Effect of Corporate Governance on Tax Aggressiveness of Quoted Manufacturing Firms in Nigeria

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Abstract

This study investigated the effect of corporate governance on tax aggressiveness among selected manufacturing firms in Nigeria. More specifically, corporate governance variables such as Board Size (BSIZE), Board Diversity (BDIV), Independent Directors (INDEP) and Proportion of Non-Executive Directors to Executive Directors (NEDED) and tax aggressiveness (effective tax rate: TAG) were employed. The study covered a period of twelve (12) years from 2005-2016; a total of 44 firms with financial statement covering the time period were selected using the random sampling technique. The expo-facto research design was employed to analyze already existing data obtained from the Annual Reports and Accounts of the firms, and the Nigerian Stock Exchange Fact Book. The data obtained were analyzed using the Ordinary Least Square technique with its Best Linear Unbiased Estimate (BLUE) Property. In addition, a regression model was developed to test the combined effects of corporate governance measures on tax aggressiveness of the selected manufacturing firms and the analysis was performed via STATA 13.0. Based on the analysis of data using the fixed effect regression, it was revealed that board size with a value of -0.016 has no significant impact on tax aggressiveness while board diversity with 0.815, independent director with 1.464 and proportion of non-executive directors to executive directors with -1.207 has a significant effect on tax aggressiveness on quoted manufacturing firms in Nigeria. Using the random effect regression model, a similar outcome was gotten. Based on the findings of the study, it was recommended among others that quoted manufacturing firms in Nigeria should pay less attention to the size of their board, but rather focus on the quality and integrity of the members of the board, gender diversity within the board composition should be encouraged as it helps decrease tax aggressiveness.

Keywords: Corporate Governance, Quoted Manufacturing Firms, Nigeria

INTRODUCTION

Corporate governance issue in recent times has received great attention and has since birthed a renewed interest in the relationship between corporate tax planning and corporate governance in Nigeria. This renewed interest stems from the fact that the government is concerned about firms' efforts toward minimizing tax burdens, often through the use of tax avoidance or tax evasion policies that border on being illegal or that which is conflicting to the disposition of tax laws in Nigeria. Ying (2015) believes that an effective governance structure may dissuade tax avoidance or evasion policies such that it may restrain corporate firms from engaging in aggressive tax minimization policies. Thus, tax aggressiveness or tax minimization polices to a very large extent, hinges upon the institutional arrangements in a particular economy and this has made the demand for more information on corporate governance and tax aggressiveness to be increasingly complex. Hairul, Ibrahim and Siti (2014) saw tax aggressiveness as an intentional reduction in the precise corporate tax liabilities of a firm. Martinez, Ribeiro and Funchal (2015), believe that tax aggressiveness give birth to certain terms in the accounting literature such as tax management, tax planning, tax sheltering and tax avoidance and are interchangeably used with tax aggressiveness. In as much as corporate tax aggressiveness is a source of revenue loss to the government and increased reputational risk, it is an alarming problem, not only to the government and firm but also to corporate governance (Hanlon &Heitzman, 2010; Khurana, & Moser, 2013; Richard, 2014).

Bertrand and Schoar (2003) believe that lack of tax governance-related information made shareholders value tax planning differently. It is generally expected that shareholders prefer tax aggressiveness since ordinarily paying less tax implies that the firm saves money for its shareholders but this may not be true in real sense as seen in the saga of Enron and World Com. Duke and Kankpang (2011) noted that lack of tax governance-related information may result to agency problem as the (board of directors) may not

align with the shareholders (investors), thereby making tax issues more and more complicated.Also, corporate tax aggressiveness may signal dishonesty being extended to the financial statements of such firms (Desai &Dharmapala, 2009). In other words, management may be dishonest to the shareholders. This results to agency problems as shareholders get skeptical about the services rendered by the management. Owing to the above background, there is therefore the need to evaluate the place of corporate governance in mitigating corporate tax aggressiveness so as to resolve the agency conflict between the board of directors and investors as a way of restoring their confidence. It was in this vein that this study was carried out to explore the effect of corporate governance on tax aggressiveness among publicly quoted firms in Nigeria.

According to Bebeji, Mohammed, and Tanko (2015), despite the provisions of the above mentioned code of corporate governance, the role played by board members in the recent collapse of some financial institutions has spurred series of arguments. Croson and Gneezy (2009) opined that board diversity can directly or indirectly impact an organization's tax aggressiveness.Laniset al (2011) showed that the inclusion of a higher proportion of outside members on the board of directors reduces the likelihood of tax aggressiveness. However, the relationship between the corporate governance measures and tax aggressiveness has been less investigated in the manufacturing sector in Nigeria. Most studies on tax aggressiveness were conducted in developed countries (Landry, Deslandes& Fortin, 2013; Khaoula& Ali, 2012; Khaoula, 2013; Laniset al., 2011; & Yeung, 2010) and the few studies in Nigeria were done using the financial sector (Osemeke, 2012; Bebeji, Mohammed &Tanko, 2015). Therefore, the need for the study becomes vital so as to ascertain which of the corporate governance measures have the tendency to moderate/reduce the probability of tax aggressiveness and agency conflicts in the manufacturing sector in Nigeria.

LITERATURE REVIEW

Conceptual Review

Concept of Tax Aggressiveness

Tax aggressiveness refers the effort of corporate entities to reduce tax payments using aggressive tax planning activities and tax avoidance (Chen et al., 2010). Frank et al. (2009) noted that tax aggressiveness is the manipulation corporate entities engage themselves in order to lower tax income due to a kind of tax planning that can be considered as tax management. This concept may have multiple conceptualizations, references and even different ways to measure, but most of them have the same meaning and the same purpose but differs in their repercussions on the companies' health. According to Bruce et al. (2007), tax aggressiveness can be defined as simple trigger tax management activities that corporate entities utilized for tax planning and have an arrival point for tax evasion. The belief is that tax aggressiveness reduces tax returns. Aggressive tax represents different handling activities to lower taxable income that can be legal or illegal. In this study, the researcher considered tax aggressiveness as a strategy employed by management of corporate organizations, a set of processes, practices, resources andchoices whose objective is to maximize income after all corporate entities as well as their liabilities owed to the state and other stakeholders. The implementation of this kind of strategies is geared towards reducing the tax base which allows generation of high potential non-tax cost that arises from agency conflicts or tax-authority, such as penalties and rent extraction (Desai &Dharmapala (2006). In fact the most significant aim of tax aggressiveness as observed by Chen et.al (2010), is aimed at increasing the net income of companies which creates a positive signal to foreign investors. It is worthy to note that tax aggressiveness have similar meaning as tax planning, tax avoidance and tax shelters in that they meet the legal and ethical provisions established by the tax authorities. However the extreme level of tax aggressiveness is tax avoidance. Tax aggressiveness is characterized by an excessive use of tax avoidance's acts (Khurana& Moser, 2013).This study examined tax aggressiveness (TAG) as a proxy of corporate tax planning. Corporate TAG basically assesses the tax performance of firms. Thus, it is the best measure to evaluate the actual corporate tax burdens. Previous studies have used various methods for measuring corporate

TAGs, where the numerator was the measure of the company's tax liability and the denominator was the measure of its income. As for this study, current-based TAG is used. It is defined as a ratio of current income tax expense (total income tax expense minus deferred tax expense) divided by pretax income.

Overview of Corporate Governance

Corporate governance plays a fundamental role in monitoring different actors and harnessing on planning procedures in an organization. Corporate governance has a global vision of the activities of management, but the question of its performance had been several debates and disputes in time and in space, as a way to rehabilitate the informational efficiency (Boussaidi & Hamed, 2015).Corporate governance arises due to principal-agent problems. The problem between principal and agent initiate costs. Some researchers divide agency cost by two: monitoring cost and bonding cost. According to Chen, Chen, Cheng and Shevlin (2010), corporate governance reduces monitoring cost by creating a higher level of control and transparency within the organization. Corporate governance is the way or manner in which organizations are controlled and directed. There are several corporate governance codes among which are the Securities and Exchange Commission governance codes and Bank codes of corporate governance.

Board Size and Tax Aggressiveness

The board size is a fundamental component of the features of the board which permits coping with aggressive managerial manipulation (Dridi& Adel, 2016). The Nigerian code of corporate governance practices recommended specific number of directors that must compose the board. This number presents the best size that promotes quick decision-making in the organization. Similarly, the literature argued that large boards are generally perceived as being less effective in the exchange of ideas, promoting coalition between board members (Firth, Fung & Ruin, 2007) as well as impinging aggressive tax measures. In the same vein, Gonzalez and Garcia-Meca (2013) believed that excessive board size can be an obstacle to speed and efficiency in decision-making of organization owing to the factor that it may cause coordination and communication problems among members of the board. A study by Lanis andRichardson (2011) found a significant association between the number of board size and tax aggressiveness. Furthermore, Dimitropoulos and Asteriou (2010) study found a relationship between the board size and the informational power of the accounting outcomes. Consequently, Xie, Davidson and DaDalt (2003) found a negative association between board size and tax aggressiveness. Thus, the above position allowed the researcher to incorporate board size as a corporate governance measures in the study.

Empirical Studies

Quite a number of studies have examined corporate governance on tax aggressiveness, earnings manipulation and a host of other variables in developed and developing countries. However, there are few studies on the relationship between corporate governance and tax aggressiveness using the manufacturing sector in Nigeria. Agundu and Siyanbola (2017) investigated the relationship between tax aggressiveness and corporate social responsibility fluidity in Nigerian firms using data from 13 distinguished firms among Nigerian Stock Exchange (NSE) top 30. The analytical methods involved descriptive, correlation and regression statistics, with robust, fixed and random effects consideration. The results established that tax aggressiveness is significantly related with CSR focal components (environmental enhancement and community involvement). Mgbame, Chijoke-Mgbame, Yekini&Yekini (2017) assessed the effect of corporate social responsibility performance and tax aggressiveness in Nigeria during the period 2007-2013 Findings of the study revealed that there is a negative relationship between CSR performance and tax aggressiveness in Nigeria. The study however did not critically analyze the composition of top management that is responsible for making decisions with respect to CSR in the organization. Hence important features like what level of influence independent directors has, when it comes CSR decisions and its influence on tax aggressiveness was not analyzed. A significant relationship was also found between firm size and tax aggressiveness, though with mixed positive andnegative results. In addition, the results revealed a negative and significant relationship between firm performance and tax aggressiveness,

and the extent of tax aggressiveness is reinforcing. Salawu and Adedeji (2017) examined the impact of corporate governance on tax planning of non-financial quoted companies in Nigeria. The result showed that there is positive and significantly relationship between Effective Tax Rate (ETR) and firm value. Growth opportunities and capital intensity were found to have a positive and significant relationship with the firm value. Although the study evaluated the impact of important variables such as firm value, growth & capital that affects management's approach to tax decisions, it did not critically analyze the impact of top management structures like board size, independent directors, board diversity, etc and how the influence tax decisions. The study further recommended that firms need to institute more healthy tax planning practice and engage the services of professional tax consultants for higher firm value. Martinez et al., (2015) investigated the effects of the Sarbanes-Oxley Act (SOX) on the tax aggressiveness of Brazilian firms listed on the BM &FBovespa between 2004 and 2012. The Partial regression analysis model was used to analyse the data collected. In practical terms, the results evidenced that the implementation of more stringent internal controls does not inhibit aggressive tax practices of Brazilian firms. Thus, they concluded that despite the strong empirical evidence that better internal controls improve the quality of accounting results, these rules alone did not appear to have a significant effect in reducing the tax aggressiveness of the firms during the period studied.

Fakile and Uwuigbe (2013) examined the interactions between corporate governance and taxation in Nigeria and found that the intersection of taxation and corporate governance have received renewed attention in recent years as a result of the concern with tax shelters and managerial malfeasance. Also, their study found that the impact of tax systems on corporate ownership patterns, and how ownership patterns in turn constrain corporate taxation, appears to warrant further analysis. Aliyu (2012) investigated corporate governance and the financial performance of quoted cement companies in Nigeria. The multiple regression model was adopted in analyzing his data. Thus the result presented a positive association between performance variable and corporate governance surrogate of managerial shareholding and institutional shareholding. Board size, board composition and composition of audit committee have significant negative relationship with the financial performance of the sampled firms. Consequently, the study recommends, among others, that board should comprise of a mix of executive and non-executive majority of who shall be non-executive directors. Balakrishnan, Blouin and Guay (2012) examined whether tax aggressiveness of firms have less transparent information environments and the extent that this greater financial complexity cannot be adequately communicated to outside parties, such as investors and analysts, transparency problems can arise. Using variables of tax aggressiveness, information asymmetry, analyst forecast errors, and earnings quality, the study suggests that aggressive tax planning decreases corporate transparency. In addition, the study revealed that managers at tax aggressive firms attempt to mitigate these transparency problems by increasing the volume of tax-related disclosure. On the overall, the study found a trade-off between financial transparency and aggressive tax planning.

On the basis of empirical review, it was found that there are scanty empirical evidence on the relationship between corporate governance and tax aggressiveness, especially in developing country like Nigeria. Hence, the need of the study to investigate whether such scenario that holds in other developed countries may hold in Nigeria and to fill the gap in literature on the relationship between corporate governance measures of board diversity, size, independent directors and the proportion of independent directors to executive directors.

Theoretical Framework

Extant literature on corporate governance mechanisms has identified the stakeholder theory and agency theory as two prominent theories upon which corporate governance mechanisms can be underpinned. Thus the theoretical framework of this study is premised on the agency theory as propounded by Jensen and Meckling (1976). This is because the agency theory defines the problem of interest divergence that represents a crucial subject to all economic entities due to the separation of ownership and control.

Agency Theory

The agency theory emphasized the connection between providers of corporate finances and those entrusted to manage the affairs of the firm. According to Jensen and Meckling (1976), agency relationship in terms of a contract under which one or more persons (the principals) engage another person (the agent) to perform some service on their behalf which involves the delegation and concentration of control on the board of directors (agent). Positivist researchers have tended to focus on identifying circumstances in which the principal and agent are likely to have conflicting goals and then describe the governance mechanisms that limit the agent's self-serving behavior (Yeung, 2010). This stream has focused almost exclusively on the principal-agent connection existing at the level of the firm between shareholders and managers. For example, Jensen et al (1976), who fall under the positivist stream, propose agency theory to explain, inter alia, how a public corporation can exist given the assumption that managers are self-seeking individuals and a setting where those managers do not bear the full effects of their actions and decisions. The AGT also assumes that tax management is a firm's strategic choice that is defined by an employment contract (actual or implied) between shareholders and tax managers. Chen and Chu (2005) indicated the suboptimal level of employment contracts resulting from a firm's tax avoidance strategy for two reasons. First, managers should be assured with ex ante compensations for future efforts to reduce tax liabilities. Thus, the level of compensation is not tied with the level of managers' actual effort. Second, managers' attempt to reduce a firm's tax liabilities would compromise the integrity of its internal control systems. Thus, managers could create on purpose and take advantage of the opaque internal control function for their own personal gains at the expense of shareholders, thus making them tax aggressive.

Stakeholders Theory

The stakeholders' theory provides that the firm is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities (Khurana, & Moser, 2013). The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services. This view is supported by Blair (1995) who proposes that the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.
Tax aggressiveness is an act aimed at minimizing tax liabilities in a planned manner. It is thus pertinent to know that the interests of stakeholders are not adequatelyprotected as a firm becomes tax aggressive. Organizations tend to violate the codes of best practices that suggest that they be ethically and morally responsible to their stakeholders; thus they tend not to be socially responsible by minimizing their tax liabilities. For instance, tax aggressiveness affects the stake of the government directly and the public indirectly; as reduction in tax liabilities shrinks government revenue which were to be used in providing infrastructures for the country, which in turns brings about enhanced economic growth and development.
In summary, the agency relationship between providers of corporate finances and those entrusted to manage the affairs of the firm is thwarted by conflict. This problem stems from the fact that the principal agents desire to maximize shareholders wealth and the self-interest agent attempts to expropriate funds. Although the use of contracts partly solves this misalignment of interest; in a complex business environment, contracts covering all eventualities are not obtainable. Hence where contracts fail to achieve completeness, principles rely on internal and external governance mechanisms to monitor and control agents and this gives rise to further agency cost. The agency theory states that the control function of an organization is primarily exercised by board of directors. With regards to the board as a governance mechanism, the issues that appear prominent in the literature are; board size, board diversity, independent directors and executive and non-executive directors.

METHODOLOGY

This study employed expo-facto research design. This design was adopted because it seeks to analyze already existing events where the researcher cannot manipulate the data. The data used were gotten from the annual reports and accounts of some selected manufacturing firms quoted on the floor of the Nigerian Stock Exchange. The population for this study consisted of all the manufacturing firms quoted on the floor of the Nigerian Stock Exchange (NSE) at November 11, 2016. These manufacturing firms are those categorized as Conglomerates, Consumer Goods, Industrial Goods and Construction materials, Textiles, and Building materials and Real Estates. There are seventy-three (73) manufacturing firms in this category that are quoted on the floor of the Nigerian Stock Exchange (NSE, 2016). Tax aggressiveness (TAG), Board Size (BSIZE), Board Diversity (BDIV), Independent Directors (INDEP), proportion of Non-executive Directors to Executive Directors (NEDED) were measured by their values as obtained from annual reports and the Nigerian Stock Exchange Fact Book. The data for the study are secondary data and were sourced from the annual reports of the manufacturing firms for the period 2005 to 2016. The data were analyzed using STATA 13.0 statistical software.

RESULTS AND DISCUSSION

Correlation Matrix

VARIABLES	TAG	BSIZE	BDIV	INDEP	NEDED	ROA
BSIZE	1.000					
BDIV	0.621	1.00				
TAG	0.317	0.23	1.000			
INDEP	0.449	-0.021	0.0061	1.000		
NEDED	-0.210	0.43	-0.318	-0.328	1.0000	
ROA	-0.194	-0.21	0.029	-0.341	-0.0127	1.000

Source: Secondary Data from STATA Output, 2017. Appendix I

In data analysis, the correlation matrix is used to test for the presence or absence of multicolinearity among variables. Multicolinearity means interdependence among independent variables in a regression model. It is an econometric problem that nullifies the result of the ordinary least square and leads to wrong statistical implications as well as misleading policy decisions in research. In order to examine the presence or absence of interdependence among the variables under investigation, a pair-wise correlation test was performed. The result showed that there is the association between each pair of the variables used. However, the correlation matrix showed that BSIZE, BDIV and INDEP were positively correlated to TAG while NEDED and ROA which are negatively related to TAG. Inspite of the inverse correlation among the variables (i.e. positive and negative), none of the correlation coefficients exceeded 0.5. Therefore, the correlation among them is weak. The implication is that there is the absence of multicolinearity among the variables under investigation.

Regression Results

The regression result showed the signs, size and significance of the coefficients of the variables under investigation. The sign encompassed the nature of relationship between the dependent and independent variables. This relationship may be positive or negative as the case may be. Also, the size showed the effect of the independent variables on the dependent variable while the significance revealed how fundamental the independent variables as determinants of the dependent variables are. The significance of

the independent variables as determinants of the dependent variable was measured by the standard error, t-statistics or the p-value.

Result of effect of regression

Variables of the Study	Fixed Effect Outcome
Board Size (BSIZE)	-0.01649
	(0.51313)
Board Diversity (BDIV)	0.815983***
	(0.21396)
Independent Directors (INDEP)	1.46489***
	(0.42531)
Non-executive (Outsider) Directors (NEDED)	-1.20702***
	(0.29929)
Return on Asset (ROA)	0.184688
	(1.35981)
Constant (TAG)	15.23795***
	(4.11121)
R-squared	0.47838

*Standard errors in parentheses ***, ** and * denote 1%, 5% and 10% level of significance respectively*

Source: Secondary Data from STATA Output, 2017. Appendix I

The results of the fixed effect regressions for the investigation of the effect of corporate governance and tax aggressiveness is presented in table 2 above. The dependent variable is tax aggressiveness (TAG) while the independent variables comprised of Board Size (BSIZE), Board Diversity (BDIV), Independent Directors (INDEP), Non-Executive (Outsider) Directors (NEDED) and Return on Asset (ROA). The result in table 2 showed that BSIZE and NEDED are negatively correlated to TAG, as seen in the coefficient of the variables -0.01649 and -1.20702 respectively while BDIV, INDEP and ROA are positively correlated to TAG as also revealed by the coefficient of the variables 0.815983, 1.46489 and 0.184688 respectively. However, BDIV, INDEP and NEDED are the variables that are statistically significant. This is revealed by the coefficients of the three variables with corresponding standard errors. The implication of the above is that the independent variables such as BDIV, INDEP and NEDED have significant effect on corporate tax aggressiveness measured by TAG of quoted manufacturing firms in Nigeria.

The extent of the effect of the variables is measured by the values of the coefficients of the variables in (see table 2). By size, the estimates of the coefficients revealed that an increase in Board Diversity (BDIV) and Independent Directors (INDEP) will respectively lead to 0.51313 and 0.42531 increase in the TAG. On the other hand, an increase in Non-executive (Outsider) directors (NEDED) will result to 0.29929 decreases in TAG. By implication, quoted manufacturing firms in Nigeria with greater proportion of non-executive directors tend to have low TAG while firms' with greater Board Diversity (BDIV) and large number of Independent Directors (INDEP) will have greater TAG. This suggests that these three corporate governance variables (BDIV, INDEP and NEDED) exert gargantuan effect on tax aggressiveness of quoted manufacturing firms in Nigeria.

CONCLUSION AND RECOMMENDATIONS

Based on the findings of the study, the study concluded that there exist a significant relationship between corporate governance measures and tax aggressiveness of quoted manufacturing firms in Nigeria. It is thus timely that regulatory bodies such as the Security and Exchange Commission (SEC) and Central Bank of Nigeria (CBN) established for the inclusion of more women and independent directors on the board as their presence on the board makes the firm less aggressive. Therefore, owing to thesignificant relationship between corporate governance measures on tax aggressiveness, the role played by corporate governance in mitigating against tax aggressiveness cannot be over emphasized. Based on the findings of the study, the following recommendations were proffered:

i. That quoted manufacturing firms in Nigeria should pay less attention to the size of their board, but rather focus on the quality and integrity of the members of the board.

ii. That quoted manufacturing firms in Nigeria should give value to diversity in the board composition within the firm as diversity in the board decreases tax aggressiveness.

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