Tax Avoidance and Dividend Policy, with Corporate Governance as Moderating Variable

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Abstract. Firm value is very important, it reflects the company's performance and can affect investors' perception of the company value. In its development, firm value can be influenced through the application of financial management functions such as tax avoidance and dividend policy. This study aims to examine the factors that can affect firm value by using the literature review method. Corporate governance is used as a moderating variable and a limitation in this study. In previous theoretical studies, it has been shown that firm value can be influenced by tax avoidance and dividend policy. Based on the discussion of relevant theories and previous research, it can be concluded that tax avoidance affects firm value and dividend policy affects firm value. Moderating corporate governance variables can moderate the effects of tax avoidance and dividend policy on firm value.

Keywords: Tax Avoidance, Dividend Policy, Corporate Governance, Firm Value.

1 Introduction

In line with information from the official website of the Indonesia Stock Exchange (IDX), the capital market functions as a platform for trading diverse long-term financial instruments such as mutual funds, bonds, stocks, derivatives, and more. Beyond its role as an investment avenue, the capital market has evolved to provide income opportunities, particularly through equity instruments. Nevertheless, the substantial correction experienced by the Jakarta Composite Index (JCI) at the beginning of 2020 until its zenith on March 20, 2020, has highlighted that comprehending the stock market involves more than just pursuing profits for investors. The decline of the JCI from the 6300 series to the 3900 series over three months shows that the current Covid-19 pandemic is indeed very serious. There are pros and cons who believe the JCI will continue to fall and there are also those who believe the JCI will recover among investors. This condition will affect the company and confront it with an uncertain situation [1].

Enhancing corporate value represents a primary objective for companies, aiming to augment the wealth of proprietors or shareholders. This objective is attainable through the adept execution of financial management functions. The significance of firm value is profound as it mirrors the company's performance, wielding the potential to sway investors' perceptions about the company's worth [2]. Fama (1978) [3] asserts that company value can be manifested in its stock price. Within the capital market, stock prices are shaped by interactions between buyers and sellers, held as indicators of the company's asset value. The composite value of a firm is delineated by the stock market's valuation index, markedly influenced by avenues for
investment. An escalation in stock value carries a consequential impact on the overall company value. Elevated stock prices conduce to heightened company value, consequently fostering the well-being of shareholders [2].

One of the management decisions related to firm value is the existence of tax activities [4]. One of the things that must be considered before the company chooses to implement tax management is that the company is able to distinguish between tax avoidance and tax evasion. Tax avoidance denotes a lawful and secure approach employed by taxpayers to diminish their tax liabilities, conforming harmoniously with the stipulations of tax statutes and regulations. This strategy involves leveraging methods and techniques that capitalize on the vulnerabilities (often called gray areas) present in tax regulations to curb the quantum of taxes that are obligatory for payment [5]. Although tax avoidance has a positive side which means it can reduce the tax burden, there is also a negative side. Managers avoid taxation not for the benefit of the owner but for opportunistic purposes, namely to increase company value [6].

Apart from tax avoidance which can affect firm value, dividend policy can be used to increase firm value. Dividend policy is a decision related to company profits where company profits will be distributed to shareholders as dividends or become retained earnings to finance future investments. Then dividends can also illustrate the company's financial performance [7]. In distributing dividends, it must be appropriate, if the dividends distributed are too high, it will hinder the company's expansion, while if the dividends distributed are too low, it will reduce investor interest. Dividend policy that is carried out appropriately will affect the high share price, which is an indicator of firm value because it is considered a positive signal to investors that the company has good prospects [8].

In accordance with agency theory, management tends to engage in opportunistic behaviors when lacking proper oversight. Therefore, the government has regulated corporate governance so that companies are managed appropriately so that managers' opportunistic actions can be limited. Weak corporate governance can nullify the benefits of tax avoidance for shareholders and might even lead to a depreciation in a company's overall value [6]. In addition, corporate governance will refer to how the board of directors makes an authentic decision in a company as well as the approval needed to invest, issue shares, and declare dividends [9].

Based on the explanation above, the focal point of this study revolves around assessing the impact of tax avoidance and dividend policy on firm value. Additionally, the study explores whether corporate governance can act as a moderator in influencing the repercussions of tax avoidance and dividend policy on firm value.

2 Literature Review

2.1 Signaling Theory

The concept of signaling theory was introduced by Spence (1973). Signals refer to actions undertaken by a company's management that offer insight into how management perceives the company's prospects. Signaling theory represents a managerial strategy that conveys to investors the management's perception of the company's outlook. The information a company presents through its financial statements serves as a signal or notification to investors, shedding light on its financial health. Investors then utilize this information when making investment
choices concerning the company. The financial data and the company's overall status that investors become privy to are interpreted as either positive or negative news. When a signal is interpreted positively, it bolsters the company's stock prices in the market. Conversely, the company's stock prices tend to decrease when the signal is perceived as negative. In this theoretical framework, the company's management, acting as insiders, imparts signals to investors or external parties via financial reports. The information disseminated by the management holds significant sway as it can impact the investment decisions made by shareholders who have invested in the company.

2.2 Agent Theory

Jensen and Meckling conceptualize an agency relationship as a contractual arrangement wherein one or multiple individuals (referred to as the principal) engage another individual (referred to as the agent) to execute specific services on behalf of the principal, with the grant of appropriate authority. Authorization is actually a necessity in this agency relationship so that the agent can report and be accountable for his activities to the principal. In every agency relationship, agency costs arise that will be borne by the principal as well as by the agent [10]. Agent conflicts can arise due to asymmetric information between owners and managers, especially when one party has information that does not belong to the other party. Managers can use various ways to get more information than investors, so that investors are not confident in the quality of the company and do not want to buy company shares, making the company's share price fall.

Owners and managers are a model consisting of two rational individuals with conflicting interests. Because of the authority they have, managers can act in their own interests and sacrifice the interests of shareholders. This creates a lack of supervision so that managers take opportunistic actions. Hence, regulatory measures have been implemented by the government to establish a framework for corporate governance aimed at ensuring proper management and constraining opportunistic behaviors carried out by managers. Companies that have poor governance, tax avoidance activities have no value for shareholders and even reduce company value. When there is an increase in profits for managers in the form of compensation, companies that have poor governance will experience a decrease in the level of tax avoidance that should be available to shareholders. On the other hand, companies that have good governance have a high level of tax avoidance as well, because tax avoidance is carried out with the aim of providing benefits to investors and not the manager's opportunistic goals [6].

2.3 Company Value

Firm value signifies an investor's interpretation of a company's level of accomplishment and is commonly intertwined with stock prices [11]. This notion of firm value is also recognized as market value, representing a proportion that encapsulates a market event. This metric can furnish insights to corporate management about the impending performance conditions and their future implications [12]. Furthermore, the valuation of a company is delineated as the company's performance manifesting within the stock price, shaped by the equilibrium of supply and demand in the capital market, mirroring the collective evaluation by the general public [13]. Establishing a company's value is underpinned by the composite value index of the stock market, a metric heavily influenced by investment prospects. These investment opportunities can furnish a positive indication regarding the company's future progression, subsequently amplifying the company's valuation [4].
2.4 Tax Avoidance

Tax avoidance constitutes an endeavor undertaken by taxpayers to legitimately diminish or fulfill tax obligations without infringing upon applicable legal provisions [14]. This strategy involves taxpayers seeking to minimize their taxable income by optimally leveraging existing taxation regulations. Entails capitalizing on authorized exemptions and deductions and exploiting the gray areas and vulnerabilities within the current tax framework. Within the ambit of tax avoidance, taxpayers aim to navigate the law without overtly transgressing it, even if, at times, this involves a nuanced interpretation that deviates from the original legislative intent and purpose [15]. Notably, the pursuit of tax avoidance incurs costs, often necessitating time and effort, and comes with the risk of exposure if such behavior is unveiled to the public. These associated risks encompass tangible penalties and interest charges, as well as intangible ones like tarnishing a company's reputation. The latter risk can have lasting repercussions, negatively impacting the company's long-term viability [16].

2.5 Dividend Policy

Dividends signify the portion of earnings that will be apportioned to shareholders based on their ownership stake in a company. The dividend policy constitutes a crucial determination encompassing the allocation of profits whether generated profits should be dispensed to investors as dividends or retained as earnings earmarked for future investments. Retained earnings constitute a pivotal source of funds utilized to finance the expansion of business operations [17]. The optimal dividend policy within a company strives for equilibrium between prevailing dividend yields and future growth prospects, such as potential increases in share values, with the overarching goal of maximizing the company's overall valuation.

The role of financial management comes to the forefront in handling the decisions made by management about financing needs for ongoing investments. Companies must factor in various elements influencing their comprehensive financial performance in shaping the dividend policy. A company can execute its dividend policy optimally through a meticulous analysis of these determinants, ideally leading to a rise in shareholder wealth as its share prices appreciate. It signifies that the stock price mirrors the company's intrinsic value. Consequently, an upsurge in the share price translates into a corresponding augmentation of the company's overall valuation.

2.6 Corporate Governance

As defined by the Forum for Corporate Governance in Indonesia (FCGI), effective corporate governance encompasses a set of regulations that delineate the interactions among shareholders, company management, creditors, employees, governmental bodies, and other internal and external stakeholders. These regulations elucidate the rights and duties of these parties, ultimately forming a system that oversees and manages the company to generate enhanced value for all involved entities. The underlying objective of such robust corporate governance is creating added value across stakeholders. Theoretically, adhering to sound corporate governance practices can elevate a company's worth by enhancing its financial performance, mitigating risks associated with self-serving decisions by the board of directors, and fostering investor confidence at large [18]. For the government, the foundational principles of good corporate governance should serve as a guiding framework for developing and
implementing effective governance practices. In a broad sense, these principles encompass five fundamental tenets: transparency, accountability, responsibility, independence, and equity.

3 Research method

This research is literature review research. Literature review is specifically related to theories, findings, and previous research literature obtained from references that are used as the basis for research activities to develop clearer thoughts from the formulation of the problem to be studied. Then the researcher summarizes, analyzes, and synthesizes critically and thoroughly from the previous literature. A good literature review must conduct a review that assesses the quality and new findings of a scientific work. Researchers analyzed some literature and then summarized the results of the research. The literature review used is the latest journal that is no more than 10 years old. Because this research is a literature review, this research does not have a population and sample.

4 Discussion

4.1 The Effect of Tax Avoidance on Firm Value

Chen et al. (2014)[19] conducted research revealing a negative correlation between tax avoidance and firm value. Their study examined the practice of tax avoidance by Chinese companies from 2001 to 2009, indicating that shareholders benefit from tax avoidance. This agency perspective underscores predictions linked to tax avoidance. Correspondingly, Fadillah (2018)[4] researched Indonesia from 2013 to 2017, illustrating the detrimental impact of tax avoidance on firm value. Suggests that corporate tax avoidance activities can influence a company's overall value. These findings align with the work of Lestari & Ningrum (2018)[5], affirming that escalated tax avoidance practices in a company lead to a decrease in its value. Additionally, heightened tax risk is occasionally associated with a negative influence on firm value, as investors may perceive high tax avoidance as risky behaviour [20].

Broadly, two perspectives the traditional viewpoint and agency theory, can elucidate the relationship between tax avoidance and firm value. The traditional perspective posits that introducing tax avoidance diminishes outgoing cash flows, increasing the owner's wealth. In other words, tax avoidance reduces the portion of cash that leaves the company, safeguarding it from taxation authorities. On the other hand, the agency theory perspective underscores positive facets of tax avoidance, such as curbing cash outflows [21].

Many studies have delved into the association between tax avoidance and firm value. Some, such as Tambahani et al. (2021)[22] and Mustika et al. (2019)[23], underscore how tax avoidance affects firm value. Conversely, Wardani & Juliani (2018)[6] research suggests that tax avoidance does not significantly impact firm value. This variance in results implies that investors and creditors may not perceive tax avoidance as detrimental to company value. Consequently, companies engaging in tax avoidance may encourage investors and creditors to invest in them.
4.2 The Effect of Dividend Policy on Firm Value

Ovami & Nasution (2020)[7] investigated dividend policy, with findings that establish a relationship between the dividend policy and the valuation of companies listed on the LQ-45 index of the Indonesia Stock Exchange. Specifically, companies implementing dividend policies, particularly through cash dividend payouts, tend to augment the liquidity of their shares. Consequently, certain investors perceive such managerial actions regarding dividend policy as positive signals for the company's prospects. Similarly, research conducted in India by Seth & Mahenthiran (2022) [24] demonstrated that the dividend payout ratio positively influences firm value. This alignment of outcomes corresponds with the research conducted by Mangkona et al. (2023)[8], which revealed a positive and significant correlation between dividend policy and firm value. Essentially, a higher dividend policy is associated with an increased company value. The principles of signal theory elucidate this connection, explaining that a rise in dividends corresponds with an escalation in stock prices. In contrast, a decrease in dividends corresponds with a decline in stock prices, effectively linking dividends to firm value [25].

Adding to the discourse, studies by Kurnia (2019)[11] and Kim et al. (2020)[26] contribute evidence affirming that dividend policy indeed influences firm value. Particularly, dividend payout policies demonstrate a notably positive effect on firm value, particularly for companies that disburse dividends even when facing financial constraints. In such cases, managers might use dividends to convey optimistic signals about the company's prospects. Nonetheless, contrary to the above research, Setyorini & Sulhan's (2023)[27] findings contend that dividend policy needs a discernible impact on firm value.

4.3 Corporate governance moderates the effect of Tax Avoidance on Firm Value

The findings derived from the study conducted by Chen et al. (2014)[19], through a specific case study in China, elucidate that companies' engagement in tax avoidance practices ultimately benefits shareholders. This accentuates the significance of corporate governance as a crucial step in evaluating purported corporate tax savings. Over two decades of progress within the Chinese capital market, companies have undertaken numerous initiatives to enhance their corporate governance practices, including augmenting the transparency of information dissemination. As a result, the adverse association between tax avoidance and firm value tends to diminish in companies adopting robust management practices. Similarly, Fadillah's investigation (2018)[4], which employs institutional ownership as a proxy for corporate governance, suggests that this facet of governance can attenuate the connection between tax avoidance and firm value. This underscores the lingering insufficiency in optimal supervisory efficacy over management performance within corporate governance. Consequently, management can engage in tax avoidance strategies to heighten company value. Wardani & Juliyan's study (2018)[6], which employs audit quality as a proxy for corporate governance, yields similar implications, showcasing that this dimension of governance can also mitigate the link between tax avoidance and firm value.

4.4 Corporate governance moderates the Effect of Dividend Policy on Firm Value

Corporate governance can moderate the correlation between dividend policy and firm value. Implementing effective corporate governance practices instills investor confidence that financial performance reporting aligns with the tenets of sound corporate governance.
Consequently, dividend distribution adheres to pertinent regulations. In this manner, robust corporate governance is conducive to elevating the company's overall valuation [28]. Dividend distribution serves as a mechanism to facilitate conflicts inherent between various stakeholders, encompassing both internal and external parties. This mitigates agency conflicts between minority and majority shareholders [29]. By managerial ownership, an alignment of interests emerges between company management and shareholders. This alignment of interests engenders a constructive impact on augmenting shareholder value. Elevated shareholder value subsequently engenders an escalation in stock prices, influencing the overall company valuation [30].

5 Conclusion

Building upon the discourse mentioned above, several influential factors contributing to a company's valuation, mirrored in its stock price, stem from the interplay of supply and demand within the capital market. This dynamic interplay reflects the general public's collective assessment of the company. The variable of tax avoidance emerges as a factor that significantly influences firm value. Underscores the proposition that the company's engagement in tax avoidance practices can impact its overall value. Similarly, the dividend policy variable exerts a discernible influence on firm value.

The observation drawn is that higher levels of dividend policy within a company correspond to elevated company value. Furthermore, corporate governance assumes a pivotal role as it can moderate the effects of tax avoidance and dividend policy on firm value, underscoring its capacity to influence the relationship between these variables and the company's overall valuation.

References


