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by Meita O

The Effect Of Profitability, Tax Avoidance And Information Transparency On Firm Value: An Empirical Study In Indonesia

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Abstract: This study aims to analyze the effect of profitability, tax avoidance and information transparency on firm value. This study is based on data of manufacturing firms listed on the Indonesia Stock Exchange from 2016 to 2018. There are 213 firms selected as samples and analyzed using moderated regression analysis. The results prove that profitability and tax avoidance partially have a significant effect on firm value. Contrary to the expectation, information transparency does not strengthen the relationship between tax avoidance and firm value.

Index Terms: Profitability, tax avoidance, information transparency, firm value.

1. INTRODUCTION

The development of information technology provides opportunities for firms to develop their business by creating innovative products and services. Innovations and business strategies are carried out solely so that the firm can avoid bankruptcy. Competition between firms is certainly not a secret anymore. The competition needs to be balanced with critical thinking and optimal use of firm resources so that the firm has competitiveness with other firms. Every firm has a goal to be achieved such as obtaining maximum profits, where the benefits generated reflect the value of the firm (Lie & Lie, 2002). Stock price statements are inseparable from the financial statements presented by the firm. Financial statements in accounting are said to be relevant if they contain useful information for managers or other users in decision making. In the capital market, stock prices reflect all relevant information where the market will react when there is new information. In Indonesia, go public firms are obliged to submit annual financial reports to the Indonesia Stock Exchange, investors, and public every year. The information is expected to always respond to the state of the firm by updating information in the financial statements (Mindra & Erawati, 2014; Suryana & Rahayu, 2018). Many factors can affect firm value, including profitability. Profitability describes the firm's ability to benefit in a certain period (Ararat, Black, & Yurtoglu, 2017). Mindra & Erawati (2014); Rudangga & Sudiarta 92016) state that profitability has a significant effect on firm value. While Ambarsari & Sidiq (2013) note different results. In addition to profitability, tax avoidance is also used as one of the factors that affect firm value. Research conducted by Chen, Hu, Wang, & Tang (2014); Kurniawan & Syafruddin (2017) state that tax avoidance has a significant effect on firm value. While Partha & Noviari (2016); Ararat et al., (2017) prove the opposite findings. Delivering complete information about the firm can attract investors. Firms need information transparency. Information transparency is defined as information disclosure to the public (Bushman & Smith, 2005). Partha & Noviari (2016); Kurniawan & Syafruddin (2017) state that information transparency can strengthen the effect of tax avoidance on firm value.

2 Literature Review and Hypotheses Development

Agency theory explains the relationship between firm owners (principal) and managers (agents). Agency conflict is a conflict that arises between owners, employees and firm managers where there is a tendency for managers to prioritize individual goals rather than firm goals. Conflicts of interest can occur because there are differences in interests between firm owners and managers so that there can be an imbalance of information that managers have more information about the firm compared to firm owners.
Firm value is a certain condition that has been achieved by a firm as an illustration of public trust in the firm after going through a process of activities for several years, i.e., since the firm was founded until now. In firms that have gone public, the value of the firm is determined by the price of shares traded. The increasing value of the firm achieves following the wishes of the owners (Lie & Lie, 2002; Rudangga & Sudiarta, 2016). Profitability is the firm's ability to generate profits. Firms that have high profitability indicate if the firm is managing wealth effectively and efficiently in making profits every period. The greater the profitability of the firm, the higher the value of the firm and make investors dare to invest in the firm. High profitability shows the firm's ability to generate profits in the future (Ararat et al., 2017). Tax avoidance is an effort to avoid tax by illegal means because it tends to exploit the weaknesses of the regulations. Tax avoidance behavior is limited to reducing explicit taxes and reflecting all transactions that affect the firm's explicit tax debt (Chen et al., 2014). Information transparency is the availability of information that is widely circulated and can be trusted on the firm's performance in a certain period, financial position, investment opportunities, government, values , and risks of the general firm (Bushman & Smith, 2005).

2.1 Profitability and Firm Value

Profitability is the firm's ability to generate profits that come from net results. By seeing high firm profits, this creates added value regarding good performance and creates positive responses from investors and increases the firm's stock price.

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The firm gets profits from product sales and investments made. Firms that have high profitability show that the firm can manage the firm's wealth effectively and efficiently in making profits every year. The greater the profitability will make the value of the firm higher and make investors dare to invest in the firm (Ararat et al., 2017; Rudangga & Sudiarta, 2016; Bushman & Smith, 2005) (Chabachib, Fitriana, Hersugondo, Pamungkas, & Udin, 2019; Hersugondo, Pertiwi, & Udin, 2019; Hersugondo & Udin, 2019; Khajar, Hersugondo, & Udin, 2018; Wahyudi, Silfani Permata Sari, Hersugondo, & Udin, 2019). Thus,
H1: Profitability significantly affects firm value

2.2 Tax Avoidance and Firm Value

Tax avoidance behavior by managers by reducing firm taxes and taking advantage of deficiencies contained in tax laws and regulations can reduce the amount of tax owed. The firm has a reason to practice tax avoidance, which is to reduce the amount of profit by not recognizing current income but being recognized in the future. Because of the higher, the firm's profits reported, the higher the tax burden. The tax avoidance behavior can lead to agency conflict between the interests of managers and the interests of investors. Tax avoidance can increase the manager's opportunistic behavior, by recognizing personal costs into the firm's operational costs to reduce the profits earned by investors. Tax avoidance behavior that reduces the content of the information provided can influence investors in making investment decisions. Firms in Indonesia are still doing tax avoidance because tax avoidance is considered to have more advantages than seeing it as a risk that can be borne in the future. The use of tax avoidance is not the only determinant of investor decisions on the value of the firm, but other factors shape investors' decisions in investing (Kurniawan & Syafruddin, 2017; Chen et al., 2014; Frank, Lynch, & Rego, 2009). Therefore,
H2: Tax avoidance significantly affects firm value

2.3 Information Transparency, Tax Avoidance, and Firm Value

Information transparency is information disclosure, both in the decision-making process and in disclosing material and relevant information about the firm (Partha & Noviari, 2016). Transparency of information provides openness in disclosing firm financial statements to the public, where the information is accurate and timely enough to be easily accepted by interested parties (Hanlon & Slemrod, 2009; Chen et al., 2014). The firm provides information on the firm's financial statements in the form of publishing it so that it is easily accessed through the official website so that investors can see the condition of the firm. This will reduce conflicts of interest between investors and managers because managers use the transparency of financial statement information as an act of preventing the decline in the value of the firm. If the firm increases the transparency of financial statement information, investors assume that the firm can be trusted because it has revealed most of the information so that investors are expected to provide positive value for firms that practice tax avoidance. Thus,
H3: Information transparency strengthens the relationship between tax avoidance and firm value

3 METHODOLOGY

The object of this study is manufacturing firms listed on the Indonesia Stock Exchange from 2016 to 2018. The selection of the objects indicates that the firms have interrelated production activities to attract investors. The samples are chosen based on the following criteria: a) manufacturing firms listed on the Indonesia Stock Exchange in 2016-2018; b) manufacturing firms that generate positive profits during the period 2016-2018; and c) have complete data following the research variables. Firm value is measured using Tobin's Q analysis. Profitability is measured using return on equity proxy. Tax avoidance is measured using an effective tax rate (ETR) proxy. Information transparency is measured using voluntary disclosure index applied in Indonesia. Data analysis of this study uses Moderated Regression Analysis with the following formulation:

$$\text{Tobin's Q} = a+\beta_1.ROE+ \beta_2.ETR + \beta_3.ETR*TP+ e$$

4 RESULTS AND DISCUSSION

There are 213 firms used in the study during the 3-year observation period (2016 – 2018).

Table 1. *Model Test Results*

Adjusted R^2	F-test
0,73	0,00

Table 2. *Hypotheses Testing*

Variables	β	t	Sig.
Constant	0,199	4,122	0,000
Profitability	7,253	30,573	0,000
Tax avoidance	0,492	1,569	0,018
Interaction between ETR* TP	-0,759	-1,523	0,129

Table 1 explains that the variables used in the study only had an effect of 73% and the remaining 27% were strongly influenced by other variables outside the model. The next model is declared feasible with a significance level of 0,000. Table 2 explains that profitability has a positive and significant effect on firm value. This is indicated by the coefficient value β = 7,253 with a significance level of 0,000. Tax avoidance also has a positive and significant effect on firm value. This is indicated by the coefficient value β = 0,492 with a significance level of 0,018 < 0,05. Information transparency does not strengthen the relationship between tax avoidance and firm value, where the significance value is 0.129 and the direction of the coefficient β (-0,759) is negative. Based on H1 testing, this shows that profitability has a positive and significant effect on firm value. In agency theory, Return on Equity (ROE) is used to measure how much net income will be generated from each fund embedded in total equity. This capability shows the state of a firm that generates profit after tax using its capital. This ratio is important for shareholders, namely to know the effectiveness and efficiency of their capital management carried out by firm management. Firms with positive profitability show good firm performance in generating profits from product sales or investments made by the firm. The success of the firm in increasing profits in the firm can affect the assessment of investors to invest their capital and give full trust in the firm. The results of this study are in line with the findings of Ararat et al., (2017), Rudangga & Sudiarta (2016), (Bushman & Smith, 2005) that profitability has a positive effect on firm value. The greater the profitability will make the firm's value higher so that it can affect the stock price. The more investors who buy firm shares will influence the increase in the firm's stock price so that it will increase the value of the firm. The results of H2 testing also indicate that tax avoidance has a positive and significant effect on firm value. The tax avoidance behavior carried out by managers aim to increase the firm's profits and reduce the burden incurred. However, although tax avoidance is considered more profitable for firms, tax avoidance is referred to as an ethical action against tax regulations. In tax regulations, this will add to costs in the future such as costs incurred due to the risk of tax audits. In agency theory where the shareholders (principal) give responsibility to the manager (agent) to manage the firm when the manager can minimize expenses for tax purposes, it means the less-burden will be incurred by the firm. Tax avoidance behavior is different from tax evasion. Tax evasion is a real action against tax regulations that is by breaking existing tax regulations, not reporting transactions or recording false transactions so that the tax paid becomes smaller. Whereas what is meant by tax avoidance is conducting transactions that are not prohibited by tax regulations, utilizing tax regulations that provide facilities so that taxes can be deducted, choosing business activities with low tax rates and exploiting weaknesses that exist in tax regulations. The results of this study are in line with the findings of Kurniawan & Syafruddin (2017), Chen et al., (2014), Frank, Lynch, & Rego (2009). The H3 test result shows that information transparency weakens the relationship between tax avoidance and firm value. If a firm does too much information transparency, it will be difficult for firms to manipulate the profits generated and will add tax costs in the future as costs arising from the risk of tax audits. This causes the profits derived by the firm to decrease, resulting in a lack of investor interest in the firm which results in a decrease in the value of the firm. Agency theory explains that to reduce the impact of a conflict of interest (agency problem) between owners and management in knowing financial information contained in the firm, more transparent information disclosure can be used. This is done so that transparency of information can reduce managers' opportunist attitudes in carrying out tax avoidance policies to reduce the risk of detection of tax avoidance on firm value. The results of this study are not consistent with the findings of Partha & Noviari (2016); Kurniawan & Syafruddin (2017) that information transparency can strengthen the effect of tax avoidance on firm value.

5 CONCLUSION

The results of this study conclude that profitability and tax avoidance partially have a significant effect on firm value. Contrary to the expectation, information transparency does not strengthen the relationship between tax avoidance and firm value. The limitation of this study is that the observation time was only done for 3 years, so the results obtained were not perfect. The results of this study cannot yet be generalized. Therefore, future studies need to add samples by extending the year of observation.

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