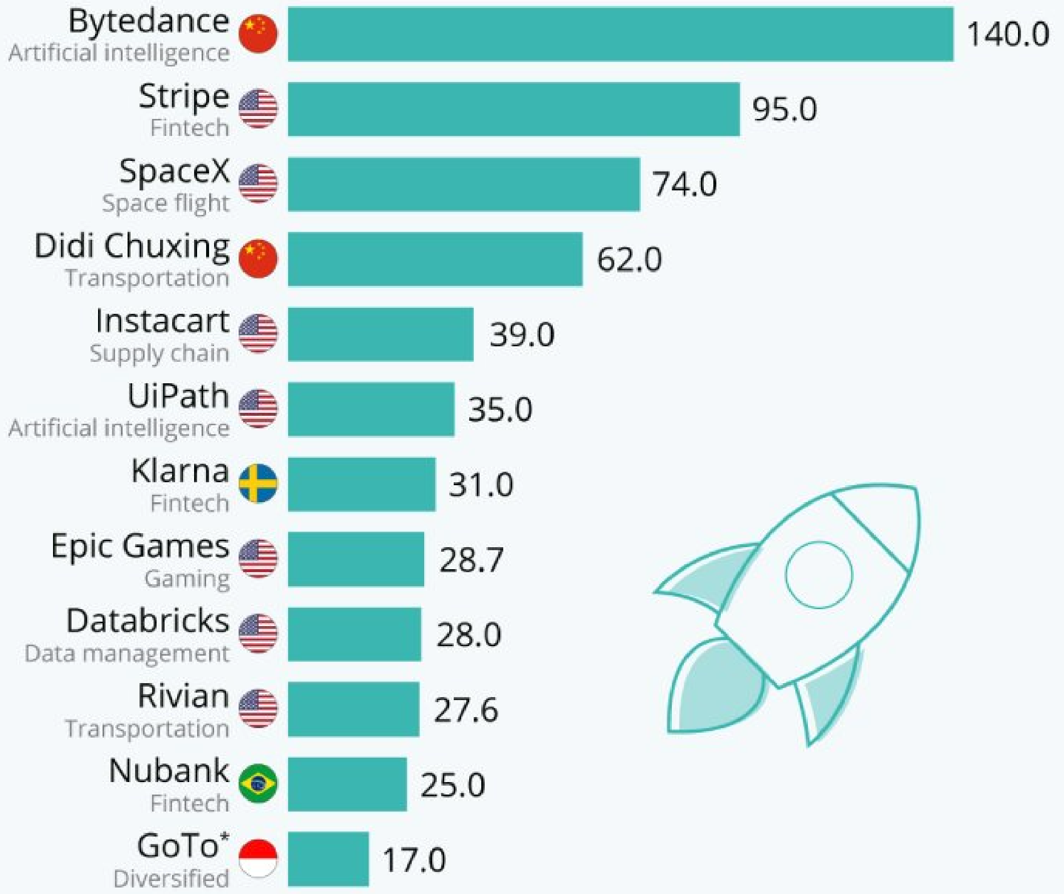
FE Advisory
Our knowledge your asset

START UP LOSSES: TRANSFER PRICING PERSPECTIVE

The Highest-Valued Startups in the World

Startup companies worldwide by valuation (in billion U.S. dollars)



* Gojek and Tokopedia combined valuation after merger
Currently private companies (including whisper valuations)
As of April 2021
Source: CB Insights

START UP LOSSES- KEY REASONS

Internal factors

- Product Research cost
- Marketing cost to establish brand
- Market penetration (low price entry)
- Operational inefficiencies
- Dispute among co-founders
- Overall failed business strategy

External factors

- Economic recession
- Foreign exchange losses
- Product-market misfit

TRANSFER PRICING POLICY EVALUATION

When a company regularly incurs losses while the Group as a whole is profitable, it can trigger scrutiny if the losses are genuine.

A company incurring **recurring losses** would cease operations unless the business continuance is important for the group as whole. The company may also have to **demonstrate** how the inter-group transactions are not the reason for its recurring losses. Losses due to **commercial rational** not linked to related party relationship and for a limited period of time can be justified

TRANSFER PRICING POLICY EVALUATION

A company's **character** could also be of an **entrepreneur** assuming significant business risk and the same should be documented in the FAR analysis

Incurring losses or earning lower than anticipated margins may be justified in some cases if for a reasonable period, if the company can demonstrate the same as its **business strategy to achieve market penetration**. However, this should be demonstrated through improved margins in later period

START UP WITH RECURRING LOSSES

Early stage companies with related party transactions should maintain below documents for TP evaluation

a) Role and Risk matrix for functions performed and risk assumed

b) Forecast on its demand estimation

c) Industry size, competitors and critical success factors

d) Identify cost factors not linked to related party relationships and its impact on recurring losses

e) Search for comparables in similar life cycle

f) Economic adjustments (working capital, risk, capacity utilisation)

www.5eadvisory.com

sprakash@5eadvisory.com

Five Elements Advisory (Certified Public Accountants)

FE Advisory

Our knowledge your asset