RELATIONSHIP BETWEEN TRANSFER PRICING TECHNIQUES AND THEIR LEVEL OF IMPLEMENTATION: A CASE OF MULTINATIONAL COMPANIES IN KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for any degree award in any university.

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This research project has been submitted for examination with my approval as university supervisor.

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DEDICATION

The project is dedicated to my wife Catherine and my daughter Shirleen for their deep love and strong sense of encouragement.

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ABSTRACT

A study conducted by Lantz (2009) stated that there are a number of administrative challenges that are faced in the implementation of transfer pricing techniques some of which include transfer pricing risks which are among the largest tax risks that tax administrations have to manage, the cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time. The objectives of the study were to determine the transfer pricing techniques adopted by Multinational companies in Kenya and also to determine the level of transfer pricing techniques implementation by Multinational companies in Kenya. A survey research design was used. The population of the study was all the forty five Multinational corporations with headquarters in Kenya as per appendix one attached. This study used both structured / closed ended and unstructured / open ended questionnaires. To test the relationship between the variables (transfer pricing techniques and challenges faced in their implementation), the study adopted both descriptive and inferential analysis. From the study findings majority indicated that the most commonly used transfer pricing techniques is cost-based transfer pricing and that the most approach to resolving the transfer pricing conflicts is that goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge. The study recommends that multinational companies should consider implementation the transfer pricing techniques to minimize the associated costs and that the challenges involved in transfer pricing techniques should be taken in to consideration by the concerned management team to reduce the unplanned losses that may occur during implementation phase.

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LIST OF ABBREVIATIONS

ATAF	African Tax Administration Forum
IMF	International Monetary Fund
IRS	internal revenue service
ITA	Income Tax Act
KRA	Kenya revenue Authority
MNC	Multinational Corporation
SPSS	Statistical Package Social Sciences Software
TP	Transfer pricing
WTO	World Trade Organization

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

A transfer price is the price at which goods or services are transferred from one process or department to another or from one member of the group to another (Kaplan and Atkinson, 1998). Transfer pricing can motivate divisional managers to make good economic decisions and thus improve the reported profits of their divisions and the profits of the company as whole. It has also been argued that transfer pricing provides information that is useful for evaluating the managerial and economic performance of the divisions and ensures that divisional autonomy is not undermined (Grabski, 1985). The transfer pricing mechanism applied by an organization can therefore have a critical impact on its performance. When a proper transfer pricing mechanism is put in place, it motivates divisional managers and provides a reasonable measure for evaluating the managerial and economic performance of the source and receiving divisions (Bernard, Jensen and Schott 2008).

The established transfer price is a cost to the receiving and revenue to the supplying division, which means that whatever transfer price that is set will affect the profitability of each division. In addition this transfer price will also significantly influence each division's input and output decisions and thus total company profits (Chung, and McAlonan, 2007).

1.1.1 Concept of transfer pricing

The accounting theorists, like the economic theorists and mathematical programmers, focused on how transfer prices affect economic decisions. These decisions, made by the division managers, regarding how much to produce based upon the transfer price, were a short-term aspect of corporate performance. Because of the performance evaluation and reward system, managers were making decisions for the short-term: that is because the quantitative methods ignore strategy in their models. Also, the performance evaluation system assumed in the models ignored strategic decisions. These strategic decisions may cause divisions to be operating under different objectives and constraints.

A study conducted by Lantz (2009) stated that there are a number of administrative challenges that are faced in the implementation of transfer pricing techniques some of which include transfer pricing risks which are among the largest tax risks that tax administrations have to manage, the cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time.

The study further stated that some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits. Another challenge involves obtaining information across borders which is cumbersome since international relations between countries differ. Also the ease of access to and the quality of relevant supporting documentation is a key practical issue for auditors when dealing with this problem (Kuntz, and Vera 2005).Finally the risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways. The differences in approach being driven to some extent by the different environments in which they are operating and the particular constraints they have to work within.

A number of approaches to resolving the transfer pricing conflicts are known. For example, goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge. However, this two-part transfer price system has a serious disadvantage because "the source division has no incentive to seek the optimal production level as it earns no profit on transactions made during the period" (Vidal and Goetschalckx 2001). Another approach is based on sharing the group profit earned on the transferred goods, but its shortcomings include problems with the book-keeping and the economic meaning of the profit. Also, a more advanced dual-rate transfer pricing system has been proposed. The problems with this approach concern the artificial nature of dual-rate transfer prices, which can lead to confusion. As a result, they are not widely used in practice (Kanodia, 2009).

Many decentralized organizations therefore use simple negotiation or negotiated optimal two-part tariffs to determine transfer prices. Although the efficiency of the latter is significantly higher than the efficiency of simple direct negotiation, the problem with this approach however, is that the outcome may depend on the managers‟ negotiation skills and their unequal bargaining power. Grabski (2005) stated that there are two main purposes of transfer pricing. Firstly, to generate separate profit figures for each division and thereby evaluate the performance of each division separately. Secondly, to help coordinate production, sales and pricing decisions of the different divisions via an appropriate choice of transfer prices.

According to Ngumyand Khanna (2010), the Transfer Pricing Rules were introduced in Kenya in 2006 by the Minister of Finance to supplement the provisions of Section 18(3) of the Income Tax Act ("ITA"). Section 18(3) of the ITA empowers the Commissioner of Domestic Taxes to adjust the profits accruing to a resident person from a course of business conducted with related non-resident persons to reflect such profit as would have accrued if the course of business had been conducted by independent persons dealing at arm's length. In effect, the Commissioner could adjust prices in cross-border transactions involving related parties to reflect an arm's-length price. Where the Commissioner has made a transfer pricing adjustment that results in the collection of any tax due and unpaid, such tax shall be deemed to be additional tax which under the ITA will attract penalties and interest for the period of time the tax has been understated. However, Section 18 (3) of the ITA did not provide a framework for the methods of determination of a transfer price comparable to one that would be reached at an arm's length. Although the TP Rules were introduced in 2006, the KRA has gradually been building capacity in this respect.

The TP provide guidelines to be applied by related entities in determining the arm's length prices of goods and services in transactions involving them and to provide administrative regulations, including the types of records and documentation to be submitted to the Commissioner by a person involved in transfer pricing arrangements. Where a taxpayer company has undertaken or regularly undertakes cross-border transactions with an affiliated entity in respect of sale of goods and provision of services or any other transactions which may affect the profit or loss of the company, it would be imperative to develop an appropriate policy that upholds arm's length pricing. Such an arm's length price should be determined in accordance with the guidelines provided in the TP Rules and the relevant documentation should be availed to the KRA upon request.

1.1.2 Implementation of transfer pricing in Multinational companies

Most multinational companies use four transfer pricing techniques namely Market-based transfer pricing, Cost-based transfer pricing, Negotiated transfer prices and central management based transfer prices (Lakhal, 2006). The market-based transfer price is a price that a selling division can get for its product in the external market or the price at which the buying division can get the product in the market place. The use of market based transfer prices allows each division to be evaluated on a stand alone basis (Eden, Luis, Valdez, and Li, 2005). The managers are therefore encouraged to treat their divisions as independent firms and can buy or sell from whatever source that seems best under the current market conditions.

Tomkins (1990) stated that the cost-based transfer pricing includes the full cost method, the full cost plus method and the marginal cost transfer price. Under the full cost method the full cost including fixed overheads absorbed that have been incurred by the supplying division in making the intermediate product is charged to the receiving division. The full cost plus method on the other hand ensures that the supplying divisions do not make any profits on the products or services transferred (Eccles, 1985).

The methods are therefore not suitable for performance measurement. To overcome this problem, a mark-up is added to enable the supplying division to earn a profit on interdivisional transfers. The marginal cost transfer price method on the other hand involves charging the variable cost that has been incurred by the supplying division to the receiving division (Grabski, 2005). The negotiated transfer pricing method involves negotiations between two managers of the selling and receiving departments/divisions. The selling manager quotes the price and delivery conditions which may or may not be accepted by the receiving manager based on alternative sources (Hirshleifer, 2006). Finally under the central management-based transfer pricing**,** the central management may determine the transfer price and communicate this to the divisional managers. In most cases the basis of this is to promote goal congruency and to allow for a standard performance evaluation criteria.

1.1.3 The relationship between transfer pricing and the level of implementation in Multinational companies

Plasschaert (1979) noted that the term “transfer pricing” often assumed derogatory connotations suggesting that large multinationals have leeway to manipulate the prices on intra firm trade and service flows for business advantage. When unrelated companies transact with each other, the circumstances of their commercial and financial relations are generally driven by market forces. By contrast, when related companies transact with each other, their commercial and financial relations may not be directly affected by external market forces in the same way. As a result, the prices charged for intra firm transfers of goods, for instance, between a foreign subsidiary of a multinational and its US based parent, may differ from those charged to independent companies for the transfer of comparable goods.

According to Tomkins (1990), a number of approaches to resolving the transfer pricing conflicts are known. For example, goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge. However, this two-part transfer price system has a serious disadvantage because "the source division has no incentive to seek the optimal production level as it earns no profit on transactions made during the period. Another approach is based on sharing the group profit earned on the transferred goods, but its shortcomings include problems with the book-keeping and the economic meaning of the profit. Also, a more advanced dual-rate transfer pricing system has been proposed.

1.1.4 Multinational companies

A multinational corporation (MNC) or multinational enterprise (MNE) is a corporation that is registered in more than one country or that has operations in more than one country. It is a large corporation which both produces and sells goods or services in various countries (Grabski, 2005). It can also be referred to as an international corporation. They play an important role in globalization. The MNC is an established and adaptable entity. The MNC benefits from the doctrine of neo-liberal economics as well as the "home and host" state quagmire, which combines with limited liability and decentralized decision-making to allow for double standards in business across different companies. Furthermore, the polices of organizations such as the World Bank, the IMF, the OECD and the WTO, have allowed the MNC to gain a position of considerable influence on economic and social agendas (Oriwo, 2010).

MNCs have massive budgets, are driven essentially by profit, use the smallest number of workers possible, move from jurisdiction to jurisdiction with relative ease, import labour to the detriment of local labour, and they always take into account the social needs of the country in which they are operating through community social responsibility.

1.2 Research Problem

A study conducted by Lantz (2009) stated that there are a number of administrative challenges that are faced in the implementation of transfer pricing techniques some of which include transfer pricing risks which are among the largest tax risks that tax administrations have to manage, the cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time.

According to Kuntz and Vera (2005) Some MNCs recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits. Another challenge involves obtaining information across MNCs which is cumbersome since mutual relations between companies differ. Also the ease of access to and the quality of relevant supporting documentation is a key practical issue for auditors when dealing with this problem. The risk assessment process is central to the success of transfer pricing programmes but MNCs approach this in very different ways. The differences in approach being driven to some extent by the different environments in which they are operating and the particular constraints they have to work within.

Most studies on transfer pricing have been conducted in developed countries such as countries in Europe and America with very few addressing the transfer pricing problem in developing countries for example Plasschaert (1979) ,Eccles (1985), Kuntz and Vera (2005) among others. Furthermore earlier studies concentrated on the empirical analysis of the appropriate transfer pricing methods to be adopted by multinational companies to maximize their profits for example the Hirshleifermodel (1956).

A local study conducted by Oriwo (2010) focused on the regulatory measures by the government of Kenya in reducing transfer pricing manipulation by multinational corporations. The study however did not analyze the various methods used in transfer pricing and the challenges Multinationals companies in Kenya face in implementing them. This research therefore sought to bridge the knowledge gap in this area and this forms the basis for this research.

1.3 Objective of the Study

1. To determine the transfer pricing techniques adopted by Multinational companies in Kenya.
2. To determine the level of transfer pricing techniques implementation by Multinational companies in Kenya.

1.4 Value of the Study

This study may help the government understand the nature and performance of transfer pricing in multinational companies and provide valuable information for policy decisions in the sense that they can develop appropriate legislation regarding transfer pricing and also enter into double taxation treaties with other countries to help multinational countries overcome the problem of double taxation. The government will also arrest the problem of tax evasion by putting in place legislative measures guiding transfer pricing.

The study will also enlighten the multinational companies about the transfer pricing problem in order to develop strategies of how to overcome the challenges faced in the implementation of transfer pricing for the entire benefit of the whole group to enhance the vital role played by transfer pricing techniques as opposed to direct charges.

The academia will also benefit from the research by getting to know the transfer pricing techniques adopted by multinational companies in developing countries and the challenges faced in their implementation and the theories used in transfer pricing. This can also pave way for further research in the area to develop new theories and models in transfer pricing. Other researchers may also borrow a leaf from the findings of this study.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter was organized into four parts. Section 2.2 discusses the theoretical literature specifically discussing the theories the study is based on. Section 2.3 deals with empirical literature on the transfer pricing problem and seek to establish the challenges faced in its implementation and the various transfer pricing techniques adopted by multinationals. Section 2.4 discusses the local studies related to transfer pricing techniques their challenges and the extent of their implementation by MNCs. Lastly section 2.5 presents a summary of the literature review.

2.2 Theoretical Literature

The following theories guide the transfer pricing literature.

2.2.1 The Economic Theory

The literature in the economic theory based approach to transfer pricing is built upon the Hirshleifer (1956) model. This was the first formal treatment of the transfer pricing issue from the economics viewpoint. This model assumed two profit centers. One was a manufacturing division and the other a distribution division. The manufacturing division had no external market for its product, whereas the distribution division had a competitive external market. The study then analyzed the problem under varying demand conditions and concluded that when a perfectly competitive market exists for the intermediate product, it should be transferred at the market price. Otherwise, the basic conclusion yielded was to price along the marginal cost curve for intra-company transfers.

This conclusion held even when the assumption of no external market for the intermediate product was relaxed. In the transfer pricing approaches based on economic theory, the firm is viewed as a mini-economy in which scarce resources need to be allocated. Just as in the general economy, prices are a mechanism to allocate these scarce resources. The objective of the economic theory based approaches was to find the transfer price that will lead the divisions, both buying and selling, to choose production levels which maximize total firm profits Eccles, (1985). Persons within the organization were viewed as rational utility maximizers. Therefore, they hypothetically will not exhibit dysfunctional behaviors that would lead to a misallocation of the scarce resources. The economic models have however been criticized that they focus on profit maximization in the short term, without regard for long term strategic decisions hence the economic models can only be applied in conceptually simple cases .

2.2.2 The Accounting Theory

According to Eccles (1985), the transfer pricing approaches based on accounting theory had the same objective as the economic theory and mathematical programming approaches. They sought to determine the transfer price that would motivate divisional managers and to make decisions that benefit the firm as a whole. The accounting theory approach also used the same assumptions about individual motivation and incentives as the preceding approaches. The primary focus of this stream of literature was whether market price or some form of standard variable cost should be used.

According to Miller (2011), in Africa there is a major concern among authorities that multinational enterprises can adjust transfer prices on cross-border transactions to reduce taxable profits. For example, a subsidiary company in one country may decide to sell its goods to its subsidiary in another country for US$1m when it is actually worth $10m. By doing this, $9m is concealed from tax authorities. Miller stated that the African Tax Administration Forum (ATAF) has identified transfer pricing as being a key potential loss of revenue for the African continent. To counteract this, African countries are beginning to follow the rest of the world with transfer pricing regulations and enforcements to protect revenue for growth on the continent.

The accounting theorists, like the economic theorists and mathematical programmers, focused on how transfer prices affect economic decisions. These decisions, made by the division managers, regarding how much to produce based upon the transfer price, were a short-term aspect of corporate performance. Because of the performance evaluation and reward system, managers were making decisions for the short-term: that is because the quantitative methods ignore strategy in their models. Also, the performance evaluation system assumed in the models ignored strategic decisions. These strategic decisions may cause divisions to be operating under different objectives and constraints.

2.3 Empirical Literature

2.3.1 Transfer pricing and level of implementation by MNCs

Plasschaert (1979) noted that the term “transfer pricing” often assumed derogatory connotations suggesting that large multinationals have leeway to manipulate the prices on intra-firm trade and service flows for business advantage. The study stated that when unrelated companies transact with each other, the circumstances of their commercial and financial relations are generally driven by market forces. By contrast, when related companies transact with each other, their commercial and financial relations may not be directly affected by external market forces in the same way. As a result, the prices charged for intra-firm transfers of goods, for instance, between a foreign subsidiary of a multinational and its US based parent, may differ from those charged to independent companies for the transfer of comparable goods. The study further argued that the US based parent theoretically exercises control over its subsidiaries and therefore has the power to fix the level of prices applied to intra-firm trade. If the overall profits of the multinational can be increased or if costs can be reduced, then the US based parent may have an incentive to artificially deviate from the “true” price for goods or services.

Grabski (1985) noted how unusual it was that only a small amount of research focusing on organizational behavior theory and transfer prices had been published by the mid-eighties. He stated that it was probably because “the transfer pricing technique is needed before the impact of the method on an individual and an organization can be addressed. Unfortunately, it appears that this viewpoint was quite prevalent because very little research had been done in this area. Yet, most of the problems pointed out in the complex mathematical models cited the inability to obtain fully truthful information from divisional managers because their compensation schemes are tied to divisional profits (Kanodia (1979 and Harris, et al., (1982).

According to Tomkins (1990), a number of approaches to resolving the transfer pricing conflicts are known. For example, goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge. However, this two-part transfer price system has a serious disadvantage because “the source division has no incentive to seek the optimal production level as it earns no profit on transactions made during the period. Another approach is based on sharing the group profit earned on the transferred goods, but its shortcomings include problems with the book-keeping and the economic meaning of the profit. Also, a more advanced dual-rate transfer pricing system has been proposed.

The problems with this approach concern the artificial nature of dual-rate transfer prices, which can lead to confusion. As a result, they are not widely used in practice. Many decentralized organizations use simple negotiation or negotiated optimal two-part tariffs to determine transfer prices. Although the efficiency of the latter is significantly higher than the efficiency of simple direct negotiation, the problem with this approach is that the outcome may depend on the managers‟ negotiation skills and their unequal bargaining power.

Kuntz and Vera (2005) conducted a study to test the results of introducing a transfer pricing mechanism between surgeons and anesthesiologists on approximately 57,000 operations carried out at the University Hospital Hamburg-Eppendorf in Germany over the period from 2000 to 2002. The results indicated that when the surgery department within the hospital was forced to directly pay for the resources of the anesthesiologists on an hourly basis, the surgically controlled time of operations was significantly reduced. The study concluded that transfer pricing policies lead to an increased awareness of the financial consequences of behavior, specifically an increased awareness on costs. The implication of this is that efficiency within organizations can be enhanced through proper application of transfer pricing policies.

Chung and McAlonan (2007), conducted a study concerning the development of transfer pricing policies that minimize the risk of economic double taxation. In a transfer pricing context, economic double taxation is best explained by way of an illustration. The study cited an example of a transaction between a Canadian financial advisory firm and its US subsidiary, whereby the US subsidiary performed extensive advertising and marketing functions for the US marketplace in exchange for a fee paid by its Canadian parent. If the internal revenue service (IRS) determines upon audit that the fee received by the US subsidiary is insufficient, they may make an adjustment to increase the amount of income recorded in the United States. This income, however, has already been recorded in Canada, which results in a tax payment in two different jurisdictions on the same portion of income. This in turn could lead to an increase in the global effective tax rate for the company. Taking into consideration this potential risk, global firms may alter their behavior, such that economic double taxation may not have a detrimental effect on the movements of capital, technology and persons and on the exchange of goods and services.

According to Bernard et al (2008), the United States was unable to collect an estimated USD 5.5 billion in corporate tax revenues in 2004 because of transfer pricing. As a result of such statistics, the Internal Revenue Service ("IRS") has indicated its intent to focus on transfer pricing issues during tax audits. In reference to a multibillion dollar transfer pricing settlement with a pharmaceutical company, IRS commissioner Mark Everson stated that "transfer pricing is one of the most significant challenges for the IRS in the area of corporate tax administration" and that "settlement of this case sends a strong message of our resolve to continue to deal with this issue going forward."

2.4 Review of Local research on the transfer pricing techniques and level of implementation by MNCs

According to Muli, (2012) in his study the relationship between tax enforcement environment, transfer prices and taxes on optimal companies identify transfer pricing as the largest tax risk facing multinational companies. In the academic literature, Njeia (2013) finds that the second-largest area of corporate income tax uncertainty as disclosed in 2010 is related to international transfer pricing. Also, Awour and Ngigi (2013) find that increased tax risk related to strict transfer pricing enforcement adversely impacts cross-border merger and acquisition premia. Given the growing focus on minimizing tax risk, it is therefore unclear whether transfer pricing is currently a useful tool for tax minimization for multinationals, or whether the operational and enforcement costs are too great to risk implementing aggressive transfer pricing strategies. Collectively, the literature does not provide direct insights into whether (and how much) certain firm practices and strategies with respect to transfer pricing lead to differences in tax minimization across multinationals. Additionally, it is unclear whether new mandatory financial reporting disclosures, such as FIN 48, impacts tax-motivated transfer pricing positions. Finally, despite impressions left in most academic research and current media, there is little evidence whether all multinationals view transfer pricing as purely an opportunity for tax minimization, and if they do, whether these firms are indeed capable of converting transfer pricing opportunities into reductions in tax burdens.

Awour and Ngigi, (2012) found that when it comes to transfer pricing strategies, non-manufacturing firms are more likely to adopt a goal of tax minimization than manufacturing firms. Also, firms with less intense internationalization are more likely to pursue a goal of tax compliance as opposed to minimization. These results are consistent with the transfer pricing literature using indirect evidence, which provides some external validity as to the quality of our survey responses. We also find that transfer pricing consumes, on average, a larger proportion of tax budgets in non-manufacturing firms and firms with more intense internationalization. Similarly, firms whose transfer pricing practices are assessed on tax minimization goals spend a higher percentage of their transfer pricing resources on tax planning relative to firms with tax compliance goals.

Mutai, (2012) in his study of the cross-sectional analysis between manufacturing firms and non-manufacturing firms planning and asset concentration also suggests that 10 years ago, manufacturing firms were spending a higher amount on planning than non-manufacturing firms, but now there is no statistically significant difference. Similarly, firms with high asset concentrations spent more on planning in 2000 than firms with lower asset concentrations, but again now there is no longer a statistically significant difference. These changes may be the result of limited planning opportunities related to increased transfer pricing scrutiny and stricter enforcement of arm's length principles that are more limiting for tangible goods, and therefore may have weighed heavier on the manufacturing industry relative to non-manufacturing firms. The results suggest a major shift in the propensity to invest in transfer pricing planning over the past decade.

2.5Summary of the Literature Review

Different types of approaches have been employed in literature when evaluating transfer pricing techniques both globally and locally. There are a number of administrative challenges that are faced in the implementation of transfer pricing techniques some of which include transfer pricing risks which are among the largest tax risks that tax administrations have to manage, the cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time (Lantz, 2009). Some MNCs recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits. Another challenge involves obtaining information across MNCs which is cumbersome since mutual relations between companies differ. Also the ease of access to and the quality of relevant supporting documentation is a key practical issue for auditors when dealing with this problem. The risk assessment process is central to the success of transfer pricing programmes but MNCs approach this in very different ways. The differences in approach being driven to some extent by the different environments in which they are operating and the particular constraints they have to work within (Kuntz and Vera, 2005).

Empirical studies in Kenya (Muli, 2012; Awour and Ngigi, 2012; and Mutai, 2012) have focused on the efficiency changes in the pricing techniques whilst establishing that MNCs are efficient from different perspectives. Muli, (2012) in his study the relationship between tax enforcement environment, transfer prices and taxes on optimal companies identify transfer pricing as the largest tax risk facing multinational companies. Awour and Ngigi, (2012) found that when it comes to transfer pricing strategies, non-manufacturing firms are more likely to adopt a goal of tax minimization than manufacturing firms. Also, firms with less intense internationalization are more likely to pursue a goal of tax compliance as opposed to minimization. Mutai, (2012) in his study of the cross-sectional analysis between manufacturing firms and non-manufacturing firms planning and asset concentration also suggests that 10 years ago, manufacturing firms were spending a higher amount on planning than non-manufacturing firms, but now there is no statistically significant difference. The studies however did not analyze the various methods used in transfer pricing and the challenges Multinationals companies in Kenya face in implementing them. This research therefore seeks to bridge the knowledge gap in this area and this forms the basis for this research.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter was organized into four parts. Section 3.2 discusses the research design adopted in this study justifying its choice for the study, section 3.3 deals with population and sample clearly describing the population of the study by understanding what the unit of analysis is in the study and explaining how the sample is going to be drawn from the population to ensure that it is representative of the study population and also states and justify the sampling technique and the sampling period. Section 3.4 deals with data and data collection instruments by stating the type of data the study is going to use, describing clearly how the data will be measured, provide a justification where the variables are measured in an unconventional manner and describe well the instruments that will be used to collect the data. Section 3.5 deals with the two parts of data analysis i.e. conceptual model and analytical model by clearly explaining how the variables are going to be measured and stating the expected theoretical relationships between the dependent and the independent variables. Relevant statistical tests, how the decision is reached and at what level of statistical significance is also discussed.

3.2 Research Design

A survey research design was used. According to Mbwesa (2006), a survey research involves collection of data from a population in order to determine the current status of that population with respect to one or more variables. A survey study seeks to identify some aspects of the population such as opinions, attitudes, believes or even knowledge of a particular phenomena.

This research design was chosen because similar studies have always used the design such as that conducted by Oriwo (2010) to study the regulatory measures by the government of Kenya in reducing transfer pricing manipulation by multinational corporations. The respondents will be at least one senior manager of each target multinational company.

3.3 Population and Sample

A population is the ‘aggregate of all cases that conform to some designated set of specifications” (Paton, 2002). The population of the study will be all the forty five Multinational corporations with headquarters in Kenya as per appendix one attached.

Since the population size is not large a census survey will be conducted where questionnaires will be circulated to all the forty five multinational corporations. Mugenda (2010) observe that a population is an enumeration of all the elements with the desired characteristics, making the universe of the study.

3.4 Data Collection

Data in the social sciences are either formal or informal settings and involve (oral and written) or non verbal acts or response. Consequently this research finds it advantageous to triangulate methods whenever feasible that is, they use more than one form of data collection to test the same research objectives. This study will use both structured / closed ended and unstructured / open ended questionnaires. Unstructured / open ended questionnaires lets the thoughts of respondents roam freely. We obtain ideas of respondents in their own language expressed spontaneously which are worthwhile as a basis of new hypothesis. This will take care of the qualitative part of the research, where the study will seek to find out the opinions and attitude of respondents on transfer pricing in their organization. The unstructured questionnaires require probing which may call for self administered questionnaires presented by the interviewer, this method ensures high respondent rate and gives benefits of degree of personal contact (Paton, 2002)

Quantitative methods will adopt structured / closed ended questions. In this questionnaire the question is accompanied by a list of all possible attentions from which respondents select the answer that best describe the situation. These questions are easy and quick to answer since there is no extended writing. The questions are economic on time and money and useful for testing research questions. The structured questionnaires will be mailed to the correspondents self addressed envelopes and stamps will accompany the questionnaire. This will save on the costs and time (Paton, 2002).

3.4.1 Validity and Reliability of the Instrument

According to Mugenda and Mugenda (1999), the reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials. In order to test the reliability of the instruments to be used in the study, a pilot study will be conducted in IBM Company involving 4 respondents who will not be sampled for the study to test the reliability of the instruments to be used. In this study, the reliability will be improved through minimizing external sources of variation say boredom, fatigue, or poor logistics and standardizing the conditions (improving the equivalence aspect) under which the measurements will be done by carefully designing the directions for measurement or measurement guide. In order to achieve content validity of the instrument, a general agreement on what constitutes adequate coverage of the problem will be made by a panel of other persons.

In order to achieve criterion validity of the instrument, all the team members involving in the research will be given an equal chance of to score well. In order to achieve construct validity of the instrument, the research team will be encouraged to keep on checking for variances in the results. Subsequently, they were required to keep on asking themselves the reason for the observed variance. Test retest and half-split reliability test will be carried out to ascertain the reliability.

3.5 Data Analysis

Data analysis involves data preparation where data is checked for accuracy, entered into a computer, examined critically and making inferences, Kombo and Tromp (2006). Immediately the questionnaires are received, they will be checked for accuracy. This will be done by checking whether the responses are legible, whether all important questions have been answered and whether the responses are complete.

3.5.1 Conceptual Model

The conceptual model will take the form of:

$$Y = f(X1, X2, X3, X4) \qquad (1)$$

Where

Y=Level of implementation of transfer pricing techniques by MNCs

X1= Market-based transfer pricing

X2= Cost-based transfer pricing

X3= Negotiated transfer pricing

X4= Central management based transfer pricing

Market-based transfer pricing

The market-based transfer price will be measured by a price that a selling division gets for its product in the external market or the price at which the buying division gets the product in the market place. Eden, Luis, Valdez, and Li, (2005) states that the use of market based transfer prices allows each division to be evaluated on a stand alone basis resulting to implementation at the divisional levels of the MNCs. Therefore market-based transfer pricing shows positive significant relationship with the implementation of transfer pricing techniques in MNCs.

Cost-based transfer pricing

Full cost method will be measured by full cost including fixed overheads absorbed that are incurred by the supplying division in making the intermediate product charged to the receiving division. Tomkins (1990) stated that the cost-based transfer pricing includes the full cost method, the full cost plus method and the marginal cost transfer price which in turn gives a positive relationship with MNCs transfer pricing techniques implementation.

Negotiated transfer pricing

The negotiated transfer pricing method will be measured by charging the variable cost that is incurred by the supplying division to the receiving division (Grabski, 2005). The negotiated transfer pricing method involves negotiations between two managers of the selling and receiving departments/divisions. The selling manager quotes the price and delivery conditions which may or may not be accepted by the receiving manager based on alternative sources (Hirshleifer, 2006). It is expected that this gives a direct signal of positive relationship between implementation of transfer pricing techniques by MNCs.

Central management based transfer pricing

The central management-based transfer pricing will be measured by the price determined by the central management and communicated to the divisional managers. According to Hirshleifer, (2006) there is a strong and positive relationship between central management based transfer pricing and implementation by MNCs asserting that under the central management-based transfer pricing**,** the central management may determine the transfer price and communicate this to the divisional managers. In most cases the basis of this is to promote goal congruency and to allow for a standard performance evaluation criteria.

3.5.2 Analytical Model

The study will aim to establish the relationship between transfer pricing techniques and the level of implementation in MNCs. Multiple regression analysis will be used. The regression equation to be tested will be as follows;

$IL = \beta o + \beta_1 MBTP + \beta_2 CBTP + \beta_3 NTP + \beta_4 CMBTP$ (2)

Where;

IL =Level of implementation of transfer pricing techniques in MNCs

MBTP = Market-based transfer pricing

CBTP = Cost-based transfer pricing

NTP = Negotiated transfer pricing

CMBTP = Central management based transfer pricing

β_0 = The constant term

β_1 = Coefficient of Market-based transfer pricing

β_2 = Coefficient of Cost-based transfer pricing

β_3 = Coefficient of Negotiated transfer pricing

β_4 = Coefficient of Central management based transfer pricing

ε_{i} = The error term

To test the relationship between the variables (transfer pricing techniques and challenges faced in their implementation), the study will adopt both descriptive and inferential analysis. The inferential statistical procedures to be used in this study are correlation coefficient *(r)* and pearsonian correlation coefficient. The tests of significance to be used are regression analysis expected to yield the coefficient of determination (R^2), analysis of variance along with the relevant t – tests, f -tests, z – tests and p – values. The choices of these techniques are guided by the variables, sample size and the research design. The inferential statistical techniques will be done at 95% confidence level ($\alpha = 0.05$). The data will be analysed using the Statistical Package Social Sciences Software (SPSS). Quantitative data will be used to present results in form of graphs and tables. As posted in the literature review by a number of scholars, e.g. Hirshleifer, (2006), a positive relationship is expected between the challenges faced by multinational companies in implementing the transfer pricing techniques and the transfer pricing techniques adopted by multinational companies in Kenya.

CHAPTER FOUR
DATA ANALYSIS, INTERPRETATION AND PRESENTATION

4.1 Introduction

This chapter is a presentation of results and findings obtained from field responses and data, broken into two parts. The first section deals with the background information of the organizations, while the other five sections present findings of the analysis, based on the objectives of the study where both descriptive and inferential statistics have been employed in this analysis and discuss the issues in the best way possible.

4.2 Summary Statistics

From the data collected, out of the 45 questionnaires administered, 39 were filled and returned. This represented 81.25% response rate, which is considered satisfactory to make conclusions for the study. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% rated very good. This also collaborates Bailey (2000) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This implies that based on this assertion; the response rate in this case of 81.25% is very good.

This high response rate can be attributed to the data collection procedures, where the researcher pre-notified the potential participants of the intended survey, the questionnaire was self-administered to the respondents who completed them and these were picked shortly after.

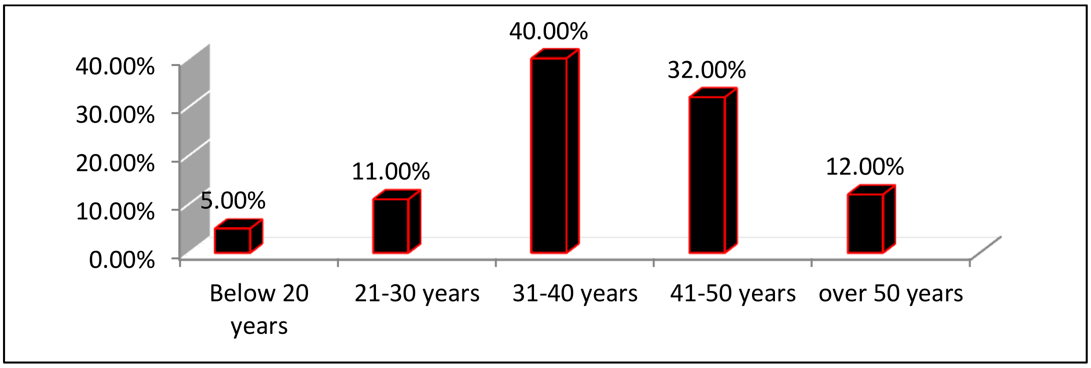
Table 4.1 Response Rate

	Questionnaires administered	Questionnaires filled & returned	Percentage
	45	39	81.25

4.3 Number of years the company has been in operation in Kenya

The study established the number of year's distribution the companies has been in operation in Kenya. The findings were as indicated in Figure 4.1

Figure 4.1 Number of years in Kenya

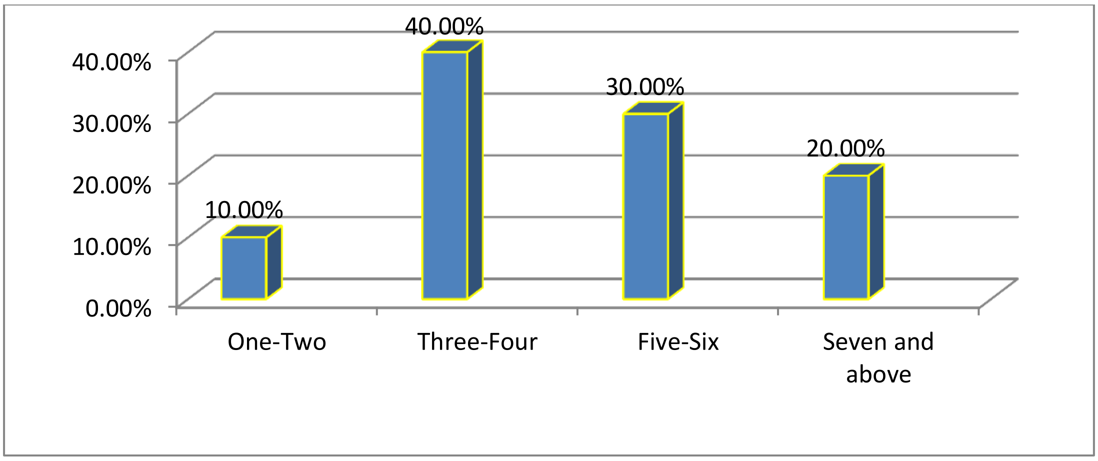


From the findings in Figure 4.1, majority (40%) indicated that they had been in operation in Kenya for a period ranging between 31-40 years, followed by those who indicated that they had been operating in Kenya between 41-50 years with few (12%) indicating that they had been operating in Kenya above 50 years. This implies that majority of the MNCs had been operating in Kenya for long time and therefore are in position to implement transfer pricing techniques.

4.4 Number of continents the companies have presence

The study sought to determine the number of continents the companies have presence; this was to ascertain the extent of their market growth in international perspective.

Figure 4.2 Continents the companies have presence

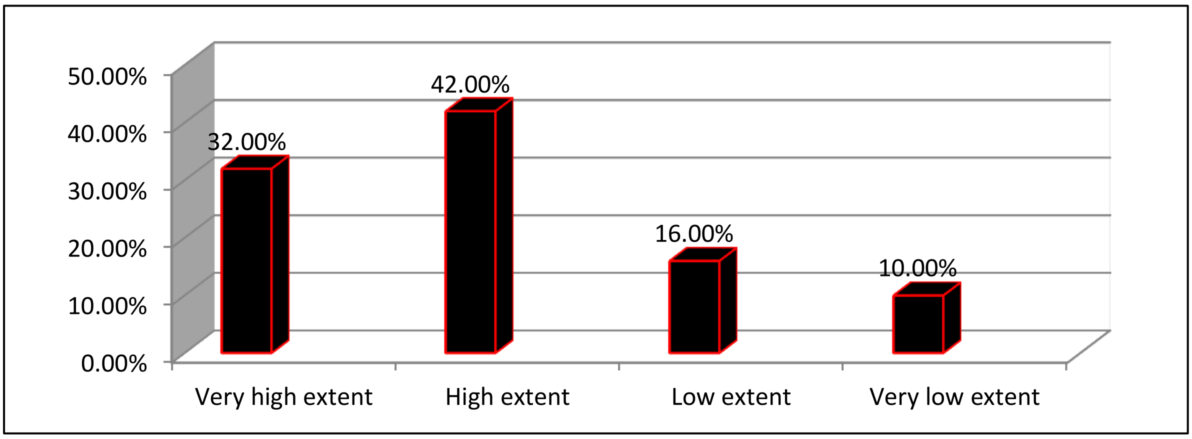


From the study findings as indicated in Figure 4.2, majority (40%) of the respondents indicated that their companies covers 3-4 continents followed by those who indicated that their companies covers 5-6 continents with only few (10%) indicating that their companies covers 7 continents and above. This meant that they would invest time and effort in market coverage to make sure they succeed. The study therefore observes that the companies cover large market worldwide. Market for the business therefore becomes a trait that ensures continuity and perpetuation of the vision of an organization (Larnsen, 2012).

4.5 Transfer pricing techniques

The main aim of the study was to establish the relationship between transfer pricing techniques and their level of implementation in Multinational companies in Kenya. The study first sought to determine the extent the transfer pricing techniques influence the management decision in MNCs. The findings were as indicated in Figure 4.3

Figure 4.3 The extent the transfer pricing techniques influence the management decision in MNCs

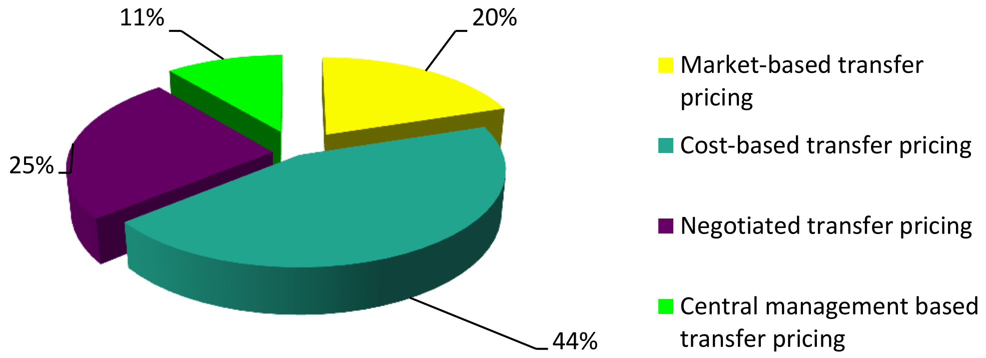


The findings were as indicated in Figure 4.3. From the study findings majority 42% indicated that transfer pricing techniques influences the management decision in MNCs to high extent followed by 32% who indicated very high extent with only few 16% and 10% indicating low extent and very low extent respectively. This can be depicted to mean that transfer pricing techniques are very crucial in any management decisions in Multinational Corporation in Kenya.

4.6 The transfer pricing techniques applicable in Multinational Corporation

The study further sought to determine the most commonly used transfer pricing techniques in Multinational Corporation in Kenya. The findings were as indicated in Figure 4.4

Figure 4.4The transfer pricing techniques applicable in Multinational Corporation



From the study findings majority 44% indicated that the most commonly used transfer pricing techniques is cost-based transfer pricing, 25% indicated negotiated transfer pricing techniques, 20% indicated market-based transfer pricing with only 11% indicating central management based transfer pricing. This implies that multinational companies consider cost very crucial in transfer pricing along departments as a motive of profit maximization.

4.7 Statements related to transfer pricing techniques

The study also evaluated the statements of transfer pricing techniques. A 5-point likert scale was developed, where 1= Strongly disagree, 2= Disagree, 3=Not sure, 4=Agree and 5=Strongly agree; 1= Very poor, 2= Poor, 3= Average, 4= Good and 5=Very good; 1=Very unlikely, 2= Unlikely, 3= Neutral, 4= Likely and 5= Very likely as per the questions. To this effect respondents were asked to affirm to their opinion on the range of issues asked, as illustrated in table 4.4 below.

Table 4.2 Statements related to transfer pricing techniques

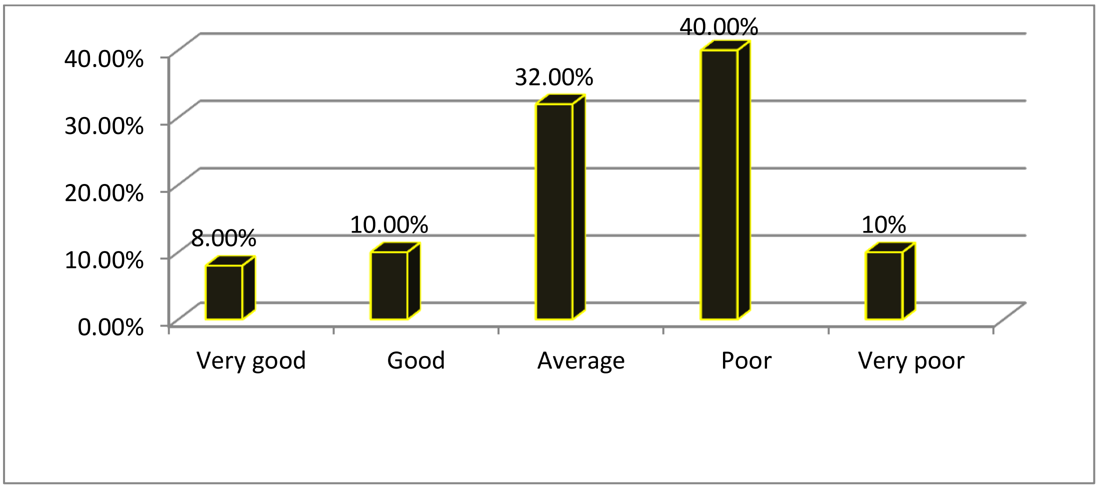
STATEMENT	Strongly disagree	Disagree
Transfer prices set by multinational firms differ between independent third parties and related party entities and the extent to which these differences are elastic to product and firm characteristics, market structure, and government policy	3.45	0.461
Tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates	3.66	0.390
Firms may be able to insulate themselves from exchange rate movements using transfer pricing	3.89	0.378
The ability to purchase goods from affiliates at lower prices may influence a firm's size, and levels of innovation, productivity, and wages.	3.67	0.389

Majority of the respondents agreed that transfer prices set by multinational firms differ between independent third parties and related party entities and the extent to which these differences are elastic to product and firm characteristics, market structure, and government policy as indicated by a mean of 3.45. Tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates as indicated by majority (3.66). Further majority also agreed that firms may be able to insulate themselves from exchange rate movements using transfer pricing as indicated by a mean of 3.89. Finally majority agreed that the ability to purchase goods from affiliates at lower prices may influence a firm's size, and levels of innovation, productivity, and wages as indicated by a mean of 3.67.

4.8 Rating the level of transfer pricing in Multinational Companies in Kenya

The study further rated the transfer pricing techniques in Multinational Companies in Kenya. The findings were as indicated in Figure 4.5.

Figure 4.5Rating the level of transfer pricing in Multinational Companies in Kenya

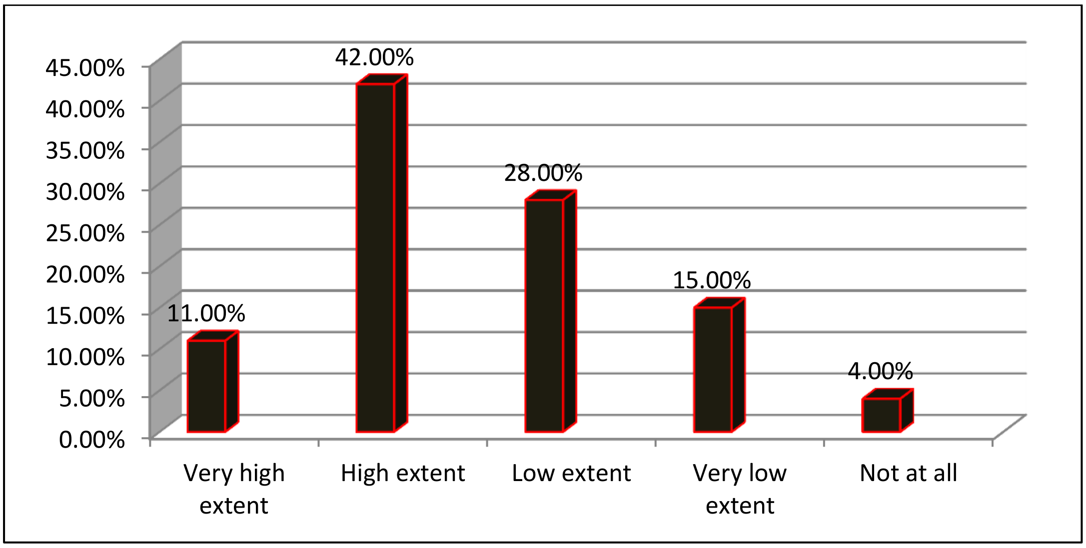


The findings were as indicated in Figure 4.5. The study findings indicates that majority 40% indicated transfer pricing techniques in Multinational Companies in Kenya as poor, 32% indicated as average with few 10% and 8% indicating as good, very poor and very good respectively. This implies that transfer pricing techniques have not been fully implemented in multinational companies in Kenya.

4.9 Level of implementation of transfer pricing techniques and associated challenges

The study further sought to determine the level of implementation of transfer pricing techniques in order to determine if Multinational Companies have an established role of transfer pricing techniques in their operations. First, the study found out the extent the respondents think transfer pricing techniques are implemented in their companies. The findings were as indicated in Figure 4.6

Figure 4.6 Level of implementation of transfer pricing techniques and associated challenges



From the study findings majority 42% indicated the extent of implementing transfer pricing techniques to high extent, 28% indicated low extent, 15% indicated low extent with only few 11% and 4% indicating very high extent and not all respectively. This implies that majority of Multinational Companies implement transfer pricing techniques in their during their business operations.

The study then determined the challenges associated with transfer pricing techniques, in relations to certain associated statements to be rated on a 5 Likert scale. The findings were as indicated in Table 4.3

Table 4.3 challenges associated with transfer pricing techniques

STATEMENT	Mean	Std deviation
The cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time.	3.632	0.7321
Some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits.	3.723	0.7562
Obtaining information across borders is cumbersome since international relations between countries differ.	3.682	0.7423
The risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways.	3.562	0.7921

The findings indicated that majority agreed that the cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time as indicated by a mean of 3.632. Further majority also agreed that some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits as indicated by a mean of 3.723. Further majority of the respondents also agreed that obtaining information across borders is cumbersome since international relations between countries differ as indicated by a mean of 3.682. Finally they also agreed that the risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways as indicated by a mean 3.562. This implies that multinational companies normally face many challenges in implantation of transfer pricing techniques during their business operations.

The study after establishing the challenges faced by Multinational Corporation in implementation of transfer price techniques further sought to determine the approaches to resolving the transfer pricing conflicts and rated on a 5 Likert scale.

Table 4.4 Approaches to resolving the transfer pricing techniques

STATEMENT	Mean	Std deviation
Goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge.	4.221	0.542
Sharing the group profit earned on the transferred goods	3.682	0.723
Simple negotiation or negotiated optimal two-part tariffs to determine transfer prices.	3.892	0.693

From the study findings majority strongly agreed that the most approach to resolving the transfer pricing conflicts is that goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge as indicated by a mean of 4.221. The respondents further agreed that sharing the group profit earned on the transferred goods is an approach to resolving conflicts as indicated by a mean of 3.682. Further the respondents agreed that simple negotiation or negotiated optimal two-part tariffs to determine transfer prices is an approach to resolving conflicts as indicated by a mean of 3.892. This implies that management applies different ways in transfer pricing conflict management for sustainable growth.

4.10 Empirical model

4.10 .1 Regression and Correlation Coefficients of transfer pricing techniques and their level of implementation

Regression analysis was utilized to investigate the relationship between the variables. These included an error term, whereby a dependent variable was expressed as a combination of independent variables. The unknown parameters in the model were estimated, using observed values of the dependent and independent variables.

The following model represents the regression equation representing the relationship between transfer pricing techniques and their level of implementation (market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing), with έ representing the error term.

$IL = \beta o + \beta_1 MBTP + \beta_2 CBTP + \beta_3 NTP + \beta_4 CMBTP$**……Equation 1**

(Equation 1: Regression Equation)

Incorporating the values of the Beta values into equation 1 we have:

$Yi = \alpha + 0.843\ (MBTP) + 0.719\ (CBTP) + 0.822\ (NTP) + 0.972(CMBTP) + έ$….Equation 2

(Equation 2: Regression Equation with Beta Values)

The βi's in the above equation represent the estimated parameters.

The correlation matrix in table 4.5 indicates that market-based transfer pricing is strongly and positively correlated with its level of implementation as indicated by a correlation coefficient of 0.843. Further the matrix also indicated that cost-based transfer pricing is also positively correlated with its level of implementation as indicated by a coefficient of 0.719. The correlation matrix further indicates that central management based transfer pricing is also strongly and positively correlated with its level of implementation as indicated by a coefficient of 0.972.

The correlation matrix implies that the transfer pricing techniques: market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing are very crucial in implementing transfer pricing related decisions.

Table 4.5 Correlation Coefficients between transfer pricing techniques and their level of implementation.

	Market-based transfer pricing	Cost-based transfer pricing	Negotiated transfer pricing	Central management based transfer pricing	Level of implementation of transfer pricing techniques in MNCs
Market-based transfer pricing	1				
Cost-based transfer pricing	0.851	1			
Negotiated transfer pricing	0.753	0.653	1		
Central management based transfer pricing	0.754	0.854	0.714	1	
Level of implementation of transfer pricing techniques in MNCs	0.719	0.843	0.822	0.672	1

4.10.2 Regression Model Summary of the transfer pricing techniques and their level of implementation.

From the results shown in table 4.6, the model shows a goodness of fit as indicated by the coefficient of determination (R^2) with a value of 0.7338. This implies that the transfer pricing techniques market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing explain 73.38 percent of the variations in their implementation.

The study therefore identifies market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing as critical techniques in implementing transfer pricing related decisions.

Table 4.6: Regression Model Summary of the transfer pricing techniques and their level of implementation

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.8566	0.7338	0.7011	0.7638

Predictors: (Constant), market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing.

4.10.3 Analysis of Variance (ANOVA)

Table 4.7: Analysis of Variance (ANOVA) results of the transfer pricing techniques and their level of implementation

	Sum of Squares	df	Mean Square	F	F-critical value	Significance
Regression	69.82	11	19.95	22.08	104.92	0.00
Residual	4.364	23	6.321			
Total	73.19	27				

NB: F-critical Value 104.92 (statistically significant if the F-value is less than 104.92: from table of F-values).

a. **Predictors: (Constant),** market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing.

The value of the F statistic, 22.08 indicates that the overall regression model is significant hence it has some explanatory value i.e. there is a significant relationship between the predictor variables market-based transfer pricing, cost-based transfer pricing, negotiated transfer pricing and central management based transfer pricing(taken together) and their level of implementation in MNCs in Kenya

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter is a synthesis of the entire study, and contains summary of research findings, exposition of the findings, commensurate with the objectives, conclusions and recommendations based thereon.

5.2 Summary of the study

The main aim of the study was to establish the relationship between transfer pricing techniques and their level of implementation in Multinational companies in Kenya. The study first sought to determine the extent the transfer pricing techniques influence the management decision in MNCs. From the study findings majority indicated that transfer pricing techniques influences the management decision in MNCs to high extent followed by those who indicated very high extent with only few indicating low extent and very low extent respectively. This can be depicted to mean that transfer pricing techniques are very crucial in any management decisions in Multinational Corporation in Kenya.

The study further sought to determine the most commonly used transfer pricing techniques in Multinational Corporation in Kenya. From the study findings majority indicated that the most commonly used transfer pricing techniques is cost-based transfer pricing, majority also indicated negotiated transfer pricing techniques, further majority further indicated market-based transfer pricing with only few indicating central management based transfer pricing. This implies that multinational companies consider cost very crucial in transfer pricing along departments as a motive of profit maximization.

The study also evaluated the statements of transfer pricing techniques. A 5-point likert scale was developed, where 1= Strongly disagree, 2= Disagree, 3=Not sure, 4=Agree and 5=Strongly agree; 1= Very poor, 2= Poor, 3= Average, 4= Good and 5=Very good; 1=Very unlikely, 2= Unlikely, 3= Neutral, 4= Likely and 5= Very likely as per the questions. To this effect respondents were asked to affirm to their opinion on the range of issues asked. Majority of the respondents agreed that transfer prices set by multinational firms differ between independent third parties and related party entities and the extent to which these differences are elastic to product and firm characteristics, market structure, and government.

Tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates as indicated by majority. Further majority also agreed that firms may be able to insulate themselves from exchange rate movements using transfer pricing. Finally majority agreed that the ability to purchase goods from affiliates at lower prices may influence a firm's size, and levels of innovation, productivity, and wages.

The study further rated the transfer pricing techniques in Multinational Companies in Kenya. The study findings indicates that majority indicated transfer pricing techniques in Multinational Companies in Kenya as poor, majority further indicated as average with few indicating as good, very poor and very good respectively. This implies that transfer pricing techniques have not been fully implemented in multinational companies in Kenya. The study further sought to determine the level of implementation of transfer pricing techniques in order to determine if Multinational Companies have an established role of transfer pricing techniques in their operations. First, the study found out the extent the respondents think transfer pricing techniques are implemented in their companies. From the study findings majority indicated the extent of implementing transfer pricing techniques to high extent. This implies that majority of Multinational Companies implement transfer pricing techniques in their during their business operations.

The study then determined the challenges associated with transfer pricing techniques, in relations to certain associated statements to be rated on a 5 Likert scale. The findings indicated that majority agreed that the cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time. Further majority also agreed that some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits. Further majority of the respondents also agreed that obtaining information across borders is cumbersome since international relations between countries differ. Finally they also agreed that the risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways. This implies that multinational companies normally face many challenges in implementation of transfer pricing techniques during their business operations.

The study after establishing the challenges faced by Multinational Corporation in implementation of transfer price techniques further sought to determine the approaches to resolving the transfer pricing conflicts and rated on a 5 Likert scale. From the study findings majority strongly agreed that the most approach to resolving the transfer pricing conflicts is that goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge. The respondents further agreed that sharing the group profit earned on the transferred goods is an approach to resolving conflicts. Further the respondents agreed that simple negotiation or negotiated optimal two-part tariffs to determine a transfer price is an approach to resolving conflicts. This implies that management applies different ways in transfer pricing conflict management for sustainable growth.

5.3 Conclusions

From the study findings majority indicated that transfer pricing techniques influences the management decision in MNCs to high extent followed by those who indicated very high extent with only few indicating low extent and very low extent respectively. From the study findings majority indicated that the most commonly used transfer pricing techniques is cost-based transfer pricing, followed by negotiated transfer pricing techniques, then market-based transfer pricing with only few indicating central management based transfer pricing.

Majority of the respondents agreed that transfer prices set by multinational firms differ between independent third parties and related party entities and the extent to which these differences are elastic to product and firm characteristics, market structure, and government. Tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates as indicated by majority. Further majority also agreed that firms may be able to insulate themselves from exchange rate movements using transfer pricing. Finally majority agreed that the ability to purchase goods from affiliates at lower prices may influence a firm’s size, and levels of innovation, productivity, and wages.

The study findings indicates that majority indicated transfer pricing techniques in Multinational Companies in Kenya as poor, majority further indicated as average with few indicating as good, very poor and very good respectively. From the study findings majority indicated the extent of implementing transfer pricing techniques to high extent. This implies that majority of Multinational Companies implement transfer pricing techniques in their during their business operations.

The findings indicated that majority agreed that the cases involving transfer pricing are blbso complex and involve extensive fact gathering leading to settlement of such cases after a long period of time. Further majority also agreed that some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits. Further majority of the respondents also agreed that obtaining information across borders is cumbersome since international relations between countries differ. Finally they also agreed that the risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways. This implies that multinational companies normally face many challenges in implantation of transfer pricing techniques during their business operations.

From the study findings majority strongly agreed that the most approach to resolving the transfer pricing conflicts is that goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge. The respondents further agreed that sharing the group profit earned on the transferred goods is an approach to resolving conflicts. Further the respondents agreed that simple negotiation or negotiated optimal two-part tariffs to determine transfer prices are an approach to resolving conflicts.

5.4 Limitations of the study

From the questionnaires filled some companies were holding some information since they thought that by responding to the questionnaire they would be exposing themselves to their competitors and the tax authority. From the study some companies didn’t fill the questionnaires since they felt that sharing such information is not in line with their group policy. In some companies the employees didn’t not fully understand the concept of transfer pricing and some felt intimidated by the questions asked.

5.5 Recommendation for further Research

The study focused on the selected transfer pricing techniques. There are other techniques that have equally important contribution towards Multinational Corporation pricing mechanisms. Therefore other studies should focus on other techniques not considered and how they can be incorporated in the variable to enhance performance of Multinational Companies.

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APPENDIX 1: QUESTIONNAIRE FOR MNCs MANAGERS

Below is a questionnaire that intends to capture your views as a manager of MNCs in Kenya. Please note that no identification is required and information given is intended for academic purposes only. Ensure that you respond to all the questions. Thank you.

PART 1: Background Information

1. What number of years has your company been in operation in Kenya

Below 20 years	[ ]	31-40 years	[ ]	Over 50 years	[ ]
21-30 years	[ ]	41-50 years	[ ]		

2. How many continents does your company have presence

One - Two	[ ]
Three - Four	[ ]
Five - Six	[ ]
Seven and above	[ ]

3. State your company's headquarters and the number of countries of presence worldwide

Headquartered in …………………………… number of countries …………………..

PART 1: Transfer pricing techniques

5. According to you, to what extent do transfer pricing techniques influence the management decision in MNCs?

Very high extent [ ] High extent [ ] Low extent [ ] Very low extent [ ] Not at all [ ]

6. The following are the transfer pricing techniques, which one is applicable to your company (you may tick more than one)

Market-based transfer pricing [ ] Cost-based transfer pricing [ ] Negotiated transfer pricing [ ] Central management based transfer pricing [ ]

6. Below are statements related to transfer pricing techniques, tick appropriately?

STATEMENT	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
Transfer prices set by multinational firms differ between independent third parties and related party entities and the extent to which these differences are elastic to product and firm characteristics, market structure, and government policy					
Tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates					
Firms may be able to insulate themselves from exchange rate movements using transfer pricing					
The ability to purchase goods from affiliates at lower prices may influence a firm's size, and levels of innovation, productivity, and wages.					

7. According to you, how can you rate the level of transfer pricing in your company?

Very good [ ] Good [ ] Average [ ] Poor [ ] very poor [ ]

8. According to you, what can be done to ensure that transfer pricing leads to proper coordination within the divisions in the company?

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PART 2: Level of implementation of transfer pricing techniques and associated challenges

9. To what extent do you think transfer pricing techniques are implemented in your company?

Very high extent [ ] High extent [ ] Low extent [ ] very low extent [ ] Not at all [ ]

10. Below are challenges associated with transfer pricing techniques, indicate your level of agreement by ticking appropriately.

STATEMENT	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**
The cases involving transfer pricing are so complex and involve extensive fact gathering leading to settlement of such cases after a long period of time.					
Some countries recover very little tax from their transfer pricing audits or enquiries whereas others recover very large amounts from almost all their audits.					
Obtaining information across					

borders is cumbersome since international relations between countries differ.					
The risk assessment process is central to the success of transfer pricing programmes but countries approach this in very different ways.					

15. Below are statements related to the challenges facing implementation of transfer pricing techniques, tick appropriately?

STATEMENT	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**
Manipulating transfer prices results in decreased cash flows and lower stock market prices for MNCs Depository Receipts.					
General economic principles compound the difficulty for multinationals who seek to solve the corporate transfer pricing problem.					
Transfer pricing increases in instances where corporate tax rates are low and tariffs are high.					

Tax minimization may indeed play a role in transfer pricing decisions made by firms, as firms appear to make substantial price adjustments to changes in country tax and tariff rates.					
The gap narrows as the domestic currency appreciates relative to the currency of the foreign country, with the implications that intra firm trade plays a role in the determination of aggregate export price indices and that firms may be able to insulate themselves from exchange rate movements using transfer pricing.					
Performance of multinationals should incorporate the effects of transfer pricing, as the ability to purchase goods from affiliates at lower prices may influence a firms size, and levels of innovation, productivity, and wages.					

16. Below are approaches to resolving the transfer pricing conflicts, rate them to a scale of 1-5 where 1-strongly disagree, 2-Disagree, 3-Neutral, 4-Agree and 5 strongly agree.

STATEMENT	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**
Goods can be transferred between the divisions at a variable cost with profit to the supplier provided by a periodic charge.					
Sharing the group profit earned on the transferred goods					
Simple negotiation or negotiated optimal two-part tariffs to determine transfer prices.					

16. What can be done to ensure that implementation of transfer pricing techniques is enhanced in MNCs?

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APPENDIX ONE

Companies with African headquarters in Nairobi as at December 2012

The following is a list of multinational companies and organizations, with their African (continent-wide or regional) headquarters in Nairobi:

Organization	District of Nairobi
BASF	Ruaraka
Bank of China	Kilimani
BhartiAirtel	Mombasa Road
Cisco Systems	Upper Hill
Chartis	Westlands
China Central Television	Hurlingham
China Daily	CBD
China Radio International	Hurlingham
Citibank	Upper Hill
Coca Cola	Upper Hill
Eltek	Upper Hill
General Electric	Westlands
Google	Westlands
Heineken	High Ridge
Huawei	Upper Hill
IBM	Chaka Road
ICAO	Gigiri
IMF	Upper Hill
Intel Corporation	Westlands
ITF	Westlands
IUCN	Mukoma
Kaspersky Lab	
Kiva	
LG	Westlands
Mastercard	CBD

Motorola Solutions	
NIIT	
Nokia	
Nestle	Industrial Area
Pfizer	Industrial Area
Pricewaterhouse Coopers	Upper Hill
Qualcomm	
Rockefeller Foundation	Upper Hill
Red Cross	Mombasa Road
Research In Motion	
RTI International	Westlands
Sage Group	Westlands
Sony	Westland
Standard Chartered Bank	Westlands
Stratlink Global	Kileleshwa
Syngenta	Upper Hill
TNT	Upper Hill
Toyota	Mombasa Road
Visa Inc.	Upper Hill
World Bank	Upper Hill
Xinhua News Agency	Upper Hill

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