STUDIA UNIVERSITATIS BABEŞ-BOLYAI OECONOMICA
VOLUME 68, ISSUE 3, 2023, pp. 26-39
DOI: 10.2478/subboec-2023-0013

EXPLORING DETERMINANTS OF TRANSFER PRICING PRACTICES AMONG ROMANIAN PUBLICLY TRADED COMPANIES

Renata FULOP[*]
Babeş-Bolyai University, Romania

Abstract. This paper explores the effect of determinants shaping the landscape of transfer pricing practices within intra-group transactions among publicly traded companies in Romania over the period 2022. The research hypothesis focuses on identifying the variables that have a significant impact on transfer pricing in the Romanian business environment. Data collection was conducted manually from various sources, including explanatory notes from annual reports and databases such as Thomson Reuters and Bloomberg. The results reveal that the size of companies, sales, capitalization, foreign ownership, sales growth, and operational profit collectively contribute to the influence on transfer pricing practices. However, individual analysis shows that only sales significantly affect the transfer pricing practice.

JEL classification: M4, H25, F23, H87

Keywords: transfer pricing; related party transactions; multiple linear regression

1. Introduction

In recent years, transfer pricing (TP) has become increasingly significant in the realm of international business, with the rise of globalization and the expansion of multinational companies (MNC) operating across borders. MNCs strategically utilize TP mechanism among affiliated entities to optimize revenues in the context of varying tax rates across jurisdictions (Cristea & Nguyen, 2016). A common approach observed in these companies is to maintain dual objectives: one for internal management accounting and another for tax reporting. This illustrates the complexity and importance of TP strategies in MNCs (Robu & Căpățină-Verdeș, 2017). With a significant portion of world trade transactions occurring between entities within the same corporate group, TP has rightfully claimed its place as a top priority on the fiscal agenda. The practice of TP remains within legal bounds as long as it complies with prevailing tax regulations. However, it has evolved into an international concern as numerous companies engage in TP practices that contravene tax laws, leading to state revenue losses (Supriyati et al.,

[*] Corresponding author. Address: Faculty of Economics and Business Administration, Babes-Bolyai University, Teodor Mihali st, 58-60, Cluj-Napoca, Romania, E-mail: renata.fulop@econ.ubbcluj.ro

2021). In Romania, TP became an official part of fiscal regulations in 2016 with the release of Order no. 442/2016, signifying a crucial development in the country's handling of intra-group transactions. Since then, understanding how publicly traded companies navigate and implement TP practices has become imperative.

Our study is motivated by the need to investigate the factors influencing TP practices. TP is evaluated through related party transactions (RPT), commonly observed when companies conduct transactions with affiliated entities, serving as the dependent variable in our analysis. We aim to explore the impact of various independent variables, including company size, sales volume, market capitalization, foreign ownership, sales growth, and net operating income, on TP practices. This analysis contributes to the existing literature, which is currently underexplored in this area. Our research aims to reveal the fundamental factors driving intra-group decisions. Understanding these factors can empower companies to optimize their financial structure and devise tax strategies more efficiently.

2. Literature review

Numerous studies have explored the factors influencing TP decisions within companies over the past decades. Since the 1970s, empirical research has investigated how companies select the optimal TP method for their environments, analyzing a multitude of factors including TP objectives, tax regulations, organizational characteristics, environmental variables, and host country constraints.

Borkowski (1992) investigated the factors shaping companies' decision-making processes in selecting TP methods, highlighting tax legislation, operational complexity, and considerations of tax risk and transparency. Wu & Sharp (1979) and Benke & Edwards (1980) categorized significant factors affecting TP method choice into organizational, environmental, and international factors. Al-Eryani et al. (1990) analyzed determinants of TP strategies among US MNCs, identifying factors such as company size, host country tax rates, and product differentiation's influence on TP. In exploring the impact of company size, Nurwati et al. (2021) found that larger companies tend to engage in more aggressive TP practices, possibly driven by their greater resources and market presence. Oyelere et al. (1999) examined the influence of environmental factors on TP decisions among UK-based MNCs, emphasizing the significant impact of tax laws, regulations, enforcement, political stability, exchange rates, and market competition. Moving beyond traditional factors, researchers have investigated the relationship between related party transactions (RPTs) and various determinants such as market capitalization, foreign ownership, and profitability. Refgia et al. (2017) explored the determinants of RPTs, including company size, in the Indonesian context, revealing a positive correlation between company size and RPT. Similarly, studies by Kiswanto (2014) and Melmusi (2016) examined the influence of foreign ownership on TP decisions, suggesting that higher levels of foreign ownership led to increased influence from foreign parties in determining TP decisions.

While tax regulations have been a consistent theme in prior studies, our focus lies on the specific context of Romanian public companies. Given the potential variations in tax regulations across countries, our study focuses on other influential factors such as company size, sales, market capitalization, foreign ownership, and operating income, which are more pertinent to the Romanian business landscape.

3. Methodology

The research method adopted is causal research selected to investigate the hypotheses regarding the influence of one or more independent variables on other dependent variables. This approach facilitates the examination of cause-and-effect relationships within the study. Utilizing quantitative data, expressed in measurable numerical form, enables analysis using statistical techniques. Data for the research is gathered from diverse sources, including databases such as Thomson Reuters and Bloomberg, as well as from the annual reports and financial statements of public companies.

To assess our hypotheses, we aimed to identify the factors influencing transactions with related parties by constructing a database for multiple linear regression, considering it the most appropriate method. Drawing from scientific literature, we evaluated various variables and selected those we believed to significantly influence the phenomenon under study. Given our focus on a sample of Romanian companies, we omitted certain indicators deemed less relevant to the local context. This analysis was conducted using the SPSS Statistics 25 software. The initial step involved testing the correlation between variables, explored, and visualized through Scatterplot diagrams. These diagrams serve to identify patterns, trends, or relationships between variables. Clustering of points in a specific manner or following a trend line may suggest a correlation between variables (Nguyen et al., 2020).

Thus, our investigation led us to the variables presented in Table 1, along with the associated calculation methods, providing a structured approach to analyze the determinants of transactions with related parties.

Table 1. List of variables. Own processing

Abbreviation	Description	Unit of Measurement
Dependent		
RPT it	Related party transactions	Value of total related party transactions (Sales and purchases)
Independent		
SIZE it	Company size	Value of total asset
SALES it	Sales	Value of total sales
MC it	Market capitalization	Market value of equity
FO it	Foregin ownership	Shares held by foreign entities / Total number of shares * 100
SG it	Sales growth	Sales growth Current period sales – Previous period sales
NOI it	Net operating income	Operating profit Revenue – Operating expenses

The hypothesis aligns with previous research findings from scholars such as Borkowski (1992), who maintained that certain independent variables play a significant role in shaping TP dynamics. Therefore, we propose the following hypotheses:

- H0: There is no significant influence of the independent variable on transactions with affiliates.
- H1: There is a significant influence of the independent variable on transactions with affiliates.

The proposed research model is a multiple regression that explores the relationship between the dependent variable, TP it and a set of independent variables. The model is expressed by the equation:

$$TPit = \alpha it + \beta 1SIZEit + \beta 2SALESit + \beta 3MCit + \beta 4FOit + \beta 5SGit + \beta 6NOIit + \varepsilon it.$$

where:

α it - represents the model intercept.
β1, β2..., β10 - are the coefficients associated with each independent variable
ε it - is the error term.

4. Descriptive Analysis

In this research, several independent variables are used: company size, sales, market capitalization, foreign ownership, sales growth, operating profit. Company size can be observed based on the size of the assets held by it and is replaced with Ln Total assets. The use of natural logarithms (ln) aims to reduce excessive data instability without changing the proportion of the original real value (Leksono et al., 2019).

The sample in this research includes companies listed on the Bucharest Stock Exchange in the year 2022. The initial sample consisted of 63 companies, however, in cases where transactions with affiliates were not published, we excluded those companies from the sample, resulting in a final number of 50 companies.

Table 2. Descriptive Analysis Results. Own processing

	N Statistic	Minimum Statistic	Maximum Statistic	Mean Statistic	Std. Deviation Statistic	Skewness		Kurtosis	
						Statistic	Std. Error	Statistic	Std. Error
RPT it (DV)	50	3.24077	22.29561	14.78515	3.68586	-.566	.337	1.507	0.662
SALES it(IV)	50	13.8243	23.24236	18.20774	2.08522	.152	.337	-.109	0.662
SIZE it (IV)	50	15.8365	23.17802	18.63699	1.78133	.589	.337	-.319	0.662
MC it (IV)	50	14.6073	22.70974	18.12601	2.01914	.190	.337	-.706	0.662
FO it (IV)	50	.000000	24.25792	8.961964	9.22932	.122	.337	-1.884	0.662
SG it (IV)	50	-32.687	117.1537	18.14855	31.3392	1.314	.337	2.169	0.662
NOI it (IV)	50	.000000	21.61399	13.98406	6.09511	-1.601	.337	1.477	0.662
Valid N (listwise)	50								

In this study, descriptive statistical analysis was used to highlight the data's picture by revealing the minimum value, maximum value, mean value, and standard deviation of the data. It is presumed that both parties involved may derive significant benefits from such TP practices Refgia et. al (2017). The variables analyzed in this research included related party transactions (RPT), company size (SIZE), sales size (SALES), market capitalization (MC it), Foreign ownership (FO it), Sales growth (SG it), and Operating profit (NOI it). Thus, a final number of 50 companies were included in the analysis. RPT was identified as the dependent variable, with a minimum value of 3.24 and a maximum value of 22.29. A minimum value of 3.24 for RPT indicates that there are companies with relatively low levels of RPT, while a maximum value of 22.29 suggests that there are also companies with larger transactions in this area. The mean of 14.79 indicates a central value of the RPT variable. The standard deviation of 3.69 shows some variability around this mean. The negative skewness (-0.566) suggests a slight longer tail on the left side of the distribution, and the Kurtosis of 1.507 indicates heavier tails than those of a normal distribution. Distributions with heavier tails than a normal distribution are characterized by higher probabilities for extreme or rare events (Nurul, 2023). The normality test was conducted using the Kolmogorov-Smirnov statistical test using the results from SPSS. The data is considered normally distributed if the Kolmogorov-Smirnov test shows a significant value above 0.05.

Table 3. Normality test results in SPSS. Own processing

Test of Normality						
	Kolmogorov-Smirnov[a]			Shapiro- Wilk		
	Statistic	df	Sig.	Statistic	df.	Sig.
RPT it (DV)	.116	50	.089	.960	50	.089
SALES it (IV)	.057	50	.200*	.993	50	.992
SIZE it (IV)	.111	50	.172	.952	50	.042
MC it (IV)	.100	50	.200*	.971	50	.246
FO it (IV)	.334	50	.000	.747	50	.000
SG it (IV)	.139	50	.017	.897	50	.000
NOI it (IV)	.261	50	.000	.743	50	.000

The results of the analysis suggest that the FO, SG, and NOI variables exhibit significant deviations from a normal distribution. On the other hand, other variables such as RPT, SALES, and SIZE seem to follow a normal distribution, with a usual significance level of 0.05. This discrepancy may be attributed to the fact that the FO, SG, and NOI variables contain values of 0, indicating either the absence of foreign ownership, decreases in sales, or the absence of net operating income in the year 2022. These exceptions affect the normal distribution of these variables.

5. The Scatterplot and multicollinearity test

The preliminary data analysis involves several steps to assess the relationships between the independent variables and the dependent variable. Firstly, multicollinearity tests and Scatterplot analyses are conducted. The purpose of these analyses is to determine the relevance of each independent variable in relation to the dependent variable. By examining scatterplots, we will look for correlations or trends between variables. Identifying significant patterns or relationships will provide us with a better understanding of the impact of each independent variable on the dependent variable. Each of these variables will be analyzed separately in relation to the dependent variable to evaluate their impact on the research outcomes.

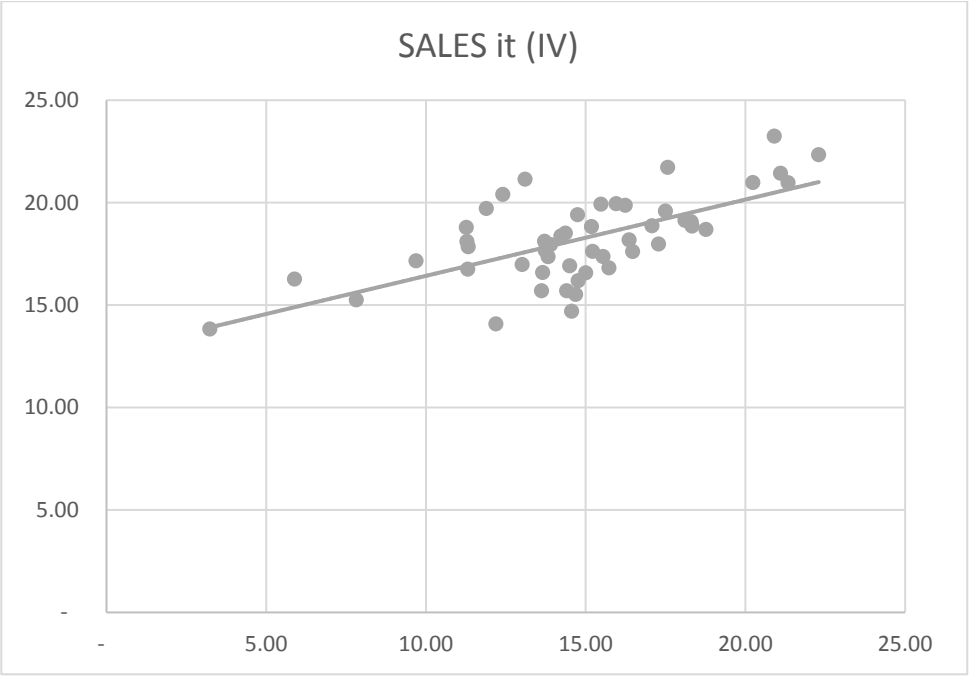


Figure 1. Own processing

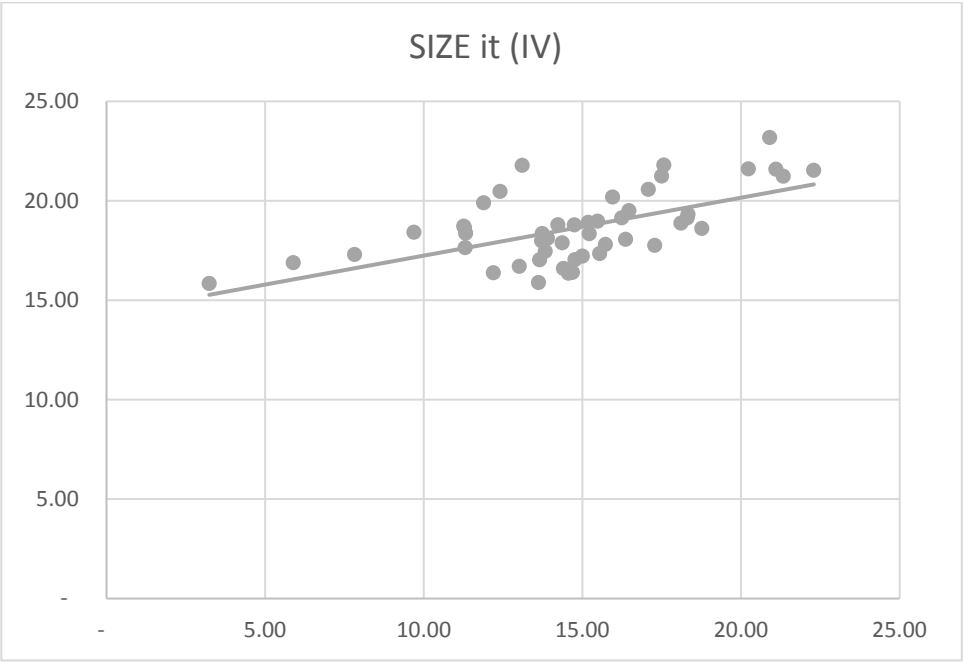


Figure 2. Own processing

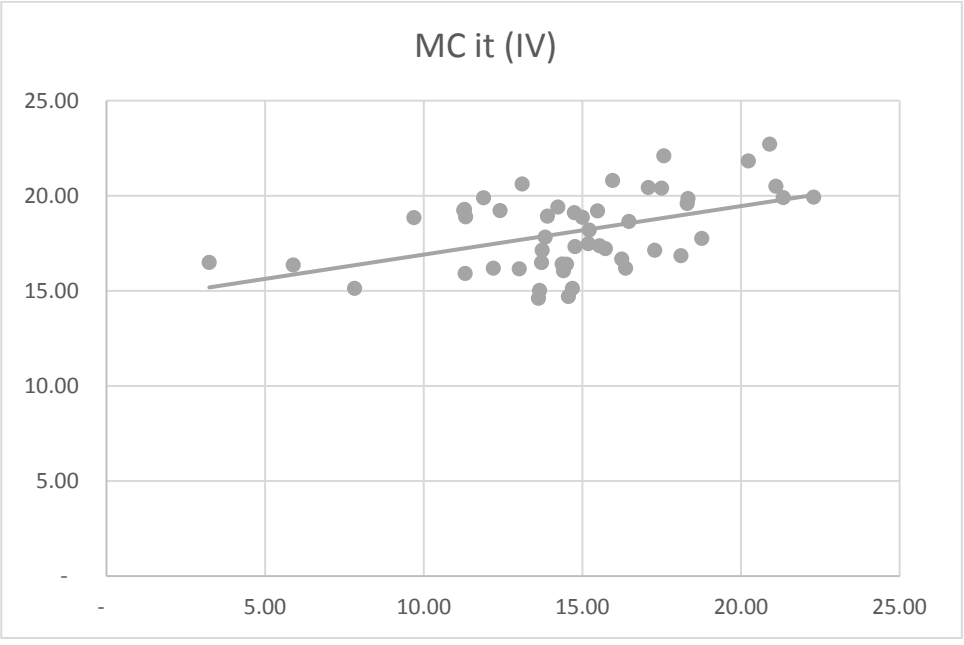
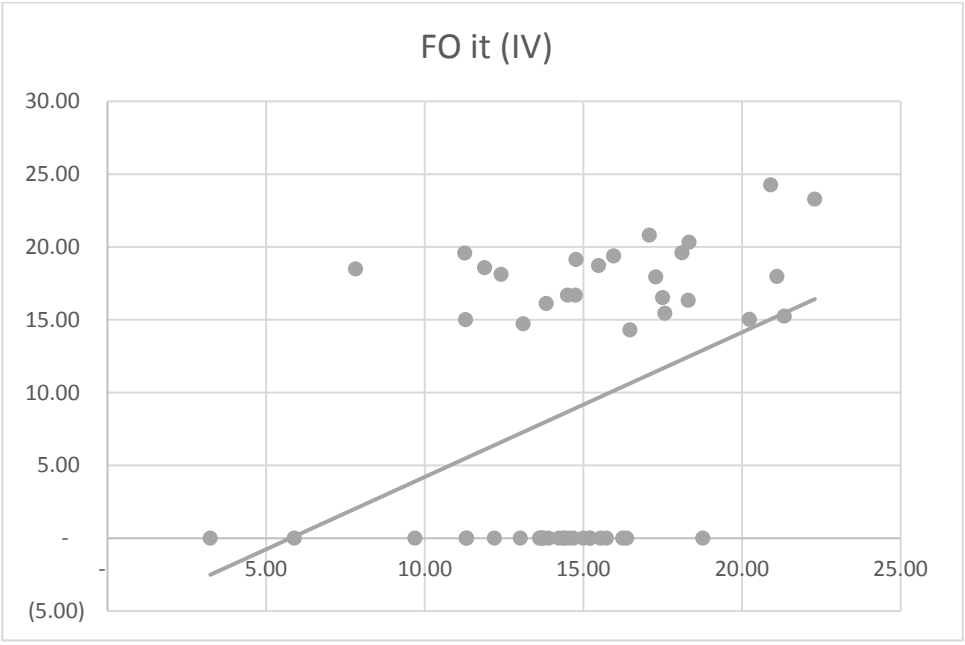


Figure 3. Own processing



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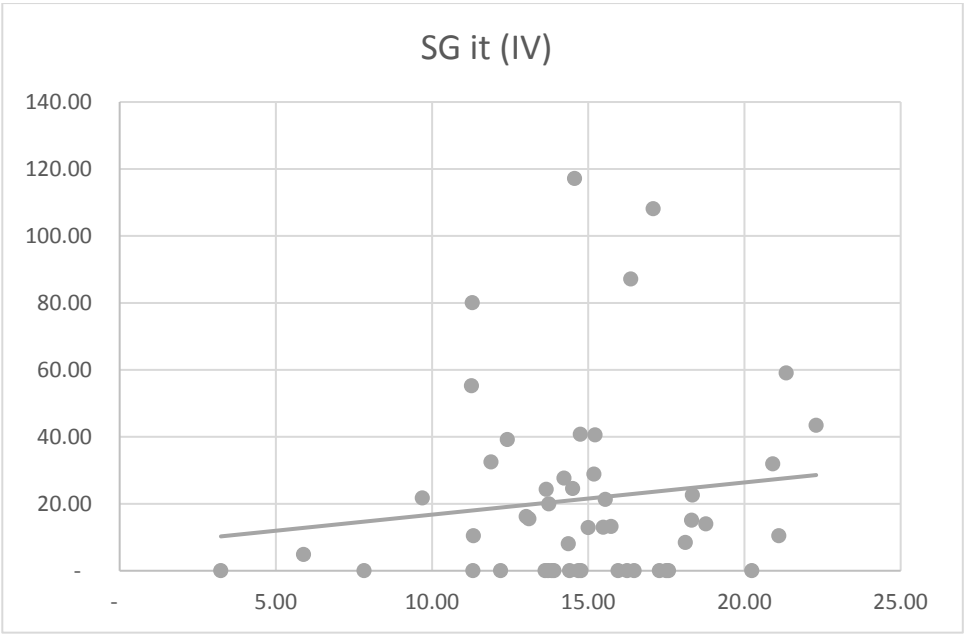

Figure 5. Own processing

Visualizing all variables on Scatterplot graphs, with the dependent ones (on the X-axis) in relation to the independent variable (on the Y-axis), we can conclude that all points on the graphs are close to the regression line. This observation indicates a good fit of the regression model to the data. In cases where there are points that do not follow a linear pattern, this could indicate either a lack of available data for those variables or that they are equal to zero.

We used the Pearson correlation coefficient method to examine the relationships between the dependent variable and the independent variables.

Table 4. Own processing

Correlations								
		RPT it (DV)	SIZE it (IV)	SALES it (IV)	MC it (IV)	FO it (IV)	SG it (IV)	NOI it (IV)
Pearson Correlation	RPT it (DV)	1.000	.603	.658	0466	.397	.161	.298
	SIZE it (IV)	.603	1.000	.933	.879	.622	.186	.615
	SALES It (IV)	.658	.933	1.000	.809	.594	.189	.599
	MC it (IV)	.466	.879	.809	1.000	.614	.151	.642
	FO it (IV)	.397	.622	.594	.614	1.000	.146	.467
	SG it (IV)	.161	.186	.189	.151	.146	1.000	.104
	NOI it (IV)	.298	.615	.599	.642	.467	.104	1.000
Sig. (1- tailed)	RPT it (DV)	.	.000	.000	.000	.002	.132	.018
	SIZE it (IV)	.000	.	.000	.000	.000	.098	.000
	SALES It (IV)	.000	.000	.	.000	.000	.094	.000
	MC it (IV)	.000	.000	.000	.	.000	.147	.000
	FO it (IV)	.002	.000	.000	.000	.	.156	.000
	SG it (IV)	.132	.098	.094	.147	.156	.	.237
	NOI it (IV)	.018	.000	.000	.000	.000	.237	.
N	RPT it (DV)	50	50	50	50	50	50	50
	SIZE it (IV)	50	50	50	50	50	50	50
	SALES It (IV)	50	50	50	50	50	50	50
	MC it (IV)	50	50	50	50	50	50	50
	FO it (IV)	50	50	50	50	50	50	50
	SG it (IV)	50	50	50	50	50	50	50
	NOI it (IV)	50	50	50	50	50	50	50

The obtained correlation coefficients, ranging from 0 to 1, indicate the presence of a positive correlation, suggesting that, generally, an increase in one variable is associated with a proportional increase in the other.

Table 5. Own processing

Model Summary[b]									
						Change Statistics			
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df 1	df 2	Sig. F Change
1	.677[a]	.458	.383	2.8957529	.458	6.065	6	43	.000

Based on Table 5, we observe that the adjusted R-squared value is 0.383 or 38.3%. This indicates that 38.3% of the variability in TP can be explained by company size, sales, capitalization, foreign ownership, sales growth, and operational profit.

The R-squared value (R^2) indicates the proportion of variation in the dependent variable explained by the independent variables included in the model. In this case, 0.458 suggests that approximately 45.8% of the variation in RPT is explained by the independent variables, and the Sig F value is the p-value associated with the F Change statistic. According to Nurwati et al. (2021), a low p-value (close to zero) indicates that adding the independent variables is significant.

Table 6. Own processing

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	305.122	6	50.854	6.065	.000[b]
	Residual	360.572	43	8.385		
	Total	665.693	49			

a. Dependent Variable: RPT it (DV)
b. Predictors: (Constant), NOI (IV), SG it (IV), FO it (IV), SALES it (IV), MC it (IV), SIZE it (IV)

The results of the ANOVA tests, as shown in Table 6, conducted to assess the influence of company size, sales, capitalization, foreign ownership, sales growth, and operational profit on affiliate transactions, obtained a significance value (Sig.) of 0.000, where this value is less than 0.05, thus accepting H1. This means that company size, sales, capitalization, foreign ownership, sales growth, and operational profit collectively have a significant influence on TP.

Table 7. Own processing

Coefficients[a]											
Unstandardized Coefficients Standardized Coefficients							Correlations			Collinearity Statistics	
Model		B	Std. Error	Beta	t	Sig.	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	-6.363	5.670		-1.122	.268					
	SIZE it (IV)	.285	.800	.138	.356	.724	.603	.054	.040	.084	11.881
	SALES it (IV)	1.291	.555	.730	2.324	.025	.658	.334	.261	.128	7.839
	MC it (IV)	-.382	.454	-.209	-.842	.405	.466	-.127	-.094	.203	4.916

Coefficients[a]											
Unstandardized Coefficients				Standardized Coefficients			Correlations			Collinearity Statistics	
	FO it (IV)	.023	.059	.057	.390	.699	.397	.059	.044	.586	1.707
	SG it (IV)	.004	.013	.033	.288	.775	.161	.044	.032	.961	1.040
	NOI it (IV)	-.072	.090	-.119	-.799	.429	.298	-.121	-.090	.565	1.769

6. Findings

The coefficient value for the variable SIZE is 0.285, with a corresponding t-test value of 0.356 and a significance value of 0.724, exceeding the threshold of 0.05. Consequently, we accept the null hypothesis (H0) and reject the alternative hypothesis (H1), indicating that company size does not significantly affect TP practices. While these results diverge from the findings of Melarosa, C. (2018), who reported a positive influence of company size on TP practices, they align with the conclusions drawn by Nurwati et al. (2021), which similarly found no significant impact of company size on TP practices.

For the variable SALES , the coefficient value is 1.291, accompanied by a t-test value of 2.32 and a significance value of 0.025, below the predetermined threshold of 0.05. Thus, we reject the null hypothesis (H0) and accept the alternative hypothesis (H1), indicating a significant relationship between the SALES variable and TP practices. This finding is supported by the research of Johnson et al. (2020), who also observed a positive influence of sales on TP practices. Conversely, Chen and Li (2017) found no significant relationship between sales and TP practices in their study.

The variabile MC has a coefficient value of -0.382, accompanied by a calculated t-test of -0.842 and a significance value of 0.405. his negative coefficient suggests an inverse relationship between the MC variable and TP practices. However, the significance value of 0.405 exceeds the conventional threshold of 0.05, indicating insufficient evidence to reject the null hypothesis (H0) that the regression coefficient for “MC” is zero. Therefore, we cannot assert a significant relationship between capitalization and TP practices. Brown and Jones (2016) similarly found no significant effects of market capitalization on TP practices, consistent with our findings. Garcia et al. (2018) reported a significant negative association between market capitalization and TP practices in their analysis, contrasting with our results.

The variable FO (foreign ownership) is associated with a coefficient value of 0.23, along with a calculated t-test of 0.390 and a significance value of 0.699. Given that the significance value exceeds the conventional threshold of 0.05, foreign ownership appears to lack a significant effect on TP practices. This finding is consistent with the conclusions drawn by Wang and Wu (2019), who similarly found no significant effect of foreign ownership on transfer pricing practices. However, Li et al. (2015) reported a significant positive impact of foreign ownership on transfer pricing practices, contrasting with our results.

Regarding the variable SG (sales growth), it exhibits a coefficient value of 0.04, accompanied by a calculated t-test of 0.288 and a significance value of 0.775. As the significance value surpasses the conventional threshold of 0.05, it indicates that sales growth does not significantly affect TP practices. This finding is consistent with the results reported by Patel and Shah (2020), who similarly found non-significant

effects of sales growth on transfer pricing practices, aligning with our observations. However, Kim and Park (2018) observed a significant positive relationship between sales growth and TP practices in their study, which contrasts with our findings.

Lastly, the variable NOI (operational profit) presents a coefficient value of -0.072, with a calculated t-test of -0.799 and a significance value of 0.429. Since the significance value exceeds the conventional threshold of 0.05, it suggests that operational profit does not significantly impact TP practices. This finding aligns with the results reported by Zhang and Wang (2016), who similarly found a non-significant association between net operating income and TP practices.

7. Conclusion and study limitations

In conclusion, our study examined the impact of various independent variables on transfer pricing (TP) practices in Romania. While some variables demonstrated significant relationships with TP practices, others did not yield significant results. Specifically, company size was found to have no significant effect on TP practices, aligning with previous research by Nurwati et al. (2021) but differing from findings by Melarosa, C. (2018). Sales volume was identified as a significant factor influencing TP practices, consistent with Johnson et al. (2020), while market capitalization, foreign ownership, sales growth, and operational profit showed non-significant associations with TP practices, which is in line with prior research by Brown and Jones (2016), Wang and Wu (2019), Patel and Shah (2020), and Zhang and Wang (2016).

However, it's crucial to acknowledge several limitations that may impact the generalizability of our findings. Firstly, the constraints posed by our sample size limited the depth of our analysis. Additionally, challenges related to data quality and transparency regarding affiliated parties compelled us to reduce the number of included companies. Moreover, given that transfer pricing is a relatively novel concept in Romania, there is a scarcity of research in this area, which may have influenced our study outcomes.

Moving forward, addressing these limitations is imperative for future research endeavors. Expanding our database and considering additional factors, such as the tax rates of host countries, could enhance the comprehensiveness of our analysis. However, this expansion would necessitate broadening our scope to include not only Romania but also other European countries or even a global perspective. Furthermore, mitigating the challenges associated with data collection, particularly regarding the volume of transactions with affiliated parties, is paramount. Implementing strategies to overcome these limitations will contribute to a more robust understanding of transfer pricing dynamics in Romania and beyond.

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