Foreign Ownership and Exchange Rates on Transfer Pricing Decisions in Manufacturing Companies Listed on The Indonesia Stock Exchange

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ABSTRACT

Transfer pricing is the company's policy in determining the transfer price of a transaction. Improved cash flow performance and marketing objectives encourage companies to allocate overhead costs and design strategies in estimating the transfer prices of goods and services produced. This study explores foreign ownership and exchange rates' impact on transfer pricing. This study uses a quantitative approach by examining foreign ownership and exchange rate variables against transfer prices. The data used are the audited financial statements of manufacturing companies listed on the Indonesia Stock Exchange for 2017-2021. The results of this study show that foreign ownership and foreign exchange rates have no impact on transfer prices. This research contributes to the transfer pricing literature regarding transfer pricing policies relating to foreign investment risk and the political power of those who support local government objectives.

Keywords:
Foreign ownership, foreign exchange, multinational company, transfer pricing, strategic planning

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1. Pendahuluan

Globalization changes the world economy (Pleninger & Sturm, 2020; Yameogo et al., 2021). Economic development encourages companies to follow economic development and compete globally (Rahman & Alam, 2022; Sha, 2023). This causes the management of each company to carry out various strategies to deal with the competition. The company's strategic planning plays an important role in the sustainability of the company (Ejigu & Desalegn, 2023; Kurpiela & Teuteberg, 2022; Ojha et al., 2023). Companies that are unable to compete will be displaced from the business world because they are unable to maintain their company performance.

The strategy of increasing the company's efficiency and effectiveness in achieving profit targets spurs the company to continue to develop its business (Jian et al., 2022; Kamrad et al., 2021; Shi et al., 2010). One of them is with intercompany transactions strategy. This strategy is to make transactions with companies in the country or abroad. Moreover, sales transactions of goods and services, licensing rights, and other intangible assets can also occur within the company or between divisions (Chang et al., 2017; de Carvalho Pereira et al., 2020; Mahmoudian et al., 2021). This transaction method will make it difficult to price the product to be transferred (J. C. Plesner Rossing & Pearson, 2022). Pricing of inter-division transactions is known as transfer pricing.

Transfer pricing is the company's policy in determining the transfer price of a transaction (Wan & Hong, 2019). There are two groups of transactions in transfer pricing, namely intra-company (Gao & Zhao, 2015; B. Liu et al., 2022) and inter-company transfer pricing. Intra-company transfer pricing is transfer pricing between divisions within one company. In contrast, the transfer price between companies is the price between two companies with a special relationship. Transfer prices are set for semi-finished products, such as goods or services, from one division to another. The transaction can be carried out in one country (domestic transfer pricing) and with different countries (international transfer pricing).

In management accounting, transfer pricing is a pricing policy applied to delivering goods or services between departments. Transfer pricing aims to measure the performance of each division or department. In addition, increasing profits, cash flow, and marketing objectives are a series of reasons that make companies need to develop processes for allocating overhead costs and design strategies to estimate the transfer price of goods and services produced (Dharmapala, 2014). But lately, transfer pricing has been recognized as a strategic tool that can facilitate companies to achieve competitive advantage. Thus, transfer pricing is a significant issue in business organizations. Companies carry out transfer pricing schemes that are not following applicable law. For example, companies often misuse transfer pricing as a form of tax avoidance (Karkinsky & Riedel, 2012; C. Plesner Rossing, 2013; Z. Wu & Lu, 2018).

A case of transfer pricing in Indonesia occurs mainly in plantation, mining, and manufacturing companies, such as the case of PT Asian Agri, PT Adaro Energy, and PT Toyota Motor Manufacturing Indonesia. For example, PT Adaro Energy Tbk is one of the transfer price cases that harms Indonesia because the company sells with affiliated companies in Singapore. The case was a public report to the Department of Energy and Mineral Resources. From the report, PT. Adaro Energy Tbk allegedly sold coal below international standard prices. This is intended to avoid paying royalties and taxes that would otherwise be deposited into the state treasury (Dharmapala, 2014). Then by Coaltrade, the coal is sold back to the market according to market prices. In Coaltrade's financial statements, Coaltrade's profit is higher than Adaro's. The financial statements raised suspicions that PT. Adaro, which owns a coal mine, has always posted small profits. This is suspected to be the practice of transfer pricing at PT Adaro with the resale method. PT Adaro sells its products to related parties, namely affiliates in Singapore.

Many factors underlie the use of transfer pricing policies for corporate tax planning purposes (Bartelsman & Beetsma, 2003; Davies et al., 2018). Such factors can come from the external and internal environment of the business, such as exchange rates and foreign ownership. Exchange rates can influence a company's decision to transfer pricing. Exchange rates are closely related to international trade because the cash flow of multinational companies uses multiple currencies where the value of each currency is relative to the dollar and fluctuates. These different exchange rates will later affect transfer pricing practices in multinational companies. Different exchange rates affect the transfer pricing practices of multinational companies. As a result, multinational companies may try to reduce foreign exchange risk by transferring funds to a stronger currency through transfer prices to maximize overall corporate profits.

Share ownership by foreign investors is also a factor influencing transfer pricing practices (Wang et al., 2023; Xiong et al., 2022). The greater the ownership of foreign investors, the greater the foreign control over the company. These controls include pricing policy's effect and the profit amount from transfer pricing transactions. Controlling investors tend to make decisions to make transactions to related parties that are expropriational in nature (Fan et al., 2022; R. Liu et al., 2022). When the controlling shareholder is owned by a foreign company, the foreign controlling shareholder can sell the product to another company (Agarwal & Chaudhry, 2022; Li & Sun, 2023; Xiong et al., 2022), they wish at a cheaper price to the detriment of the non-controlling shareholder.

The practice of transfer pricing in multinational companies is very interesting. Therefore, researchers are motivated to research the phenomenon of transfer pricing. Some motivations influence management to carry out transfer pricing schemes to increase profits in the current period, namely exchange rates and foreign ownership.

The Effect of Foreign Ownership on Transfer Pricing Decisions

Foreign ownership is the ownership of shares owned by foreign individuals or institutions. The higher the controlling rights held by controlling shareholders, including foreign controlling shareholders (Hasan et al., 2022), enable controlling shareholders to control the abuse of rights to conduct related party transaction policies. Abuse of control harms non-controlling shareholders and benefits controlling shareholders (Zeitun & Goaied, 2021). Foreign controlling shareholders sell products from companies they control to private companies at below-market prices. Foreign controlling shareholders do this to gain benefits over non-controlling shareholders. Foreign shareholders tend to favor larger, less profitable companies but come from well-governed countries (Lindemanis et al., 2022). Companies with low foreign ownership tend to have minimal productivity (Klein, 2019). The greater the ownership of foreign controlling shares, the greater the influence in determining company decisions, Including pricing policy and number of transfer pricing transactions. Thus, in this study the following hypothesis was formulated,

H1 : Foreign ownership has a significant positive effect on transfer pricing decisions.

The Effect of Exchange Rates on Transfer Pricing Decisions

The exchange rate is the price of one unit of foreign currency in domestic currency. Exchange rates have two accounting effects: entering foreign currency transactions and disclosing profits (or losses) that may affect the company's overall profits. As a result, multinational companies attempt to reduce foreign exchange risk by transferring funds to strong currencies through transfer prices and maximize overall corporate profits. Agency theory suggests that an agent's motivation is to choose strategy to maximize the firm's overall exchange rate benefits (or minimize overall foreign exchange losses). The exchange rate has a significant positive effect on transfer pricing decisions, which is in line with the formulation of the hypothesis. Significant differences in the effect of exchange rates need to be retested. Thus, in this study the following hypothesis was formulated,

H2: Exchange rates have a significant positive effect on transfer pricing decisions.

2. Method

This research is quantitative research with a descriptive approach. This research design aims to explain empirical phenomena accompanied by statistical data and patterns of relationships between variables. Data is documented from secondary data in the form of audited financial statements, annual report of manufacturing companies listed on the Indonesia Stock Exchange for 2017-2021 obtained through the homepage of the Indonesia Stock Exchange (IDX).

Population and sample

The population in this study is all manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2017-2020 period. Samples are selected based on the purposive sampling method, which is a sampling method by setting certain criteria for certain purposes so that the sample to be obtained is representative enough (representative of the population). The following criteria determined the sample data of this study: (1) Manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2017-2020, (2) Foreign-controlled companies with a foreign ownership percentage of more than 20%. This is following PSAK No. 15 which states that the controlling shareholder is a shareholder or equity securities of 20% or more, (3) The Company has foreign exchange gains (losses) in the financial statements, (4) Companies that present financial statements in rupiah.

Transfer Pricing

Transfer pricing is measured using the ratio of proxy values of related-party transactions (RPT). Based on PSAK no. 7, related party transactions are the transfer of resources or obligations between related parties, ignoring the price calculation of these resources. Related party transactions in this study are related party sales transactions. This is considered to allow the company to transfer pricing to affiliates. Transfer pricing decisions are dummy variables where the sample will be valued "1" if the producer sells to a party with a special relationship. The sample will be valued "0" if the manufacturing company does not sell to parties with a special relationship.

Foreign Ownership

Foreign ownership is shares owned by foreign individuals or institutions (Tang, 2023). Foreign ownership is the controlling shareholder of a foreign company that owns a 20% of shares. Foreign ownership is measured using a scale of the ratio of the number of foreign ownerships divided by the number of shares outstanding.

$$\text{KA} = \frac{\text{Number of shares owned by foreig party}}{\text{Number of shares}}$$

Exchange rate

An exchange rate is an agreement known as the currency exchange rate for payments today or in the future between two currencies of each country or region (He et al., 2023; Sercu & Uppal, 2003). Foreign exchange gain (loss) is measured from company transactions using foreign currencies. The exchange rate is calculated using a ratio scale (T. Wu et al., 2023). The ratio scale used is foreign exchange difference gain (loss) divided by profit (loss) before tax. Furthermore, researchers will also use the same ratio scale.

$$\text{NT} = \frac{\text{E}xchange\ rate\ gain\ (loss)}{\text{Profit (loss)}\ before\ tax}$$

Analysis Methods

The data analysis method uses quantitative methods measured in numerical or numerical scales. In this study, quantitative analysis is carried out by quantifying research data to produce information needed for analysis. The analytical tool used in this study is logistic regression analysis (logistic regression) with the help of the IBM Statistical Package for Social Sciences (SPSS) program version 23. Logistic regression methods are used for dichotomous or dummy dependent variables, which can be analyzed by logistic regression. Descriptive statistical analysis is used in research to provide an overview of the variables in this study. Descriptive tests used include mean, standard deviation, maximum and minimum. Descriptive statistics present a numerical measure that is very important for sample data, so the reader can more easily understand the context.

Model Overall Analysis Assesses the fit of the overall model. The first step is to assess the overall model fit from the data. The hypotheses to evaluate model fit are,

H0 : Hypothesized model match to the data

Ha : The hypothesized model does not match the data

From this hypothesis it is clear that we will not reject the null hypothesis in order for the model to fit with the data. The statistics used are based on the probability function. The probability of an L model is the probability that the hypothesized model describes the input data. To test the null hypothesis and alternatively, L is converted to -2LogL. A decrease in probability (-2LL) indicates a good regression model or in other words the hypothesized model matches the data.

Hoster and Lemeshow analyses were used to test the null hypothesis of matching empirical data to the model. Suppose the statistical value of Hosmer and Lemeshow's Goodness-of-fit test equals or less than 0.05. In that case, the null hypothesis is rejected which means that there is a significant difference between the model and the observation value, so the model fit is not good because the model cannot predict the observation. If the statistical value of Hosmer and Lemeshow Goodness-of-fit is greater than 0.05 then the null hypothesis cannot be rejected and means that the model can predict the value of its observations, or it can be said that the model is acceptable because it matches the observational data.

Logistic Regression Analysis is used to see the effect of exchange rates and foreign ownership on company decisions in transferring pricing. The following equation formulates the regression model:

$$\mathbf{Y = \alpha + \beta 1KA + \beta 2NT +}$$

Where:
TP : Transfer Pricing
α : Constant
β1- β2 : Regression Coefficient
KA : Foreign Ownership
NT : Exchange rate
ε : error

3. Result

Descriptive Analysis

This descriptive test result aims to see the quality of research data shown by numbers or values contained in the mean and standard deviation. If the mean is greater than the standard deviation, then the data quality is better. Here are the results of a descriptive analysis of this study.

Table 3.1. Descriptive Analysis Results

	N	Minimum	Maximum	Mean	Std. Deviation
Transfer Pricing	124	,00	1,00	,9758	,15427
Foreign Ownership	124	21,71	99,77	62,9506	21,81672
Exchange rate	124	-3,92	1,51	-,0372	,41420
Valid N listwise)	124				

Sumber : SPSS 21.0 (2022)

Based on Table 3.1 the descriptive test value for the transfer pricing variable has a mean value of 0.9758, the standard deviation is 0.15427 with minimum and maximum values of 0 and 1, respectively. This shows that most % of the sample companies were listed on the IDX in the 2017-2020 period, 97% transfer pricing, while the remaining 3% do not transfer pricing. The variable foreign ownership shows a mean value of 62.9506 or 62%. This shows that companies listed on the IDX in 2017-2020 with foreign ownership of more than 20% of the total outstanding shares will exercise controlling shareholder rights to carry out transfer pricing. This Variable's maximum, minimum and standard deviations are 99.77 and 21.71.

The analysis using the exchange rate descriptive test showed an average value of -0.0372. This shows that the rupiah exchange rate for the 2017-2020 period is average
-0,037. This is because the range of exchange rate variations is quite high as indicated by a maximum value difference of 1.51 with a minimum value of -3.92 and a standard deviation in this variable 0.41420.

Overall Model Analysis

An overall model assessment is performed to assess whether the model fits the data or not in logistic regression analysis techniques using the overall fit test model. The Overall Fit Test model is performed by comparing the value between -2 Log Likelihood (-2 LogL) at the beginning (Block Number = 0) with the value of -2 Log Likelihood (-2 LogL) at the end (Block Number = 1). A reduction in value between the initial -2 LogL and the late -2 LogL indicates that the hypothesized model fits. Here is a comparison table of the initial -2 LogL (block number = 0) with the end -2 LogL (block number = 1).

Table 3.2 Results of the Overall Model Analysis

Block Number	-2 Log Likelihood	Information
0	45.883	Value difference -2 LogL = l223
1	45.660	

Source: Processing results with SPSS 21

Based on Table 3.2 Test results of the entire regression model, it can be seen that the initial value of -2 log likelihood (-2LogL) (Block Number = 0) decreased to -2 log likelihood (-2LogL) at the end (Block Number = 1) after including several independent variables in this study. It can be seen that the initial value of -2 log likelihood (-2LogL) (Block Number = 0) is 50,484. While the value of -2 log

likelihood (-2LogL) at the end (Block Number = 1) decreased after including several independent variables in this study, the value of -2LogL became 50,107. This decrease indicates a good regression model or in other words, a hypothesized model fit with data, meaning that the addition of independent variables, namely foreign ownership and exchange rates, will increase the model fit in this study.

Tes Hoster and Lemeshow

Hosmer and Lemeshow tested the null hypothesis that the empirical data matched the model (there is no difference between the model and the data so the model can be said to be fit). Suppose the value of the Hosmer and Lemeshow Test is 0.05. In that case, the null hypothesis is rejected which means that there is a significant difference between the model and the observation value so the Goodness Fit model is not good because the model cannot predict the value of the observation. If the value of the Hosmer and Lemeshow Test > 0.05, then the null hypothesis cannot be rejected and means that the model can predict the value of its observations, or it can be said that the model is accepted because it matches the observational data. Below is a table of results from the Hosmer and Lemeshow Test.

Table 3.3 Hoster and Lemeshow Test Results

Chi-kuadrat	Sig	Information
4.447	0,815	Null hypothesis accepted

Source: Processing results with SPSS 21

Based on the table of Hosmer and Lemeshow Test Results, the statistical value of Hosmer and Lemeshow is a chi-square of 4.447 with a significant probability of 0.815, whose value is greater than 0.05, then the null hypothesis is accepted. Thus, it can be concluded that the regression model is feasible to be used in subsequent analyses.

Classification Matrix

The classification matrix is used to explain the strength of the regression model to predict the likelihood of financial difficulties occurring in the company. In the 2 x 2 table, the correct and incorrect estimated values are calculated. The classification table produces overall accuracy.

Table 3.4 Classification Matrix Results

Observed			Predicted		
			Transfer Pricing		Percentage Correct
			,00	1,00	
Step 1	Transfer Pricing	,00	0	3	,0
		1,00	0	121	100,0
	Overall Percentage				97,6

a. The cut value is ,500

Source: Processing results with SPSS 21

Table 3.4 above shows that the strength of the regression model in predicting the company's decision to do transfer pricing is 100%, namely from a total of 124 data samples indicated to execute transfer pricing from 121 data samples that do transfer pricing. While the prediction power of the model for samples that do not do transfer pricing is 0%, meaning that the regression model used is that no company is predicted to do transfer pricing from a total of 10 data samples that do transfer pricing.

Results of Logistic Regression Analysis

Table 3.5 Logistic Regression Coefficient Test Results
Variables in the Equation

		B	Sig.	Decision
Step 1[a]	KA	0,039	0,249	Rejected
	NT	-0,721	0,762	Rejected
	Constant	1,545	0,374	-

a. Variable(s) entered on step 1: KA, NT.
Source: Processing results with SPSS 21

From table 3.5 of the test results above, the logistic regression coefficient produces the following logistic regression model:

TP = 1,545 + 0,039 KA - 0,721 NT + e

The result of the above logistic regression equation is as follows:

1. The constant is 1.545, meaning there will be a change in the transfer price of 1.545 if foreign ownership is assumed and the exchange rate does not change (constant).
2. The regression coefficient for the foreign ownership variable is 0.039. This shows that every 1% increase in foreign ownership will have an impact on increasing transfer pricing by 0.039, assuming the other independent variables are considered constant. A positive coefficient means that there is a unidirectional relationship between foreign ownership and transfer pricing, the greater the ratio of foreign ownership in a company, the greater the company's decision to transfer pricing.
3. The regression coefficient for the exchange rate is -0.721. This shows that every 1% increase in the exchange rate will impact decreasing transfer pricing by 0.721, assuming the other independent variables are considered constant. A negative value coefficient means that there is a disoriented relationship between the exchange rate and transfer pricing, the greater the exchange rate ratio, the lower the company's decision to transfer pricing.

Test the hypothesis

The hypothesis will be tested using a significance level or an alpha level of 5% or in other words a confidence level of 95%. Researchers use a significance level or alpha level of 5% (0.05) against the background of the type of data used as the object of research in the form of financial statements, where many internal and external factors can affect the level of stability of the figures presented in the financial statements. If the significance value is less than alpha 5% (0.05), then it can be said that there is a significant influence between the independent Variable and the dependent Variable. The following are the results of testing the two hypotheses proposed:

1. The Effect of Foreign Ownership on Transfer Pricing
   Table 5 shows that the foreign ownership variable has a positive regression coefficient of 0.039 with a significance value of -.249 greater than the alpha of 5% (0.05). This result can be interpreted that foreign ownership has a positive and insignificant effect on the transfer pricing decision of manufacturing companies. This is following the first hypothesis proposed that foreign ownership affects transfer pricing decisions, then the first hypothesis (H1) is rejected.
2. The Effect of Exchange Rate on Transfer Pricing
   Table 5 shows that the exchange rate variable has a positive regression coefficient of -0.721 with a significance value of 0.762, greater than alpha 5% (0.05). These results can be interpreted that the exchange rate has a negative and insignificant effect on the transfer pricing decisions of manufacturing companies. This is not following the second hypothesis proposed, namely that exchange rates affect transfer pricing decisions, then the second hypothesis (H2) is rejected.

Coefficient of Determination Test

Nagelkerke R^2 is a test conducted to determine how much the independent Variable can explain and influence the dependent Variable. The value of Nagelkerke R2 varies between 1 and 0. The closer to the value of 1, the model is considered as goodness of fit, while the closer to 0, the model is not good of fit. Here is a table of results to see the coefficient of determination:

Table 3.6 Coefficient of Determination Test Results
Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	26,554[a]	,014	,067

a. Estimation terminated at iteration number 7 because parameter estimates changed by less than ,001.
Source: Processing results with SPSS 21

Table 3.6 shows a Nagelkerke R Square value of 0.067 which means that the variability of the dependent Variable that the independent Variable can explain is 6.7%, the remaining 93.3% is explained by other variables outside the research model. Variations in foreign ownership variables and exchange rates can demonstrate a company's transfer pricing decision of 6.7%.

4. Discussion

The Effect of Foreign Ownership on Transfer Pricing

The logistic regression coefficient test results showed that the level of significance possessed by the foreign ownership variable was 0.249 > 0.05. This shows that foreign ownership does not influence the company's transfer pricing decisions. This result shows that the foreign controlling shareholder did not exercise its controlling rights to instruct management in transferring pricing. In public companies, foreign investors tend to follow the management decisions of local investors (Ding et al., 2020), but foreign investors can impact a company's competitive position (Toh & Jia, 2021; Yildirim et al., 2021). When foreigners have invested in public companies in Indonesia with a percentage of more than 20%, foreign parties can exert significant influence on decisions made by companies (Ullah et al., 2023), including transfer pricing decisions involving foreign parties. Thus, the greater the foreign ownership in a company, the greater the influence of foreign parties in determining the least amount of transfer pricing (Koch & Smolka, 2019). The absence of foreign ownership influence in transfer pricing practices is likely due to other non-foreign controlling shareholders in the sample company that can influence transfer pricing decisions. Like research (Chen et al., 2017) found that corporate strategic choices are determined not by the proportion of foreign ownership dominance but rather by groups with the political goals of government actors. The large number of foreign share ownership does not necessarily give shareholders have a strong position to control the company (Alquist et al., 2019), including implementing transfer pricing policies.

The Effect of Exchange Rates on Transfer Prices

Based on hypothesis testing that has been done, it can be known that the exchange rate variable has a significance value of 0.991 (greater than 0.05). This shows that the exchange rate does not affect the company's transfer pricing decisions. The average exchange rate of the sample company of -18.62% means that many sample companies experience foreign exchange losses; in other words, changes in the exchange rate do not affect the company's transfer pricing decisions. Therefore, the second hypothesis was rejected. The exchange rate has no effect on transfer pricing decisions with the conclusion that the exchange rate does not affect the company's valuation (Corbo & Di Casola, 2022; Faltermeier et al., 2022) whether the company will choose to do transfer pricing or choose not to do transfer pricing. This may be because there are many foreign exchange losses in the company's sample financial statements, so exchange rates are not the main focus in management's tendency to utilize transfer pricing transactions. Exchange rates do not strengthen or weaken management's operational decisions (Likitwongkajon & Vithessonthi, 2022). Foreign exchange losses include foreign exchange intervention in the management of the company's financial policy (Choi & Limnios, 2022; Nasir et al., 2020). Exchange rate changes do not affect directors' decision to conduct transfer pricing because many sample companies experience foreign exchange losses in their operations. However, losses on exchange rate changes affect the accuracy of forecasts, opinions, and analysis of the company's performance (Yusoff et al., 2023). The complexity of exchange rate changes is why analysts ignore foreign exchange risk in their financial forecast models (T. Ho et al., 2020). With these losses, the company views that changes in exchange rates do not provide benefits for the company, one of which is due to the weakening of the domestic currency. The presence of foreign investors can hurt the domestic currency (E. H. C. Ho, 2022). The weakening of the domestic currency makes companies lose money in transacting with foreign

parties using exchange rates. Management tends to use currency exchange differences to straighten out its goals in using transfer pricing. Exchange differences from operating activities in the income statement and profit and loss before tax that can represent the degree of propensity of party management to take advantage of differences in currency exchange rates (Kohlhase & Wielhouwer, 2023).

5. Conclusion

This study examined several factors that influence the company's transfer pricing decisions. These factors include foreign ownership and exchange rates. Based on the data analysis that has been collected and processed, the conclusion of this study explains that foreign ownership variables have a positive and insignificant effect on the company's transfer pricing decisions. This indicates that foreign owners make considerations to make transfer pricing. The next conclusion shows that exchange rate variables have a negative and insignificant effect the company's transfer pricing decisions. The research concludes that exchange rate variables have a negative and little effect on the company's transfer pricing decisions.

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