THE RELATIONSHIP BETWEEN TAX AVOIDANCE AND FIRM VALUE, MODERATED BY EXECUTIVE COMPENSATION

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Abstract

This research attempts to find out the significant relationship between tax avoidance and firm value and moderate by executive compensation. The theories that are related to this study are agency theory and bonus plan hypothesis. This study is a quantitative research that used secondary data of manufacturing companies listed on the Indonesia Stock Exchange from the period 2016 - 2019. The sampling technique is done by purposive sampling which results 58 companies with 232 data observations. The statistical analysis tool of this study is Smart-PLS version 3.3.2 to test the hypothesis. The results showed that tax avoidance has a negative significant influence on firm value, executive compensation has positive significant influence on firm value, and executive compensation moderate the relationship between tax avoidance and firm value.

Kata Kunci: Tax Avoidance, Firm Value, Executive Compensation

INTRODUCTION

Indonesia is the highest gross domestic product in Southeast Asia. Based on the World Bank 2019 data, the GDP of Indonesia in 2019 amounted to US$ 1.119 trillion, meanwhile in the second and third positions Thailand and the Philippines were US$ 544 billion and US$ 377 billion. The financial market in Indonesia shows remarkable growth. The market capitalization of Indonesia in 2019 was US$ 523.322 billion, a growth of 143% from 2015 which US$ 214.941 billion. It means that investors are still interested in Indonesian companies.

The investor interest is usually associated with the firm value. The maximization firm value is one of the goals of an established business because the greater firm value will increase the shareholder's wealth [1]. [2] stated firm value is an indication of the market value of the firm, meaning that firm value is the summary of an investor's perceptions of the overall performance of the company. the increasing firm value is depended on how well the company is performing means that the firm value is related to firm performance [3]. Furthermore, to maximize firm value, companies tend to reduce expenses, especially tax expenses because taxes are not directly contributed to the firm performance [4]. Therefore, the companies tend to do tax avoidance to reduce tax burden.

Tax avoidance practice could affect the value of the firm. Since firm value is related to a company's performance, companies might do tax avoidance to produce better after-tax income [5]. However, tax avoidance action is still classified as non-compliance activities and also has a high-risks such as penalties and reputation loss if tax avoidance is proven to violate the law by tax authorities [6]. Several studies showed that investors will not interest

in the company that did tax avoidance activities, because management tends to report fake financial reports to the public [4, 7]. Therefore, tax avoidance practice is suspected to have a negative relationship to firm value.

The study related to tax avoidance and firm value is important but still under question [7,8]. Some studies have investigated the linkage of tax avoidance and firm value with different samples and year observations, but the results are mixed. For instance, [8,9] found there is a positive association between tax avoidance and firm value because they argued tax avoidance can produce better after-tax income. Meanwhile, [4, 7, 10] found tax avoidance have a negative association with firm value because they believed that tax avoidance can increased information asymmetry and could have a high potential cost if the tax avoidance practice is known by tax authorities. The inconsistency of the results of these studies motivates the researcher to examine this issue and the researchers want to add a moderating variable that can strengthen or weaken that relationship which is executive compensation.

The executive compensation is expected to align the interest between principal and agent because the shareholders have limited control to operate the company [11]. Executive compensation constitutes a reward in the form of material or non-material to motivate an agent to maximize firm value [12]. However, a prior study argued that executive compensation could also view as part of agency conflict [13]. The executive compensation might lead to an agent do some financial manipulation to achieved high compensation. Correspond with bonus plan hypothesis, [14] stated along with the high motivation to achieve incentive, the agent tends to manipulate financial statement to make the company looks more profitable. Hence, executive compensation seems to strengthen the negative effect of tax avoidance and firm value.

Furthermore, [8] suggested examining the link between tax avoidance and firm value in other Southeast Asian countries and adds some variables related to corporate governance mechanism. Supported by [4] which stated there is still limited study related to tax avoidance affect firm value in Indonesia cases. Therefore, this research aims to examine the influence of tax avoidance towards firm value using executive compensation as a moderating variable in Indonesia. Also, this study used three control variables which are return on asset, debt to equity ratio, and firm size to create a robust model.

LITERATURE REVIEW

[11] stated that there is a contract between one party (principal) and another party (agent) in which the agent is a delegation of shareholders to carry out all company activities and makes decisions on behalf of the principal. An agent expected to make decisions under the interests of the principals through increasing firm value. However, there is conflict of interest between principal and agent where the principal is more concerned to maximize their wealth which is a high return on investment whereas managers also want to maximize their welfare which is high compensation with lower effort [15].

Due to the limitations of shareholders in accessing information and the conflict of interest, shareholders can provide compensation to the executive to motivate managers to work under the principal's interest which is a high return on investment [11]. By giving compensation, an agent might be motivated to act in a manner and influence the decision-making process to maximize the shareholder's wealth and enhance firm value [16]. The decision-making process including determining the level of tax avoidance, since if tax avoidance has done successfully, it will be increasing after-tax income [5].

Bonus Plan Hypothesis

The Bonus plan hypothesis by [14] suggested that managers will changes accounting data that will shift future income to

the present period to get a target income, which means the manager will manipulate financial statements by an increase or decrease the company's income to maximize their bonus. In line with [17] which stated the managers could channel the chances to get the higher compensation by manipulated the report given to be able to show the higher level of performance. Therefore, the bonus or compensation given to the manager does not always give a positive effect. An agent might be manipulated financial statements to gives the impression that the company has a good performance, also it might lead to tax avoidance practices since tax avoidance can produce better after-tax income [5].

Firm Value

One of the goals established business is to maximize firm value [1]. By maximizing firm value, it will increase the prosperity of shareholders [18]. The firm value itself is an economic way to determine how much the company is worth [19]. Firm value also reflection of the level of public trust in the company where the higher firm's value means the public have a good assumption toward the company, so it will attract the investor to invest in the company, and vice versa the lower firm's value, the investor has a bad assumption so the company will lose the public trust [20]. In other words, firm value is the summary of an investor's perceptions of the overall company's performance.

Tax Avoidance and Firm Value

[21] stated that the goals of every decision in the company are to maximize firm value, therefore an agent tends to reduce tax expense to get higher after-tax income. One way to reduce taxes is by doing tax avoidance. Tax avoidance refers to the company's strategy to minimized tax expense to get more profit [22]. This action is done by utilized gray areas or loopholes in State jurisdictions. [8] found tax avoidance have a positive connection with firm value because tax avoidance could increase after-tax income and affecting to enhance firm value. However, the negative consequences of tax avoidance seem to have higher than the benefits. Tax avoidance is not an easy thing to do, companies might prepare business transactions that are quite complicated to do tax avoidance [4]. Tax avoidance can be said to manipulate actual financial performance and can increase information asymmetry [8]. [23] examined U.S companies found that tax avoidance has negative influence to firm value, they argued that tax avoidance is the practice of hoarding bad news and when the accumulation of bad news can no longer be contained, investors will no longer interested in companies and will have an effect on the decreasing firm value which is marked by fall down of company's share prices. Also, tax avoidance can raise a risk such as penalty by tax authority if this action proven violate the law, or even reputational loss [4, 6].

H1: *Tax avoidance has negative influence to firm value*

Executive Compensation and Firm Value

Since shareholders have limited control in managing the company, shareholders can provide executive compensation to reduce the agency conflict [11]. Executive compensation is considered a reward in the form of material or non-material given by shareholders to executives who manage the company to motivate managers to achieve a higher income and increasing the value of the company [12]. By setting compensation, companies can boost firm performance, produce a higher profit, then the shareholders can receive more return on investment, and enhance firm value [16]. Using 255 sample companies in Indonesia, [24] also found evidence executive compensation is a significant association with a firm value that is measured by accounting-based and market-based in Thailand listed companies. [15], using 350 companies in the UK of 2010-2014, found that CEOs and executives have a better performance in the future when they received compensation that measured based on the past performance.

H2: *Executive compensation has positive influence to firm value*

Tax Avoidance, Executive Compensation and Firm Value

The executive compensation is expected to control the actions of executives who are concerned with the interests of their welfare [25]. However, the compensation does not always give a positive impact. An agent might be doing some financial manipulation to give an impression the company has a good performance. Correspond with Bonus Plan Hypothesis by [14] which stated the existence of bonus will lead to manipulating financial statement to an achieved bonus. This manipulation is also related to tax avoidance practice to reduce tax expenses to generate more after-tax income. In line with [6,26] which found incentive compensation has a positive association with tax avoidance. In conclusion, since the compensation is expected to motivate the executive to generate better firm performance, it might be increasing the tendency of tax avoidance practice to achieve more return to the shareholders that affect to decreasing firm value.

H3: *Executive compensation strengthen the relationship of tax avoidance and firm value*

Research Framework

Figure 1 Research Framework
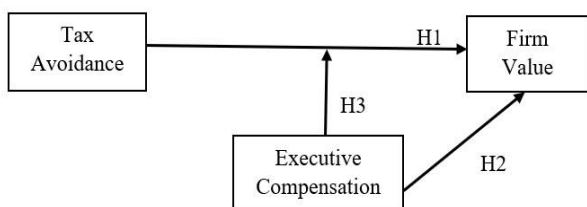
RESEARCH METHOD

This descriptive explanatory research used quantitative approach, focusing on 145 manufacturing companies listed on the Indonesian Stock Exchange. We selected manufacturing companies because they are considered as large-scale company compare to others, so they contribute higher in tax revenue. To select the sample, we used purposive sampling with criteria in Table 1 as follows:

Table 1 Samples Criteria

CRITERIA	COMPANIES
Manufacturing companies listed in IDX 2016- 2019	145
Manufacturing companies uncomplete financial statement from 2016-2019	(5)
Manufacturing companies reported a net loss	(40)
Manufacturing companies used foreign currency	(25)
Manufacturing companies do not have complete data for research variables	(13)
Outlier data	(4)
Total sample per year	58
Total sample observation (58 x 4 years)	232

Source: Data processed in 2020

Firm Value

The firm value is dependent variable of this research. Firm value was measured by Tobin's Q formula. The greater Tobin's Q ratios value, means the company has great profitability or high firm value. Following prior research of [8,15], the formula is written as follows:

$$\text{Tobin's Q} = \frac{\text{Equity Market Value} + \text{Debt}}{\text{Total Asset}}$$

Tax Avoidance

The tax avoidance is the independent variable of this research. Tax avoidance was measured by the cash effective tax rate ratio. When the rate of cash ETR is high, it reflects the lower rate of tax avoidance, and if the rate is low, that means the company conducts high tax avoidance. Following [8, 27], the cash ETR calculation formula is written as follow:

$$\text{Cash ETR} = \frac{\text{Cash Income Taxes Paid}}{\text{Earning before taxes}}$$

Executive Compensation

The executive compensation is the moderating variable of this research. Following [6, 26], executive compensation measured by using logarithm natural of the

total compensation received by executives in one year or it can be written as follows:
Executive Compensation=

Ln Total Compensation

Control Variables

To create a more robust model, this research used three control variables following [4, 6] which are return on equity, debt to equity ratio, and firm size. The formulas are written in Table 2 as follows:

Table 2 Control Variables Measurement

Variables	Measurement
Debt to Equity	$\dfrac{\text{Total debt}}{\text{Total Shareholders'Equity}}$
Return on Equity	$\dfrac{\text{Net Income}}{\text{Total Shareholders'Equity}}$
Firm Size	Ln (total asset)

Data Analysis Method

The data analysis was conducted using Structural Equation Model (SEM) with PLS approach using Smart PLS 3.3.2 software because according to [28], SEM PLS is suitable for the measure the structural model in which this research has a moderating variable. This research did several tests such as descriptive statistical analysis, coefficient determination to measure how much the dependent variable is influenced by the other variable test in the study, also hypothesis test by Bootstrap resampling method. The equation that will be used in this study are:

$FV = \beta_1 TA + \beta_2 EC + \beta_3\ DER + \beta_4\ ROE + \beta_5 SIZE + \beta_6 EC*TA + \beta_7 EC*DER + \beta_8 EC*ROE + \beta_9 EC*SIZE + \varepsilon$

RESULTS AND DISCUSSION

Descriptive Statistical Analysis

The result of descriptive statistics shown in following Table 3 as follows:

Table 3 Descriptive Statistical Analysis

	Min	Max	Mean	Std. Dev
Tax Avoidance (CETR)	0.020	2.920	0.389	0.382
Firm Value (Q)	0.300	12.960	1.660	1.508
Executive Compensation (EC)	20.060	27.920	23.754	1.558
Debt Equity Ratio (DER)	0.080	4.190	0.786	0.637
Return on Equity (ROE)	0.000	0.380	0.118	0.078
Firm Size (SIZE)	26.250	33.490	28.874	1.550

Source: researcher data processed by Smart PLS

CETR has a minimum score of 0.020 and a maximum score for 2.920. The mean score of 0.389 or 38.9%, indicates the sample in this study on average were did not do tax avoidance. If the companies did tax avoidance, the cash effective tax rate will have a value less than the corporate income tax rate that applied in Indonesia which is 25% (Directorate General of Taxes). Since the mean for tax avoidance is higher than 0.25, it is indicated the samples of this study on average are comply in paying taxes. The standard deviation of 0.382 shows that data dispersion is quite low.

Q has a minimum score of 0.300 and maximum for 12. The mean score 1.660 and the standard deviation score for 1.508. This data indicates on average the data dispersion is not high around 1.660 ± 1.508.

EC has a minimum score of 20.060 or if converted Rp. 515,000,000 and maximum for 27.920 or if converted Rp. 1,332,000,000,000. The mean score is 23.754 or if converted Rp. 20,712,433,312 and standard deviation for 1.558.

DER has a minimum score of 0.080 and the maximum score for 4.190. The mean score for 0.786 and the standard deviation for 0.637. This data indicates on average the data dispersion is not high around 0.786 ± 0.637.

ROE has a minimum score of 0.000 while the maximum score for 0.380. The mean score is 0.118 and the standard deviation for 0.078.

It is indicated that the data dispersion is not excessively high but the data's range quite large.

SIZE has a minimum score of 26.250 or if converted Rp. 252,452,307,121 and the maximum score for 33.490 or if converted Rp. 351,958,000,000,000. The mean score for 28.874 or if converted Rp. 3,465,922,684,031 and standard deviation for 1.550.

All the data in this study shows a mean greater than the standard deviation. Standard deviation is a reflection the deviation is very high. It means that the data dispersion in this research shows a normal dispersion or there is no data that too extreme values and not varied.

Partial Least Square Model Scheme

The hypothesis test was carried out using techniques Partial Least Square (PLS) analysis with the Smart PLS software version 3.3.2. PLS model scheme which is tested is in Figure 2

Figure 2 PLS Model Scheme *Coefficient Determination (R^2)*
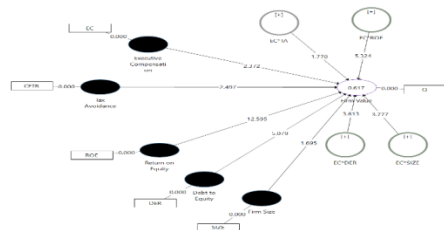
Coefficient determination (R^2) is used to determine how strong the model can explain endogenous variables through variation [28].

Table 4 Result of R^2

Dependent	Independent	R-Square
Firm value	Tax avoidance	0.617

Source: data processed by Smart PLS

The result it indicates the influence of tax avoidance and three control variables has an influence of 61.7% towards firm value and the rest 38.3% is influenced by another factor outside of this study.

Hypothesis Test and Discussion

The results of hypothesis testing that have been done using the Bootstrapping in Smart PLS 3.3.2. The results of Hypothesis testing are described in Table 5.

Table 5 Result of Bootstrapping

Description	Path Coeff	T Statistics	P Values
TA -> FV	0.096	2.497	0.006
EC -> FV	0.169	2.372	0.009
DER -> FV	-0.216	5.079	0.000
ROE -> FV	0.522	12.595	0.000
SIZE -> FV	0.114	1.695	0.045
EC*TA -> FV	0.070	1.770	0.039
EC*DER -> FV	-0.178	3.613	0.000
EC*ROE -> FV	0.359	5.324	0.000
EC*SIZE -> FV	-0.109	3.777	0.000

Source: data processed by Smart PLS

As shown in Table 5, all variables are significantly affected by the dependent variable, therefore all the research hypotheses are accepted.

Tax Avoidance toward Firm Value

CETR to Q has a path coefficient of 0.096 with T- statistic for 2.497 > 1.645 (Sig. 5%), and the p-value is 0.006 which means that the cash effective tax rate has a positive relationship to Tobin's Q. Since the higher cash effective tax rate indicated the company did not conduct tax avoidance practice [27], it means that the more companies do not do tax avoidance, the higher the firm value. This result empirically proved that Indonesian investors still express considerable concern for tax avoidance. Although tax avoidance is legal but it still classified as noncompliance action [4]. Tax avoidance might increase the company's cost [7] because the tax avoidance implementation is quite hard and complex transactions. Furthermore, tax avoidance has high risk such as penalty by tax authority if this action proven to be violated the law [6]. If the company already has a tax dispute case, the company will lose its reputation and might have a higher cost to resolve tax disputes which can reduce the future cash flows, thus the investor will less interest in the company. This result is In line with [4, 7, 23] which

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found tax avoidance has negative effect to firm value. Thus, H1 is supported.

Executive Compensation toward Firm Value

EC to Q has a path coefficient of 0.169, T-statistic for 2.372 > 1.645 (Sig. 5%) and P values for 0.009, indicated the executive compensation is positively significant influence firm value. Theoretically, the agency theory [11] argued the executive compensation can reduce the agency conflict. Since the principal has low control in managing the company, by giving compensation, an agent more motivated in improving the value of the company because they might satisfy with the compensation that they received. This result in line with [24, 29] which found the greater compensation can drive firm performance that resulted in higher firm value. Thus, H2 is supported.

Tax Avoidance on Firm Value Moderate by Executive Compensation

EC*TA to Q has a path coefficient of 0.070 with manipulate financial statements such as shift future income to the present period to maximize the bonus. Supported by [17] which stated the managers could channel the chances to get the higher compensation by manipulated the report given to be able to show the higher level of performance. [13] also stated the executive compensation could increase the manager's devotion. That manipulation is also related to tax avoidance to reduce tax expenses to generate more after-tax income. [4] stated the company tends to reduce expenses, especially tax expenses to generate higher income. Thus, executive compensation can motivate an agent to do tax avoidance. Supported by [6, 26] which found the incentive compensation has a positive association with higher tax avoidance. Therefore, executive compensation could strengthen the negative association between tax avoidance and firm value. Thus, H3 is supported.

Control Variables

The three control variables in this study showed significant influence. DER has a negative significant relationship to firm value.

It indicated the debt is seen as a burden for the company [4]. The higher debt to equity ratio has an impact on the reducing firm value because the company that has high DER tends to have a high risk since they should pay a debt and might be low ability to produce high dividend to the shareholders. Thus, the investor is less attracted to a company that has a high debt to equity ratio. This result in line with [30] which found debt to equity ratio has a negative effect on firm value.

Return on Equity (ROE) has a positive relationship with firm value. The greater return on equity indicates a better company's management and a greater rate of return to shareholders. ROE shows the ability of a company to generate profits from the investment of shareholders, it also reflected the profitability of the company. The higher profitability, the more investor attracted to the firm, thus it will increase the value of the firm. This result in line with 1.770 > 1.645 (Sig. 5%) and the p-value is return on equity has a positive relationship to firm value.

Firm size (SIZE) has a positive relationship with firm value. The larger company indicated the more ability of the company to conduct activities to expand the business [4].Thus, it will affect the increasing firm value because the investor is more attracted to the company that has the larger firm size [32]. This result in line with [32] which found firm size has a positive relationship to firm value. The larger firm size reflected the company had grown so the investor will interest, thus it has an impact on the increasing firm value.

CONCLUSION

This study extends the prior research of [8] with the aims to determine the effect of tax avoidance on firm value moderate by executive compensation in 58 manufacturing companies listed on Indonesia Stock Exchange for the period 2016 until 2019. This study has three findings, which are:

1. Tax avoidance has a negative relationship with firm value;

2. Executive compensation has a positive relationship with firm value;
3. Executive compensation strength the negative relationship between tax avoidance and firm value.

Limitations

This study has several limitations which are: First, this study only used a sample of manufacturing companies for the period 2016-2019. Second, only used one indicator to measure tax avoidance. Third, this study only focused on tax avoidance toward firm value, where there are other factors that can influence firm value.

Suggestions

Based on the limitation above, the recommendation that can be given to the future researcher as follows: (1) expand the scope of research and extended the research period to obtain more accurate results. (2) future research should add more indicators to measure tax avoidance such as book-tax differences. (3) future research should add another factor that can influence firm value. The future researcher may examine the influence of tax avoidance on firm value moderate by institutional ownership because institutional ownership is expected to have better monitoring [33].

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HALAMAN INI SENGAJA DIKOSONGKAN