

# Transfer Pricing

## Arm's Length Standard

### Complexities of using African comparable companies

There have been repeated requests from clients for Deloitte to use African comparable companies in our search strategies in order to align the clients' geographical regions in which they operate from e.g. for goods sold from South Africa to Angola – include Angolan companies in the search strategy.

However, using this approach seems to be easier in theory than in practice. This is because, although, there may seem to be, at the outset of the search, a sufficient number of companies located within the African geographical region - 19 595 companies – this number is only available before applying our standard search steps.

Therefore, in order to provide a better understanding of the availability of African companies on the Orbis database, we performed a high-level study of the companies included on the database and subsequently applied the standard search criteria.

The results of our study showed the following:

- The initial number of companies – pre-standard search criteria applied – using only the Africa geographical region was 19 595 companies. The African countries which were represented included: Algeria, Botswana, Burkina Faso, Cameroon, Cape Verde, Cote d'voire, Egypt, Gabon, Ghana, Kenya, Liberia, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Sudan, Swaziland, Tunisia, Uganda, Tanzania, Zambia and Zimbabwe.

- The next step was to apply the independence indicator criteria – A+, A, A- and U (unknown percentage of ownership) – which are the standard search criteria used both in South Africa and other African practices. After this step there were 16 810 remaining companies.
- One of the most important considerations when performing a benchmark search is to be able to obtain companies which have relevant financial information such as operating revenue, operating costs, earnings before interest and tax, etc. Without this information being included in the database, the search will not be of much value as we will not have the ability to calculate the necessary ratios. Therefore, in order to confirm that the remaining 16 810 companies have the necessary financial information we applied the Operating Revenue Test in order to confirm that the companies have the financial information.

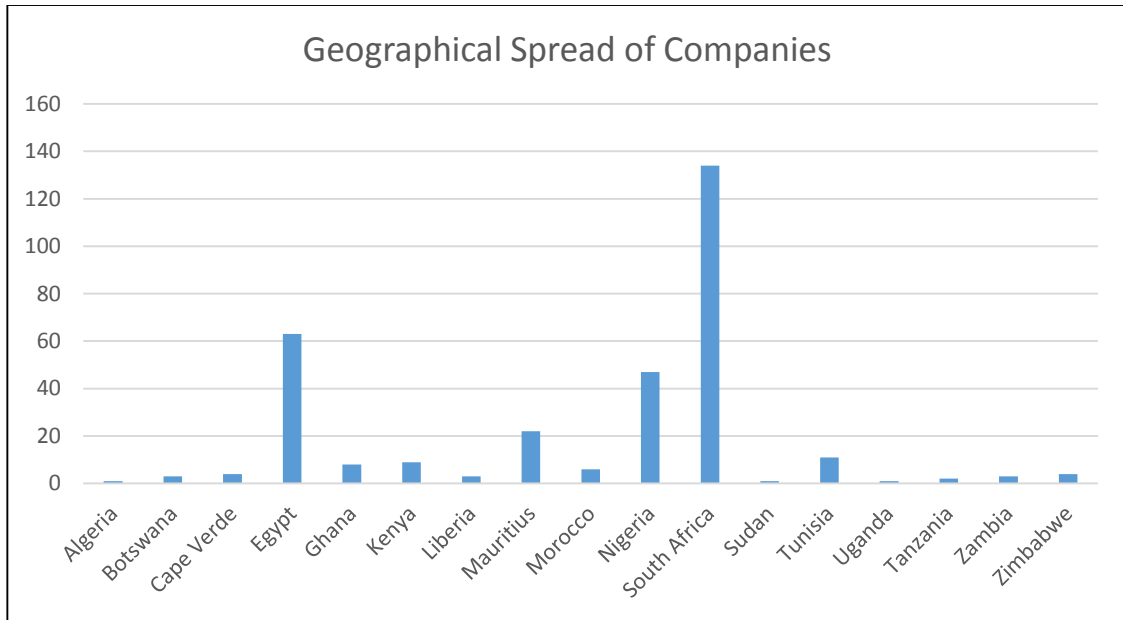
The search step applied is as follows:

1. **Absolute Approach:** Set the search process to: Operating Revenue: Min. USD 1 000 for all of the last 3 years (2013, 2012, 2011).

The results of this approach indicated a set of 340 companies which were subsequently exported to an excel spreadsheet for further analysis.

African companies available on the database	340
Less:	
- Unconsolidated with Subsidiaries	(8)
- Unconsolidated and Part of Group	(10)
Total	322

The 322 companies remaining can be represented per geographical region in the graph below:



The bar chart above indicates that most of the companies available for further analysis are located in South Africa (135), Egypt (62), Nigeria (47) and Mauritius (22) while the remainder of companies located in other parts of Africa are insignificant per region.

Furthermore, in order to determine the actual types of company available (e.g. listed companies, private companies, etc.) further analysis was performed for each country and the results are as follows:

Country	Types of Company	Country	Types of Company	Country	Types of Company
Algeria	Unconsolidated	Liberia	Mostly Unconsolidated	Uganda	Consolidated
Botswana	Mostly Unconsolidated	Mauritius	Consolidated	Tanzania	Consolidated
Cape Verde	Unconsolidated	Morocco	Consolidated	Zambia	Consolidated
Egypt	Consolidated	Nigeria	Consolidated	Zimbabwe	Consolidated
Ghana	Consolidated	South Africa	Consolidated and Unconsolidated		
Kenya	Consolidated	Tunisia	Consolidated		

Based on the table above, except for companies located in Algeria, Botswana and Liberia (Unconsolidated), the companies located in the other regions were regarded as listed companies (consolidated) and accordingly traded on the stock exchanges in their respective countries. However, even though the companies were consolidated the problem is that many of the companies were regarded as holding or industrial companies in that they held investments in many industries which in turn rendered the companies, in most cases, unusable for benchmark search purposes.

In addition, with regards to South Africa<sup>1</sup>, Bureau van Dijk has also included private companies and close corporations<sup>2</sup> which were unconsolidated. After reviewing the private companies, many of these companies were rejected based on the fact that they formed part of a group and therefore, were unusable.

South Africa has close corporations which is a unique form of corporate entity. This type of entity offers the benefits of limited liability for its members (similar to shareholders) and is similar to a company. However, it is not required by legislation to have an audit of the financial statements. Therefore, as the financial information does not go through a process of audit verification, there may be risk that the financial information may be misrepresented. Another challenge is that many of these entities are family owned or relatively small which in turn may have an impact of the integrity of the financial information.

Therefore, the results of the study indicates that there are significant limitations when it comes to using African companies as comparables. This is due to a number of factors, including the limited amount of companies available and the fact that most of the companies operate as holding or industrial companies.

So until the filing of financial statement of private companies becomes mandatory on the African continent, we face significant challenges in incorporating these companies in our benchmark searches.

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<sup>1</sup> The OneSource Database can also be used to find Africa companies.

<sup>2</sup> Close Corporation have been abolished with the new companies act.

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