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Does Tax Avoidance Matter in Sustainability Reporting-Financial Performance Relationship: Evidence From Indonesia?

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Abstract

Financial performance is a measure of the success of a company's operation. Optimum financial performance is said to be achieved when company operation successfully increases company turnover. Sustainability reporting uncovers the financial and non-financial aspects of this company's operations. This research aims to examine the effect of sustainability reporting on financial performance with tax avoidance as mediating variable. This research was conducted in 58 companies that led sustainability reporting in the 2014-2018 period. Data were analyzed with regression and causal step testing. This research has some results, which among others are: that sustainability reporting has a positive effect on corporate financial performance and that tax avoidance has a negative effect on corporate financial performance. It was also found that tax avoidance is not mediating variable for the effect of sustainability reporting on corporate financial performance.

Keywords: ***Financial Performance; Sustainability Reporting; Tax Avoidance***

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INTRODUCTION

The main reason why every company does business is to improve its financial performance. Whether corporate financial performance increases or decreases depends on the presence of a measurement mechanism. The measurement of corporate financial performance provides a yardstick to company management to determine whether company policy is right or wrong after considering financial and non-financial aspects. Company performance measurement enables company management to find out how far company performance is and helps the decision-maker plan the proper strategies to improve company performance. This action is consistent with what is required by the Decree of Financial Minister No. 740/KMK.00/1989 dated on 28 June 1989. Moreover, Kurniasih & Ratnasari (2013) said that several aspects need to be understood if the company wants to improve its performance. One of these aspects is the financial aspect, such as company profitability. The most frequently used measurer for profitability is the return on asset

(ROA), which refers to a company's capability to use its asset efficiently to produce a profit. Besides underlying its decision on the financial aspect, the company also takes into account social and environmental aspects that are presumed to bring short-term and long-term benefits for the company's wellbeing. For example, the manufacturing sector has once experienced a fluctuating change in its profitability. In 2015, it declined dramatically from 9.6% to 4.3%. Later, in 2016 and 2017, it went upward from 9.2% to 12% (Muqsitha, 2019). The different condition was found in the banking sector, where its profitability tends to go low. From 2013 to 2016, the banking sector's profitability declined periodically, especially when it is measured with ROA. In 2013, the banking sector's ROA went down from 0.7% to 0.2% in 2016, but in 2017, it successfully ascended to 1.39%. It seems that banking companies' asset productivity is improved and getting better in achieving profit (Ariansyah, 2019).

The next example is on State-Owned Enterprises. In a Working Paper released by Asian Development Bank (ADB) titled ‘The Impact of Government Support on the Performance of Indonesia’s State-Owned Enterprises,' publicized during August 2019, it was stated that government support to State-Owned Enterprises (SOE) did not have a significant impact on the financial performance of these enterprises. Government support has many forms, such as state capital participation, government infrastructure transfer to SOE, and government assistance to SOE. From 2010 to 2015, government support to SOE still failed to increase SOE's financial performance. Data presented by the Finance Minister in Budget Agency of People's Representative Council showed that State-Owned Enterprises' financial performance had not improved yet from 2014 to 2018. These enterprises' income moved up from IDR 1.997 trillion in 2014 to IDR 2.339 trillion in 2018. The net earnings of the enterprises decreased from IDR 154 trillion in 2014 to IDR 149 trillion in 2018. Cumulative assets grew from IDR 4,580 to IDR 8,092 in 2018. Unfortunately, those improvements were not reflecting SOE’s profitability because it went down from 3.4% to 1.4%, which signifies that the asset management of SOE is not yet optimized and incapable of attaining high profitability (www.ekonomi.bisnis.com).

Opinions on financial performance were given by Hastuti (2005) and Supriyati & Tjahjadi (2017). In general, their research found that some factors influence company performance and one of them is the disclosure of social and environmental aspects. The disclosure is done through Sustainability Reporting (SR), in which the company's values and advantages are communicated to stakeholders. Stakeholders can use the information contained in SR to measure profitability, company growth, and company stability. Moreover, stakeholders often use maximum profit as a yardstick in making a company policy (Lech, 2013; Adewale & Rahmon, 2014; Supriyati & Tjahjadi, 2017). Regarding sustainability reporting, it was mentioned by Natalia & Tarigan (2014) and Wijayanti (2017) that sustainability reporting is an indication of transparency, and this transparency helps the management to improve company image and stakeholder trust. High transparency level and good company image will produce loyalty that further can increase company income. Investors usually choose transparent companies for their investment, and transparency puts them putting great trust in management. The company management has made many efforts to increase company performance, either in financial or non-financial aspects. One strategy to improve financial performance is tax avoidance. For a company, tax always becomes a burden that can reduce net earnings. Optimization of non-taxable income and deductible expenses can minimize tax burden without forcing the company to

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violate tax provisions (Hardika, 2007; Zeng, 2016; Hudiwinarsih & Supriyati, 2018; Supriyati et al., 2019).

Nonfinancial aspect disclosure and tax avoidance are two strategies that the company can use to deal with a tax problem. These two strategies can be integrated with other processes to attain optimum financial performance. The point that the current research tries to emphasize is that tax avoidance is mediating the effect of sustainability reporting on financial performance. This position is less consistent with the results given by several previous types of research. For instance, researches conducted by Choi et al. (2010), Tahir & Razali (2011), Luthan et al. (2017), and Supriyati & Tjahjadi (2017) generally showed that Corporate Social Responsibility (CSR) has an effect on Corporate Financial Performance (CFP), with CFP proxied by Return on Asset (ROA). Different findings were given by Wijayanti et al. (2011), Yuparto et al. (2013), and Mantaputri (2016), which generally indicated that CSR did not have a significant effect on CFP, with CFP proxied by ROA. Regarding the relationship between CSR and tax avoidance, some researches, precisely those conducted by Lanis & Richardson (2012), Dharma & Noviari (2017), and Ningrum et al. (2018), generally found that CSR has a negative, but significant effect on tax avoidance. On the other hand, Watson (2015), Maharani et al. (2017), and Hoi et al. (2018) discovered that CSR did not have an effect on tax avoidance. Furthermore, the effect of tax avoidance on Corporate Financial Performance (CFP) was investigated by Eka & Muid (2017) and Chen (2017), and the results showed that tax avoidance has a negative effect on profitability. Different findings were imparted by Chen et al. (2016), Kristianto et al. (2017), and Hanny et al. (2019), which generally showed that tax avoidance has a positive effect on financial performance, with financial performance proxies by profitability.

It was Jensen & Meckling (1976) who said that in a company, conflict of interests always occurs between the company owner (*principal*) and manager (*agent*). The main reason behind this conflict of interests is a different goal that every position in the company must attain. The agent usually wants the principal to give a big bonus for their performance, while the principal desires big profit from their stockholding and requires the agent to give reports on the actual condition. Both principal and agent have different expectations or interests, which often contradict one another (Angelia & Dwimulyani, 2019). To keep the agent acting in compliance with the principal's desire, the principal pays a certain amount of cost to supervise the agent's activity, give bonus, salary, and compensation for an agent, and create a corporate control system. This cost is called *agency cost* (Wilopo, 2014; 229). Therefore, *the principal-agent relationship* is a good discourse to construct a company strategy to position the company in a progressive environment. Furthermore, Hadi (2011:48) said that legitimacy is important for company growth because legitimacy is one of the strategic factors that determine the company development in the future. According to O'Donovan (2000), legitimacy is something given by the community to the company, and something wanted or sought by the community. Legitimacy can support a company's well-being. Legitimacy theory explains that the disclosure of corporate social responsibility should be implemented properly to ensure that company performance is well responded to by the community. Positive responses will increase company profitability.

A company that investors desire is a company with good financial performance. The size of investment that investors are willing to put in is determined by profitability. In the context of this research, profitability is a measure used to understand the capability of a company in producing profit. Higher profitability is associated with more information that the manager will provide. It is expected that Sustainability Reporting will give proof that the company is not only orienting toward profit, but also caring about social and environmental issues. The company must give attention to the sustainability factor, because investors often associate sustainability with a good company image. Investors consider a good company image as assurance that the invested capital will give them a good return. Also, investment helps the company to develop salable products, which then has a good impact on corporate financial performance. The perspective of legitimacy theory underscores the importance of Sustainability Reporting. Legitimacy theory suggests the company convinces the community that both activity and performance of the company are acceptable. The company uses sustainability Reporting to describe its social and environmental responsibilities to make a company presence acceptable. There is a presumption that community acceptability to company presence can increase company value (Wibowo & Faridza, 2014). Regarding all explanations above, one hypothesis is proposed:

H1: Sustainability Reporting affects Corporate Financial Performance

Profitability is always the goal of why a company is founded. Company profitability should be growing and sustainable, and for this matter, the company is required to give attention to 3P (profit, people, and planet). Sustainability can be assured only if the company shows commitment to improving community welfare while performing its business practice. Indeed, the company must not seek profit only, but also care about the well being of the surrounding community. It has been said by Deegan et al. (2002) that the company does tax avoidance make tax burden become more efficient, which then enables the company to maximize net earnings, with sustainability as the end result. A company that discloses sustainability reporting is a company that performs legitimation theory to change community perception of the company and obtain legitimacy from the community. By conducting sustainability reporting, the company is considered not only to emphasize profit (earnings) but also to promote the interests of the community (people) and the environment (planet) where the company stands (Rokhlinasari, 2016). Taking all statements above into consideration, one hypothesis is made that is written as follows:

H2: Sustainability Reporting has an effect on Tax Avoidance.

Corporate financial performance can be analyzed through various methods. The most popular among these methods is by profitability analysis. This analysis attempts to describe the company performance review based on efficiency and effectiveness of company operations in achieving profit (earnings). Financial performance usually proceeds with Return on Asset (ROA), where ROA refers to a ratio of outcome to the asset (Kasmir, 2014:201). It is presumed that ROA can measure the capability of the company to produce profit in the past and then to project this capability in the future. Company manager always attempts to obtain high profit. But, high profit is often followed by a high tax burden, and the company reduces its tax burden with tax avoidance. This position is consistent with the finding given by Rahardjo et al. (2016), which showed that high ROA is always associated

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with high company profit. However, high profitability is maintained with tax avoidance. Desai & Dharmapala (2009) admitted that tax avoidance is a decision made by a company manager to save company finance, but it also risks leading the manager to become an opportunist that may harm company performance in the future. Based on what has explained above, a hypothesis are declared as follows:

H3: Tax Avoidance has an effect on Corporate Financial Performance

Sustainability report contains information about financial performance and non-financial information, which is usually information about social and environmental activities conducted by the company (Elkington, 1997). The company's social and environmental activities give an indication that the company cares about the interests of investors and the community. Disclosing these activities would improve the company image in the eyes of investors. A better company image would convince investors to invest in the company, which enhances the company's opportunity to maximize profit. In-law No.36/2008, Article 6 stated that the cost of sustainability reporting activity is covered by the company's gross income, which is therefore still not yet counting income tax. This Law seems to give companies a chance to intentionally report social and environmental activities to be intended as tax avoidance, which is done by marking up the cost of unplanned social and environmental activities. Such unprecedented cost will reduce gross income and then lessen the tax burden. A company that avoids its tax responsibility by increasing the estimated cost of social and environmental activities will later change the financial performance report's presentation. Better financial performance and good company image are always successful in persuading investors to invest in the company. But, tax avoidance forces the company to the risk of decreasing its profitability. One hypothesis are then proposed concerning this position, and this is described as follows:

H4: Tax Avoidance mediates the effect of Sustainability Reporting on Corporate Financial Performance

Taking into account theoretical bases and the results of previous researches, then the frame of thought of the current research can be illustrated as follows:

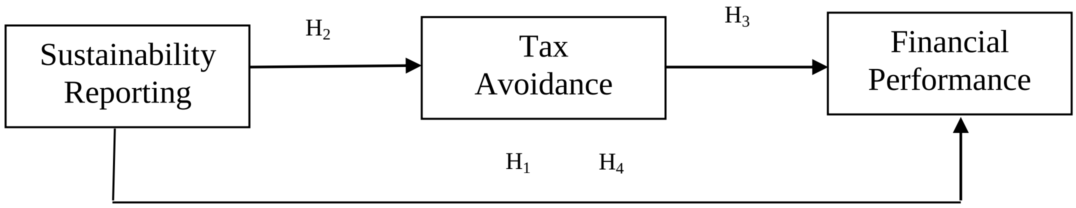

Figure 1. Basic Framework of the Research Model

RESEARCH METHOD

The research population is all companies listed on the Indonesia Stock Exchange, especially companies that have conducted sustainability reporting disclosure for the period 2014-2018. The total number of companies to be observed is 68. Data were obtained indirectly from the internet, including the annual reports publicized on Indonesia Stock

Exchange's website, www.idx.com, and the sustainability reports publicized on the website of each company. Three variables are examined, which respectively are: Corporate Financial Performance as the dependent variable, Sustainability Reporting as an independent variable, and Tax Avoidance as mediating variable. Corporate Financial Performance is a financial condition of a company after measuring its financial ratio. The popular measure of Corporate Financial Performance is Return on Asset (ROA), which is counted by dividing after-tax earnings with the total asset. Next, Sustainability Reporting (SR) is the effort to give information about financial performance and social and environmental aspects. Sustainability Reporting is measured by giving a score of 1 if there is a disclosure of social and environmental aspects and a score of 0 if there is no disclosure. After scoring all items, the scores are summed up to obtain the total number, which is then divided by 91 expected items. Tax avoidance is an effort to make payable tax becoming more efficient without violating tax provisions or tax regulations. Tax avoidance is measured using the Current Effective Tax Rate (CETR), which, according to Hanlon & Heitzman (2010), it is counted by dividing the tax with before-tax earnings. Regression test was conducted with a software called SPSS 24, which involves three phases, which respectively are: a) descriptive statistic test; b) classical assumption test, which consists of normality test, multicollinearity test, autocorrelation test, and heteroscedasticity test; and c) hypothesis test, which comprises of simultaneous significance test (F-test), model determination test (R^2), individual parameter significance test (t-test), and causal step testing.

$$CFP = \alpha + ß_1 SR + \varepsilon \quad (1)$$
$$TA = \alpha + ß_1 SR + \varepsilon \quad (2)$$
$$CFP = \alpha + ß_2 TA + \varepsilon \quad (3)$$
$$CFP = \alpha + ß_1 SR + ß_2 TA + \varepsilon \quad (4)$$

Where:
CFP = Corporate Financial Performance
TA = Tax Avoidance
SR = Sustainability Reporting

RESULTS AND DISCUSSION

A descriptive statistic is a description of something when it is understood from the values of mean, standard deviation, variance, maximum, and minimum. The total number of processed data is 139.

Table 1. Result of Descriptive Analysis

Variable	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*
SR	139	0.05494	1.0000	0.28223	0.16898
TA	139	0.00012	1.0000	0.24929	0.16813
FP	139	0.00135	0.1205	0.03632	0.02469

Source: data processed

The mean value of financial performance (FP) is 0.036 (4%), which signifies that, averagely, public companies (State-Owned Enterprises) that submit sustainability reporting (SR) have very low profitability. The mean value of these companies' after-tax earnings is

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IDR 163,936 trillion, while the mean value of their total asset is IDR 4,520,426 trillion. The finance & banking sectors dominated the data of the research sample. This sector's income is low due to some reasons, such as the decreasing income from consumer credit, the increasing number of defaulted credit, and the rising interest rate. The mean value of sustainability reporting (SR) is 0.282 (28%), which indicates that public companies can only disclose 28% of SR items or precisely disclosing 28 items of 91 items. One of the factors that cause low disclosure is that the finance & banking sector data are mostly not disclosing social and environmental aspects. Indeed, this sector does not directly impact society and the environment, or precisely that this sector does not perform activities that, for instance, emit greenhouse gases, contaminate water streams, or cause physical troubles to society and the environment. The mean value of tax avoidance (TA) is 0.249 (25%), which can be said that public companies have a low inclination to commit tax avoidance, and it is shown by low tax avoidance, which is 25 %. If the value of CETR approaches to 0 indicates tax avoidance, and if the value comes near 1, tax avoidance does not exist.

A classical assumption test has been conducted. It involves several tests, and the results are explained as follows: a) result of normality test shows that significant value is 0.055, which is above 0.05, and it signifies that error is normally distributed; b) result of multicollinearity test indicates that VIF value of the independent variable is above one and tolerance value is less than 1, which declares that there is no multicollinearity among independent variables in regression model; c) result of heteroscedasticity test reveals that significance value of an independent variable from regression operation is respectively 0.291 and 0.666, which indicates that regression model does not experience heteroscedasticity case; and d) result of autocorrelation test shows that the obtained values can be arranged as 1.6938< 1.7521 <2.024 or DL<do<DW, which therefore can be said that autocorrelation does not occur in the regression model.

A hypothesis test has also been carried out. The results of the test are described in the following table.

Table 2. Results of a hypothesis test

Model	ß	Sign
Test on Direct Effect:		
SR on CFP	0.064	0.000
Test on Mediation Effect:		
SR on TA	0.200	0.520
SR on CFP	0.066	0.520
TA on CFP	-0.006	0.025

Source: data processed

Based on the contents of Table 2 above, it can be said that 1) sustainability reporting has a positive effect on corporate financial performance; 2) sustainability reporting has a positive effect on tax avoidance; and 3) tax avoidance has a negative effect on corporate financial performance. The direct effect (C) of sustainability reporting on corporate financial performance has been tested, and the result shows a significant result. Causal step testing (CA) was implemented on the direct effect relationship by entering tax avoidance, and the result indicates that the direct effect is still significant. It signifies that tax avoidance is incapable of mediating the effect of sustainability reporting on corporate financial performance. The results of the hypothesis test and causal step testing are shown in Table 3.

Table 3. Hypothesis Test and Causal Step Testing

Hypothesis	F-test	ß	Sig.	R^2	Description
SR on CFP	0.000	0.064	0.000	0.187	Influencing
SR on TA	0.469	0.200	0.520	-0.004	Not influencing
TA on CFP	0.000	-0.006	0.025	0.191	Influencing
SR and TA on CFP	0.000	0.066	0.000	0.191	Influencing

Source: data processed

As indicated by the table above, the result of the determination coefficient test (R^2) reveals that the independent variable can explain the dependent variable for 19.1%, while the remaining 88.9% are explained by an error that is beyond the research model. The result of the F-test shows that the significance value is 0.000 with an alpha rate of 0.05. It signifies that the research model is considered fit (reliable). The result of the t-test indicates that sustainability reporting has an effect on corporate financial performance, and after involving tax avoidance as a mediating variable, the direct effect relationship is still significant, which is proved by a significance level of 0.000. Another hypothesis test results show that sustainability reporting does not influence tax avoidance, and tax avoidance has a negative effect on corporate financial performance.

The first hypothesis states that Sustainability Reporting has an effect on Corporate Financial Performance. Regarding the result of a hypothesis test, the first hypothesis are accepted because the effect of sustainability reporting on corporate financial performance is significant. Corporate financial performance is measured using Return on Asset (ROA). When a company discloses sustainability reporting more frequently, than the financial performance of the company is increasing. Good financial performance can convince investors to put their investment in the company. The relationship between investors and company managers is maintained by using sustainability reporting as an instrument to promote the company to investors. Moreover, sustainability reporting is also proof that the company is oriented toward profit and caring about social and environmental issues surrounding the company. Sustainability becomes an important matter because a sustainable company is considered as a company with a good image. It is assumed that a company with a good image is the company that investors want to support. If the number of investors who support the company is increasing, then company profitability will improve. High profitability is the indication that the company has a good financial performance. This position corresponds to legitimacy theory. Any company gets its legitimacy either from the community and investors. A company uses sustainability reporting to promote its presence to investors and show its responsibility to the company's social and environmental issues. It is expected that sustainability reporting makes the company acceptable to the community. Being accepted by the community and receiving trust from investors are two conditions that enable the company to improve its profitability. This position is aligned with the findings given by Rahardjo et al. (2019), Luthan et al. (2013), and Choi et al. (2016)

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The second hypothesis is that Sustainability Reporting has an effect on Tax Avoidance. Based on the hypothesis test result, the second hypothesis is partially supported because it is found that the effect of sustainability reporting on tax avoidance is not significant. It signifies that sustainability reporting cannot explain whether the company is committing tax avoidance or not. A company is always required to be responsible for its activities. A company that discloses sustainability reporting is supposed to have spent some costs for implementing its social and environmental activities. These costs are required by Article 6 in Law No.36/2008. Surely, these costs will cut down before-tax earnings. Surprisingly, the declining profitability of the company will decrease the payable tax burden. There is a supposition that the company is intentionally increasing the costs of its social and environmental activities in order to avoid tax. The company needs a company that discloses sustainability reporting surely desires legitimacy of the government, investors, creditors, consumers, and also the community, and this legitimacy to survive. Once again, it supports legitimacy theory, especially in relation to community support. The company is considered acceptable by the community if the company is willing to disclose its social and environmental activities. However, any effort intended for tax avoidance can risk losing trust from the community. In this context, sustainability reporting does not influence tax avoidance because it realizes that disclosing sustainability reporting is important for the company's wellbeing, not merely for tax avoidance. This finding is in line with the results of previous researches such as Maharani (2017), Leonita & Kusbandiyah (2017), and Lanis & Richardson (2012)

The third hypothesis declare that Tax Avoidance has an effect on Corporate Financial Performance. By virtue of the result of a hypothesis test, the third hypothesis is rejected because the effect of tax avoidance on corporate financial performance is negative. Tax avoidance is measured by the Current Effective Tax Rate (CETR). If CETR is low, there is an indication that the company is committing tax avoidance. Ironically, tax avoidance helps the company not only to achieve profit, but also to obtain high financial performance. On average, companies in the research sample have low tax rates, and therefore, there is the assumption that these companies are conducting tax avoidance. It can be said that corporate financial performance is high when the company is strongly inclined to commit tax avoidance. In other words, the company gets high profit only when the tax rate that the company must pay is low. Conversely, if CETR is high, then the company will have a low Return On Asset (ROA). This situation indicates that the company does not do tax avoidance. This position supports an agency theory. Moreover, tax avoidance can lead the manager to become an opportunist because the manager can believe that tax avoidance has a good impact on the future financial performance. Anyhow, investors consider financial performance as the main priority before they make an investment, at least because investors want the company to keep producing profit. However, achieving high profit requires the company to commit tax avoidance to minimize its tax burden. The strong inclination toward tax avoidance is associated with a lower tax burden and higher profitability. Later, high profit gives an impression of good financial performance. This position conforms to the findings delivered by Eka & Muid (2017) and Cheryl, Laurel Dan & Meita (2009),

The fourth hypothesis asserts that Tax Avoidance mediates the effect of Sustainability Reporting on Corporate Financial Performance. The hypothesis test result shows that tax avoidance is incapable of mediating the effect of sustainability reporting on corporate financial performance, and therefore, the fourth hypothesis is not supported. It is found that sustainability reporting can directly influence corporate financial performance without the mediation of tax avoidance. Disclosing sustainability reporting more frequently does not indicate that the company commits tax avoidance. By disclosing sustainability reporting, the company wants to get legitimacy from the community, government, and investors, and this legitimacy will help the company to produce a good corporate image. So far, it can be said that sustainability reporting does not influence tax avoidance, but corporate financial performance is affected by tax avoidance. A company that pays lower tax tends to have higher financial performance because the company always wants to get high profits to maintain its performance. The company does tax avoidance to ensure that the company will get a high profit.

CONCLUSION

This research aims to obtain empirical evidence regarding the effect of sustainability reporting, as an independent variable, on corporate financial performance, as the dependent variable, using tax avoidance, as mediation variable, in the companies listed on the Indonesia Stock Exchange on period 2014-2018. The sample of companies has produced 139 sample data. The results of this research show that: 1) sustainability reporting has a positive effect on corporate financial performance; 2) the effect of sustainability reporting on tax avoidance is not significant; 3) tax avoidance has a negative effect on corporate financial performance; and 4) tax avoidance is incapable of acting as mediator variable to the effect of sustainability reporting on corporate financial performance.

Although the results of the research have been already clear, this research has two limits, which respectively are: 1) that number of companies that did not disclose sustainability reporting in the research period is too many, and it may eliminate some data of research variables. This situation greatly influences the number of data that must be used in statistical tests; and 2) that this research has conducted normality tests twice, which eliminates 53 company data because these data have unique characteristics that can disturb the research process. By taking into account these limits, two suggestions are given by this research, which respectively is: 1) that further research must include companies other than those listed on the Indonesia Stock Exchange, but the criterion is the same, which is, disclosing sustainability reporting. Adding such companies to the research population can increase the number of data regarding sustainability reporting, and 2) that the next research should use proxy other than Return on Asset (ROA) for measuring corporate financial performance, and the suggested alternative is Return on Equity (ROE) because it can measure the value of company almost in all sectors.

In relation to the results of research, this research has some implications, which are explained as follows: 1) For academicians, it is expected that this research will give them insight into corporate financial performance, especially when Return on Asset (ROA) is used as a proxy for corporate financial performance. At least, this research helps academicians know how a company commits tax avoidance using sustainability reporting for corporate financial performance; 2) For companies, this research should deepen their discipline awareness to pay tax and present dependable and non-deviant financial statements. Such awareness is needed to maintain the trust and satisfaction of external parties in the company and its wellbeing; and 3) For government and tax regulator, this

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research can be used as consideration material in order to produce better policy regarding taxation and also to guide them in solving a tax problem that is recently becoming a trend in Indonesia, namely tax avoidance.

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