to.

“In some cases I just think that no tax auditor will even look at this, so why do we even bother, so let’s just keep it simple and nobody will ever look at it. And

sometimes they are too much into details and wanting every single detail perfect. It takes a lot of time if you want to be perfect” (Factory Controller B).

4.7 The Sales Companies

4.7.1 Organizing

The HQ in Stockholm is the organ providing the formal guidelines for the TP process. The Regional Controller 1B for the SCs viewed these formal guidelines as subject for adaptation: “What HQ says and what the local regulation says might be completely different. We are trying to adapt as much as we can here”. If something is not adaptable from the guidelines to the local tax regulations, then they need to go back to HQ and try to find a solution of how to adapt or find some other mutual solution that satisfies both the HQ and the local authorities. In a case like the example below illustrates, the process of changing the transfer price is initiated from the sub-unit level. The Regional controller exemplified this process of change:

“For example, we had an issue in one of the sub-units with TP three years ago, where we were doing continuously negative EBIT. When the company was doing continuously negative EBIT in that country we were really getting close to getting a huge fine from the local government. Because the transfer price for the local P/L is just something that the HQ is providing, that is what we are earning locally. Too much profit was kept in the HQ from Country X due to the TP policy. Therefore we were really in danger to getting a huge fine, so we had to adjust our transfer prices”.

The SCs have a greater responsibility and ability to affect the pre-set transfer prices, after management approval. The same Regional Controller further elaborated on how they can influence the transfer prices: “We do not have a formal form of how to adjust it [the transfer price] but we do have a formal document stating that: yes that is how a TP is calculated for each of our countries, but then some issues like the one I described are popping up, then of course we can adjust it. We need some management approval of it, not only from the B-sector, but also the A-sector has to sign it. Since it is affecting both sectors, but as soon as it is signed by both sectors then we can make adjustments on the transfer prices”.

In all the European countries there are different local rules and legal requirements. For example, in Country Y you as a company are able to do losses for a couple of years and then you need to make at least one or two years of profit in order to avoid big fines. On the other hand, in Country Z for example, the situation is different. There you will have to pay taxes even if your company is making losses, which is normally not the case. For this reason the Regional Controller also argued that ManuCo needs to focus on optimizing its local EBIT-margins, because at the end of the day they are paying taxes on the local EBIT, which is based on the transfer prices. It is visible that the SCs had a more delegated responsibility and dual communication regarding the adaptation of the TP guidelines to the local markets in comparison to the factories. Even though the guidelines are formal, it seemed to be an informal understanding that the guidelines were “just guidelines” and did not signal strict adherence. Rather, the impression was that they functioned as a very basic recommendation.

4.7.2 Planning

There is a top-line budget of what all markets and individual entities need to reach. This year however, ManuCo introduced regional targets, instead of having individual targets for each of their countries. It is from the budgeted net sales that the transfer prices are derived. One of the Regional Controllers described the budgeting process: “The top-line budget is coming from Stockholm, of course. We do have some small chance to influence it, but I would say that it is really low. So what Stockholm is sending out is the top-line budget, which is usually what we need to deliver by the end of the day. The targets are very hard to reach”.

The problem within the SCs is that the HQ expectations are usually much more above the local sales units’ expectations. The HQ does not consider that the ability to reach a pre-set budget target might have been due to a one time deal, which will perhaps not happen the following year. Without considering extra ordinary events, targets are set on a historical basis dating two years back. If the SC is lucky, they receive the same target as the previous year, but usually the target increases each year. Without the in-depth knowledge of how a target has been reached, a historical target for the next year is set that the SC perceives as very stretched. The possibilities to affect the reliability of the targets, was expressed by interviewees as very low. Further, the Regional Controller 1B emphasized that they are always trying to bring in their opinions to the table in the budgeting process: “We try to communicate, or we never give up, we try to give our comments of course, and also presenting proofs for our opinion, but usually the HQ says that “this is it” and then we need to find a way to work it out. And we will see if we are going to reach the targets this year or not”.

4.7.3 Evaluating & Rewarding

The targets set by the HQ are evaluated on a common corporate practice with regards to follow-up and frequency in order to make it simple and comparative for the different sub-units. The common targets that constitute the basis for the yearly bonus payment are sales, EBIT, net operating working capital (NOWC) and cash-flow. One of the Regional Controllers highlighted that there are also non-financial metrics in the SCs that they look at: “These variables are not directed by HQ, it is for us to motivate and incentivize them [the sales force]”. Every quarter, the sales units have established local sales targets for the sales people. These local and non-financial targets are initiated by the SCs for local motivation and are not set by the HQ. However, the financial targets and their KPI’s are determined by HQ.

Interestingly, the common targets for the SCs are affected by transfer prices and they also have implications for the financial reward system. Two impacts were identified by the interviewees, the NOWC and the integrated results. The inventory is included in the NOWC and calculated on the transfer price. If the transfer price is high, the inventory value is high. This gives a negative impact as a high NOWC ties up capital and hence decreases the local cash-flow which is one of the evaluation metrics for the SCs. A potential solution of how to manage this impact according to the Regional Controller 1B would be to instead of evaluating on the transfer price, the calculation in the cash flow could be done on the factory cost, the STC, because that is the cost that the SC really have to pay for the products to be produced. The second impact on the integrated result also results from the calculation not being based on STC, but rather on the transfer price. The HQ takes the local results

and allocates HQ and factory charges, hence the integrated result is affected by the transfer price between the SC and the HQ which is part of the evaluation. This is something that the Regional Controller 1B experienced as unfair, and has lobbied for a change for how the integrated results are calculated.

“Since more than three years back I am trying to change it to the proper calculation of integrated result where you are not affected by where the profit stays, because it is only about where you keep the profit of the transfer price adjustment and nothing else. Let’s see if I ever succeed” (Regional Controller 1B).

In the SCs, the TP is affecting the evaluation and rewarding system and is experienced as a visible issue in their daily work. The perception is that transfer prices are not something that are neutralized away, rather it need management attention as TP causes unfair treatment in the evaluation of the sub-units performance.

Table 3. *Summary of TP impacts on the MCS with regards to the SCs*

Organizing
• Centralized decision making • Centrally pre-set TP method and margin (resale price minus 1%)
Planning
• HQ sets annual budget and targets • Frozen transfer prices for both sectors
Evaluating & Rewarding
• Evaluation on integrated results for the sector and region • Financial rewards on EBIT, Sales, NOWC, Cash-flow • Non-financial local measures for motivation of sales force

4.8 Perception of transfer pricing in the Sales Companies

ManuCo has a different transfer price for each country which are calculated based on the estimated local cost and minimum income that should be generated in the legal entities. In the B-sector, there is a high focus on the statutory income statement, which refers to the local results in the legal entities. This means that the HQ is very attached to the follow-up on the local profitability of each entity which implies that the transfer price plays a big role in this sector. Within the A-sector, the statutory income statement is not used, since they do not believe that it represents the business performance as a whole, although it has a huge influence according to the VP Controller A. He explains that the mindset is much more about “we do not care about transfer prices” compared with how the situation is in the B-sector (VP Controller A). Furthermore, he also explains how he believes that the local profitability is a good measure and indication for the integrated profitability: “From my perspective, if you have an issue with your local profitability, the statutory one, you will also have an issue with the integrated profitability, which is supposed to calculate how much the business income is for this entity”. However, the other interviewees had a completely different

perception, the Regional Controller 2B explained: “We have the integrated result and then we have the local result, which is the “artificial” one. This can create confusion if they do not match. Sometimes the integrated gross profit can increase in comparison to the budget, while the local gross profit is decreasing”.

How can you make sure that the local results can give you at least an indication if you are going in the right or in the wrong direction? As the net sales are picked from the budget, it means that for all products in one market ManuCo should have the same local gross profit. Furthermore, VP Controller A elaborated on how he perceives the importance of both the integrated perspective and financial perspective, i.e. the local results:

“If an entity lacks -2 % in its local results it will also lack -2 % in its integrated results. You cannot loose here [in the local] without losing here [in the integrated]. The financial view related to the transfer price may also be used as an indicator of how the business is going. You have a kind of traffic light; red, yellow, green. When you see how the local margin is developing you can react to see if it is aligned with the budget assumptions, because it is based on the budget assumptions”.

What are the consequences if there is a gap of 2 % when the TP adjustments are done every quarter? Every quarter ManuCo take the local EBIT and the assumption that the local result should be 1 %, which is the theoretical local EBIT. If the actual is -2 %, it means that ManuCo have to do a transfer price adjustment of +3 %. In practice, ManuCo issues a credit note from the HQ to the SC of -3%. This is not an issue from the business perspective as the transfer price adjustment is something that is neutralized in the consolidated view.

For the SCs the transfer prices are frozen for the whole year. That is why caution needs to be taken in the calculation and estimation, as no transfer price adjustment is made when new forecasts are made every quarter. One could argue that if ManuCo wants to decrease its risk on the transfer price adjustment it could change its transfer price every quarter in conjunction to the other financial revisions. However, this was deemed unfeasible as changing transfer prices implies changed assumptions every quarter and a risk of losing track (VP Controller A; VP Controller B). Almost all of the interviewees emphasized the administrative machinery that TP implies, VP Controller A described this issue:

“You need a special system to calculate the transfer price because if you have 1000 products per market, then you will need to multiply 1000 by 35 [number of markets]. You will get 35 000 different transfer prices for the SCs. We are piling our P/Ls. So it means that it is a huge admin task and that is where we hit the limits of the TP policy. It requires a lot of systems, a lot of resources to keep it. We need to slightly double our ERP system, because of the TP policy. And one would be used for the local financial view and the other one would be used for the integrated view. But you must try to keep the same connection. If you have a problem with TP at the HQ, you are completely screwed”.

Every quarter ManuCo makes a new forecast of the full-year, it means that the HQ has to estimate how much the EBIT or the gross profit will be for the SCs. This also implies that ManuCo have to make sure that in their systems they have the same way of forecasting the local results. To make sure everyone is forecasting in the same way, ManuCo define rules such as from which system the information should be taken and when the data should be frozen, in other words on which date everyone shall take the data. It is from these forecasts and budgets that the transfer price is taken.

Furthermore, several of the interviewees mentioned the issue of always looking at two systems. VP Controller A explained his view of the connection between these different systems:

“There are different perceptions of the TP system. But the point is to demonstrate that there are connections. We have bridges between the local and the consolidated results. The point is that we need a kind of, double reading of the results, always! That is what is the most difficult in a big organization. Because people will tell you, but why are you boring me with your transfer prices, I don’t care! Tell me if I am doing good business or not. Yes! But it is not that simple. However, that is something that I am changing”.

Additionally, the issue of transparency and visibility in the integrated result was mentioned as an issue by both Regional Controller 1B and 2B. Regional Controller 1B explained how they need to use the local P/L in parallel to the integrated one, in order to make sense of the numbers in the integrated calculation.

“The problem is that normally integrated results would be the way to look at the company’s result in the countries as well, but I would say that we have a very complex integrated calculation. Therefore not all the data is visible in the integrated result, we have just some summaries there [...]. In order to be able to see what costs we pay on logistics, warehouse or whatever, we would really have to go into detail, so therefore we are using our local P/L. That is the only reason actually, because the integrated is not providing enough information about cost”.

Regional Controller 2B emphasized that for some people there is a discomfort involved in the integrated result since the calculation of costs are not transparent enough. However, it was also mentioned that this issue of transparency is something that everyone is aware of and are struggling with.

This lack of transparency was also exemplified through how the local result is affected by the product mix and the volumes. If you do not sell in accordance with the budget, the local gross profit will change. According to the Regional Controller, this change can sometimes go in a different direction from the integrated gross profit. Further, it was also mentioned that her work would be simplified if the B-sector also had a better integrated system, as in the A-sector: “My sector [B] is the smallest sector but the most profitable one, as we have high-margin products. But we have to be more concerned with transfer prices than the A-sector. They are bigger in terms of size, and

therefore they get more resources to manage their transfer prices so it is not affecting their daily operations. Despite that their portfolio consists of low-margin products”.

4.8.1 Summarizing the empirical findings

The case findings show that the TP relationships within ManuCo consist of two relationships, the relationship between the HQ and the Factories and the relationship between the HQ and the SCs. These two relationships are identified to be of different organizational types, i.e. *Cooperative and Collaborative* (Eccles, 1985), contingent on the interaction taking place and the TP method used. The reason for why we have isolated these two relationships and classified them is because HQ and sub-units can be “mixed motive dyads” (Birkinshaw et al., 2000). Our aim is through this classification being able to analyze if this is the case in ManuCo with regards to their TP process. We believe that this can aid in our understanding of why the TP impact is perceived as it is in ManuCo. These relationships entail both differing perceptions of the TP impact on the major MCS areas but also tensions on how these impacts are managed.

5 Analysis

This part further analyzes the case findings aiming to answer our research questions of how the transfer pricing (TP) process impacts the MCS and how this impact is perceived in ManuCo. First, we summarize the main case findings, representing the derived impact in the different hierarchical levels in the variables by Chow et al. (1999). From these, we analyze how the differing perceptions are managed to comply with TP by using Ahrens & Chapman's (2004) coercive and enabling principles.

5.1 The transfer pricing impact on the major management control functions

In this section we will answer our first research question of how TP impacts the major management control functions; organizing, planning, evaluating and rewarding (E&R), and if there is any difference in perceived impact between sub-units in ManuCo. Our findings are summarized below:

Table 4. *Summary of TP impacts on the MCS*

HQ	Factory	Sales Company
Organizing	Organizing	Organizing
- Increased centralization through installment of Global Tax Department - Uniform TP methods: Cost-plus 2.5% and Resale Price Minus 1%	- Centralized decision making - Centrally pre-set TP method and margin (cost-plus 2.5%)	- Centralized decision making - Centrally pre-set TP method and margin (resale price minus 1%)
Planning	Planning	Planning
- HQ sets annual budgets and targets - Top-line annual targets for regions and sectors	- HQ sets annual budget and targets - TP adjusted quarterly in A, frozen in B	- HQ sets annual budget and targets - Frozen TP for both sectors
Evaluating & Rewarding	Evaluating & Rewarding	Evaluating & Rewarding
- Evaluation and rewards on integrated results for the sectors and regions - No evaluation on local results - Financial reward measures primary source of rewards	- Evaluation on integrated results for the sector and region - Financial rewards on six items in Bill of Materials - Non-financial local measures for efficiency, quality and warranty claims	- Evaluation on integrated results for the sector and region - Financial rewards on EBIT, Sales, NOWC, Cash-flow - Non-financial local measures for motivation of sales force

5.1.1 Organizing

5.1.1.1 The HQ

Our first observation is that the HQ and the Tax department address the organizing controls (Chow et al., 1999) by centralizing and documenting the TP policy and process. TP is handled by the Tax and Audit department only, eliminating any participation from lower level managers, with an exception of regional controllers for local adaptation. The TP policy was communicated formally through a document at the sub-units. As the Tax department has the sole decision-making authority, no other managers are involved in setting the transfer price or principles and no delegation of decision-making to lower level managers is allowed in order to facilitate the TP process. This is a response to the contemporary increased pressure and focus on TP, in line with the national tax regulations and OECD Guidelines (Cools & Slagmulder, 2009; OECD, 2010).

Acknowledging the reasoning of Busco et al. (2008), it seems as the organizational tension between centralization and decentralization have been managed in ManuCo by centralizing all the TP decisions at the expense of local flexibility and adaptation. However, this was not perceived as an issue, but rather as a necessity in a response to the external environmental pressures. With strict adherence to a centralized decision-making structure, the organizing controls at the HQ confirms Cools et al.'s (2008) Proposition 1 of more centralized functions due to TP and a high impact on the organizing controls at the HQ, both with regards to the management and perception of the impact.

Sub-units are organized into sectors, meaning that they are organized by product type, rather than being organized by function. The TP impact on the organizing controls is therefore found to be high, as ManuCo has adapted their structure to fit a TP tax compliant organizational structure.

5.1.1.2 The Factories

The factories initiated a change of TP policies to employ uniform margins regardless of market in order to simplify calculations. Even though the HQ and Tax department were very assuring in their statements that no negotiations with sub-units were made with regards to TP, we observed a window of opportunity for initiating discussions when the TP policy and process did not function consistently. The HQ could still pursue their objectives with the TP policy through the formal document describing the routine procedure, but now entailing uniform margins. In general, even if the decision-making was not delegated to the factories, an opportunity for feedback in order to align the TP process even more was observed, making the TP impact perceived as high – but with room for improvement if any issue related to TP was discovered at the factories it was brought bottom-up for discussion and acted upon and thus the management we deem to be medium. Thus, if an issue with regards to TP is perceived there is an allowance of bringing these issues to the table and there is an opportunity of influence on the decision-making authorities in the relationship between the factories and HQ. Since the relationship is classified as a cooperative organizational type (Eccles, 1985), it also strengthens the cooperative elements within the organizing controls.

5.1.1.3 The Sales Companies

The sales companies (SCs) are affected daily by transfer prices and empirical findings stressed that transfer prices are “top of mind”, as they are dealt with in the organizing controls on a daily basis. When transfer prices are not inserted in the enterprise resource planning (ERP) system or missing it causes conflict and frustration in the SCs. The lack of decentralized decision-making causes lag in the operations, resulting in sub-optimal effects due to the centralization of TP process. Thus, in an isolated relationship setting there is a clash between the individual sub-units objective of self-driven operations and the corporate objectives of top-down control. (Birkinshaw et al., 2000; Busco et al., 2008; Ezzamel, 1995). The HQ's trade-off of leveraging synergies through the use of top-down control and centralization implicates a visible loss of flexibility and local adaptation (Busco et al., 2008; Emmanuel & Mehafdi, 1994). Even if the SCs are allowed to adapt to local regulations and perceive the internal guidelines of TP as “just guidelines”, the SCs always need approval to any change made making the HQ's influence over the organizing controls high and hence also perceived as high at the SCs. However, this window of opportunity for local adaptation can be interpreted as a somewhat restricted local allowance, hence partly managing the tension between centralization and

decentralization and thus we deem the management to be medium (Busco et al., 2008). Nevertheless, we observed a tension between the HQ and SCs as the relationship was bearing strokes of differing perceptions with regards to the TP impact on the organizing controls.

The reason for these differing perceptions we find to be both the organizational structure and type. The structure restricts the process of convergence towards standardization of global practices and the possibilities for local adaptation and divergence, confirming the theoretical findings from Cools et al. (2008), Busco et al. (2008) and Emmanuel and Mehafdi (1994). Moreover, the collaborative organizational type (Eccles, 1985) exemplifies that the SCs must function as an individual entity and profit center, preventing optimal profit outcomes for the group. Hence, the optimal solution for TP purposes might not create the best incentives for the internal management (Ezzamel, 1995). This results in a high TP impact on the organizing controls in the SCs, despite the HQ prophetic assurance that “TP is something that is adjusted away and never gets to the operational sub-units”.

In our case at the SCs, the TP impact is so high it becomes the SCs enacted reality with operational consequences. TP does therefore not only impact the degrees of cooperation and integration between the HQ and SCs, it also influences the extent of decision-making enjoyed by the SC managers (Spicer, 1988). Further, the case illustrates the reasoning from Ezzamel (1995) that in the trade-off between corporate optimality and sub-unit autonomy it is not clear when in conflict, which one should be sacrificed in favor for the other.

5.1.2 Planning

5.1.2.1 The HQ

The effects of the organizing controls in turn also affected the planning controls. Budgets are set centrally and stretched targets were imposed related to these. The TP impacts the budgeting process as the forecasted net sales targets are stretched, and the EBIT margin is based on the budgeted net sales. When targets are stretched, the transfer price becomes high, as the actual sales differ from the stretched sales in the budget. Since the transfer prices are based on the budgets that are set at the HQ-level, and the low degree of controllability and participation that sub-units could exercise in terms of participative budgeting and setting targets causes the perception of the TP impact to be high and the management to be high in the planning controls.

5.1.2.2 The Factories

Budgets are set centrally for the factories, based on the standard product cost. The chance to influence the outcome of the budgeting process was perceived as limited. The budget process allowed for a bottom-up discussion, but not participative budgeting. Further, the planning process for TP has been simplified through the change to frozen transfer prices leading to less administration in the B-sector. However, this was not the case in the A-sector. In the A-sector, the use of adjusted transfer prices are employed every quarter, nevertheless, the impact is not perceived as giving rise to any issue thanks to the use of a common ERP system. Despite the great effect that the budget has on the transfer prices, the impact is perceived as medium in the factories for both the A and B-sector. The factories could be argued to be better integrated with the HQ than the SCs, one reason being the cooperative relationship type (Eccles, 1985), and another reason being that the

transfer prices helps the factories to illuminate their responsibility and to define the separate stages of production (Ezzamel, 1995; Swieringa & Waterhouse, 1982).

With a routine based TP mechanism as the cost-plus method, the HQ achieves the required integration in the factories as the standard operating rules and procedures are relied upon frequently in the budgeting process (Ezzamel, 1995). Even though the budget and related targets are perceived as hard to reach, it is deemed as necessary in order to enhance the alignment towards corporate goals. For the factories producing products where 60 % of the final price is made up of productions costs, there is a common understanding that ambitious budgets and targets are necessary in order to assure future company survival. Thus, the budgeting process helps in aligning corporate and factories goals resulting in aligned motives in the dyad (Birkinshaw et al., 2000). However, since the transfer prices are based on the stretched targets, the outcome will most probably differ from the budget and thus a transfer price adjustment must take place at the end of the year or each quarter. In this case it is the budget that impacts the TP and not the other way around, hence the management of the TP impact is deemed as low.

5.1.2.3 The Sales Companies

As within the factories, the SCs budgets are also set centrally by the HQ. The local statutory income statement is the base for the budget and the transfer prices are frozen for the whole year for both sectors. With the lack of participation from sub-unit managers in setting budgets and targets, the case could be argued to confirm Cools et al.'s (2008) Proposition 2. The second proposition entails an increase of internal and common budgets and targets, at the expense of sub-units managers' ability to affect those. Therefore, the TP impact was perceived as high while the management of the impact was low, as sub-unit managers were not allowed to participate in any processes in the planning controls.

However, this partly contradicts Yunker's (1982) findings that MNE's engaged in TP with the aim to increase corporate profits are putting less emphasis on profit measures at the local levels. Our findings show that in ManuCo the profit measure EBIT is the most emphasized measure at the local level. However, the integrated results were also emphasized in the budget planning and target setting.

The uniform TP margins and profit targets leads to potentially harmful economic situations, as the loss of the ability to differentiate in the product mix to affect profitability leads to sub-optimal business decisions at the SCs. The HQ's opinion of significant administrative simplification of the TP determination was not perceived uniformly at the SCs, where the general opinion was that the TP process has a high impact on both the budget planning and targets. Within the planning control, the dyad seems to have differing perceptions. The risk with the high TP impact and the low integration in the HQ-SCs relationship with diverged perceptions is that if HQ imposes constraints in the way managers run their sub-units, the managers may feel alienated which can induce them to behave in a manner that is inconsistent with the corporate interest (Ezzamel, 1995). When the sub-units feel restricted in the decision-making regarding the optimization of their activity level, i.e. their product mix, the goal of corporate optimality becomes overriding at the expense of SCs autonomy.

Economic theory states that sub-units should receive maximum autonomy to determine the optimal transfer price and product mix that maximizes profits. This relationship, exemplifies the tension between economic theory in the SCs and the TP policy and process (Baumol & Fabian, 1964; Ezzamel, 1995; Williamson, 1975).

5.1.3 Evaluating & Rewarding

5.1.3.1 The HQ

The E&R system focused on the financials and distinguished attainment in terms of financial measures such as the bill of materials, Cash-flow, EBIT, Net Sales and Net operating working capital (NOWC). For TP reasons sub-units are not evaluated and rewarded on their local results but rather on their contribution to the company as a whole, through regional and sector targets. The TP impact on the E&R system is managed through the use of integrated results and therefore perceived as low at the HQ. The HQ is of the strong opinion that TP never affects the sub-units evaluation or the financial rewards connected to certain targets. With evaluation on integrated EBIT the TP effect is removed. Nevertheless, it could be argued that although HQ's perception of the impact is low, the management impact is high, as they have adapted their E&R systems to an integrated one, compared to using the local results for local evaluation. In other words, because of the TP impact, the E&R system has been managed to fit the TP context. Any previous, potentially perceived tension of TP appears to be managed at the HQ level (Busco et al., 2008; Cools et al., 2008). The E&R system is focused on the financials measures. No official E&R system focusing on non-financials is in place, however, local measures have been developed at the sub-units for motivational purposes although not as a response to TP. The lack of increased use of non-financial measures is diverging from previous theoretical findings (Cools et al., 2008).

5.1.3.2 The Factories

The standard product cost (STC) is built up of the six items in the bill of materials, with cost targets assigned to them by the HQ. The evolvement of local non-financial measures related to surrounding operations in the factory, cannot be explained as a "response" to the TP policy and process, as they are measures that the factories would have had any way, even if ManuCo was not engaged in TP. This somewhat contradicts Cools et al.'s (2008) Proposition 3 that the E&R controls of financial targets diminish under TP and instead there is an increased use of non-financial metrics. In our case, the HQ sets the benchmarks for the financial targets as well as the transfer prices. Factories have no influence over cost, sales or volume decisions as these are made in a centrally planned manner. The operational measures were locally developed but did not gain in importance due to TP, rather they were used in the factory as supplementing measures and for motivational purposes.

The focus at ManuCo, as confirmed by the empirics, was on the financial measures for evaluation and for financial contingent rewards. The award of a cash bonus at year-end depended on attainment on the financials, but not of the local non-financials. As the HQ's aim is to only evaluate units on what they can be accountable for, the impact of TP is deemed to be low in the factories. Within the relationship, the HQ's practice of E&R on integrated results to remove any TP impact in the units is also the perception in the factories. In general, the lack of impact on the E&R controls in

the HQ-Factory relationship was primarily due to the high management to use of E&R based on integrated results, and not on the increased use on non-financial measures as theory suggests (Cools et al., 2008). In this relationship, the tension the TP impact gives rise to by evaluation on the local results is therefore managed by the implementation of integrated results making the management of the TP impact high.

5.1.3.3 *The Sales Companies*

The same cannot be said about the SCs. The SCs have all their financial reporting based on transfer prices, while their evaluation is based on the integrated results. The HQ's perceived "solution" to the TP impact on the E&R system was not aligned with the view and perception at the SCs. The TP have implications on both the evaluation system as for the financial reward system because of the NOWC and the integrated result at the SCs. The NOWC is affected by transfer prices as the inventory is part of the NOWC and calculated on the TP value. If the TP value is high, the inventory value is high, causing a rise in unrealized value for the inventory by tying up capital. In other words, one of the evaluation metrics that the SCs have is the cash-flow and the TP impacts on this measure by tying up cash in inventory.

The SCs evaluation on the integrated result is also based on transfer prices and not on the STC as in the factories. The HQ takes the local results and allocates HQ and factory charges, hence the integrated result is affected by the transfer price between the SCs and the HQ which is part of the evaluation. The factories are not evaluated in the same way, thus this impact is not visible at the factories causing a sense of frustration and unfair treatment at the SCs. Further, the SCs even had a suggestion of how to handle this problematic impact by changing the integrated results calculation and evaluating on STC instead, as the current E&R practices affected their financial bonus if targets were not met. Thus, the perceived impact of TP was high, while the management was perceived as medium, as the complications that the current way of evaluating gave rise to was not acted upon by the HQ.

In line with Yunker's (1982) conclusion on possible explanation for this diverging perception and treatment between the sub-units could be that the SCs have a market-based TP method, the resale price minus, which focuses on profit-oriented measures in the sub-units performance, while the factories have cost-based oriented criteria for performance in the bill of materials. Contrary to Smith's (2002b) relaxation that integrated profit is used as a performance measure, we also see an emphasis on the weight of sub-unit profit measures, in this case impacted by transfer prices and thus considered to be an important financial factor that SCs are held accountable for, although they are unable to affect the outcome (Simons, 2000; Otley, 1980).

5.1.4 **Summarizing the transfer pricing impact on the MCS**

In summation, the answer to our research question: *How does TP impact the major management control functions; organizing, planning, evaluating and rewarding, and is there any difference in perceived impact between sub-units in a tax compliant MNE?* could be summarized as having the greatest impact in the organizing controls at the HQ, as the organizational structure is built around a TP tax compliant set-up. The set-up gives rise to a high impact in the planning process, as the top-line budget is influenced by

transfer prices and targets correspondingly. The lowest impact is observed at the E&R controls, as the use of integrated results removes any impact of TP.

The factories have in general a high/medium impact on their organizing and planning controls, due to their function as cost-centers for management control, even though they are profit centers pro-forma, and they did not experience any unfairness in the evaluation due to TP, making the perceived impact low. A plausible explanation could be the higher integration the HQ has with the factories, as the relationship is characterized as a cooperative type, leading to aligned perceptions in the dyad (Birkinshaw et al., 2000; Eccles, 1985).

The SCs, were the sub-units most hit by transfer prices in all MCS areas. The lack of decision-making and top-controlled adaptability to local markets made the sub-units suffering their divisional optimality for corporate formality, confirming the clash with economic theory as the global standardization lead to economic inefficiencies (Ezzamel, 1995; Williamson, 1975). A plausible explanation for the differing impacts and higher presence of TP within the SCs could rise from the collaborative organizational type, where perceptions are different and the desire for divisional autonomy is greater (Birkinshaw et al., 2000; Eccles, 1985). Hence, TP does give rise to an impact on the MCS and in our case study we have showed that there are differences between sub-units with regards to how this context is perceived and managed.

We have identified and labeled the TP impact in the variables by Chow et al. (1999), and assigned the perception and management from the different levels with the weights high, medium and low to summarize our analysis.

Table 5. *Summary of the perception and management of the TP impact at HQ and sub-unit levels*

Management control function	HQ	Factory	Sales Company
Organizing	Perception: High Management: High	Perception: High Management: Medium	Perception: High Management: Medium
Planning	Perception: High Management: High	Perception: Medium Management: Low	Perception: High Management: Low
E&R	Perception: Low Management: High	Perception: Low Management: High	Perception: High Management: Medium

5.2 Coercive and enabling uses of the MCS

In this section we aim to answer our second research question of how the TP impacts are managed with regards to coercive and enabling uses of the MCS. We will analyze our findings in the three different management control functions through the use Ahrens and Chapman's (2004) four design principles; repair, internal transparency, global transparency and flexibility.

5.2.1 Organizing

The TP process in ManuCo has led to a centralized organizational structure, however with some flexibility for alignment of TP margins and adaptation of TP to local markets (Busco et al., 2008; Cools et al., 2008; Cools & Slagmulder, 2009; Ezzamel, 1995). With regards to the organizing controls we were able to identify a repair mechanism in the factories. The urge to align TP margins for improving operations and enhance tax compliance was satisfied with a change to uniform margins regardless of market or product. We could see that despite the HQ's reassurance that TP policy and practices were set centrally, eliminating lower level management participation, the ability to repair from the lower levels led to both increased transparency internally and globally. The change in TP margins allowed for an enabling use of the MCS in line with Ahrens & Chapman (2004) as the factories were put in a position where they had to deal inevitably with the contingencies in their daily work. The common margins allowed for flexibility when it simplified the manufacturing activities, more emphasis could be put on efficiency and repair as the breakdown of the control processes enabled an opportunity for fixing these through the visibility of both internal and overall organizational processes. In essence, all the four design principles suggested by Ahrens and Chapman (2004) could be argued to be in place in the relationship between the HQ and the Factories. This illustrates that there is a window for flexibility and enabling use of the MCS if there is a perceived issue with regards to TP in the organizing controls.

In addition, the identification of the relationship between the factories and the HQ as a cooperative relationship (Eccles, 1985) strengthens the case of a more processual and enabling use of the MCS in the relationship, in contrast to the coercive use. As the cost and volume data were developed locally and used by the HQ when determining the transfer price, the cooperative element enables an alignment and integration of sub-unit goals with corporate goals, resulting in less TP impact in general for the factories. As the empirical findings suggest that factories are better aligned with the HQ it could be argued that they have succeeded to simultaneously employ both efficiency and flexibility in their relationship. This results an aligned dyad where dynamics and processes have enforced integration, organizational learning and adaptation in line with Swieringa and Waterhouse (1982).

Further, the same could be argued to apply for the SCs allowance to adapt the TP policy to fit the local regulations. This allowance signals an enabling use of the MCS despite the fact that the HQ has the final say and must approve any local adaptations. In general, the MCS used in the relationship between the HQ and SCs is of a more coercive character, however with enabling features of both repair and flexibility if there is a situation demanding that. However, we are unable to say if these enabling features led to any increased internal and/or global transparency in the relationship between the HQ and the SCs (Ahrens & Chapman, 2004; Mundy, 2010). The collaborative organizational type that the HQ-SCs has been classified as, can partly explain the lack of internal transparency despite the local adaptation (Busco et al., 2008; Mundy, 2010). The SCs function as profit centers and are hence competitive, making local adaptation of TP unique for every market. With the lack of a common ERP system to help increase the transparency of the adapted transfer

prices, the cooperative element is diminished in the HQ-SCs relationship, forcing a coercive use of the MCS.

5.2.2 Planning

Top-down annual budgets and target processes, but with an opportunity for bottom-up discussions by the sub-units is the case in ManuCo. However, the coercive use of the HQ control restricted any changes to the top-line budget or the stretched targets by the sub-units. The focus on centralization and pre-planning was communicated by applying the same targets to similar factories and SCs, as well as establishing both regional and sector targets for the annual budgets. Hence, by applying uniform budgets and targets for similar operations, the internal and global transparency increased at the expense of flexibility and repair for the sub-units as the coercive use of the budgets and targets made everyone aware of what was expected from them (Ahrens & Chapman, 2004; Cools et al., 2008; Mundy, 2010). In essence, we did not identify any enabling uses of the MCS for the sub-units within the planning controls. Mundy (2010) argues that firms need to balance between controlling and enabling uses. At ManuCo, a participative budget process and locally developed targets could be viewed as enabling forces that would counteract the current coercive use. With budgets better aligned with the local reality, ManuCo could as suggested by Mundy (2010) create a competitive advantage and eventually the decrease in TP variances would enhance the performance in the long run.

5.2.3 Evaluating & Rewarding

We see a lack of repair in the E&R system (Ahrens & Chapman, 2004), as any breakdown of control processes to sub-units in order to provide them with the enabling forces to fix TP impacts like the NOWC and the calculation of integrated results is a process where managers have been “trying for years”. This mechanism requires however both internal and global transparency, two parameters that seems to be lacking in the relationship between the HQ and SCs. By evaluating on the factory cost, the STC, the impact in the SCs would be managed in a satisfactory way, however due to the coercive use of management control employed by the HQ, there is no room for either flexibility or adaptability (Ahrens & Chapman, 2004).

A transparent, internally consistent MCS is essential in all levels of the organization in order to get sub-units alignment with corporate objectives (Birkinshaw et al., 2000; Ezzamel, 1995; Mundy, 2010). Today, there is too much difference between sub-units in ManuCo and a part of the underlying reason has been the lack of a common ERP system. In an MNE pursuing an acquisition strategy for growth, it is not unusual with 50 different ERP systems operating simultaneously. When sub-units and HQ do not even have the same reporting system, there is always an overarching risk of important financials getting lost in the transfers between the different systems. That also, imposes constraints on an efficient MCS.

We acknowledge that Cools et al.’s (2008) Proposition 4 holds true in our case, there is an increase in the coercive use of ManuCo’s MCS. However, this was in general not identified in an increase of internal and global transparency, rather there was a decrease of internal and global transparency due to the lack of a common ERP system with regards to the E&R controls. In line with theory, there

was however a decrease of flexibility and repair, as TP made ManuCo more centralized and structured in their MCS in all areas.

5.2.4 Summarizing the coercive and enabling uses of management control

In summation, the answer to our second research question: *How are these transfer pricing impacts, if any, managed with regards to coercive and enabling uses of management control within the functions organizing, planning, evaluating & rewarding?* we can conclude that ManuCo in general uses a top-down coercive MCS in their major control functions. However, the impact of the TP policy on the use of the MCS was twofold, where theory suggests that TP leads to increased transparency counterbalanced by losses in flexibility (Ahrens & Chapman, 2004; Mundy, 2010). Overall, a more coercive use of the MCS was in place, limiting sub-unit managers to not include the enabling forces of repair, internal and global transparency and flexibility to tackle TP impacts by improving efficiency or innovation in the operations. Moreover, the inability to balance between the coercive and enabling use of the MCS in ManuCo led to slower decision-making, instability, insecurity and eventually lower organizational performance confirming Mundy's (2010) reasoning.

Some exceptions were identified if there was a prevailing situation that needed repair, like the change to uniform TP margins in the factories and the local adaptation in the SCs. In the factories the change led to increased internal and global transparency, however, in the SCs the same conclusion could not be drawn. The local adaptation rather confirms Ahrens & Chapman's (2004) flexibility and repair variables, while the factories entail all four. Within the planning controls, a coercive use was enforced and we did not come across any enabling forces at the sub-units. The lack of transparency in the calculation of the integrated result and the E&R systems differing practices between the sub-units was caused by a coercive use of the MCS. In general, the lack of transparency that the coercive use caused could be derived from the insufficient common ERP system. The HQ seemed to largely underestimate how the adherence to the TP policy would affect the MCS at the sub-units and the profound effect of not having a common ERP system. The strong reactions, by especially the SCs, emphasize the extent of undesirable side effects of TP.

Table 6. *Summary of the coercive and enabling uses of management control*

Management control function	HQ	Factory	Sales Company
Organizing	Coercive	Enabling, all four	Enabling, repair + flexibility
Planning	Coercive	Coercive	Coercive
E&R	Coercive	Coercive	Coercive

5.3 Discussion

While previous research would like to acknowledge the benefits of TP for making an organization more structured, transparent and especially integrated, we can in our case exemplify that this is not the perceived case. In a mature MNE with all structures in place, the perception of TP as an issue in

the MCS does not exist at the HQ-level or at the factory level. However, at the SCs sub-units the perception was almost the opposite. One could argue that in this case company this tension is so well managed that it is practically resolved, at least in the eyes of the HQ. However, this goes against some researchers stating that tensions should be managed and not resolved (Busco et al., 2008; Cools et al., 2008; Mundy, 2010; Plesner Rossing, 2013). Nevertheless, one could also argue that ManuCo has managed this tension in a very structured manner, and thus the implication has been that the HQ has not perceived TP as a problem that affects their sub-units operational decisions. Or, as mentioned in the beginning of this paper, in a perfect world, TP should be neutral and not impact any area of the MCS. We have in our study showed that this is not the case, and especially by covering the whole value chain in the studied MNE.

The impacts caused by TP on the MCS are in accordance with Cools et al.'s first three propositions. However, regarding the last proposition the use of a MCS in our study shows a contradictory result causing an imbalance between Ahrens and Chapman's (2004) dimensions of MCS use. The more coercive use of the MCS resulted in line with theory in a loss of flexibility and repair for the sub-units, but there was no increase in internal and global transparency in ManuCo. The reason for this we found to be the lack of a common ERP system, causing lags, inefficiencies and insecurity in the operations at the sub-units.

The increase in bureaucracy and formalization caused by the TP policy limited local and sub-unit managers in the SCs discretion to such degree that their commercial flexibility and business creation facilities seemed jeopardized. At the factories, the impact was not prevailing as much as in the SCs, due to a more cooperative relationship with the HQ and cost-center focus, which facilitated a more efficient exercise of management control. ManuCo simplified its tax compliant TP policy for the factories by changing to uniform profit margins and mark-ups for the factories transfers regardless of market. The simplification was welcomed from an administrative point of view, and also helped in integrating and aligning the factories with the goals of the HQ (Birkinshaw et al., 2000).

The SCs did not experience this positive effect that TP can bring, and the main reason for the deprivation was expressed as due to an insufficient ERP system. We have therefore showed the importance of ERP systems in enhancing the organizational goals, but also in order to stay tax compliant. In sum, the importance of a well-functioning ERP system was found to be essential for enhancing internal and global transparency, and for integrating the MNE in the study. Furthermore, a common ERP system would enhance the internal consistency in the organization, giving a clear and coherent message to sub-units regarding the TP policy and what to prioritize (Mundy, 2010). Right now, the SCs view themselves as more differentiated and alienated, thus, the internal consistency is lacking. The TP policy does not bring along the converging, cooperating, integrating, structure and visibility that theory claims that it does (Ahrens & Chapman, 2004; Busco et al., 2008; Ezzamel, 1995; Mundy, 2010; Spicer, 1988). Rather it had an opposite effect, as perceived in the SCs.

Another interesting empirical observation is that there seems to be a difference between the A and B-sector rather than between hierarchical levels. An amplified focus on TP was observed in the B-

sector, and an almost “non-caring” behavior was found in the A-sector. The empirical responses explaining this contradictory finding was the amount of resources the A-sector generated from the HQ due to its size. Despite their low margin products, the A-sector represented the biggest contribution to the turnover, compared to the B-sectors contribution of approximately 10 %. Nevertheless, it has been established that not only the lack of a common ERP system causes TP implication on the MCS, but also the lack of HQ resources being designated for the simplification purpose of TP to the B-sector. If the A-sector receives resources for investing in a common ERP system in order to facilitate their transfer prices, it is not surprising that the focus on an impact of TP in the A-sector is lower.

Drawing upon the reasoning from Swieringa and Waterhouse (1982) there are differences in behavioral experiences both between the sub-units and between the sectors in ManuCo. The reason for the difference between the factories and SCs, we find to be the level of integration with the HQ. The extent of cooperation between the factories and HQ is greater, partly explained by the TP method cost-plus (Ezzamel, 1995) and partly explained by the organizational type that we view the dyad to be classified as (Eccles, 1985). The HQ has succeeded in a better alignment with the factories towards common, corporate goals where the TP process have resulted in illuminating responsibility and thus achieved the required integration (Birkinshaw et al., 2000).

Further, another plausible explanation in line with Swieringa and Waterhouse (1982) is an elaboration on the fact that through the processes of dealing with problems, such as the change to uniform TP margins for enhanced simplification and clarity in the factories, individuals and the environment of the organization can learn and create a common ground which in turn can contribute in creating the basis for structuring and controlling. Viewing the TP process as an enabler of structure and control will in turn allow for attention on organizational learning and adaptation. The TP process could therefore enable learning within the organization as a whole, especially between sub-units and between sectors. Shared understandings of situations and agreements on future actions can be attained by encouraging interaction between managers between sub-units and sectors, at the HQ. Thus, by allowing for organizational learning to evolve the HQ can through this achieve the required integration with the SCs, which we found to currently have a lower level of integration compared to the factories in a dyadic setting (Birkinshaw et al., 2000; Swieringa & Waterhouse, 1982). By learning from the characteristics in the HQ-Factory relationship the SCs can move from their current “competitive” state towards a more “cooperative” state and organizational type (Eccles, 1985). However, it is not only the SCs who is supposed to learn and adapt from the factories, rather the HQ needs to have a better understanding of the current situation and the impacts the TP process have at the SC sub-unit level (Birkinshaw et al., 2000). Only then can the organization go through stages of adaptive behavior, if the learning process is bidirectional (Swieringa & Waterhouse, 1982).

Moreover, we view the lack of transparency and the differences between the sectors to also recognize the pressures for organizational learning and adaptation, where the B-sector can learn how to handle the impact of TP processes from the A-sector by implementing an integrated ERP system.

As organizations are undergoing constant change, rather than being rigid and static (Swieringa & Waterhouse, 1982), we add to this perspective the pressures from the external environment – in our case both the tax compliance and our finding of technological pressure – as variables that has to be considered in the processes of dealing with TP impact related issues internally and in order to increase transparency. The rapid technological development can both enable integration, and simultaneously cause new dynamic tensions related to technological progresses (Davenport, 1998; Yamin & Sinkovics, 2007). However, in a first step we view the internal learning between the sectors and adaptation of an integrated ERP system as a base for continuous refinement of the TP impacts in order to minimize the prevailing differences between the sectors. In addition, the action may enable a greater opportunity for structuring and controlling and at the same time help in achieving the required rate of integration and transparency in the organization for aligning sub-unit and corporate goals (Birkinshaw et al., 2000; Ezzamel, 1995; Mundy, 2010).

“The financial view related to the transfer price may also be used as an indicator of how the business is going. You have a kind of traffic light; red, yellow, green. When you see how the local margin is developing you can react to see if it is aligned with the budget assumptions, because it is based on the budget assumptions”.

Finally, one effort for organizational learning was exemplified by the VP Controller A, to use the local results, i.e. the TP results for indication purposes. By using the TP result as an indication tool, TP does not have to be perceived as a cumbersome calculation exercise, but rather as a traffic light signaling whether the sub-units should accelerate or hit the brakes.

6 Conclusion & Contribution

The main goal of our case study was to explore how transfer pricing (TP) impacts the major management control functions organizing, planning, evaluating and rewarding (E&R) in an MNE that uses tax compliant transfer prices. The perception of these impacts and potential tension management was done on the HQ and at the sub-unit level to determine if there were any perception gaps in the relationships in isolation (Birkinshaw et al., 2000). In contrast to earlier contingency studies, this study has gained from a process view by incorporating the dynamic character of the TP impact on the internal MCS (Otley, 1980, Swieringa & Waterhouse, 1982). From a taxation point of view, the arm's length principle forces the MNE to treat its sub-units as if they were profit maximizing and independent legal entities. However, from an MCS point of view the set-up in an MNE in a TP context is said to integrate the company pursuing corporate objectives over sub-unit objectives (Cools & Slagmulder, 2009; Ezzamel, 1995). Given the lack of empirical studies covering the potential impact and perception differences of a TP policy, we undertook an in-depth case study with the aim to cover these issues.

As TP at ManuCo is perceived as something that is neutralized away at the HQ level, it refutes the theoretical tension of causing goal misalignment in the organization. TP is in general not regarded as an issue and its impact is only marginal within the major management control functions according to the HQ. However, moving one level down in the organization; different perception gaps have been revealed in the sub-units (Birkinshaw et al., 2000). With a low perception gap and low TP impact within the factories, the situation was almost the opposite at the SCs. The SCs experienced a TP impact in almost all areas of control and had TP on the top of their mind on a daily basis. The perception gap was also high and the TP impact made goal alignment a daily challenge, resulting in frustration, a feeling of disconnection, and a sense of unfair treatment. Apparently, the TP policy was revealed as giving rise to a tension between the HQ and the SCs that needed attention and management in order to align the corporate goals with the goals of the sub-unit in a satisfactory way.

This study contributes to the literature in various ways. First, it adds to the limited empirical investigations of combining TP research and management control research (Cools et al., 2008; Cools & Slagmulder 2009; Plesner Rossing & Rohde, 2010; Plesner Rossing, 2013). Contrary to what we might expect from the previous literature review, the theoretical tension between aligning goals from a tax and management control perspective was not perceived as an issue. The TP context had no effect on the operations, at least at first sight. Digging deeper, divisional and sub-unit managers had lively diverging views of the TP impact on the different management control functions investigated. While the factories in general were the least affected and more integrated with the goals and objectives of the HQ, the SCs were differentiated and perceived the TP impact as a daily issue that needed attention both for operational purposes and in managing the tension that it gave rise to. Second, this study contributes to the research by documenting and explaining how the MCS is designed and used under the constraint of external environmental pressures (Chenhall, 2003). Previous research has not addressed the weight of the TP contexts effect on the internal enterprise resource planning (ERP) system, a system necessary for dealing inevitable with the contingencies from the tax regulatory environment. In our study we believe that the current use of parallel ERP

systems is a contributor to the implications in the organizing, planning and E&R controls. Third, we provide an insight of the consequences of the arm's length principle and the chosen TP methods cost-plus and resale price minus for the internal decision-making, budget planning, performance evaluation and managerial motivation against the background of these broad tensions.

6.1 Managerial implications & Significance of the findings

We want to stress that when seeking to understand the MCS design and use in complex and contemporary MNEs you need to take into account the priority corporate management devotes to TP and tax compliance. Our study proposes a refinement of contingency literature in terms of how external factors influence the potentially active role of internal management accounting (Ahrens & Chapman, 2004; Chenhall, 2003). Instead of listing the objectives of the TP policy and the factors inducing the methods employed (Borkowski, 1992b; Cravens & Shearon, 1996; Cravens, 1997; Emmanuel & Mehafdi, 1994), this study investigated the TP impact on the three major management control functions found in a Swedish multinational enterprise. Our findings suggest that there are different perceptions and impacts of the TP process on different hierarchical levels in the studied organization.

6.2 Limitations & Suggestions for future research

Finally, we would like to acknowledge the limitations of an in-depth single case study. With the aim of analytical generalization (Scapens, 1990; Yin, 2009), we based our investigation on the analysis of one single case company favoring the use of one single set of TP books in daily business activities, through the use of two OECD (2010) Guideline methods; the cost-plus method in the HQ-Factory relationship and the resale price minus method in the HQ-Sales Company relationship as the best and most suitable methods for TP tax compliance. We cannot conclude that non-tax compliant TP policies interact with the design and use of the MCS in a similar or different way, nor whether the degrees of tax compliance are feasible or not. Thus, the characteristics of the case clearly provide ways to extend this type of research.

A potential extension of this research would be to increase the amount of MNEs and compare and contrast the TP impact on different hierarchical levels. An increased sample size with semi-structured interviews in combination with a survey would help to achieve this goal. For future research we suggest researchers to investigate the importance of ERP systems in a TP setting, including parameters such as organizational structure, size, and industry. Also, a study of the use of two sets of TP books for indication or signaling purposes to help future researchers to understand the benefits of keeping two sets of books internally. However, acknowledging the legal conflicts we would like to call for a more detailed study of the benefits of keeping two sets of books without violating the current legislation.

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8 Appendix A – Conducted interviews

Role	Country	Quantity	Physical/Phone	Date
Tax Manager 1	Sweden	2	Physical	2013/09/13 & 2013/11/22
Tax Manager 2	Sweden	2	Phone & Physical	2013/10/15 & 2013/11/22
Group Control	Sweden	1	Phone	2013/10/28
VP Controller A	Sweden	2	Physical	2013/10/30 & 2013/11/25
VP Controller B	Sweden	2	Physical	2013/11/06 & 2013/11/25
Region Controller 1B	Austria	1	Phone	2013/11/07
Factory Controller B	Sweden	1	Physical	2013/11/08
Country Holding Officer	Hungary	1	Phone	2013/11/11
Factory Manager B	Sweden	1	Phone	2013/11/12
Factory Controller A	Sweden	1	Physical	2013/11/12
Region Controller 2B	Sweden	1	Physical	2013/11/14
Country Controller B	Denmark	1	Phone	2013/11/19

9 Appendix B – Interview protocol

Introduction of yourself

- Main responsibilities
- Years in the company
- Bit about your background

The transfer pricing process

- How are transfer prices set? (Established corporate rules or procedures?)
- Which individuals are involved? (Different managers on different levels?)
- What information is used to determine the transfer price? (Data on costs, internal and/or external transactions?)
- When are transfer prices set or do they ever change? (Frequency and under what conditions do they change?)
- How is conflict managed? (Who is involved in conflict resolution and what tools are used to avoid conflict?)

Internal management control and transfer pricing (TP) impact

- Organizing – Decentralization & structuring of activities
 - Are you involved in the decision making regarding TP? If so, do you have the ability to affect the outcome?
 - Are there any formal or informal policies, rules or manuals with regard to your TP? If so, could you give an example?
- Planning – Participative budgeting & Standard tightness
 - Are you involved in setting the budget and the targets? If not, who does it?
 - Are these budget and targets hard to reach? If so, what makes them hard to reach? Can you influence the setting of the budget and targets?
 - Do you adjust the budget and targets? If so, how often? Who makes the decision of adjustment?
- Evaluating and rewarding – Participative performance evaluation & Performance contingent financial rewards

- How is the evaluation and rewarding system set up, in the HQ and in the legal entities? Is there a global system? What metrics and KPIs are used for evaluation and rewarding? Are there different metrics for different sub-units? Which are they?
- Are they the same across borders?
- Do you have any non-financial measures?
- How have you managed TP's effect on the reward system? Does TP have an impact on the rewards system? If so, how is this eliminated?

Concluding remarks

- How would you describe that your daily work is affected by TP?
- In what area (organizing, planning, evaluating and rewarding) do you think that TP has a large impact?
- In what area (organizing, planning, evaluating and rewarding) does TP have no impact?
- Is there anything else you would like to add or emphasize with regards to TP, internal management control, goal alignment?