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Diffusion of transfer pricing innovation in the context of commercialization—a longitudinal case study of a government trading enterprise

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Abstract

This paper examines the diffusion of transfer pricing as an innovation in a government trading enterprise (GTE) as it moved from protected monopolistic status to commercialization. Using data from semi-structured interviews and documentation, the paper draws on theories of transfer pricing choice and diffusion of innovation to analyse and explain events surrounding the introduction, abandonment and reintroduction of transfer pricing in the case organization over the ten-year period from 1991 to 2000. The study demonstrates the importance of multiple theories and perspectives in understanding how and why management accounting innovations diffuse or not, as well as the importance of focusing on the secondary stage of innovation adoption and on organizational values, norms and past experiences as they affect secondary adoption. The study also provides support for the role of transfer pricing as an accounting mechanism to effect cultural and strategic change in organizations and for the reciprocal relationship between transfer pricing and organizational strategy over time.

Keywords: Transfer pricing; Management accounting change; Diffusion of innovation

1. Introduction

This paper examines the diffusion of transfer pricing as an innovation in a government trading enterprise (GTE) during a period when the enterprise underwent major management and structural changes associated with movement from a protected monopolistic status towards competition, commercialization and corporatization in a deregulated market environment. The enterprise is a major energy distributor and retailer in Australia and is referred to in this paper as Energy. Transfer pricing was one of a number of changes in the management and accounting practices of Energy which, as a GTE, was at the forefront

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of government pressure for financial, management and structural reform of public sector organizations during the late 1980s and 1990s.

Transfer pricing has been the subject of much research over many years (van der Meer-Kooistra, 1994, p. 123), being seen as "at the heart of inter-profit center relations" (Ghosh, 2000, p. 661), a pervasive issue in the design and implementation of management information and control systems (Emmanuel et al., 1990, p. 277; Colbert and Spicer, 1995, p. 423), and important in terms of strategic and operational decisions in organizations and having behavioral and performance appraisal consequences (van Helden et al., 2001, p. 358; Boyns et al., 1999, p. 85). Despite this, Boyns et al. (1999, p. 85) argue that "our understanding of the determinants of the choice of transfer price is (still) patchy."

The literature on the determinants of transfer pricing choice comprises theories and approaches which seek to prescribe or predict the method of transfer pricing (e.g. cost versus market) based on elements of organizational context. Discussed more fully later, these theories and approaches typically view transfer pricing as being determined by organizational contextual factors such as structure (Watson and Baumler, 1975), vertical integration and diversification (Eccles, 1985), strategy, intra-firm transactional context, structure and control systems (Spicer, 1988; Colbert and Spicer, 1995; Emmanuel and Mehafdi, 1994; van der Meer-Kooistra, 1994). Common to these approaches are two assumptions. The first is that transfer pricing choice and change can be understood through contingent relations with contextual factors drawn from the economics of internal organization and transaction cost theories. The second assumption is that transfer pricing is determined by those factors, particularly strategy and structure (including both organizational and transactional structure).

Contemporary research, however, suggests that such assumptions, while necessary, are not sufficient to provide a full understanding of transfer pricing choice and change. With respect to the first assumption, Boyns et al. (1999), for example, argue from their longitudinal study of transfer pricing in a UK coal and iron company, that corporate history, power and evolution must also be considered. Similarly, in their study of Hoogovens Steel in The Netherlands, van Helden et al. (2001) note the importance of history and organizational learning in understanding the development of a transfer pricing system over time, and its linkages with (changing) organizational structure and broader management control systems. With respect to the second assumption, Boyns et al. (1999) provide evidence to suggest that transfer pricing might not be a product of strategy, but might be used to enact strategy.

Contemporary research also stresses the importance of understanding the process and dynamics of transfer pricing change. van Helden et al. (2001) note that there "has been very little research into the processes through which transfer pricing practices emerge over time in individual organizations," and van der Meer-Kooistra (1994, p. 150) also state:

> Transfer pricing systems are in a permanent state of flux, not only because of changing circumstances, but also because the parties involved learn as they go along. Therefore research into the functioning of transfer pricing systems has to take full account of the processes of change and adaption, or the dynamics of the phenomenon.

The present study seeks to develop our understanding of transfer pricing choice and change by drawing on, and combining, the above approaches. Specifically, the study is designed to incorporate both the technical contingency approaches which posit appropriate configurations of contextual factors and transfer pricing methods; and what may be called the processual approaches which posit the changing nature of transfer pricing and which require the study of organizational history and learning, and focus on movements in the transfer pricing phenomenon over organizational time and space.