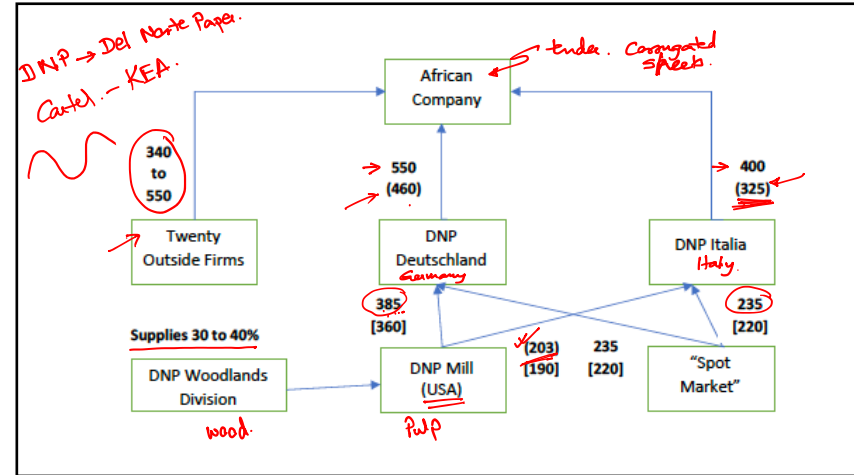


Transfer Pricing

- Staffing Policy → Culture.
- Accounting/Control.

1



2

Alternative Choice analysed	DNP-Italia	DNP-Italia	DNP-Deutschland	DNP-Deutschland
Source of Contribution	Spot ✓	KEA (ophan)	Spot (ophan)	KEA ✓
European Subsidiary				
Conversion	\$325-\$235 = \$90	\$90 ✓	\$75	\$460 - \$385 = \$75
Purchase price	\$235	-	235	-
DNP's American Mill				
Direct Cost		\$190 x 1.07 = \$203		\$203
Freight		\$45 x 1.07 = \$48		\$48
DNP Woodlands				
Contribution on sale	X	X	X	X
	\$325	\$341-X	\$310	\$326-X

KEA Pulp Starting necessary.

3

Alternative Choice analysed	DNP-Italia		DNP-Deutschland	
	Spot	KEA	Spot	KEA
European Subsidiary				
Sales Revenue	\$400	\$400	\$400	\$400 \$550
Direct Cost	(\$325)	\$385 + \$90 = (\$475)	(\$310)	(460)
DNP's American Mill				
Contribution on sale	-	\$385 - \$203 = \$134	-	\$134
DNP Woodlands				
Contribution on sale	X	X	X	X
	\$75	\$59 + X	\$90	\$74 + X

4

What should John Powell do about Frank Duffy?

Handwritten notes: VS CEO, Different Countries tax % → Italy CEO.

- Tax implication of this transaction? *transfer funds → CapEx*
- Fund transfer implication of transaction? *Subsidiaries → Losses, HR → Profit, Retention Incentives.*
- “Secret Little Book” syndrome? *Castel.*
- Why DNP is in KEA? *Castel. working Capital → India → EU.*
- Why are subsidiaries self-financed? *CapEx*
- Management Control System and decentralization? *Control System.*

5

What Is the Strategic Role of HRM in International Firms?

The Role of Human Resources in Shaping Organizational Architecture

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6

What Is a Staffing Policy?

- Staffing policy is concerned with the selection of employees who have the skills required to perform a particular job
 - can be a tool for developing and promoting the firm’s corporate culture
 - the organization’s norms and value system
 - a strong corporate culture can help the firm implement its strategy

Handwritten notes: German → followed → lost the tender. Italy → disobeyed → Revenue. → Profits

7

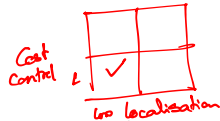
What Is a Staffing Policy?

- Three main approaches to staffing policy:
 - The **ethnocentric** approach - fill key management positions with parent-country nationals *Nestle. CPO. Maggi.*
 - The **polycentric** approach - recruit host-country nationals to manage subsidiaries in their own country, and parent-country nationals for positions at headquarters *HUL*
 - The **geocentric** approach - seek the best people, regardless of nationality, for key jobs *GE*

8

Why Choose an Ethnocentric Staffing Policy?

- Firms that pursue an **ethnocentric** policy believe that
 - there is a lack of qualified individuals in the host country to fill senior management positions
 - it is the best way to maintain a unified corporate culture *HQ Control.*
 - value can be created by transferring core competencies to a foreign operation via parent country nationals
 - it makes sense with an international strategy
- But
 - it limits advancement opportunities for host country nationals
 - it can lead to "cultural myopia"



9

Why Choose a Polycentric Staffing Policy?

- The **polycentric** approach
 - makes sense for firms pursuing a localization strategy
 - can minimize cultural myopia
 - may be less expensive to implement than an ethnocentric policy
- But
 - host-country nationals have limited opportunities to gain experience outside their own country and so cannot progress beyond senior positions in their own subsidiaries
 - a gap can form between host-country managers and parent-country managers



BAT → ITC.

10

Why Choose a Geocentric Staffing Policy?

- The **geocentric** approach
 - is consistent with building a strong unifying culture and informal management network
 - makes sense for firms pursuing a global or transnational strategy
 - enables the firm to make the best use of its human resources
 - builds a cadre of international executives who feel at home working in a number of different cultures
- But
 - can be limited by immigration laws
 - is costly to implement



11

Which Staffing Policy Is Best?

Comparison of Staffing Approaches

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TABLE 19.1

Comparison of Staffing Approaches

Staffing Approach	Strategic Appropriateness	Advantages	Disadvantages
Ethnocentric	International	Overcomes lack of qualified managers in host nation Unifies culture Helps transfer core competencies	Produces resentment in host country Can lead to cultural myopia
Polycentric	Localization	Alleviates cultural myopia Inexpensive to implement	Limits career mobility Isolates headquarters from foreign subsidiaries
Geocentric	Global standardization and transnational	Uses human resources efficiently Helps build strong culture and informal management networks	National immigration policies may limit implementation Expensive

12

What Is Expatriate Failure?

- Firms using an ethnocentric or geocentric staffing strategy will have expatriate managers
- **Expatriate failure** is the premature return of an expatriate manager to the home country
 - each expatriate failure can cost between \$40,000 and \$1 million
 - between 16% and 40% of all expatriates in developed countries fail and almost 70% of assigned to developing countries fail

Airtel → Africa.

13

Why Do Expatriate Managers Fail?

- The main reasons for expatriate failure are
 - the inability of an expatriate's spouse to adapt
 - the manager's inability to adjust *← Languages food.*
 - other family-related reasons
 - the manager's personal or emotional maturity
 - the manager's inability to cope with larger overseas responsibilities

14

How Can Firms Reduce Expatriate Failure?

- Firms can reduce expatriate failure through improved selection procedures
- Four dimensions that predict expatriate success are *Loose energy → Introvert. Gains energy → Extrovert.*
 - **Self-orientation** - the expatriate's self-esteem, self-confidence, and mental well-being
 - **Others-orientation** - the ability to interact effectively with host-country nationals
 - **Perceptual ability** - the ability to understand why people of other countries behave the way they do
 - **Cultural toughness** - the ability to adjust to the posting

15

Accounting and Finance in IB

16

Why Are International Accounting Standards Important?

GAAP

- The **International Accounting Standards Board (IASB)** is a major proponent of standardization of accounting standards
 - most IASB standards are consistent with standards already in place in the U.S.
 - by 2012, 100 nations had adopted IASB standards or permitted their use in reporting financial results
 - the EU has mandated harmonization of accounting principles for members
 - there soon could be only two major accounting bodies with substantial influence on global reporting
 - FASB in the U.S. and IASB elsewhere

17

How Does Accounting Influence Control Systems?

- The control process in most firms is usually conducted annually and involves three steps
 1. Subunit goals are jointly determined by the head office and subunit management *targets*
 2. The head office monitors subunit performance throughout the year *Rev Profit*
 3. The head office intervenes if the subsidiary fails to achieve its goal and takes corrective actions if necessary

18

How Do Exchange Rates Influence Control?

- Budgets and performance data are usually expressed in the corporate currency
 - normally the home currency
 - facilitates comparisons between subsidiaries
 - but, can create distortions in financial statements

⌘ ↺

19

How Do Exchange Rates Influence Control?

- The **Lessard-Lorange Model** *translation risk*
 - firms can deal with the problems of exchange rates and control in three ways
 - The **initial rate**
 - the spot exchange rate when the budget is adopted *beginning of FY*
 - The **projected rate**
 - the forward exchange rate forecast for the end of the budget picture *→ 365 days forward rate.*
 - The **ending rate**
 - the spot exchange rate when the budget and performance are being compared *→ end of FY*

20

What Is the Lessard-Lorange Model?

Possible Combinations of Exchange Rates in the Control Process

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Rate Used to Translate Actual Performance for Comparison with Budget

		Initial (I)	Projected (P)	Ending (E)
Rate Used for Translating Budget	Initial (I)	(II) Budget at Initial Actual at Initial	(IP) Budget at Initial Actual at Projected	(IE) Budget at Initial Actual at Ending
	Projected (P)	(PI) Budget at Projected Actual at Initial	(PP) Budget at Projected Actual at Projected	(PE) Budget at Projected Actual at Ending
	Ending (E)	(EI) Budget at Ending Actual at Initial	(EP) Budget at Ending Actual at Projected	(EE) Budget at Ending Actual at Ending

Handwritten notes: "Begin of FY" next to Initial (I) row; "End of FY" above Ending (E) row; "Spot" next to Initial (I) and Ending (E) rows; "FR" next to Projected (P) row; a red circle around the (PP) cell; red 'X' marks in (IP), (PI), (EP), and (EI) cells; red arrows pointing to (PI) and (EP) cells.

21

How Do Firms Move Money Across Borders?

- Firms can transfer liquid funds across border via
 - Dividend remittances
 - Royalty payments and fees
 - Transfer prices
 - Fronting loans

22

What Are Dividend Remittances?

- Paying dividends is the most common method of transferring funds from subsidiaries to the parent
Dividend tax
- The relative attractiveness of paying dividends varies according to
 - tax regulations – high tax rates reduce attractiveness
 - foreign exchange risk – dividends might be sped up in risky countries
 - the age of the subsidiary – older subsidiaries remit a higher proportion of their earning in dividends
 - the extent of local equity participation – local owners' demands for dividends come into play

23

What Are Royalty Payments and Fees?

- Royalties - the remuneration paid to the owners of technology, patents, or trade names for the use of that technology or the right to manufacture and/or sell products under those patents or trade names
 - can be levied as a fixed amount per unit or as a percentage of gross revenues
 - most parent companies charge subsidiaries royalties for the technology, patents, or trade names transferred to them

? Suzuki

24

What Are Royalty Payments and Fees?

- A fee is compensation for professional services or expertise supplied to a foreign subsidiary by the parent company or another subsidiary
 - royalties and fees are often tax-deductible locally

25

What Are Transfer Prices?

- Transfer prices - the price at which goods and services are transferred between entities within the firm
- Transfer prices can be manipulated to
 - ~~reduce tax liabilities~~ by shifting earnings from high-tax countries to low-tax countries
 - move funds out of a country where a significant currency devaluation is expected
 - move funds from a subsidiary to the parent when dividends are restricted by the host government
 - reduce import duties when ad valorem tariffs are in effect

26

What Makes Transfer Prices Unattractive?

- Using transfer pricing can be problematic because
 - governments think they are being cheated out of legitimate income
 - governments believe firms are breaking the spirit of the law when transfer prices are used to circumvent restrictions of capital flows
 - it complicates management incentives and performance evaluation

27

What Are Fronting Loans?

- Fronting loans are loans between a parent and its subsidiary channeled through a financial intermediary, usually a large international bank
- Firms use fronting loans
 - to circumvent host-country restrictions on the remittance of funds from a foreign subsidiary to the parent company
 - to gain tax advantages

28

What Are Fronting Loans?

An Example of the Tax Aspects of a Fronting Loan

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