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Book of Abstracts

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"Business Growth and Sustainable Development Goals in Emerging Market Economies"

November 11th - 12th, 2019
Padang, West Sumatera - Indonesia

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Dr. Harif Amali Rivai, SE., M.Si.
Dean of Economic Faculty

Dr. Fauzan Misra, SE., M.Sc., Ak. CA.
Conference Chair

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The Effect of Exchange Rates, Profitability and the Bonus Mechanism in the Decision of Transfer Pricing at Consumption Goods Industry

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Abstract

This study aims to analyze the effect of exchange rates, profitability and the bonus mechanism in transfer pricing at consumption goods industry. Data is taken from financial statement presented on Indonesia Stock Exchange in 2014-2018. The sample was obtained a sample of 10 companies with purposive sampling method from 40 public companies. Panel data processing uses Eviews9 to obtain the fixed effect regression equation, t test (partially), F test (simultaneously) and the discussion of influence analysis. The result revealed that transfer pricing decision was significantly affected by profitability (-) . The decision of transfer pricing was not influenced by exchange rate and bonus mechanism. F test states exchange rates, profitability and bonus mechanism simultaneously influenced significantly in the decision of transfer pricing. The highest and the lowest influence in changing of profitability was on HMSP and SKLT.

Key words: Exchange Rate, Profitability, Bonus Mechanism, Transfer

Pricing **1. Introduction**

Transfer pricing is allowed as a legal transactions. In practice, companies sometimes misuse transfer pricing to tax avoidance. Transfer pricing in goods and services transactions raises interesting problems in domestic and foreign operations management. According to Mark Checini et al (2013: 18) for multinational companies that have a network of operations in various countries, transfer pricing schemes is the best alternative for achieving excellence competitive companies in the field of managing risk and costs arising from imperfections in market structure cooperation partner countries. Exchange rates are related to international trade because the cash flows of multinational companies are denominated by several currencies, each of which is valued relative to the value of the dollar. Different exchange rates affect transfer pricing practices in multinational companies (Marfuah et al, 2014). Companies that obtain higher profits tend to do transfer pricing to increase profitability. The effect of profitability on transfer pricing is reflected in the company's efforts to transfer profits from the parent company to subsidiaries that have lower tax rates. In other words the company practices transfer pricing to reduce the amount of tax that must be paid. Profitability shows the effectiveness of management performance in efforts to make a profit. The success is appreciated by giving a bonus. The bonus mechanism impacts management in manipulating profits and managers tend to maximize net income. In accordance with the bonus plan hypothesis where managers will use accounting procedures that increase profits with the practice of transfer pricing.

2. Literature

2.1. Transfer Pricing

Transfer pricing is a company policy in determining the transfer pricing of a transaction, not only goods, services, intangible assets, but also financial transactions carried out by the company. Understanding of transfer pricing can be divided into two meanings, namely the transfer pricing is neutral without reduction of tax expenses. and no neutral with saving tax expenses. While on many practices, the transfer pricing has shifted profits to countries with lower tax rates (Suandy 2014). In additional by Suandy (2004) that transfer pricing in multinational can maximaze global revenues and reduce income tax especially income tax article 25. Transfer pricing to be accounted by dividing relationship receivables and total company receivables

2.2. Exchange Rates

The exchange rate is a comparison between the value of one country's currency with another country. The difference between the real exchange rate and the nominal exchange rate is important to understand because both have different effects on exchange rate risk. Changes in the nominal exchange rate will be followed by changes in the same price that makes these changes have no effect on the relative competitive position between domestic companies and their foreign competitors and there is no effect on cash flow. While changes in the real exchange rate will cause changes in prices with prices of foreign goods. The exchange rate is calculated based on the ratio scale of the foreign exchange gain or loss divided by the profit or loss before tax, (Marfuah and Andri Puren N.A. 2013). According to Chan et.al (2002) that multinational companies might try to reduce the risk of foreign currency exchange rates with move funds to a strong currency through transfer pricing to maximize profits company as a whole

2.3. Profitability

Profitability According to Sunyoto (2013: 113) profitability is the company's ability to benefit from its business. Profitability describes the effectiveness of management in managing the company so that it can achieve the expected targets. Profitability also shows whether the company has a good opportunity in the future. Therefore the company will always try to increase its profitabilit. As we know, profitability level at the best retrun of using assets is return on assets (ROA) that it shows net income divided by total assets. Research conducted by Bava, et al (2017), states that the lower a profitability company, the higher the possibility
profit shifts that occur, in other words increasingly there is also a great suspicion that the company has a transfer pricing.

2.4 Bonus Mechanism

Management performance is a factor that motivates the accounting profit-based compensation plan. Bonus planning gives managers incentives to maximize company value. As stated by Purwanti (2010), bonuses are awards given by the GMS to members of the Board of Directors each year if the company makes a profit. This bonus compensation system can enable principals, especially managers in the company, to engineer the company's financial statements in order to obtain the maximum bonus mechanism.

3. Methodology

This research uses explationary survey, which is a study aims to analyze the factors of transfer pricing decisions. The data used are secondary data in the form of financial statement and disclosures from consumer goods industry during 2014-2018. Sample selection is determined by using purposive sampling technique base the principle of reducing the portion of the population that does not meet the criteria. The chosen sample there is 10 companies of 40 public compnies in customers goods industry.

4. Result and Discussion

4.1. The Decision of Transfer Pricing was influenced by profitability

Based on the results of hypothesis testing using partial test (t test) showed that the t- test was -2.751897 with a significance level of t less than 0.05 (0.0091 < 0.05) and the value of the regression coefficient was negative at -0.639683. Then the results obtained from the study are H0 rejected and H1 accepted so it can be concluded that the profitability variable has a significant negative effect on the transfer pricing decision. This is consistent with research conducted by Deanti L.R (2017) which states that the greater the level of profitability obtained by a company, the transfer pricing of the company will decrease. In contrast, this result is not in accordance with the research result of DT Hapsoro (2015). However, this result support the agency theory that states both principal and management agree on profitability. The principal want increase their wealth on profitability and the management as agent also want increase their certain objectives on profitability especially the decision of transfer pricing. In market of customer goods as Indonesia market absolutely still need the profitability to develop the business, and the decision of transfer pricing still became the basic objective of management.

4.2. Logical explanation of exchange rates and bonus mechanism

The results of hypothesis testing indicate that the t count is 0.110778 with a significance level of t greater than 0.05 (0.9124 > 0.05) and the value of the regression coefficient is positive at 0.017392. H0 is accepted and H1 is rejected so it is concluded that the exchange rate does not significantly influence the transfer pricing decision. In accordance with research Marfuah and Azizah (2014). These results identify the size of the exchange rate does not affect the consideration of companies doing or not doing transfer pricing. In the financial statements that there are losses on foreign exchange differences, the exchange rate changes do not provide any benefit and can even weaken the domestic currency. The result of this study to be supported by Marfuah and Azizah (2014) but in contrast with the result of Chan et.al (2002). Even this research do not support agency theory because the difference of exchange rate to be used to do tarnsfer pricing.

Another test of the bonus mechanism shows that the tcount is 1.340954, the significance level of t is greater than 0.05 (0.1881> 0.05) and the value of the regression coefficient is positive at 0.023734. This result shows that H0 is accepted and H1 is rejected, so it is concluded that the bonus mechanism does not affect the transfer pricing decision. This is because if only because of the motive of wanting to get a bonus the directors dare to do transfer pricing transactions in order to provide a temporary increase in profits for the company then this is very unethical given there is a much greater interest in maintaining the company's value. Company management must present financial statements that are closer to reality and can be used for decision making purposes.

Conclusion

This study concludes that firstly the profitability significantly and negatively effect on transfer pricing decision, secondly the Exchange Rate and Bonus Mechanism do not significantly influence transfer pricing decision at customer goods industry in Indonesia.

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