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The effect of business strategy and financial distress on tax avoidance in consumer non-cyclical companies

Laili Vita Cahyaningrum, Indriyana Puspitosari
Universitas Islam Negeri Raden Mas Said Surakarta
*Corresponding author: lailivita14@gmail.com, indriyana.puspitosari@staff.uinsaid.ac.id

Abstract

This study was conducted to determine the effect between business strategy and financial distress on tax avoidance. This study uses consumer non-cyclicals sector companies as the population and uses quantitative methods with a sample of 66 observations consisting of 21 consumer non-cyclicals companies listed on the Indonesia Stock Exchange for the period 2018-2022. This study uses multiple linear regression data analysis techniques. The results of this study indicate that companies with financial distress conditions have a positive effect on tax avoidance. While companies with prospector and defender business strategies have no effect on tax avoidance. the results of this study indicate that the company's financial condition has more influence on corporate tax policy than business strategy.

Keywords: Tax avoidance, Business strategy, financial distress, prospektor, defender

INTRODUCTION

Implementing taxes is not an easy thing to do. Companies consider that taxes are a big burden for the company. Meanwhile, from the government's perspective, tax is a source of revenue that can increase the country's income (Masri & Martani, 2012).

(Putri & Chariri, 2017) stated that tax avoidance is associated with tax planning. Tax planning is a way for taxpayers to minimize their tax debt, if income tax or other tax expenses are owed. By doing tax avoidance or tax avoidance can cause future tax impacts, namely by way of tax sanctions. If the company is known to avoid its taxes, and does not report some sales or expand costs by false means, because the company will be penalized for its taxes (Dewi et al., 2020).

Tax Justice Network reported evidence of tax evasion by the company. On May 8, 2019, a case was reported where the tobacco company British American Tobacco (BAT) committed tax evasion in Indonesia through PT Bentoel Internasional Investama Tbk, affecting the state, at a loss of US$14 million per year. BAT transferred some of its revenue out of Indonesia through intra-company loans between 2013-2015. BAT provided loans from jersey through a company in the Netherlands (Rothmans Far East BV) to avoid withholding tax on interest payments, the loans amounted to IDR 5.3 trillion (US$ 434 million) in August 2013 and IDR 6.7 trillion (US$ 549 million) in 2015.

Non-cyclical consumer companies are companies that produce services and products that are primary in nature. So that consumer non cyclicals companies have many enthusiasts. Consumer non cyclicals companies are also primary consumer companies where all people must need these products for their daily needs. According to (Utami, 2020) the consumer non cyclicals sector has a defensive nature and is able to survive during economic crisis conditions. (Surtiningsih & Wijaksana, 2015) also stated that non consumer non cyclicals companies have good opportunities in the future where these companies will not be affected by bad economic conditions.

There are several factors that influence tax avoidance, including financial distress which is considered to be able to avoid taxes. When a company experiences financial difficulties, tax avoidance strategies that were previously considered risky and require more costs will be taken into account and opportunities for companies due to the existence of profits that are considered higher (Rahmana, 2022). Research carried out by (Sadjiarto et al., 2020), (Hermawan & Aryati, 2022) has results that state that financial distress has a significant effect on tax avoidance. While (Monika & Noviari, 2021) , (Fauzan et al., 2021) states that financial distress has no significant effect on tax avoidance.

Consumer non-cyclicals companies have several financial problems that have an impact on business strategy. Which when the company is experiencing financial difficulties or financial distress can influence company managers in an effort to change financial reports to benefit the company. This can also cause information to be conveyed to those who use it (Chen et al., 2014). Therefore, the company will launch more tax avoidance regardless of all the risks experienced by the company (Dhamara dan Violita, 2017). Before starting a business, companies need a business strategy that is usually made by managers, which affects all company activities (Arieftiara, Utama, Wardhani, & Rahayu, 2015). There are two types of business strategies, namely prospectors who are concerned with productmarket innovation. And defenders who emphasize cost control and efficiency (Faradiza, 2019). For tax avoidance actions taken by companies, the defender business strategy has the same goal, namely profit. Profitability in the defender business strategy is done by minimizing production costs, operating costs and tax costs arising from company profits. (Rheny et al., 2022).

This research only uses 2 business strategies, namely perspectors and defenders because previous researchers stated that the analyzers type has two types of characteristics and this reactor is considered non-strategic (Martinez & Ferreira, 2019). Research by (Sadjiarto A et al., 2020), (Faradiza S, 2019) stated that business strategy prospectors have a positive influence on tax avoidance, and business strategy defenders have a negative influence on tax avoidance. While (Martinez & Ferreira, 2019) in his research has different results, depending on the measurement of tax avoidance. Business strategy defenders are more likely to practice tax avoidance when tax avoidance is measured by VATR. and the results are different on the measurement of tax avoidance using Cash-ETR, where the business strategy of both defender and prospector is not significant.

LITERATUR REVIEW

LITERATURE REVIEW AND HYPHOTESIS DEVELOPMENT

Literature Review

Agency theory is the difference in duties between principles, namely investors, and agents who have different duties Jensen meckling (Haryaningsih, 2019). The link between agency theory and tax avoidance is the manager's decision to the Company by doing things that can cause problems so that it does not only harm one party (Khoiriyah, 2018). This is done so that managers can act according to company regulations. The relationship between agency theory and tax avoidance is that poor corporate governance can lead to conflicts or agency problems that harm many parties (Khoiriyah, 2018).

Pohan (2018) stated that tax avoidance is an attempt by taxpayers to reduce or eliminate the amount of tax payable by using gray areas in tax laws and regulations. The action does not violate the current tax regulations and is legally valid. measurement of tax avoidance using cash ETR is considered more capable of explaining tax avoidance (Drake et al., 2020). Cash ETR is also able to describe large temporary differences that have implications for earnings persistence, so that it can describe tax avoidance.(Zhou, 2016). The advantage of measurement using Cash-ETR is that it focuses more on the output cash flow of the company to pay income tax and has a tax avoidance strategy that is not affected by changes in tax accounting accruals (Tang, 2020). Therefore, Cash-ETR uses tax payments with a certain year to assess a company in paying its taxes (Heitzman, 2020). (Dyreng et al., 2008) in his research states that Cash-ETR is the best measurement for short-term tax avoidance. The measurement of tax avoidance using income tax expense is considered insufficient to show corporate tax aggressiveness because the income tax expense in a tax year does not indicate the amount of tax payments in that year (Carolina & Oktavianti, 2021). Therefore, CASH-ETR uses tax payments in a particular year to assess how much the company pays to pay taxes. Because in principle, tax aggressiveness aims to reduce the amount of corporate tax payments. The greater the company's tax payments, the less tax avoidance it is..

Financial distress is a condition where the company experiences conditions whose obligations cannot be resolved or when the company's cash flow cannot pay its financial obligations (Cita & Supadmi, 2019). Financial distress is a situation where the company is experiencing financial difficulties and when paying its obligations the company is unable to pay.

Identifying the types of business strategies is critical to understanding the type and timing of strategic decisions made in order for a firm to remain competitive. Business strategies consist of a variety of activities designed to create a position in a given situation. As summarized by (Gimenez, 2000), business strategy according to Miles and Snow concentrates on three fundamental ideas: the construction of the business environment is formed through organizational planning actions, organizational procedures are formed to what extent the firm's administration chooses strategy, and organizational processes and strategy structure conditions. Research on business strategy mostly analyzes prospector and defender types. In (Higgins et al., 2015) study, Analyzers firms were not considered because, as mentioned above, they have the characteristics of both Prospectors and defenders. Reactor firms were also not considered, as they do not have the characteristics of strategic. These three types can be measured by four proxies as done by (Ayem & Tarang, 2021). The four proxies are:

1. *Ratio of Employees to Sales (EMP/SALES)*
2. *Market to Book Ratio*
3. *Ratio of Advertising Expense to Total Sales (MARKET)*
4. *Ratio of Fixed Asset Intensity (PPEINT)*

The measurement of business strategy is different from the previous measurement which used 6 ratios. Measurement of business strategy with this ratio does not use the R&D ratio because in the financial statements, very few companies disclose R&D costs. proxies in its measurement. For the first three proxies (EMP/SALES, MtoB, and Market), sample companies in the top quintile score 5, sample companies in the bottom quintile score 4, and so on. The score for PPEINT is the reverse of the first three proxies. For the sample companies in the top quintile score 1, those in the bottom quintile score 2, and so on. below them get a score of 2, and so on. The score for each sample company are summed over all proxies that have been given a score. The maximum score is 20 (prospector) and the minimum score is 4 (defender).

Hypothesis Development

Agency theory explains that companies facing financial distress will encourage them to engage in tax avoidance. (Cita & Supadmi, 2019). If the company experiences financial difficulties or financial ditress, this will encourage managers to improve the state of the company and this is indicated by maintaining the state of the company again, allowing managers to apply tax avoidance. Therefore, the researcher proposes a hypothesis:

H1: financial distress has a positive impact on tax avoidance

According to agency theory, agency costs are defined as a business strategy that can incur costs. (Wardani & Khoiriyah, 2018). The defender strategy, which is characterized by closing down part of the market entirely to create a stable market sector, makes it more likely not to engage in aggressive tax avoidance, whereas prospectors focus more on innovation to create new products and markets, thus prospectors do not think about minimizing costs and are more aggressive in tax avoidance (Faradiza, 2019). Therefore, the researcher proposes a hypothesis:

H2: Companies with a prospector strategy have a positive effect on tax avoidance.

H3: Companies with a defender strategy have a negative effect on tax avoidance

RESEARCH METHODS

Unit Analysis

This research uses quantitative research using a descriptive approach. The purpose of this study was to determine the effect of business strategy and financial distress on tax avoidance. The object of this research is a consumer non-cyclicals company listed on the IDX, with variables financial distress (ZSCORE), business strategy Prospector (PROS), Business Strategy Defender (DEF) and tax avoidance (Cash-ETR). In addition, this study uses the control variables of company size (SIZE), profitability (ROA) and leverage (LEV). The population used in this study includes 122 consumer non-cyclicals companies listed on the Indonesia Stock Exchange (IDX) for the period 2018-2022. To determine the research sample, determine purposive sampling using criteria based on predetermined settings. The resulting sample was 27 companies with a period of 5 years so that the number of observations was 135 companies. However, the companies detected by the analyzer strategy in outliers were 69 so that the number of observations in this study was 66 companies.

Tabel 1. Measurement Variables

CODE	Description	Formula
Cash-ETR	Effective rate of tax payments	$\text{CASH} - \text{ETR} = \frac{\text{taxes paid during the fiscal year}}{\text{Pre tax Income}}$
Zscore	Financial Distress	Altman Z-score : Z = 1,2A + 1,4B + 3,3C + 0,6D + 0,99E A = working capital divided by total assets B = retained earnings divided by total assets C = income before interest and tax expense divided by total assets D = market value equity divided by book value of total debt E = sales divided by total assets (Arja Sadjiarto, 2020)
PROSP	Prospectors	Company with business trategy Prospectors
EFEN	Defender	Company with business strategy Defender
SIZE	Firm size	Natural Logaritm of company total asset
LEV	Leverage	Debt to asset ratio
ROA	Return on Asset	Pretax income divided by total asset (Khoiriyah, 2018) dan (Ayem & Tarang, 2021)

Source: Data processed

RESULT AND DISCUSSION

The average value of Cash-ETR is 0.222817 when compared to the effective tax rate in Indonesia, which is at 25% and 22%, the amount of tax avoidance for this non-cyclical consumer company is not too aggressive.

The financial distress variable has mean of 4.16. with this average value companies that have a Z-score> 2.99 are classified as companies in the safe zone. In the Altman Z-score model, companies that have a Z-score > 2.99 are classified as healthy companies, while companies that have a Z-score < 1.81 are classified as potential bankrupt companies. Furthermore, scores between 1.81 and 2.99 are classified as companies in the gray area. A higher Altman Z-score indicates that a company is in a better financial position and has a lower probability of going bankrupt in the near future. From 135 observations, 61 observations had a business analyzer strategy so they were not included in the data processing. The sample business strategy in this study consists of 14 companies with a defender business strategy and 60 companies with a prospector business strategy.

Tabel 2. Descriptive statistics

	Minimum	Maximum	Mean	Std. Deviation
CASH-ETR	.02595	.42428	.2228117	.08050553
ZSCORE	1.30236	8.34795	4.1603884	1.85712402
SIZE	27.33972	32.72561	29.4824298	1.47129324
ROA	.02393	.36938	.1194184	.06692933
LEV	.10563	.78210	.3951967	.19552736

Source: Data processed

It can be seen that most of the non-cyclical consumer companies are in the Analyzer business strategy. Defender is the business strategy of the smallest number of companies. So we can conclude that non-cyclical concumer companies in Indonesia do not have strategic characteristics and can mostly be classified as analyzers, or in other words, they wait for events to happen and observe what prospector and defender companies are doing in the market before making decisions. Commercial companies tend to use very bold management strategies to attract customers.

Tabel 3. Variable Feasibility Test

Variables	Hypothesis	Coefficient	Sig	Conclusion
PROSP	+	-0.015	0.806	Hypothesis not supported
DEFEN	-	0.009	0.870	Hypothesis not supported
ZSCORE	+	0.017**	0.042	Hypothesis supported
SIZE		0.018**	0.017	
ROA		-0.431**	0.011	
LEV		-0.052	0.438	
Adj R Square	0.155			
F-statistics	2.982			

*Significance level of 1 per cent (99% confidence); **Significance Level of 5 per cent (95% confidence); ***Significance Level of 10 per cent (90% confidence)

Source: Data processed

The results of data processing for PROSP and DEFEN variables do not support the research hypothesis. For the PROSP and DEFEN variables the results show that both have no significant effect. Z-score shows a positive coefficient on cash ETR. In other words, financial distress increase the practice of corporate tax avoidance, which means that the results of this study support the research hypothesis..

Some of the control variables in this study show a significant effect on the amount of tax paid. only LEV does not show significant results. SIZE has a significant positive effect at the 95% level on Cash-ETR, while ROA shows a significant negative result on Cash-ETR at the 95% level.

The first hypothesis states that financial distress has a positive effect on tax avoidance. The analysis results in the table above show a positive regression coefficient of 0.017 with a significance value 0.042, which means that Z-Score has a positive and significant effect on Cash-ETR. Higher Z-score indicates that the company is in a better financial position. The results showed a positive relationship between Z-score and Cash-ETR, this means that if the company is in a better condition, the tax payment will be greater, and vice versa, the more in a state of financial distress a company is, the smaller the tax paid. When firms are under financial distress, the benefits of tax avoidance may outweigh the costs, leading to an increased incentive to avoid tax. This is because in times of financial difficulty, firms may be more inclined to use tax avoidance strategies to improve their cash flow and financial position (Richardson et al., 2015).

Company financial distress is associated with higher tax avoidance, and this relationship is likely magnified during an economic downturn. In the setting of financial distress, tax avoidance is the most preferred strategy because it provides a source of internal financing and benefits the shareholders (Ariff et al., 2023). Therefore, the higher level of financial distress, the greater the incentive for firms to engage in tax avoidance.

Although tax avoidance provides both benefits and costs to companies and shareholders, there is a possibility that companies in financial distress will use it. Given the existing pressures, coupled with the few options available, the need to survive becomes a great incentive and motivation for managers to carry out tax avoidance policies. Companies experiencing financial difficulties are willing to take greater risks where under normal conditions, tax avoidance strategies are expensive strategies, but in conditions of financial difficulties tax avoidance strategies become more attractive because they are considered as a way out.

The second hypothesis shows a prospector strategy with a regression coefficient of -0.015 with a significance value of 0.806 which is greater than the level of significance. While the third hypothesis of the defender strategy shows a regression coefficient of 0.009 with a value of 0.870 which is greater than the level of significance. This proves that companies with prospector and defender business strategies have no effect on tax avoidance..

Martinez & Ferraira (2019) showed that both prospector and defender business strategies were unable to influence management on tax avoidance policies as measured by Cash-ETR.

These results are according to the research of (Muhammad, 2012; Novitaria & Santoso, 2012; Wardani & Khoiriyah, 2018) which state that business strategy has no effect on tax avoidance, because the average company has not been able to establish a consistent competitive strategy from year to year. from the sample of companies observed, it can be seen that the application of business strategies has not been consistent. even more apply the analyzer strategy. this inconsistency causes the business strategy of both defender and prospector cannot be a determinant of tax avoidance.

CONCLUSION

This study is to determine the effect of business strategy and financial distress on tax avoidance (case study of non-cyclic consumer companies listed on the Indonesia stock exchange for the period 2018-2022), where this research refers to the research of (Sadjiarto et al., 2020). So that for business strategy using two types, namely prospector and defender using four proxies (Ayem & Tarang, 2021). In this study, the financial distress variable is measured by the Altman Z-score, while tax avoidance or tax avoidance uses the measurement (CASH-ETR).

In consumer non cyclicals companies, most of them use an analyzer business strategy compared to using a prospector and defender business strategy. This is in accordance with the results of the research conducted, namely financial distress has a significant positive effect on tax avoidance practices. while the business strategy of both prospectors and defenders has no effect on tax avoidance.

The results of research on non-cyclical consumer companies provide an illustration that business strategy is not a factor that determines the company's tax avoidance policy. Companies use financial distress as a factor that determines the company's tax avoidance policy. In addition to the inconsistency of the company's business strategy in consumer non-cyclicals from year to year, the fact that when companies are under financial pressure, they will use their cash more to improve the company's condition than to pay taxes. Because tax payments cannot be directly benefited by the company. With tax avoidance much-needed cash will be a viable option that offers marginal benefits that exceed marginal costs, especially when they consider that reputational risk becomes less significant during financial distress.

Some implications for corporate tax policy when experiencing financial distress. For example, an increase in the cost of capital, reduced access to external funding sources (especially debt) faced by companies experiencing financial distress. Managers must still pay attention to the benefits obtained must be higher than the costs that must be incurred.

The relationship between business strategy and tax avoidance appears to be complex and may vary depending on the specific circumstances and the industry. Further research and analysis may be needed to clarify the impact of prospector and defender business strategies on tax avoidance.

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