Asia-Pacific Management Accounting Journal, Volume 6 Issue 2, 85-106, 2011

Transfer Pricing in Australian Service Organisations

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Abstract

Most transfer pricing studies focus on domestic or international manufacturing organisations. This paper reports the results of a survey of the domestic transfer pricing practices, in particular, objectives and methods of Australian service organisations. A novel aspect of this study was the exploration of the notion of "internal customer value" in the transfer pricing practices of service organisations. Survey responses from 80 large Australian service organisations indicate that goal congruence and ease of understanding transfer pricing are the most important objectives; cost-based and multiple methods of transfer pricing are most commonly adopted. This study also suggests that the value-based transfer pricing method is not adopted, and that lack of awareness of and interest in internal customer value typify the internal markets within the Australian service sector.

Keywords: Transfer pricing; services; value

Introduction

A transfer price is a charge by one division (transferring division) to another division (receiving division) within the same organisation (Hoque, 2005; Horngren, Wynder, Maguire, Tan and Datar, 2011), and thus represents revenue for the selling division and a cost for the buying division. Determination of a transfer price may have far-reaching implications for many facets of an organisation, including operational performance, tax burden, cash flow (Ernst and Young, 2007), performance evaluation of departments (Colbert and Spicer, 1995), efficient allocation of resources (Abdel-Khalik and Lusk, 1974), cost

ISSN 1675-3194

allocation (Kovac and Troy, 1989), corporate performance (Cravens, 1997) and profits (Ghosh and Boldt, 2004).

Previous studies of transfer pricing (TP) have considered aspects of the phenomenon such as methods (Al-Eryani, Alam and Akhter, 1990; Tang, 1992), theory (Watson and Baumler, 1975; Spicer, 1988; Colbert and Spicer, 1995), TP change (Boyns, Edwards and Emmanuel, 1999), fairness (Emmanuel and Gee, 1982; Eccles, 1985; Tomkins and McAulay, 1992), negotiation outcomes (Chan, 1998), determinants of TP (Burns, 1980; Al-Eryani et al., 1990), international taxation (Picciotto, 1992), uncertainty (Ronen and Balachandran, 1988), strategy (Eccles, 1985; Spicer, 1988), and conflict (Abdel-Khalik and Lusk, 1974). The focus of most previous TP studies has been on manufacturing industries and multinational corporations. Shields (1997) attributed the heavy emphasis on manufacturing-focused research to management accounting's historical concern with product costing and factory cost control in the manufacturing environment. In contrast, the concentration of research on multinational corporations has been motivated by the implications and impacts of TP on corporate taxation. With a few notable exceptions (e.g., Tyler and Fridholm, 1975; Lucien, 1979; Owens, 1982; Drury, 1994; Oyelere and Turner, 2000), few researchers have empirically investigated TP in service industries. Despite the potentially complex and challenging nature of TP in service organisations (Keegan and Howard, 1988), the economic significance of the service industry worldwide provides strong motivation for research in this area. In the past few decades, service industries have steadily increased their proportion of the gross domestic product (GDP) in the economies of developed countries. The International Bank for Reconstruction and Development (2009) reported that the services sector is the largest component of high-income economies, accounting for more than 70 per cent of gross domestic product on average.

The primary aim of this study was to explore and describe TP practices within the services industry in Australia. Given the limited existing research on TP in the services industry, the objectives, methods and issues of transfer pricing identified in prior studies in manufacturing industries were used as a point of departure, allowing these particular aspects of transfer pricing to be contrasted across the two industries. A subsidiary aim and distinctive feature of this study is the exploration of the internal customer's perception of value received in the TP process. Value is reflected in the perceived benefits received by the buying division for the transfer price paid (Zeithaml, 1988). It has been argued that the provision of (superior) value to internal customers contributes to an improvement in the financial performance of the organisation (Schneider and Bowen, 1985; Heskett, Jones, Loveman, Sasser and Schlesinger, 1994), and hence the satisfaction of external customers (and generation of revenue) is contingent upon the satisfaction of internal customers (Johnson 1993; Mehafdi and Emmanuel 1997).

This paper is structured as follows. Section two examines literature germane to objectives and methods of TP and internal customer value in the TP process. Section three describes the research method and the administration of the research instrument, and the results are presented and discussed in section four. Section five presents the conclusions, and section six contains a brief discussion of areas for future research.

Literature Review

Transfer pricing is arguably one of the least researched areas of management accounting. Scapens and Bromwich (2010) examined management accounting articles published in *Management Accounting Research*, and reported that articles that relate to pricing (including TP) comprise 3% of articles published during 1990-1999 and 2% in 2000-2009. The paucity of TP research in Australia was highlighted by Chenhall and Smith (2011) in their review of 231 papers published by Australian researchers in 10 leading management accounting journals between 1980 and 2009; they found that only 1.3 per cent of articles published by Australian researchers during this period pertain to pricing/TP. While Scapens and Bromwich (2010) reported a significant increase (from 7% to 14%) in management accounting research carried out in services contexts during 2000-2009 compared to the preceding decade, there are still few studies that examine TP for services. This is surprising given the worldwide growth in the services sector. The determination of transfer prices between departments in service organisations is strategically important in that it can affect external (market) pricing, especially where services are entirely developed within an organisation and external pricing is largely based on the aggregate of internal prices.

Notwithstanding the strategic importance of TP in external pricing, the limited research in the rapidly growing services industry has tended to focus on issues similar to those reported in studies involving the manufacturing industry, i.e., the objectives, methods, policies and motivations of TP users.

Purpose of Transfer Pricing Systems

The generally acknowledged primary objective of transfer pricing is to achieve goal congruence within an organisation (Abdallah, 1989), which means that the goals of each service department (or sub-unit of the firm, as they are sometimes described) are congruent with those of the organisation as a whole. It is difficult to divorce transfer pricing from the fundamental objectives and strategies of an organisation, and hence goal congruence is a key objective (Maciarello and Kirby, 1994; Horngren et al., 2011; Hansen and Mowen, 2011) together with performance evaluation and autonomy. However, as Pitt and Foreman (1999) argued, the goals of employees and their organisations are often different. The transfer price therefore, serves as a means of communicating organisational performance objectives, motivating managerial effort of departments and evaluating departmental performance (Horngren et al. 2011, p. 748). Hilton (1981) investigated TP policies used by Australian manufacturing firms and found that enhancing goal congruence was their primary objective. Similarly, in reporting executive views on internal pricing, Ellig (1993, p. 10) inferred that firms' foremost TP objective was goal congruence, drew attention to the self-interest of internal departments, and concluded that departments know "the price of everything and the value of nothing". Oyelere and Turner (2000) surveyed TP practices in UK banks and building societies, and wrote that the achievement of corporate goals and fairness and neutrality were ranked highest among ten TP objectives, and that market-based TP was the principal basis for setting transfer prices. Table 1 presents a selection of the TP studies in the accounting literature in both service and manufacturing settings, and highlights the findings with respect to TP objectives.

Domestic and multinational studies reveal that particular TP objectives – such as simplicity or ease of understanding, divisional performance evaluation, and profit maximisation – are consistently viewed as important. In the absence of guidance from previous investigations of the TP practices of Australian services organisations, the first research question to be considered in this study is:

RQ1. What are the transfer pricing objectives adopted in Australian service organisations?

Transfer Pricing Methods

As tabulated in Table 2, a well-documented range of TP methods is evident in the mainstream management accounting literature, including cost-based, market-based and negotiated TP methods. The selection of one or a combination of TP method/s is generally regarded as influenced by the extent to which the transfer price method motivates managers to achieve their organisations' strategic objectives (Horngren et al., 2010), for example, meeting a desired level of cost and/or quality of service. Joye and Blayney (1991) explored TP as one of several cost and management accounting practices adopted in Australian manufacturing companies, finding that the three most widely used methods of TP in order were cost-based, market-price based and negotiated price, and that most companies used only one method of TP. Joye and Blayney (1991) also reported that less diversified firms were often inclined to employ cost-based methods. A Price Waterhouse survey (Keegan & Howard, 1988) showed that while historically services were transferred at cost or at a mandated market price (standard cost plus mark-up), large companies expected market-based TP to become more popular.

Table 1: Comparison of Transfer Pricing Objectives Reported in Selected Studies

	Current study	Abu-Serdaneh et al. (2008)	Oyelere & Turner	Elliott (1998) (2000)	Cravens (1997)	Mueller et al.	Alam & Hoque (1997)	Johnson & Kirsch (1995)	Yunker (1982) (1991)	Benke & Edwards	Tang (1979) (1980)	Wu & Sharp (1979)
Type of transfer pricing Domestic (D) / International (I)	D	I	D	I	I	I	D	I	I	I	D	D
Industry surveyed Service (S) / Manufacturing (M)	S		S	43% M	N/R*	N/R	N/R	N/R	N/R	M	N/R	N/R
Ease of understanding	1		5	2			2	3	2	3		
Optimal pricing	2											
Enhancing goal congruence	3		1		4	3				1		
Divisional evaluation	4	1	4			2	1			2	2	2
Managerial motivation			6		5							
Preserving divisional autonomy		2	10									
Communicating information that results in desirable decision making by managers						1						
Profit maximization		5		1				2	1		1	1
Cost of administration		6										
Evaluation of divisional manager's performance			7				3	5	3			
Moving profits between divisions		4										
Fairness and neutrality			2									
Equitable performance evaluation of managers			3		3							
Acceptability to branch managers			8									
Determination of profit-related pay for branch managers			9									
Maintain competitive position					2							
Minimisation of overall corporate taxes								1				
Compliance with tax regulations		3										3
Managing tax burden and related objectives					1							
Increasing overall corporate sales								4	4			

*N/R: Not reported Rankings are in terms of importance with 1 being the most important.

Drury (1998) investigated the association between TP and the profitability of building societies in the UK, and found that a funds transfer rate was used to allocate internal revenues to net fund providers and internal expenses to net fund users.

He concluded that a specific universal transfer price cannot be recommended. Owens (1982) examined TP in the UK public service from an internal auditing point of view, and suggested that the TP policy should be fair to the manager of the buying division, and a policy for transferring of goods and services should be in the best interests of the company. Turney (1977) explored the application of a cost-based TP system to the services of corporate management information systems, and recommended setting transfer prices for information systems based on step-variable costs. Tewes (1976) investigated bank funds valuation for allocation and pricing decisions, concluded that setting a proper internal transfer price for funds is essential in determining the profitability of each component of a bank's business, and recommended a marginal cost approach to setting transfer prices.

Although the use of different scales in selected surveys makes comparative analysis difficult, cost-based pricing methods (Table 2) dominate. While no particular trend is discernible, market price is the second-most widely used basis for TP. Oyelere and Turner's (2000) study is particularly noteworthy in that it is a relatively recent study in the services industry (banks and building societies) and identifies a strong emphasis (57.1%) of market-based TP methods. As shown in Table 2, our knowledge of methods used for TP in the service industry is limited and outdated. This discussion leads us to the second research question:

RQ2. What are the transfer pricing methods employed by Australian service organisations?

Consideration of Customer Value in the Transfer Pricing Process

Another dimension of transfer pricing (which, to the best of our knowledge, has not been investigated to date) is the interplay between transfer price and the internal customer's perception of value. The emergence of the notion of the 'internal customer' is relatively recent; hence the management literature in general and the accounting literature in particular afford relatively greater attention to external customers. For internal organisational transactions, Gummesson (1987) advocated that everybody in an organisation should be regarded as both an internal customer and supplier of goods and services, and as such there should be no distinction between external and internal customers. Zeithaml (1988) describes customer value as the difference between the benefits of a service received and the cost of its acquisition. In the context of TP in a service organisation, the value (benefits) of an activity performed by one department for another department (the internal

Table 2: Transfer Pricing Methods (Bases)

	Current study	Wolff (2007)	Oyelere & Turner (2000)	Drury et al. (1993)	Tang (1992) (1991)	Joye & Blayney	Bafcop et al. (1991)	Borkowski (1990)	Mehafdi (1990)	Mostafa (1982)	Tang (1981)	Chenhall (1979)	Tang et al. (1979)	Tang et al. (1979)	Vancil (1979)	Tomkins (1973)	Rook (1971)
Country	Australia	Germany	UK	UK	USA	AUS	France	USA	UK	UK	USA	Australia	USA	Japan	USA	UK	UK
Domestic (D) Not reported N/R	D	D	D	D	D	D	D	D	D	D	D	D	D	D	D	D	D
COST-BASED (%)		46	35.7	49.0	46.2	65	70	44.7	36.3	34.1	62	39.4	50.4	46.2	46.8	45.4	46.1
Variable Cost (%)					4.5			3.6							4.6	6.8	4.7
Variable cost at standard (%)	20.0			20.0			15.1	2.4			1.8		3.0	0.8	2.9		
Variable cost at actual (%)	38.2			38.2				0.6			4.3		0	0	1.7		
Variable cost plus (%)	23.3			21.9			6.1	0.6	6.1	7.3	1.8		0.9	0.9		13.6	
Full Cost (%)					41.7			41.1		9.7	18.4				25.5	6.8	46.1
Full cost at standard (%)	57.4			56.2			36.4	14.3	15.1		12.9		16.8	15.1	12.5		28.5
Full cost at actual (%)	38.6			39.8			27.3	7.1		2.4			9.0	9.2	13.0		17.6
Full cost plus (%)	51.2			50.0			9.1	19.7	15.1	7.3	22.7		19.0	20.2	16.7	18.2	
MARKET BASED (%)		33	57.1		36.7	13	9.1	32.7	45.5		50.3	52.9	31.5	33.7	31.0		
Market based current (%)	39.3			38.6			3.0	20.2	27.3		38					47.7	53.9
Market based adjusted (%)	23.1			21.4			6.1	12.5	18.2		2.3			17.7			22.3
Other market based (%)													8.2	16.0			31.6
NEGOTIATED (%)	21.3	22	7.2	20.7	16.6	11	12.1	22.6	42.4		27.6	7.7	18.1	19.3	22.2	21.5	16.1
Other (%)	9.4			14.3	0.5	11	9.1				7.4	7.0	1.7	1.0		4.5	

customer) is reflected by the transfer price (the acquisition cost). According to Pfau et al. (1991), a lack of attention to internal customer relationships can adversely affect external customer satisfaction (and arguably financial performance). As an organisation's internal services increase, new questions such as "how do we assess or price their value?" arise (Mills and Ungson, 2001). Although many researchers agree that external customers are strongly value-orientated (Heskett et al., 1994; Parasuraman, 1997), lack of empirical evidence means it is unknown whether service firms place importance on the "value" for internal customers and whether the presumed value is considered in setting the transfer price. Grönroos (1981) suggested that an organisation's departments should strive to provide their internal customers with better performance, lower costs and other benefits of value, as would be the case with the organisation's external customers. In this sense, the notion of internal customer value can be seen to have links to a firm's competitive advantage, as it draws attention to the costs and benefits of developing a service across the value chain activities or various functional departments of an organisation (Porter, 1985; Shank and Govindarajan, 1992). As Mills and Ungson (2001) noted with respect to internal relationships between departments, it is imperative that internal providers' efforts are maximised so that the user can get maximum service and the quality of service supplied to external customers can be enhanced. Similarly, Cressman (1999) and Mehafdi (2002) emphasised the strategic importance of the transferor (supplying division) assessing its ability to create value for the transferee (buying division), which in turn must assess its ability to create value for the final customer. As research in value-based TP is still at a nascent stage, it is not known if, or to what extent, customer value is considered in internal pricing. This aspect of internal customer value leads to the third research question in this study:

RQ3. Are notions of internal customer value formally recognised in the transfer pricing practices of Australian service organisations?

Research Methods

The data for this study were collected as part of a wider study of TP via a postal survey of senior divisional (business unit) managers in service firms in Australia. Databases of the Australian Stock Exchange, Australian Financial Conference, Australian Prudential Regulatory Authority, Advertising Federation of Australia, Insurance Council of Australia and *Business Review Weekly*'s Top 500 Companies list were used to create a study population, and a sample of 285 service firms was drawn using the stratified sampling method. Following Alam and Hoque (1995), firms that had an annual turnover of minimum AUD $15m were included in the sample.

To ensure responses were received from divisionalised firms, the questionnaire initially asked respondents to state the kind of responsibility centre they represented, whether or not they only bought, only sold or both bought and sold from other internal divisions. Survey questions were developed around the three research questions listed earlier. The first section of the survey contained questions about the organisations' TP objectives, their level of importance (ranked using a five-point Likert-type scale, where 1 = very important and 5 = not at all important), the type and number of TP methods employed and whether formal procedures were employed to determine if TP objectives had been achieved. These questions were developed from previous studies (e.g., Parasuraman, Zeithaml and Berry, 1988; Zeithaml, 1988; Emmanuel and Mehafdi, 1994; Lapierre, 2000). The second section of the survey sought to explore respondents' views on the importance of considering value (benefits) for internal customers in setting transfer prices, their perceptions of those elements that constitute value and whether they considered internal customer value may have an effect on their organisation's external customer value and competitive advantage. The questionnaire also included a section on the profile of respondents' firms by size (annual turnover) and by service sector category (e.g., finance, health services, telecommunications). With a view to ascertaining the relevance, clarity, understandability, order and the time taken to complete the questionnaire, prior to mailing, the questionnaire was pre-tested with eight academics, two of whom had managerial experience of dealing with TP in large organisations. Amendments were made to reflect their suggestions. In terms of administering the survey, several researchers (e.g., Hoshower and Mandel, 1986; Colbert and Spicer, 1995; Emmanuel and Mehafdi, 1994) suggested that TP surveys be undertaken at the business unit (divisional level), as this was where transactions occur and where managers have direct responsibility for TP.

Accordingly, the questionnaire was initially directed to the CEO (or equivalent) of each business unit to complete the survey or identify the divisional manager who was best qualified in terms of knowledge and/or experience of TP to complete the questionnaire. A follow up mail-out was sent four weeks after the initial mail-out of 285 questionnaires. Initial and follow up mail-out resulted in 36 and 44 responses respectively, so 80 usable responses were received for a response rate of 28%. To assess non-response bias, the responses received from the first mailing were compared to those responses received after the second mailing; no significant differences were detected.

Descriptive statistics were used to examine the results related to all three research questions.

Results

Profile of Respondents

The profile of respondents by revenue is displayed in Table 3.

Table 3: Profile of Respondents by Annual Sales Volume

Annual Turnover ($)	Number of firms	Percentage
Less than 20m	6	7.5
20-Less than 40m	11	13.7
40-Less than 80m	19	23.8
More than 80m	44	55.0
Total	80	100.0

Fifty-five per cent of respondents had an annual turnover of more than AUD$80 million, twenty-four per cent had an annual turnover of AUD$40-80 million, and the remainder had a turnover of less than $40 million. As shown in Table 4, two-thirds of the respondents were from finance and insurance (37%) and property and business services (29%), with the remainder spread relatively equally over transportation and storage, telecommunications and healthcare services.

Table 4: Respondents by Sector

Service Category	Number of firms	Percentage
Transportation and storage	12	15
Telecommunications	8	10
Health services	7	9
Finance and insurance	30	38
Property and business services	23	29
Total	80	100

Objectives of Transfer Pricing

Respondents rated the "ease of understanding of the transfer price" as the most important objective of the transfer pricing system, followed by optimal pricing and goal congruence (Table 5). All objectives identified, except "greater divisional autonomy", were rated as important. Optimal pricing was the second most important objective of TP identified in this study, a notable finding insofar as this objective did not rate as important in other TP studies (Table 1). Profit maximisation was not identified as an important objective in the current study but was important in previous studies (Table 1). This is an interesting finding particularly as the respondents indicated a focus on cost-based TP methods (see section 4.3).

Table 5: Objectives of Transfer Pricing Ranked by Importance (Current Study)

Objectives of Transfer Pricing	Mean
Ease of understanding	1.88
Optimal pricing	2.04
Goal congruence	2.30
Divisional evaluation	2.43
Managerial motivation	2.97
Greater divisional autonomy	3.15

1 = Very important, 5 = Not important at all

This study's findings for 'ease of understanding', 'achievement of goal congruence', and 'divisional evaluation' as the most widely sought TP objectives are relatively consistent with previous studies in manufacturing and service industries (see Table 1).

Evaluation of Objectives

As indicated in Table 6, only 26% of respondents indicated they had formal procedures designed specifically to determine whether their TP objectives were achieved. Five per cent of respondents stated that they did not believe it is important to evaluate if their TP objectives had been satisfied. In effect, 76% of respondents did not have a formal method of evaluating whether TP objectives were achieved. While specific objectives of TP were identified by respondents (see section 4.2), the finding of limited formal evaluation procedures in organisations suggests that TP is not a significant organisational concern. Alternatively, this finding highlights an aspect of organisational performance management that has potentially been overlooked by the respondent organisations.

Transfer Pricing Methods

The results shown in Table 7 indicate that full cost-based transfer price is the most widely used transfer pricing method, followed by market-based and negotiation-based TP. The overall dominance of the cost-based TP methods is consistent with the findings of previous studies (Table 2). Of particular interest is the finding that 86% of respondents used more than one TP method, indicating that a range of objectives is considered within organisations for which different methods are adopted.

Table 6: Procedures Used to Determine if the Transfer Pricing Objective has Been Achieved

Procedures	Frequency	Percentage
There are formal procedures designed for this purpose	21	26
There are no formal procedures	33	41
Through intuition	18	23
Do not believe it is significant to explore this relationship	4	5
Other	4	5
Total	80	100

Table 7: Transfer Pricing Methods Used

Transfer Pricing Method	Percentage Used
Variable cost at standard	20%
Variable cost at actual	38%
Variable cost plus	23%
Full cost at standard	57%
Full cost at actual	39%
Full cost plus	51%
Market price-based (current)	39%
Market-price based (adjusted)	23%
Negotiated	21%
Other	9%

The locus of decision-making for TP lies with headquarters (Figure 1). Sixty per cent of respondents stated that transfer prices were set at the headquarters and 28% reported that transfer price was set jointly by headquarters and divisional management together. Only 11% of respondents stated that divisional management

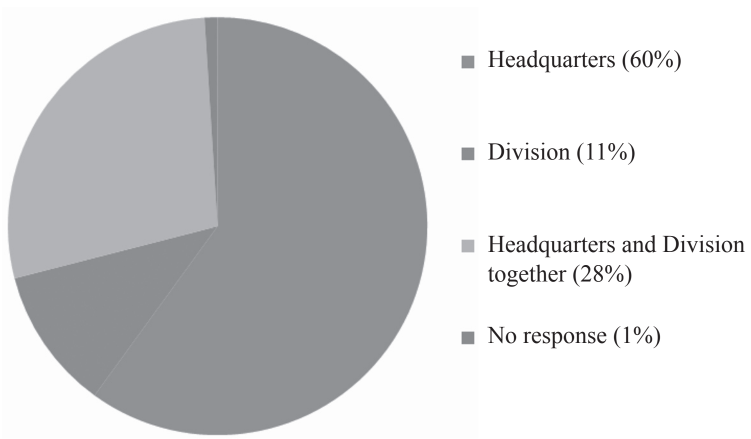

Figure 1: Locus of Transfer Pricing Decision

could solely determine transfer price. These findings are broadly consistent with those of Shih's (1996) survey of the 400 largest Canadian firms, which showed that more than three-quarters (77.5%) made TP decision at the corporate level.

Transfer Pricing and Internal Customer Value

Following Zeithaml (1988), the net value was defined as the sum of perceived benefits (gross value) minus the sum of all the perceived costs. Customers feel satisfied where they receive a net benefit – a gross value that exceeds the cumulative costs incurred in acquiring a service. Respondents' definition of value was equally divided between "value is everything I want in a service" and "value is the quality I get for the price I pay" (31% of respondents chose each statement). Only 10% of respondents related value to low price. In response to the question, "how important is it to price internal transfers with value creation in mind?" a third of respondents (33%) stated that they considered value creation for internal customers 'very important' or 'important' in setting transfer prices (Table 8). Forty-two per cent of respondents stated that value creation for internal customers was either 'of little importance' or unimportant', with the remaining 25% being undecided.

Table 8: Importance of Value Creation in Setting Transfer Price

	Very important	Important	Undecided	Of little importance	Not important
How important is it to price internal transfers with value creation in mind? (%)	11	22	25	37	5

To the question "I believe the internal supplier cares about reducing my costs without sacrificing what I get from services", 35% of respondents answered in the affirmative ('strongly agree' and 'agree' combined), 40% answered 'strongly disagree' or 'disagree', and the remaining 25% were undecided (Table 9).

Table 9: Do Internal Suppliers Care about Reducing the Buying Department's Costs?

	Strongly agree and agree	Undecided	Strongly disagree and disagree
I believe the internal supplier cares about reducing my costs without sacrificing what I get from services	0.35	0.25	0.40

The findings reported in Tables 8 and 9 suggest that the notion of internal customer value is relatively unimportant to Australian service organisations and that there is considerably less consideration of combined costs and benefits (value) afforded by supplier departments when providing internal services. This is consistent with the predominant focus on cost-based TP methods adopted by respondent organisations, i.e., cost is the focus of TP, not value (cost and benefits). This finding accords with those of Drury and Tayles (1995), who argued that cost-based TP does not reflect customer perceived value as there is hardly any incentive for department managers to be concerned about providing value to internal customers – their primary motivation is to recover their costs. Further supporting this suggestion is the finding that only 24% of respondents perceived internal customer value to be likely or most likely associated with the competitive advantage of the organisation (Table 10).

Table 10: Value Created for Internal Customer and Competitive Advantage

	Most likely	Likely	Neither likely nor unlikely	Not likely	Not at all likely
In your opinion, do you believe if there is a relationship between value created for internal customers and competitive advantage at the product level?	0.06	0.18	0.56	0.16	0.04

The link between the satisfaction of internal customers (through a focus on their particular needs/benefits requirements) and the satisfaction of external customers is well documented in the literature (Heskett et al., 1994; Lings and Brooks, 1998). By satisfying the needs of its internal customers, an organisation can upgrade its capacity to satisfy the needs of its external customers (Greene, Walls and Schrest, 1994). The findings in this section of the current study suggest that competitive advantage is not a major consideration in TP in the respondent organisations, or alternatively that their primary means of competing lies in cost advantages. The emphasis on cost-based TP methods reported in section 4.2 provides some support for the alternate conclusion. Only 33% of respondents perceived an association between the satisfaction of internal customers and satisfaction of external customers to be important (Table 11), while 42% did not believe there was such a relationship. Finally, unawareness or disinterest in internal customer value was also manifest in the respondents' extensive use of cost-based and marked-based pricing, while value-based TP approaches were never mentioned.

Table 11: Relationship between Satisfaction of Internal Customers and External Customers

	Very important	Important	Undecided	Of little importance	Not important
Do you believe that there is an association between satisfaction of internal customers and satisfaction of external customers	0.11	0.22	0.25	0.37	0.05

Conclusions

The objective of this study was to explore and describe the transfer pricing objectives and methods adopted in Australian service organisations. An aspect of this study that differentiates it from previous research was its exploration of whether notions of internal customer value were formally recognised in the respondents' TP practices. On the basis of our data, we conclude that the objectives of TP in Australian service organisations reflect many of those adopted in manufacturing organisations; the objectives of achieving goal congruence and the ease of understanding (simplicity) emerged as common threads across service and manufacturing industries. The limited number and different emphasis of TP studies to date, particularly in the services industry, are major factors in our tentative conclusion.

Our data imply that cost-based TP remains the preferred method in both service and manufacturing organisations in Australia, and show that a large majority of the respondents use more than one method of TP. We find little evidence to suggest that the notion of internal customer value is considered in the TP of Australian service organisations. The emphasis on cost-based rather than value-based methods of TP by service organisations in this study may better reflect the lack of concern for the needs of internal customers. The dominance of cost-based methods and limited notions of internal customer value may also be interpreted as reflecting the focus of service firms on cost control and/or on seeking competitive cost advantages.

Limitations and Directions for Further Research

Inherent limitations of mail questionnaires apply. The sample was not representative of the population; therefore, the generalisability of this study's findings may be limited. This exploratory work represents a starting point for understanding transfer pricing in a service context. Given that organisational and environmental influences differ between domestic and international TP, unlike most of the prior research, research setting needs to be stated as either domestic or international. Research findings to date pertaining to objectives of TP are confusing; therefore, further research using (preferably) a qualitative or case study approach will help to unravel the current complexity. A similar research approach is recommended for studies designed to ascertain TP methods. Furthermore, in addition to identifying the methods most commonly employed, future studies might also explore the reasons why particular TP methods are employed and examine the decision-making process of setting transfer prices. Further research might explore the association between transfer price and internal customers' perceptions of value in greater depth by undertaking organisational case studies or interviews with department managers within an organisation. This would go some way to overcome a limitation of this study in its reliance on single respondents within each participating organisation.

Acknowledgement

The authors would like to thank the anonymous reviewers of this Journal for their insightful comments.

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