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## THE ANALYSIS OF PRE AND POST NEGOTIATION OF FRAMING AND PARTNER'S OBJECTIVE ON TRANSFER PRICES

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### ABSTRACT

Transfer price negotiations are important to managers as they influence both their own and other divisional profits. These transfer prices are affected by both economic factors (market prices) and behavioral factors including fairness on judgments about negotiated transfer prices. In the current study, we examine whether the impact of accounting information on managers' transfer price expectations are affected by the way accounting information is framed (either as potential gains or potential losses) and the managers' perception of the other negotiation partners' objective (whether their partner's objective involves high or low concern-for-others). These expectations are important as they directly affect the costs and outcomes of negotiations.

A controlled laboratory experiment was conducted to test the proposed hypotheses, using a  $2 \times 2 \times 2$  between-subjects design. The participants of experiment were 216 undergraduate accounting students from Faculty of Economics and Business, Soegijapranata Catholic University, Semarang. The results of this study that compared to a gain frame, a loss frame exacerbates managers' self-serving bias and increases the transfer price expectation gap between buyers and sellers. Further, we found that the negotiation partner's objective had a significant impact on sellers' transfer price judgments. This finding also found that the degree of concern for the other party has a significant impact on the judgment in particular the transfer price for the seller division.

### INTRODUCTION

Transfer pricing is the price of a product or service that is transferred internally by the centres of responsibility (division) in a decentralized company (Sugiri, 2009). Negotiating the price of the transfer is very important for managers because it affects the profits of the business unit managers as well as corporate profits as a whole. Based on previous research showing that the transfer price is influenced by economic factors (market price) and the degree of concern for others (social) such as behavioural factors during the negotiation process, including fairness in the process of negotiating agreements (Luft, *et al.*, 1997).

Some research in the study of negotiation gives an overview there is still a potential difference of the effectiveness of negotiations that can affect a negotiator to be biased perspective on the negotiation process either before, during, and after the negotiation

process. Negotiations become a very common method used by companies to determine the transfer price (Ghosh, 2000). Watson and Baumler (1975) states that the negotiated transfer pricing models benefit the organization as a potential vehicle to integrate the goals of the organization of the various divisions goal, despite having weaknesses can cause distortion performance measurement emphasize negotiating power of the dominant function than performance-based economy. The agreement becomes outcome of negotiated transfer prices affect earnings for managers associated with the negotiation process and also affect company profits when quality and price become an important element of the negotiation process itself. Although the external market conditions exist, the transfer price negotiations become a very useful control mechanism to create a balance between economic considerations and social considerations are spacious with an interdependent business units (Kachelmeir, et al., 2002). While Bazerman (2000) conducted a study to investigate how the perception of the negotiators of the negotiation situation that affects the output of the negotiations. Lipe (1993) and Luft (1994) also concluded in their study that the framing of problems affecting the assessment and the manager on duty preferences and other domains (such as variance investigation and option contracts). Several studies above show that the presentation of the monetary equivalent options such as profit, loss, bonuses and penalties affect how managers frame the issues and make judgments.

This study examined the effects of variables that affect the self-serving bias in coverage of transfer prices by using two perspectives simultaneously, namely the framing effect and purpose of negotiation partners are expected to affect the level of managers consideration in determining their own output. For example, the perception that says that the negotiating partners have a degree of concern for the other party causes higher profit managers their business unit and received fewer transfer price. With the use of these two perspectives of researchers tried to explore a more comprehensive understanding of how the negotiation process works and how to overcome obstacles in the negotiation process in order to achieve a more effective negotiation stage.

## RESEARCH METHODS

### Design Research

This study was designed in the form of experiments in order to test the hypothesis by using a  $2 \times 2 \times 2$  between subjects design. Three independent variable is the role of the manager of the negotiations (experimental participants act as buyer or seller), framing effects (positive or negative frames frame), and the degree of concern for the others (the high or low level), the dependent variable in this study is the negotiated transfer prices. The participants were also given a question to indicate the lowest prices expected that the seller is willing to accept that level (the seller's reservation price).

**Table 1. Design of Experiments**

The role of negotiator	Framing	Level of Concern for Others
Sales Division	Positive / Negative	High / Low
Buyer Division	Negative / Positive	Low / High

### Participants

Participants in this experiment were 216 undergraduate degree majoring in Accounting, Faculty of Economics and Business Unika Soegijapranata Semarang. To get a

closer picture of the ability, experience, and behaviour management accountants, participants must meet the requirements that participants have graduated from courses in Management Accounting and Management Control Systems (MCS). Participants will be divided into two parties, namely the seller's business unit managers (parts) and buyer's business unit managers (assembly) by taking a random card. The negotiation process will take place during the round that lasted about 30 minutes. Instructions will be presented to the participants to independently negotiate and negotiate with a new partner or have never negotiated before, or so-called *turnpike design*. The design is intended that no participants who have the same negotiating partners.

### **Validity, Manipulation Checks and Pilot Test**

Validity test is done to determine the extent of the ability of the instrument to measure what it is supposed to measure (Cooper and Schindler, 2006). According Nahartyo (2010) there are four types of validity that is popular among researchers that statistical, internal, construct and external validity. In the application of research theory, such as experimental research design is more concerned with the internal validity than external validity. Internal validity must be supported by a strong statistical validity. It is necessary to generate the validity of the results of experiments that gave priority to internal validity as an essential condition for the absence of this, the validity of experimental results become useless. Internal validity problems associated with the design of experiments that should be seriously considered. Internal validity of this study will also be strengthened by doing manipulation check, exit questionnaire, as well as a pilot test.

Manipulation check is used to determine the understanding of the treatment given. Manipulation checks for the condition of the role of the manager is done by giving the question whether the role of participants in the earlier negotiations. To answer this first manipulation check, participants were asked to choose one answer that is the role of seller division manager or buyer division manager. As for the manipulation check, the framing conditions is to give you true question seeks to gain additional benefit or not benefit. To answer this manipulation check, participants were asked to choose one correct answer is "Yes" or "No". Furthermore, for the manipulation check on the condition of consideration for the other party is to give the question of whether you are interested in maximizing the return on your own division or maximize profits for both divisions. To answer this manipulation check, participants were asked to choose one answer is "Yes" or "No". From the results of the manipulation checks are carried out, all the respondents who total 216 people (100 percent) has answered the question correctly manipulation check. Questionnaires cover given to know the understanding of the subject on a given case. In the first stage are given four questions to make sure participants understand the context of the transfer price of a given story. Tabulation of results, the number of participants who answered correctly all questions of 75.9 percent, which is the correct answer 3 of 4 questions of 18.5 percent and the correct answer 2 of 4 questions of 5.6 percent. This means, the context of the story that transfer prices experimental material can be well understood by all participants. And at the last stage, in addition to the manipulation check participants were asked to review the respondent's identity data that is already filled.

While the pilot test intended to provide a complete picture and gather feedback and suggestions for improvement, so that when the main experiments performed, errors and any shortcomings can be minimized. The pilot test in this study, has been done 2 times. The first pilot test consisted of 18 participants who were considered to have failed by

researcher, because in addition to the instruments that are less represents the intent of the study, design of experiments is still considered not too clear by the participants. Meanwhile, second pilot test consisted of 24 participants. The participants of experiments different with the first pilot test and considered successful because the second pilot test illustrates the situation and the expected results on the main experimental conditions.

### **Experimental Procedure**

Experiments were performed in all participants' meeting in accordance with the adequacy of each group manipulation conditions. There are 5 experimental groups. Group A consisted of 16 participants, group B consisted of 42 participants, group C consisted of 44 participants, group D consisted of 60 participants, and the group E consists of 54 participants. Thus, the total number of participants was 216 participants experiment. Experimental subjects are students who have finished taking courses in Management Accounting and Control Systems. Researchers contacted lecturers on a predetermined schedule and request time for 45 minutes to conduct experiments. Researchers began experimenting with introducing self sufficient researchers and other information while distributing instruments randomly to all students who have requested voluntary willingness to participate in this experiment.

In the implementation of the experiment, I was assisted by two assistants to support the experiment. The assistants assigned to distribute and collect research instruments. Upon completion of all phases, I tried to explain briefly about what they want through experimentation, as well as opportunities for participants to ask questions about this experiment.

Following the steps of the process of experiments that have been performed:

1. Participants who have entered into randomly paired classrooms (division buyers and sellers) by using the card, and then occupy a seat that has been provided by the presence of the distance between the pair of the other spouse. Afterwards, participants will be given experiment experimental materials such as books and sheet main assignment randomly distributed in accordance existing cell (cell 8 experiments). The main book contains general information, checking personal inclination, cases, role, and questions questionnaire. While the assignment book will be used in the next stage to get an understanding of the level of judgment against a partner experiments in each group.
2. I expressed early experimental protocol and contains information order, and some of the common things that it is necessary to know the beginning. In this section, the researchers stressed the need for participants to work on all phases that exist with seriousness and sincerity. And in appreciation of the seriousness and sincerity, participants will be given an incentive prize (door prize) in the form of USB that has been inserted into each envelope. Each end of the stage, researchers will draw the lucky participants, and the assistant will make corrections to the work of each step to determine the feasibility of participants to get a prize. The prize is intended to motivate them to be serious in every stage of the existing work in the series of experiments conducted by researchers.
3. Experiments carried out in three phases with a total duration of 45 minutes. The first stage, the time allowed +/- 5 minutes. Participants will get a little explanation of the experiment, and then asked to fill out a questionnaire data themselves participated in the experiment. Entering the second phase, the researcher explained the conditions that will be encountered participants in this stage. Further researchers asked participants to open the second stage together, carefully read and consider carefully the illustrations

given case. Participants were asked to condition ourselves as indicated in the illustration given case, and perform the appropriate tasks as instructed. Then answer the questions provided in accordance with the perception of the perceived and experienced. Time for the second phase is +/- 30 minutes. In closing, participants were asked to answer all remaining questions that manipulation checks and questionnaires after the process of negotiating to get a clear picture of the course of the negotiation process in this experiment for +/- 10 minutes. While the last 5 minutes is allocated for other things such as a door prize draw.

- At the end of the meeting, researchers do not forget to thank the sincere and provide the highest appreciation to all participants of the experiment and describes the experiments carried out by leaving a message to be willing to be contacted directly or indirectly, if need more detail on experiments that have taken place.

## DATA ANALYSIS AND RESULTS

### Characteristics Data

In general, respondents who follow the description of the experiment can be seen in detail in the table below.

**Table 2. Profile of Respondents**

No.	Information	Number	percentage	Total percentage
1.	Sex			
	Male	<b>69 People</b>	<b>31.9</b>	
	Female	<b>147 People</b>	<b>68.1</b>	<b>100</b>
2.	Age			
	<20 years	<b>18 People</b>	<b>8.3</b>	
	20-24 years	<b>197 People</b>	<b>91.2</b>	
	> 24 years	<b>1 Person</b>	<b>5</b>	<b>100</b>
3.	Background			
	Education			
	Accounting	<b>216 People</b>	<b>100</b>	<b>100</b>

The table above shows that the respondents in this study were 216 students / student that all educational background Accounting Bachelor (S1) of Unika Soegijapranata Semarang. They consisted of 69 men (31.9 percent) and 147 women (147 percent). The average age of respondents was 20-24 years (91.2 percent), there were 18 (8.3 percent) under the age of 20 years and only 1 (5 percent) over the age of 24 years. I conducted an analysis of variance and the result was no statistically significant difference between each treatment condition for gender and work experience. As for age and educational background is clear there is absolutely no difference between any of the treatment conditions. From the description contained in the above table, it can be concluded that all respondents generally have similar characteristics, so that I can be confident that the respondent is randomly placed in each experimental treatment condition, has the equivalence or having equivalent characteristics. It is important to ensure that the threats to internal validity that the selection has been able to be controlled, so I believe that the results are actually derived from the treatment given.

### Testing Hypothesis 1

To test hypothesis 1, I used *Analysis of Variance* (ANOVA) with attention to the significance of the difference between the two averages comparable conditions. The following are the results of statistical testing of the hypothesis 1.

**Table 3. Descriptive Statistics of Seller Division and Buyer Division**

**Seller Division (In Thousands, RP)**

Information	N	Lowest	Highest	Mean	Standard Deviation
Profit level	108	10	50	33.82	8,401
Estimated Profit Level	108	10	60	49.04	10 809
Given Profit Level	108	0	50	25.04	9,272
Final Transfer Price	108	20	75	52.59	9917
Estimated Final Transfer Price	108	20	80	61.71	16 193
Ideal Transfer Price	108	20	80	53.56	12 324
Reservation Price	108	20	80	61.39	17 652

**Table 4. Buyer Division (In Thousands, RP)**

Information	N	Lowest	Highest	Mean	Standard Deviation
Profit level	108	7	55	26.45	9207
Estimated Profit Level	108	7	60	43.88	15 446
Information	N	Lowest	Highest	Mean	Standard Deviation
Given Profit Level	108	0	50	32.27	10 576
Final Transfer Price	108	25	75	52.73	9156
Estimated Final Transfer Price	108	20	80	40.05	14 859
Ideal Transfer Price	108	20	70	47.41	13,140
Reservation Price	108	20	80	39.63	19 002

Hypothesis 1 predicts that seller's estimated final transfer prices are higher than the buyers' estimated final transfer prices. To test this hypothesis, I compared the average price of the estimated final transfer for sellers and buyers. In table 4.2. it can be seen that the sellers' estimated transfer price was Rp 61.710,00 and buyers' estimated transfer price was Rp40.050,00. This means that the results support what the hypothesis 1 (H1). Thus, the first hypothesis is supported.

Information	DF	Mean Square	F	P (Sig.)
The role of negotiator	1	25285.771	126 493	.000
Concern Other Party	1	1037.421	5.190	.024
Frame	1	858 148	4,293	.040
Role * Concern Others	1	3746.241	18 741	.000
Role * Frame	1	3084.229	15 429	.000
Concern * Frame	1	1024.187	5,124	.025
Role * Concern * Frame	1	75 023	0.375	.541
Error	208	41579.008		

### Testing Hypothesis 2

Hypothesis 2 predicted that the difference in estimated final transfer price between buyers and sellers is smaller when information provided to negotiating managers is framed as gains rather than losses. To test the hypothesis 2, I used *Analysis of Variance* (ANOVA) were the result of the test summary statistics can be seen in the table below.

**Table 5. Mean (Standard Deviation) of the Estimated Final Transfer Price  
(In thousands, RP)**

The role of negotiat or	Level of Concern for Others						Total Frame		Total I	
	High Concern		Total I	Low Concern		Total I				
	Positiv e	Negativ e		Positiv e	Negativ e	Positiv e	Negativ e			
Seller	48, 04	62, 83	54, 71	64.00	72, 41	67, 98	56, 29	68, 00	61, 71	
	(16, 85)	(11, 16)	(16, 23)	(15, 89)	(83, 63)	(13, 46)	(18, 10)	(10, 78)	(16, 19)	
	N = 28	N = 23	N = 51	N = 30	N = 27	N = 57	N = 58	N = 50	N = 108	
Buyer	41, 07	43, 04	41, 96	42.67	33, 52	38.3 3	41, 90	37, 90	40, 05	
	(15, 83)	(16, 70)	(16, 09)	(12, 78)	(12, 99)	(13, 57)	(14, 23)	(15, 42)	(14, 86)	
	N = 28	N = 23	N = 51	N = 30	N = 27	N = 57	N = 58	N = 50	N = 108	
Total Column	44, 55	52, 93	48, 33	53, 33	52, 96	53, 16	49, 09	52, 95	50, 88	
	(16, 5 8)	(17, 24)	(17, 31)	(17, 89)	(22, 41)	(20, 07)	(17, 75)	(20, 10)	(18, 93)	
	N = 56	N = 46	N = 102	N = 60	N = 54	N = 114	N = 116	N = 100	N = 216	

The descriptive statistics in table further indicate that the difference in estimated transfer prices between sellers and buyers under gain frame condition (Rp56.290,00 - Rp41.900,00 = Rp14.390,00) was lower than that under the negative frame condition (Rp68.000,00 - Rp37.900,00 = Rp30.100,00). Hypothesis 2 was also confirmed by the results which explains the significant interaction between role and frame ( $F = 15.429$ ,  $p = 0.000$ ). Thus, the second hypothesis is supported.

### Testing Hypothesis 3

Hypothesis 3 examined the effect of the negotiation partner's objective on managers' transfer price judgements. Both buyers' and sellers' transfer price expectations would be lower if they were negotiating with a partner with high concern-for-others (Rp54.710,00 + Rp41.960,00 = Rp96.670,00) than if with a partners who had low concern-for-others (Rp67.980,00 + Rp38.330,00 = Rp106.310,00). The difference is shown in table as a

significant interaction effect between role of negotiator with other parties concerned ( $F = 18.741, p = 0.000$ ). Thus, the hypothesis 3 is supported.

### Additional Analysis

I also take measurements of the experimental participants after the negotiation process (post-negotiation). Here is a summary of the results of the questions after the negotiation process related to satisfaction with the agreement negotiated between the buyer and seller division.

**Table 6. Satisfaction of Negotiations Agreement**

No.	Question	The role of negotiator		Total
		Buyer	Seller	
1.	How satisfied are you with the results of a negotiated settlement?	47 (21.8 percent) Satisfied	35 (16.2 percent) Satisfied	82 (38 percent)
2.	How satisfied with the profits you get?	40 (18.5 percent) Satisfied	50 (23.1 percent) Satisfied	90 (41.7 percent)
3.	How do you think the deal negotiations?	45 (20.8 percent) Good	44 (20.4 percent) Good	89 (41.2 percent)
4.	Do you feel that this negotiation process undermine confidence in the negotiations as a whole?	36 (16.7 percent) Not	37 (17.1 percent) Not	73 (33.8 percent)
5.	Is this negotiation makes you feel no or very competent as a negotiator?	32 (14.8 percent) Neutral	31 (14.4 percent) Highly Competent	63 (29.17 percent)

Based on the above table, it can be explained that the overall course of the negotiations between buyers and sellers division went very well. To the level of satisfaction with the agreement negotiated division buyers have a higher level of satisfaction than the seller divisions namely 21.8 percent and 16.2 percent. Related to satisfaction in getting profit, division seller has a higher satisfaction level of 23.1 percent while 18.5 percent buyer division. Other results show that the negotiation process does not undermine the confidence of participants both buyers and sellers for the division of the overall negotiations, the division of 16.7 percent buyers and sellers of 17.1 percent. The results further show that for division associated neutral buyers feel his ability as a negotiator in the amount of 14.8 percent while the seller was very competent division related to his ability as a negotiator in the amount of 14.4 percent.

**Table 7. Satisfaction of Negotiations Partner**

No.	Question	Consideration of Others		Total
		High	Low	
1.	Do you behave in accordance with the principles and values that you have yourself in the negotiation process?	48 (22.2 percent) Yes	47 (21.8 percent) Yes	95 (44 percent)
2.	Is this negotiation gives the impression of a negative or positive about yourself?	46 (21.3 percent) Very Positive	37 (17.1 percent) Neutral	83 (38.4 percent)
3.	Do you feel that the other party in the negotiations consider your goals?	38 (17.6 percent) Yes 38 (17.6 percent) Highly Yes	36 (16.7 percent) Not	112 (51.9 percent)
4.	What level of difficulty or ease in reaching a negotiated settlement?	45 (20.8 percent) Very Easy	39 (18.1 percent) Neutral	84 (38.9 percent)
5.	How to care for others and consideration of your interest in this negotiation process?	39 (18.1 percent) Very Concerned	33 (15.3 percent) Neutral	72 (33.4 percent)

Based on the above table, it can be related to the satisfaction of negotiation partners. There is no difference between the division with the degree of concern for the other party high and low associated principles and values that they had during the negotiation process that is equal to 22.2 percent and 21.8 percent. As for negotiators who have a high level of awareness of other parties have a very positive impression of herself that is equal to 21.3 percent and for negotiators who have a low level of awareness of the other party feel neutral towards himself that is equal to 17.1 percent. Other results showed that the negotiators who have a high awareness of other parties feel strongly consider other hand 17.6 percent contrary to the negotiators who have a low awareness of other parties was not considering the other party of 16.7 percent. This reinforces that the negotiators who have high levels of high concern for others they really consider the other side and vice versa. The results further showed that the negotiators who have a high level of awareness of others find it very easy to reach a negotiated settlement in the amount of 20.8 percent. As for negotiators who have a low level of awareness of others feel neutral with respect negotiated agreements in the amount of 18.1 percent. Concerns associated with other parties to the interest and consideration in the process of negotiation, negotiators who have a high level of concern for the other party feel very concerned about the interest and consideration of other parties in the negotiation process that is equal to 18.1 percent, while for negotiators who have a low level of concern for the other party feel neutral towards interest and consideration of other parties in the negotiation process that is equal to 15.3 percent.

#### MANAGERIAL IMPLICATION

Choice of respondents who are students of undergraduate program majoring in Accounting can be a matter of debate in determining whether the relevant enough to describe the condition of the negotiations manager in the real world. Although I have my own arguments to claim that this design can represent what is desired by this study. Students of undergraduate program majoring in Accounting as respondents in this study have completed courses in Management Accounting and Management Control Systems (MCS). This indicates that respondents have understood the context of negotiated transfer pricing well so with the understanding held by respondents to describe the condition of the negotiations manager in the real world.

## CONCLUSION

Three important conclusions that can be drawn in this study, namely:

1. This study provides empirical evidence that the framing described by prospect theory, theory of economic man, behavioural decision theory, the dual concern models, and social presence continuum have significant effect on the behaviour of managers in determining negotiated transfer prices.
2. This study shows that the negative framing/losses will worsen the self-serving bias managers and improve estimated transfer prices between the buyer and seller.
3. This research can also proved that the degree of concern for the other party has a significant impact on the judgment in particular the transfer price for the seller division.

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