The Effect of Strategy Business on Tax Aggressiveness

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Abstract: The purpose of this research is to obtain empirical evidence about the impact of strategy business on tax aggressiveness. Companies that follow either prospector or defender strategies tend to seek tax aggressiveness to increase their profit. Using a purposive sampling method, the empirical data was drawn from 66 manufacturing companies listed in the Indonesia Stock Exchange (IDX), observed over a three-year period during 2013–2015. Multiple regression models were examined to test the hypotheses. The results showed that business strategies had a significant impact on tax aggressiveness. This is significant, because companies used the same strategy from 2013 to 2015 to increase their profit and subsequently improve performance. The value of this research is the empirical study and enrichment of literature regarding tax aggressiveness.

1 INTRODUCTION

Although taxes are a source of state revenue, it can be said that tax revenues are still not fully optimized. This is evident from the increase in revenue in 2014 (up 92% compared to 2013) but in 2015 there was a decline to 83.3% (data realization of the APBN 2013–2015). There is an under-optimization of tax revenue because taxpayers attempt to reduce taxes by tax evasion.

Tax aggressiveness is an attempt made by the taxpayer to reduce tax collection paid to the state in cash. Tax evasion consists of three forms, namely tax avoidance, tax aggressiveness, and tax evasion. Tax aggressiveness is an effort to avoid tax, which is within legal limits but is unethical as tax shifting conducts company operations in tax haven countries.

According to Armstrong et al. (2012), corporate characteristics are factors that influence tax evasion. Companies with a high innovation culture will affect the level of profit earned due to the high expense of research and development of their products. Therefore, companies with such characteristics will seek to reduce expenses through aggressive taxes in order to increase profits and will subsequently perform well.

Companies with good performance, an ambition to become market leaders, and the desire to achieve a competitive advantage, will strive to demonstrate effective strategies and strengthen their businesses using a number of methods, including functional policies and an organizational structure (Porter, 1996). Miles and Snow (1978) classify organizations into four types: those that use the defender strategy, prospector strategy, analyzer strategy, and reactor strategy.

The business strategies discussed will focus on the prospector and defender types. The prospector is a company strategy that promotes the manufacture of innovative products to master the market and take existing opportunities to increase profit. Because the company has spent more money on research and development, it looks for alternatives to reduce its expenses, such as tax aggressiveness. Companies using the defender strategy are opposed to the prospector strategy because the defender is more focused on preventing competitors from entering its markets using competitive pricing. Therefore, businesses using the defender strategy are tax-aggressive to ensure that costs incurred during the production of goods are not inflated and goods can be sold at a competitive price.

Higgins et al. (2013) link a company's business strategy with tax evasion, which leads to the conclusion that prospectors are more tax-avoidant in their business processes than defenders and analyzers. Hsu et al. (2014) discovered that companies following cost leadership strategies, such as the defender strategy, minimize risk and uncertainty, strive to maintain organizational and

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operational stability, and have a lower cash effective tax rate (ETR) when there is at least one expert director of finance from the audit committee. Firms that focus on innovation and looking for new markets (prospectors) have a higher ETR when at least one expert director of finance from the audit committee is present. The closer the ETR to zero, the greater the tax avoidance rate in the company. So, it can be concluded that a defender company, when there is an expert director of finance from the auditing committee, will be more inclined to tax avoidance than companies that adopt the prospector strategy. However, Novitaria and Santoso (2013) found that the companies' business strategies do not significantly influence the level of tax evasion.

With the above background, it is necessary to re-examine the influence of corporate business strategies on tax aggressiveness. The population used in the research are manufacturing companies that make evident changes to materials from their raw to finished states during the production process, so there is an opportunity for the practice of tax aggressiveness.

2 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Competitive Advantage Theory

Barney (1991) proposed a clear formal definition with the notion of a sustained competitive advantage: the excellence achieved continuously by implementing a strategy of accomplished unique values that competitors do not have. The company will excel in the market and increase its performance if it offers lower prices than competitors for equivalent benefits or unique benefits beyond the offered price (Porter, 1980).

Companies that choose a strategy to offer their products at lower prices than competitors in order to excel in their markets, make various efforts to reduce financing during operations, including reducing expenses by tax evasion resulting in low taxes paid by the company. The cost during production will be lower so the company can offer products at lower prices, and the company subsequently gains an advantage.

2.2 Agency Theory

Jensen and Meckling (1976) describe the agency relationship as a contract whereby one or more people (employers or principals) employ other people (agents) to carry out some delegation of authority to make decisions for the agent. Agent conflicts arise due to differences in the interests of agents and principals, in which the principal wants the company to improve the welfare of the principal, but the agent wants to improve the welfare of the company. For a company that has a lower pricing strategy than its competitors, it will seek to perform efficiencies during operations. However, if the principal wants its welfare to improve, it will show an increase in corporate finance, prompting companies to attempt to reduce this through tax evasion.

2.3 Competitive Typology

Miles and Snow (1978) explain that there are four typologies of corporate competitive strategy: prospector, defender, analyzer, and reactor. In this study, just the prospector and defender strategies will be used due to their opposing nature. The prospector strategy focuses on innovation and creativity to create new products or markets so the financing of research and development is relatively high. However, through product innovation and new market opportunities, sales will increase. In contrast, the defender strategy emphasizes the stability and sustainability of the company so that products and services offered are of high quality but have a lower price. This is because the emphasis is on efficiency and low cost. Efficiency will be achieved by strictly controlling costly areas, such as research and development.

2.4 Hypothesis Development

2.4.1 The Influence of Corporate Business Strategy to Tax Aggressiveness

Higgins et al. (2013) explains that the potential for tax avoidance is greater for corporate prospectors than defenders because prospectors will be more aggressive in taking on existing opportunities to ignore tax positions. This is because one of the prospector strategy's characteristics is to take existing opportunities and risks with no regard for uncertainty. However, firms that adopt the defender strategy tend to squeeze in cost-efficiency as a cornerstone of competitive advantage and tax expense is the main cost of most companies. Therefore, defender firms should be more likely to avoid taxes than firms that adopt a prospector strategy.

Hsu et al. (2014) explain that companies that embrace costly leadership strategies, minimize risk and uncertainty, and strive to maintain organizational and operational stability (defenders) have a lower ETR when there is at least one expert director of finance from the audit committee. On the other hand, firms that are focused on innovation and looking for new markets (prospectors) have a higher ETR when at there is at least one expert director of finance from the audit committee. However, Novitaria and Santoso (2013) found that the corporate business strategy did not significantly influence the tax avoidance rate. Based on the above description, the hypothesis is formulated as follows:
H1: Corporate Business Strategy Affects Tax Aggressiveness.

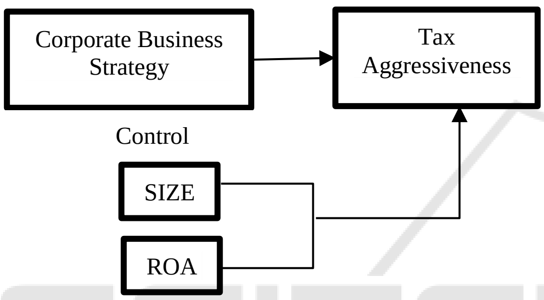

Figure 1: Conceptual Framework

3 RESEARCH METHODS

3.1 Operational Variable Definition

3.1.1 Independent Variable

In this research the independent variable is the Corporate Business Strategy (X). The measurement of business strategy variables are used in accordance with those used by Higgins et al. (2013).

1. The Ratio of Research and Development to Sales (RD)

The ratio of RD to sales serves as a measure of the company's tendency to search for new products (Higgins et al., 2013). Company prospectors tend to have large numbers on innovation activity and expect to have higher research and development costs than defenders (Hambrick, 1983).

$$\mathrm{R\&D/SALES} = \frac{\text{Research and Development}}{\text{Total Sales}}$$

2. The Ratio of Total Employees to Total Sales

The company's ability to efficiently produce and distribute goods and services is critical to the company's business strategy (Thomas et al., 1991). Because the defenders focus on organizational efficiency, defenders expect to have an employee cost figure of fewer sales (Higgins et al., 2013).

$$\mathrm{EMP/SALES} = \frac{\text{Number of Employees}}{\text{Total Sales}}$$

3. The Ratio of Company Growth

Measurement of growth ratio is used because it is believed that prospector strategies have a chance to grow faster than defenders (Higgins et al., 2013).

$$\mathrm{GROWTH} = \frac{\text{Total Sales n} - \text{Total Sales n} - 1}{\text{Total Sales n} - 1}$$

4. The Ratio of Marketing to Sales

Defender firms tend to focus on a market to survive in the marketplace and companies that embrace defender strategies will seek to provide their product information to customers through advertising, so that defender firms tend to have high advertising costs due to the provision of product information to customers.

$$\text{Market} = \frac{\text{Advertisement Expense}}{\text{Total Sales}}$$

5. Intensity of Fixed Assets

Companies that adopt a prospector strategy tend to produce new products according to consumer tastes so the prospector company will have a higher PPE/TA value than the defender.

$$\mathrm{PPEINT} = \frac{\text{Property, Plant, and Equipment}}{\text{Total Assets}}$$

3.1.2 Tax Aggressiveness (Y)

The measurement of tax aggressiveness using Book ETR, which describes the tax avoidance activity that affects net income directly and not the tax burden paid in the next period (Hanlon & Heitzman cited in Hsu et al., 2014).

$$\text{Book ETR} = \frac{\text{Total Tax Expense}}{\text{Pre} - \text{tax Book Income}}$$

If the company has an ETR score close to zero, this indicates that tax avoidance in the company will increase. Conversely, if the ETR is far from zero then the existence of tax evasion in the company will decline.

3.1.3 Control Variables

1. Corporate Size *(SIZE)*

Zimmerman (1983) says that the relationship between firm size and effective corporate tax rate is positive, which means that the bigger the company, the more taxes will be paid.

$$\text{SIZE} = \ln(\text{Total Assets})$$

2. Asset Return Rate *(ROA)*

Anderson and Reeb (2003), cited in Sari and Martani (2010), suggest that firms with higher profitability and firms with fewer fiscal loss compensation rates are seen to have higher ETRs. So, it can be concluded that the higher the profitability of the company the higher the tax burden paid by the company.

$$\text{ROA} = \frac{\text{Pre} - \text{Tax Revenue}}{\text{Total Assets}}$$

3.2 Population and Sample

The population used in this study is a manufacturing company that uses the strategy of prospectors and defenders listed on the IDX period 2013–2015. The purposive sampling method was used with the criteria required for the research. There were 22 sampled companies each year, so over a three-year period, the total sample comprised 66 companies.

3.3 Hypothesis Analysis and Testing Technique

The analysis technique used in this research is multiple linear regression, while the analytical model used is cluster analysis, which aims to classify objects or variables into specific groups where the group has the same characteristics. In this study, the business strategies are categorized into prospectors and defenders. Five independent variable measurement proxies will be classified to form groups using cluster analysis. Furthermore, hypothesis testing is done, consisting of a test of coefficient of determination and statistic test t with level of trust (α) used is 5% (0, 05).

4 RESULTS AND DISCUSSION

4.1 Group Testing

Company samples are grouped into two groups: prospector and defender. Based on research and development ratios, fixed asset intensity, EMP/sales, corporate growth and MARKET, the company grouping is carried out using multivariate analysis and cluster analysis. So, group analysis based on cluster analysis for all sample companies amounted to 66.

4.2 Hypothesis Testing

Based on table 1, the regression equation was obtained as follows:

$$Y = 0{,}551 + 0{,}018X_1 - 0{,}012X_2 + 0{,}088X_3 + 0,\ 0325130$$

It can be concluded that the company's business strategy has a positive and significant effect on the ETR book. SIZE has a negative and significant effect on the ETR book. ROA has positive but not significant effect on ETR book. It can be seen from the p-values of <0, 05 which explains a significant effect and if> 0, 05 is influential but not significant.

Table 1: Statistic t Test

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.551	.084		6.584	.000		
	STRATEGI	.018	.009	.243	2.058	.045	.990	1.010
	SIZE	-.012	.003	-.514	-4.064	.000	.863	1.159
	ROA	.088	.048	.230	1.825	.074	.871	1.149

a. Dependent Variable: BOOK

Source: data processed, 2016

Table 2: Coefficient Determination Test Results

Model Summary[b]			
Model	R	R Square	Adjusted R Square
1	.518[a]	.269	.227

Source: data processed, 2016

Based on table 2, obtained Adjusted R Square value of 0.227 (22.7%). This shows that business strategy variables, firm size, and asset returns can predict the dependent variable, i.e. a tax aggressiveness of 22.7%, while the remaining 77.3% is predicted by other variables not used in the research.

4.2 Discussion

4.2.1 The Influence of a Corporate Business Strategy on Tax Aggressiveness

One hypothesis in the research is the corporate business strategy influence on tax aggressiveness. The results show that individual business strategy variables have a significant effect. So, it can be concluded that the company's business strategy has an influence on tax aggressiveness and Hypothesis one, which states that the corporate business strategy affects the aggressiveness of the tax accepted. A regression coefficient of business strategy variable equal to 0,018 explains that if there is a change of strategy from defender to prospector, then the book value of ETR will experience an increase equal to 0,018 times and impact on the reduction of tax aggressiveness action. So, it can be concluded that the prospector has a negative effect on tax aggressiveness, and conversely, the defender has a positive influence on tax aggressiveness.

Firms that adopt defender strategies tend to have limited products and narrow markets, so they typically put more emphasis on efficiency and low costs. Achieving efficiency will be evident in the strict controlling of costs, such as research and development, so companies that adopt a defender strategy will try to offer products of high quality but lower prices than competitors to survive in the market. This does not rule out the possibility that the defender company may practice tax aggressiveness to lower the cost so that goods offered to the market will be relatively cheaper. The lower the ETR book owned by the defender strategy, the higher the aggressiveness practices of the company, resulting in the lower price of offered goods so that companies following the defender strategy can survive in the market. In contrast, firms that adopt the prospector strategy tend to operate in less stable business environments, seek new market opportunities and innovate products, and tend to have flexible control systems, providing a wider scope for informal communication. So, to be able to survive, the prospector company will continue to innovate rather than lower the price of goods offered to the market, resulting in a high ETR book and low tax aggressiveness.

The results indicate that there is influence of the corporate business strategy on tax aggressiveness. The results of this study are in line with Higgins et al. (2013) and Hsu et al. (2014) who explain that there is a correlation between the corporate business strategy on tax aggressiveness, and contrary to research by Novitaria and Santoso (2013) who explain that there is no relationship between business strategies and tax aggressiveness. Novitaria and Santoso (2013) used 2010–2011 data, moving in the manufacturing industry in Indonesia due to the population, using inconsistent strategies each year.

5 CONCLUSION

The results of this study prove that there is a relationship between business strategy and tax aggressiveness because companies tended to use a consistent strategy during the period 2013–2015 and business strategies to achieve higher profits using tax aggressiveness.

Based on the results of research and previous discussion, it is suggested that further research should be carried out to look for other control variables that can affect tax aggressiveness. Future research should comprise longer-term observations to oversee long-term results and adjust to current trends. Subsequent research may add other non-financial corporations to increase the number of samples for investigation.

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