The Impact of Institutional Ownership and a Firm’s Size on Firm Its Value: Tax Avoidance as a Moderating Variable*.

ABSTRACT

The objective of this study was to investigate how institutional ownership and the size of a firm affect the value of the firm value. The study also investigated the moderating effect of tax avoidance on the relationship between institutional ownership and the size of a firm on firm its value. A model was developed and tested by using a sample of 66 manufactured manufacturing companies listed on the Indonesian Stock Exchange, collected from 2012 to 2014. Data were collected and analyzed by using least square regression and moderated regression analysis. The study showed that institutional ownership and a firm’s size affect firm its value. The results also indicate that tax avoidance moderates the effect of institutional ownership and also of a firm’s size on firm its value.

Type of Paper: Empirical

Keywords: Institutional ownership, firm size, tax avoidance, firm value.

1. Introduction

The credibility and prosperity of the owner can be reflected in the firm’s value of a firm; therefore, the firm’s value needs to be improved or at least maintained because the a high firm value will be related to the investors’ interest in maintaining their investment in the company. A higher firm value shows indicates the higher credibility for the company’s credibility, and also describes the welfare of the owner (Wahyudi and Parwestri, 2006). According to Allen and Philips (2000), the a company's financial performance will have an impact on increasing purchases of the shares by outside block ownership. Therefore, management will made undertake various efforts in order to increase the firm’s value. A corporate governance mechanism is a tool that can help the principal chief executive officer [CEO] to increase the firm’s value, because it that tool can control the agency’s cost, which ultimately has an impacts impact on an increasing increase in the firm’s value. According to Jensen and Meckling (1976), institutional ownership is one of the corporate governance mechanisms that can reduce an agency’s conflict problems. According to some researchers, institutional ownership is believed can thought to affect the company’s performance because of the controls that they have the firm has implemented (Nuraina, 2012). A firm’s size can
also be an indicator that shows of its the development of a company. Large companies will be able to more easily access to capital markets, This will thereby allowing the company to have the flexibility and ability to raise funds, and that a condition perceived is captured by investors as a positive signal and a good prospect. Firm The size of a firm can give promote a positive influence on the firm’s value (Nuraina, 2012). Currently in Indonesia, tax revenues are still not in accordance with the specified targets. Meanwhile, Indonesia’s the current state revenues are largely sourced from taxes, revenues. This a situation that is probably due to tax avoidance practices. Saifudin and Yuanda (2016) found that tax avoidance at by manufacturing companies listed on the Indonesian Stock Exchange increased every year during the period 2011-2014, increasing every year. In 2012, the average ETR [Effective Tax Rate] increased of by 0.02 units from the previous year; in 2013, to 0.270; and in 2014, also increased to 0.271. This condition becomes appears to be one of the indications an indication that the tax-avoidance phenomenon from year to year still increased.

2. Literature Review

Institutional investors are sophisticated investors, so they are better able to utilize the current period information to predict earnings, and this conditions a condition that will affect the increase in a firm’s value. According to the Agency theory concept of Jensen & Meckling (1976), agency relations arise when the principal executive officer delegates the authority to the agent to provide a service. Differences of in interest between managers (agents) and shareholders (principal executive officers) can cause agency problems, Agency problems which can lead to non-achievement of corporate objectives in increasing a firm’s value. The percentage of certain shares owned by the institution may affect the process of preparing the financial statements, and in which there is no possibility of accrualisation in the interest of the management (Gideon, 2005). Thus the existence of institutional investors will be able to reduce intra-agency conflict and can increase the firm’s value. Herawati (2008), Nuraina (2012), and Wida and Suartana (2014) all found that institutional ownership affects the firm's value. Cornet et al. (2008) concludes that corporate oversight by institutional investors can encourage managers to focus more attention on the company's performance, thereby reducing opportunistic or self-serving behaviour. These findings indicate that high institutional ownership will increase a firm’s value.

Saxena (2009 in Mule et al., 2015) asserted that a large company can find better ways to deal with market risk and uncertainty and consequently have a better chance of dealing with losses. Companies that have large assets will tend to be more capable and more stable to generate in generating profits when compared to companies with small total assets (Dewinta and Setiawan, 2016). In Thus, companies with large profits will have an impact on the company's stable their stability. These findings indicate that the larger the company’s size, the more able and stable conditions of the that company will have, thus impacting the better value of the firm value. The size of the firm size (which is proxied proxied by its total assets) illustrates the development of the company, which in turn can trigger a positive response that impacts on the improvement of improvement of the company's market performance. The A relatively larger market share reflects the company's high competitiveness.

Tax avoidance is an avoidance effort in paying taxes a minimisation strategy conducted undertaken by taxpayers legally and not contrarily to in accordance with the provisions of taxation laws by using methods and techniques that tend to take advantage of the weaknesses contained within the pertinent laws and regulations of taxation itself, so that the amount of taxes to be actually paid will be reduced (Pohan, 2015: 23). Tax avoidance behaviour by managers tends to have lead to a decrease in a firm’s value, as investors tend to assume that low profits will result in low stock returns as well. Santa & Regende (2016) found that tax avoidance have has a negatively negative effect on a firm’s value. Another study conducted by Chen et al. (2014) found that tax avoidance behaviour increases agency costs and reduces a firm’s value. However, Chen, Kee, and Rasiah (2016) found an indirect
relationship between tax avoidance and market value as a proxy of a firm’s value; While whereas, Desai & Dharmapala (2009) found that tax avoidance activity by firms does not lead to increases in firm the value of the firms.

As discussed earlier, institutional ownership will affect a firm’s value; i.e., the greater the institutional ownership, the higher the firm’s value. Aina (2016) found that the occurrence practice of tax avoidance will decrease in a firm’s value. Large and stable firms tend to be more inclined to implement engage in tax avoidance. This occurs because, in general, stable and large companies tend to earn large profits as well, which in turn will have an impact on increasing tax costs. This phenomenon is what triggers the desire of large companies to do engage in tax avoidance. The impact is that the larger the size of the company, the more likely it is to implement tax avoidance. Darmawan (2014) and Swingly (2015) found that a firm’s size had a positive effect on tax avoidance; Meanwhile however, Praditasari and Setiawan (2017) found that institutional ownership and firm the size of a firm had a negative effect on tax avoidance, which they hypothesised as follows:

H1: Institutional ownership affects firm value
H2: Firm Size affects firm value
H3: Tax avoidance moderates the effect of institutional ownership on firm value
H4: Tax avoidance moderates the effect of firm size on firm value.

3. Research Methodology

3.1 Population and sample

The population of the study is consisted of all manufacture listed manufacturing companies listed on the Indonesian Stock Exchange between 2012 and 2014. From all of manufacture companies listed on the Indonesian stock exchange from 2012 to 2014 that population, a total of 66 companies were selected as a qualified sample. After screening based on the criteria depicted below listed in Table 3.1, the finally sample size was 198 observation-years, as shown in the detailed list in Table 3.1.

Table 3.1. Sample Description

| Manufacture Manufacturing companies listed, 2012-2014 | 144 |
|Incomplete data | (78) |
|Qualified samples | 66 |
|Total observation-years-observations | 3*66 = 198 |

3.2 Measurement of Firm Value

Firm Value is was measured by using Tobin’s Q, which is was also used by Desai & Dharmapala (2009).

Tobin’s Q =: \( \frac{MVE + DEBT}{TA} \)

Where:
MVE = closing stock price x outstanding shares
DEBT = current liabilities + long-term liabilities
TA = Book value of total assets
Institutional ownership = % institutional ownership in the company (Ratnawati & Ali, 2015)
Firm Size = \text{is defined as the natural log (ln) of total assets} (Hasan et al., 2012; Mansor, Ahmad Zaluki, & Osman, 2013)

\text{Tax Avoidance} = \text{Cash Effective Tax Rates (Cash\_ETR), which as developed by Dyreng et al. (2008).}

\[ \text{Cash\_ETR} = \frac{\sum \text{CashTaxPaid}}{\sum \text{PretaxIncome}} \times 100\% \]

3.3 \textbf{Analytical Techniques of data Analysis}

The test of hypotheses was done implemented by using multiple regression models, as stated formulated below:

Hypothesis 1 and 2: \( FV = \alpha + \beta_{1}\text{InsOwn} + \beta_{2}\text{FSz} + \varepsilon \)
Hypothesis 3: \( FV = \alpha + \beta_{1}\text{InsOwn} + \beta_{2}\text{InstOwn}\times\text{TxAv} + \varepsilon \)
Hypothesis 4: \( FV = \alpha + \beta_{1}\text{FSz} + \beta_{2}\text{FSz}\times\text{TxAv} + \varepsilon \)

Where
- \( FV \) = Firm Value
- \( \text{InstOwn} \) = Institutional ownership
- \( \text{FSz} \) = Firm Size
- \( \text{TxAv} \) = Tax Avoidance

\textbf{Normality Testing}: The normal distribution of data obtained for the study was detected obtained by using normal probability plot analysis. The normality test results in this study showed indicated that the points are spread around the diagonal line, and the distribution follows the direction of the diagonal line, thereby indicates indicating that the data meet the normality assumption.

\textbf{Multicollinearity Testing}: To determine whether there is autocorrelation, the result of the multicollinearity testing was conducted to obtain the Variance Inflation Factor (VIF) value of each independent variable, as shown listed in Table 3.4.1.

Table 3.4.1 Regression Results

<table>
<thead>
<tr>
<th>Model</th>
<th>Collinearity Statistics Tolerance</th>
<th>VIF</th>
<th>P Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>InstOwn</td>
<td>0.682</td>
<td>1.466</td>
<td>0.026</td>
</tr>
<tr>
<td>Firm Size</td>
<td>0.929</td>
<td>1.076</td>
<td>0.003</td>
</tr>
<tr>
<td>InsTav</td>
<td>0.294</td>
<td>3.401</td>
<td>0.006</td>
</tr>
<tr>
<td>FSSizeTav</td>
<td>0.278</td>
<td>3.602</td>
<td>0.002</td>
</tr>
</tbody>
</table>

Dependent Variable: Firm Value (Y)

Table 3.4.1 shows indicates that all the independent variables have a tolerance value > 0.10 and VIF <10. Therefore, it can be concluded that the independent variables used in the regression model of this research are free from the problem of multicollinearity (Gozali, 2013).

\textbf{Autocorrelation Testing}: To determine whether there is autocorrelation can be seen ascertained from the DW [Durbin-Watson] value was calculated for each variable, as shown listed in Table 3.2 below. The Durbin-Watson value of 1.761 and the value range between the values DW -2 to +2, which means indicate that there is no autocorrelation (Gozali, 2013). Thus, there is no problem of autocorrelation in the regression model of this study.
Heteroscedasticity Testing: The results are shown in Figure 1 that the points on the image do not form a specific pattern, and the data are spread above and below the number 0 on the Y-axis. This indicates that the model did not exhibit heteroscedasticity, which means that the sample variance of the observation residuals to other observations have are in common and can be said to be efficient. Therefore, based on the basis of the assumptions of the classical test results indicating that the model is free of autocorrelation, multicollinearity, and heteroscedasticity, this model is fit for use in this study.

![Scatter Plot Heteroscedasticity Test Results](image)

Figure 1. Scatter Plot Heteroscedasticity Test Results

4. Results

Based on the basis of Table 3.4.1, it can be observed that the P values of institutional ownership and firm size, respectively, have positive values of 0.026 and 0.003, which are smaller than 0.05. Therefore, it can be concluded that both institutional ownership and a firm’s size affect its value. The Table also shows that the values of InsTav and FsizeTav, each being 0.006 and 0.002, respectively, which are both smaller than 0.05 too. It means that tax avoidance moderates the effects of institutional ownership and a firm’s size on its value.

5. Discussion

5.1 Institutional ownership, Firm Size, and Firm Value

The results show that the higher the institutional ownership and firm size of a firm, then the higher the firm value of the firm. It indicates that institutional ownership has the ability to control management. Such control is implemented through effective monitoring so that it will impact on the increased credibility of the company, that will be followed by a decrease in the tendency of dysfunctional behaviour. These conditions will of course affect the increase in a firm’s value. This finding is in line agreement with Dechow et al. (1996), who found that high institutional ownership would be followed by an increase in the credibility of the company's financial statements. Gideon (2005) also found that a certain percentage of shares owned by the institution could affect the process of preparing financial statements, which does not rule out any accrualisation in the interest of the management. Generally, institutional investors are sophisticated investors, and it will lead to institutional investors hence, better able to utilise they will become more capable of utilising the current period information to predict future earnings, in comparison to investors other than comparison with non-institutional investors. This finding is also in line accord with Herawati (2008), Nuraina (2012), and Wida and Suartana (2014). These findings also indicate that high institutional ownership will impact on the increasing firm value of a firm. Other findings by Gillian and Starks (2003) and Cornett et
al. (2008) found reveal empirical evidence that controls by institutional investors may limit the manager's dysfunctional behaviour, which results in a decrease in a firm's value. Meanwhile, Cornet et al. (2008) suggest that the control of a firm by an institutional investor can encourage managers to focus more attention on the company's performance so that it will in order to reduce opportunistic or self-serving behaviour, which will ultimately have an impact on the improvement of improving the firm's value. Gill and Obradovich (2012), Prasetyorini (2013), and Pratama and Wiksuana (2016) also found that a firm's size has a positive influence on the firm's value. Thus, the a larger the firm size will be followed by lead to the higher firm value. According to Saxena (2009), in Mule et al. (2015), a large corporation is will be able to find discover better and more meaningful ways to avoid market risk and uncertainty and also have a better chance of avoiding losses. According to Dewinta and Setiawan (2015), companies that have large assets tend to be more able to generate capable of generating profits than companies with a smaller total of assets. A firm's size proxies by total assets represent the development of the company, which can trigger a positive response that impacts on the company's market performance. The Therefore, a relatively larger market share reflects the company's high competitiveness of a company.

5.2 The Moderating Role of Tax Avoidance

The test results by using from moderated regression analysis shows show that tax avoidance acts as a variable that moderates the influences between institutional ownership and a firm's size on the firm's value. Negative beta values indicate that tax avoidance weakens the effects both between both institutional ownership on a firm's value and the firm size of a firm on firm its value. The occurrence of tax avoidance in companies will further weaken the influence of institutional ownership on the firm’s value. The test results also indicate that the higher institutional ownership, it will be followed by the lead to a higher value of the for a company. The occurrence phenomenon of tax avoidance will reduce the strong influence of institutional ownership in increasing the firm value of a firm.

Tax avoidance behaviour by managers tends to have lead to a decrease in a firm’s value, caused by small profits as a direct result of tax avoidance. Low earnings will result in low stock returns as well, resulting in followed by a negative outlook resulting from negative outlook from investors. This condition will affect the a decline in stock prices will and also ultimately impact on the result in a decline in corporate value. According to Armstrong et al. (2010), if a company avoids taxes with by poor governance, it the firm poses a the risk of a conflict of interest, which will in turn trigger an opportunity for managers to divert costs for toward their personal interests. Is Tax avoidance may also have an impact on the value of the company. According to Aina (2016), the occurrence of tax avoidance will decline reduce the firm value of a firm.

The results from hypothesis testing results that test to measure the effect of a firm’s size on firm its value indicates indicate that the firm size will indeed affect firm value. A positive beta value indicates that the larger the firm size of a firm, the higher the firm’s value. But However, large companies tend to practice tax avoidance to minimize tax payments remittances due. Thus, further tax avoidance will reduce a firm’s value.

Testing on of the role of tax avoidance as a variable that moderates moderating the effect between of a firm’s sizes size on firm its value shows resulted in a significant P value, as well as a beta value, which is was negative. This indicates Therefore, it has been demonstrated that the occurrence practice of tax avoidance weakens the influence between of a firm’s sizes size on firm its value. The occurrence of tax avoidance at Hence, the a company will thereby reduce the role of firm size in affecting firm corporate value.

6. Conclusion
The results showed that both institutional ownership and firm the size of a firm have a positive influence on firm the value of the firm. This indicates These results imply that institutional investors are sophisticated investors individuals who exercise expert corporate control the company well. The findings also show indicate that larger firms will have an impact on the higher firm values of such firms. This is because the more able and stable conditions of the a company thus impacting better impact the the better firm value of a firm. The This study also found that tax avoidance weakens the influence of both institutional ownership and firm the size of a firm against firm on its value. Thus, tax avoidance practices will have an impact on the reduced of result in a reduction in the value of a firm value. The results of this study can help institutions such as those on the Indonesian Stock Exchange and also individual investors to know better understand how the institutional ownership and firm size can affect the firm value. Besides Moreover, from the a theoretical aspect, these findings can provide a better clearer and broader understanding of the Agency theory more broadly.

English Editor’s Notes:
(1) I stopped my detailed editing at this point, but I glanced through the References and deleted some bold formatting that appeared on a few words to comply with APA style.
(2) I reduced the font size in the tables and captions because your target journal’s template specifies 11-pt—NOT the 12 pt that appeared throughout.
(3) The Table 3.1 that you sent me separately was identical to the table in this manuscript; hence, I corrected the numbering in reference to that table in the main text. Please accept my apology for requesting what I thought was a “missing” table.
(4) Because the narrow strip at the bottom of the window in this Microsoft Word document displays the words “English (United Kingdom),” I revised some of the spelling so that British usage would be consistent throughout the manuscript.

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