

The Impact of Leadership Style on Seller's Transfer Price: The Moderating Role of Compensation Scheme

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ABSTRACT

Transfer pricing can lead to conflicts between divisions. This is because the seller tends to charge a higher transfer price than the buyer. Therefore, this study examines whether the type of leadership and compensation scheme can influence the seller's transfer price decision to approach an equal profit. This study uses a 2x2 factorial design experimental method on the leadership type variable (supportive vs. non-supportive) and compensation scheme variable (high bonus percentage vs. low bonus percentage). This study indicates that sellers will set transfer prices close to equal profits when under supportive leadership. This is because the type of supportive leadership supports a collaborative work climate and focuses on achieving common goals. In addition, the seller will charge a transfer price close to the equal profit when the compensation scheme has a low bonus percentage. The low bonus percentage is not strong enough to bring out the egocentrism of the seller. The influence of a compensation scheme with a standard bonus percentage will be more substantial if a supportive leadership type supports it. This study provides knowledge to companies to formulate effective strategies to reduce transfer price negotiation conflicts by considering the kind of leadership and compensation schemes.

Keywords: Leadership Style, Locus of Control, Budgetary Slack.

1. INTRODUCTION

Firms commonly set transfer prices when divisions are treated as profit centers and rely on other divisions to source certain commodities. Negotiated transfer price is a widely used transfer pricing method and potentially impacts a division's profit and managers' compensation [1]. Hence, many transfer price negotiations cannot reach an integrative agreement, creating conflicts between divisions [2]. Conflicts in negotiated transfer price could cause divisions to deal with external suppliers, while top management would prefer divisions to deal internally to put price pressures [3]. Furthermore, independent divisions of vertically integrated companies commonly use negotiated transfer prices to mitigate information asymmetry [4]. Conflicts between negotiators are caused by self-interest and unequal bargaining power [5]. Sellers tend to set transfer prices higher while buyers tend to put equal profit of transfer price [6].

A continued relationship between divisions can be reached on a fair distribution of profit conditions [7]. Thus, it is essential to know how top management could force divisions to get equal profit prices to manage conflicts in setting negotiated transfer prices. A previous study found that negotiated transfer prices could be induced by economic factors and behavioral factors [8]. Senior management can create a climate of the work environment to shape employee behavior. Leadership style can raise others' concerns and motivate division managers to deal with an equal-profit price [4]. In addition, compensation schemes based on division profits significantly impact negotiated transfer price judgment [1]. Although the empirical evidence suggests that compensation schemes can affect transfer price judgment, a prior study demonstrated that joint profit incentives on compensation schemes could not mitigate leadership style's effect on transfer price decisions. Collective profit incentives could encourage free-rider behavior and are less controllable by division than divisional

profit incentives, making them less attractive to division managers [9]. Thus, this study uses divisional profit incentives to determine manager compensation to set transfer prices in the presence of leadership style.

This research wants to examine the role of leadership style (supportive and non-supportive) to mitigate the division manager's self-interest in setting transfer prices. This research tries to validate previous who found that higher compensation could mitigate the social motives of individuals. This research has a contribution to accounting management literature by filling the gap in prior studies by using compensation scheme based on division profit to determine the tendency of managers to set transfer price that is close to equal profit price and validating the previous study that lower compensation was able to induce social motives of individuals.

2. LITERATURE REVIEW

2.1. Leadership Style on Transfer Price

Leadership could affect the work environment [10]. Furthermore, managers' decisions when considering self-concern or other-concern are influenced by the organization's internal environment [11]. The norm of reciprocity in social exchange theory states that the other party will reciprocate treatment given by one party with the same treatment [12]. Therefore, in organizations, employees will respond or take action according to those of their superiors or their organizational environment. Subordinates tend to imitate the positive behavior of their leaders by acting mutually, supporting each other, and building a friendship with peers [13]. In addition, Employees' behavior could be induced by a leader's reputation [14]. This shows that leaders of organizations could influence employees by setting the organization's environment. Therefore, leaders must adopt certain behaviors to shape organizational culture in achieving organizational goals.

Supportive leadership promotes positive attitudes and behaviors to subordinates. Supportive leaders emphasize teamwork and focus on reaching the organization's goals [15]. Thus, a supportive leadership style can motivate divisions to be a concern to others and joint outcomes. Employees with higher social motivation will be concerned about their organizational benefit [16]. Negotiators engage in many problems solving when they have a social basis in negotiation [5]. Showed that division managers who show other-concern would reach

integrative agreements closer to the equal profit price. Thus, the following hypothesis was posited:

H1: Transfer price of seller will be closer to equal profit price in the work environment with supportive leadership style than in the work environment with non-supportive leadership style.

2.2. Compensation Scheme on Transfer Price

Managerial decisions can be influenced by compensation schemes [17]. That compensation scheme includes fixed components and variable components that depend on performance can influence relative thinking. Relative thinking implied that individuals consider both the absolute amount that can be obtained and the relative amount in income by exerting more effort in performance. This comparative reasoning is not significant when the performance-based variable components have a low income. Thus, the company's compensation plan can affect the motivation of employees.

Someone made more efforts when performance was rewarded with higher compensation [18]. Sellers with a compensation structure with a high percentage of bonuses on division profits will consider profit on negotiating transfer price an important goal compared to sellers with a compensation structure with a low bonus rate on division profits. The transfer prices are estimated the further away from prices that provide equal profits for both divisions. Monetary incentives weaken social behavior [19]. Therefore, the more significant percentage of bonuses given to managers, the more triggering the emergence of narcissistic behavior when estimating transfer price.

Social exchange theory stated that individuals consider the long-term benefits to themselves or their communities both economically and socially [20]. If someone in the exchange process gets social benefits beyond financial benefits such as partnership, trust, reputation, and status consistency, the exchange can be based on social benefits [21]. Thus, a seller with a compensation structure with a low bonus percentage on the division's profit will assume that the social benefits exceed the economic benefits. Trust and partnership are seen as more critical goals in the long run. Accordingly, the following hypothesis was posited:

H2: Transfer price of seller will be closer to equal profit when bonus compensation has a lower percentage than when bonus compensation has a higher rate.

2.3. Leadership Style and Compensation Scheme on Transfer Price

Role modeling is essential mechanism that determines individual’s behavior [17]. Prosocial motivation in the workplace tends to encourage other-concern. Prosocial leadership style encourages concern-for-others [22]. Thus, leadership style has an essential role in affecting subordinate prosocial motives and behavior. Motivating subordinates to contribute within organization is one of the superior's main tasks [23]. A leader's behavior that can facilitate prosocial motivation by strengthening values and norms aligned with prosocial motives will increase prosocial impacts [22]. Incentives and prosocial motives have an inverse relationship where incentives of individuals with higher prosocial motives are usually lower [24]. Thus, prosocial motivation employees will act more prosocial if the organization supports a compensation scheme with a lower bonus percentage. Prosocial motivation can induce employees to be concerned about prosocial tasks, and less socially motivated employees choose high compensation [16]. Hence, on a lower bonus percentage of divisional profit, managers will focus on joint income, which results in win-win negotiation outcomes. Thus, the following hypothesis was posited:

H3: In a work environment with a supportive leadership style transfer price of seller will has more significant effect on lower percentage of bonus compensation than a higher percentage of bonus compensation.

3. RESEARCH METHODS

3.1. Experimental Design

This study used experimental method using a 2x2 factorial design. This study used supportive and non supportive treatments for leadership style and low bonus percentage and high bonus percentage treatments for compensation scheme. The participants consisted of undergraduate accounting students at Universitas Ahmad Dahlan. These participants took courses in management accounting and control systems to understand and work on experimental cases regarding transfer pricing. Each participant is given a random manipulation of the four available manipulations. Of the 94 responses, 15 failed the manipulation checks, resulting in 79 usable responses for data analysis. The table below illustrates the design of the experiment more clearly.

Table 1. Experimental Design

Factor and Level		Leadership Style	
		Supportive	Non-Supportive
Compensation Scheme	Low Bonus Percentage	Group 1	Group 2
	High Bonus Percentage	Group 3	Group 4

Participants in supportive leadership style conditions would receive manipulation that senior management supported good relationships among employees in their division and other divisions. In contrast, participants in nonsupportive leadership style conditions would receive manipulation that senior management focused on individual performance. Furthermore, participants would receive 3% of the bonus percentage on their divisional profit in low bonus compensation conditions. In contrast, participants would receive

30% of the bonus percentage on their divisional profit in high bonus compensation conditions.

3.2. Experiment Procedure

Each participant randomly received one of the four experimental design manipulations. Participants were given 2 minutes to read and sign an agreement that they were willing to become voluntary participants without coercion from any party. Participants were given approximately 10 minutes to read general information regarding the company’s profile and their role in the company. In the next stage, participants were faced with

manipulating leadership style and compensation scheme. After that, participants can set the expected transfer price. Participants then filled out a manipulation check to ensure that participants understood the experimental scenario. In the last stage, participants were asked to fill in demographic data in the form of gender, age, and work experience. Then, participants are allowed to leave the room.

3.3. Definition of Variables

3.3.1. Manipulated Variables

Leadership Style. The leadership style was conditioned by two conditions. Subordinate was supported to support each other and work as a team for supportive leadership style condition. In contrast, subordinate was not supported to support each other and viewed supporting as a waste time. Thus, relationship between employee was not valued for non-supportive leadership style condition.

Compensation Scheme. The compensation scheme is manipulation on the bonus percentages from division profit. Manager will achieve 3% of bonus percentage of the divisional profit in low compensation condition. Furthermore, manager will achieve 30% of bonus percentage of the divisional profit in high compensation condition.

3.3.2. Measured Variables

Transfer Price. Transfer price determined by the manager of the seller division. The variable measured was transfer price.

4. RESULTS AND DISCUSSION

4.1. Experimental Design

This research involved 79 participants as usable research data. The gender mix consisted of 58 females and 21 males. Participants' ages ranged from 19 to 25 years. 77% had no working experiences among the participants, while 22,8% had working experiences. Demographic characteristics were tested to ensure that gender, age, and work experience do not affect the dependent variable using two-way ANOVA. The results showed significant value of 1.000 ($p > 0.05$) for gender variable, 0.487 ($p > 0.05$) for age variable, and 0.531 ($p > 0.05$) for working experience variable.

Randomization was tested to ensure that each participant was randomly placed in the experimental group by comparing the demographic characteristics of all experimental groups. Testing randomization using Chi-Square for gender and working experience and one-way ANOVA for age. The results showed significant value of 0.547 ($p > 0.05$) for gender variable, 0.699 ($p > 0.05$) for working experience variable, and 0.438 ($p > 0.05$) for age variable. These results indicated no difference between gender, age, and work experience between manipulation groups.

4.2. Results

H1 predicts that transfer price of seller will be closer to equal profit with supportive leadership style rather than a non-supportive leadership style. Table 2 shows the results of leadership style which have significant effect ($F=39.761, p=0.000 < 0.05$). The supportive leadership style is closer to IDR 500.000 (equal profit price). The descriptive statistics (Table 3) also show that supportive leadership style has a greater effect to reach equal profit price than non-supportive leadership style (IDR 548.91 versus IDR 619.70). Thus, this result supports H1.

Table 2. Two Ways ANOVA Results

Dependent variable: Transfer Price

Source	df	Mean Square	F	Sig.
Corrected Model	3	53626.320	21.446	0.000
Intercept	1	26279583.764	10509.661	0.000
Leadership Style	1	99422.597	39.761	0.000
Compensation Scheme	1	62373.313	24.944	0.000
Leadership Style*Compensation Scheme	1	7707.158	3.082	0.083
Error	75	2500.517		

Total	79			
Corrected Total	78			

R Squared = 0.462 (Adjusted R Squared = 0.440)

Table 3. Descriptive Statistics

Compensation Scheme	Leadership Style		Total
	Supportive	Non-Supportive	
Low	Group 1	Group 2	
Percentage	n = 23	n = 17	n = 40
	x = 530.43	x = 582.35	x = 552.50
	SD = 44.566	SD = 53.531	SD = 56.557
High	Group 3	Group 4	
Percentage	n = 23	n = 16	n = 39
	x = 567.39	x = 659.38	x = 605.13
	SD = 58.473	SD = 41.708	SD = 66.684
Total	n = 46	n = 33	n = 79
	x = 548.91	x = 619.70	x = 578.48
	SD = 52.163	SD = 63.663	SD = 66.835

H2 predicts that transfer price will be closer to equal profit price when bonus compensation has a lower percentage than when bonus compensation has a higher percentage. The results show that the compensation scheme significantly affects transfer price ($F=24.944, p=0.000 < 0.05$). On average, the lower bonus percentage of the compensation

scheme is closer to IDR 500.000 (equal profit price). The descriptive statistics (Table 3) also demonstrate that the effect of a lower percentage of bonus compensation is more significant than a higher percentage of bonus compensation (IDR 552.50 versus IDR 605.13). This result provides support for H2.

Table 4. One Way ANOVA Results

Variabel dependen: Transfer Price

	df	Mean Square	F	Sig.
Between Groups	1	15706.522	6.475	0.015
Within Groups	44	2425.889		
Total	45			

H3 predicts that in a work environment with a supportive leadership style, a lower percentage of bonus compensation on the seller's transfer price has a greater effect than a higher percentage of bonus compensation. This hypothesis was tested using a one-way ANOVA. The results (Table 4) show that $F=6.475, p=0.015 < 0.05$. The descriptive statistics (Table 3) also show that supportive leadership style has a greater effect on a lower percentage of bonus compensation than a higher percentage of bonus compensation (IDR 530.43 versus IDR 567.39). This result provides support for H3.

4.3. Discussion

The first hypothesis shows that negotiated transfer price set by sales division manager is closer to equal profit price when a manager is in an environment with a supportive leadership style than a non-supportive leadership style ($F=39.761, p=0.000 < 0.05$). These results can be explained by the norm of reciprocity in social exchange theory which states that the other party will reciprocate treatment given by one party with the same treatment [12]. In organizations, this can be seen when employees respond or take action according to those of their superiors or their organizational environment.

The results of this study support a prior study that states that supportive leadership style significantly affects division to set negotiated transfer price closer to equal profit price. A supportive leadership style can increase the pro-social motivation of employees. It is caused by supportive leadership giving attention and care to their subordinates, creating a friendly work environment, and supporting and facilitating positive relationships between subordinates [15]. This study also supports a prior study that states that negotiators will reach an integrative agreement when they have pro-social motivation on unequal bargaining power conditions. Individuals who have pro-social motivation will think in the interest of both parties. Thus, managers will set transfer prices close to equal-profit prices despite having more substantial bargaining power.

The results of the second hypothesis found that the negotiated transfer price determined by the sales division manager is closer to equal profit price when a manager gets a bonus based on division profit with a lower percentage than a higher percentage. The results of this study support a prior study that found that performance evaluations and compensation schemes influence the behavior and outcome of a negotiation. Social exchange theory supports this result which states that individual considers costs and benefits for themselves or their communities, both monetary and social [20]. Suppose someone in the exchange process gets long-term social benefits beyond short-term financial benefits such as partnership, trust, and reputation. In that case, the exchange can be based on social benefits [21]. Therefore, on a lower percentage of bonuses in the compensation scheme, the social benefits obtained exceed monetary benefits in the long-term period, which makes the manager set the negotiated transfer price closer to equal profit price.

The results of the third hypothesis show that when the sales division manager is in an environment with a supportive leadership style, the manager will determine a transfer price lower to market price when a manager gets a bonus based on division profit with a lower than a higher percentage. Leadership style is a crucial mechanism that determines the spread of pro-social behavior in an organization in which pro-social leadership style encourages concern-for-others [17]. Furthermore, organizations with a pro-social mission and a compensation scheme that does not trigger employees' self-interest will make employees act more pro-social [25].

The results of this study support a prior study that found that compensation and pro-social motivation have an inverse relationship that high payment will increase pro self-motivation and decrease pro-social motivation. A high percentage of bonuses on compensation schemes will make employees act egocentrically because that pay attention to the monetary benefits. In contrast, a low rate of dividends on compensation schemes will make employees work pro socially because social benefits gained exceed economic benefits. Thus, individuals who have social motivation due to supportive leadership will act more pro-socially with a lower percentage of bonuses on compensation schemes.

5. CONCLUSION

This study examines leadership styles and compensation schemes to mitigate self-interest in sellers' transfer price decisions. This study provides evidence that sellers would set transfer prices closer to equal profit in a work environment with a supportive leadership style rather than a non-supportive leadership style. These results support a prior study that found that a supportive leadership style can mitigate self-interest managers to set transfer prices closer to the same price. Furthermore, these results support social exchange theory which states that the other party will reciprocate treatment given by one party with the same treatment, which is called the norm of reciprocity [12].

This study provides evidence that the seller's transfer price is closer to equal profit when bonus compensation has a lower percentage than when bonus compensation has a higher rate. These results align with a prior study that found that performance evaluations and compensation schemes influence behavior and outcome. In addition, these results support social exchange theory which states that individual considers costs and benefits for themselves or their communities, both monetary and social [20]. This study provides evidence that under a supportive leadership style, a lower percentage of bonus compensation on the seller's transfer price is more significant than under a higher rate of bonus compensation. These results align with prior studies that found that reward and pro-social motivation have an inverse relationship. Hence, firms can increase managers' social motivation to mitigate conflicts under supportive leadership style and compensation schemes with low bonuses.

This study extends management accounting literature by understanding the influence of

leadership styles and compensation schemes on transfer pricing. Our research has theoretical implications that answer the suggestions of prior studies to use performance evaluation based on division profit. This research provides practical implications that companies can prevent transfer pricing negotiation conflicts with a supportive leadership style in the presence of a lower bonus percentage of a compensation scheme. This finding indicates that firms with a supportive leadership style and a lower bonus percentage of compensation schemes can benefit from decentralization.

Our research has some limitations. First, the study used experimental method with simplified case materials of real-world negotiations. Hence, this case may not have captured real-world negotiation. In addition, the use of students as experimental participants may be a potential limitation to generalizing the findings of this research. Future research could use the field study method or managers as experimental participants to test the variables used in this study. Second, the participants only used written scenarios on the instrument without participating in a negotiation. Hence, their decisions were the expected transfer price not agreed transfer price. Future research could do negotiations or automated negotiations. Third, this study only investigated external factors and did not investigate individual internal factors, such as emotions and cognitive assessments. These individual internal factors may have an impact on transfer pricing.

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