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Tax Avoidance on Institutional Ownership: Case Study of Banking Companies in Indonesian Capital Market

Yefri Reswita[1]*, Syukri Lukman[2], Rahmat Febrianto[3], Fajri Adrianto[4]
[1]*Department of Management, Universitas Andalas & Universitas Baiturrahmah, Indonesia*
[2,3,4]*Department of Management, Universitas Andalas, Indonesia*

Abstract

One of the causes of tax avoidance actions is influenced by corporate governance factors, including ownership structure. This study examines the relationship between institutional ownership structure and tax avoidance activities, with the moderating effect of independent directors. The research utilizes panel data from banking companies listed on the Indonesia Stock Exchange (IDX) from 2013 to 2022, totaling 430 firm-year observations. The estimation model employs Ordinary Least Square (OLS) approach. The results indicate that institutional ownership structure has a significant negative effect on tax avoidance actions. The moderating effect of independent directors does not have a significant influence on the relationship between institutional ownership structure and tax avoidance activities. Monitoring and internal control mechanisms are essential to mitigate actions detrimental to the interests of minority shareholders.

Keywords: institutional ownership; tax avoidance; independent director

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**Corresponding author:* *yefrireswita@fekon.unbrah.ac.id*

Introduction

Tax is a mandatory cost for companies that have operational profits. On the other hand, the company has a goal to achieve maximum profits as possible. In circumstances like this, the company is in a position of having to balance the interests of profits that must be achieved so that they can be received maximally by shareholders and reduced profits caused by the obligation to pay taxes (Duhoon & Singh, 2023). This situation is important in making financial decisions. So it is important to research company policies related to taxes. Companies utilize tax rates, tax incentives and tax policies to carry out tax evasion activities in continuously updated and varied ways (Qi et al., 2023).

From the agency theory perspective, there is a conflict of interest between controlling shareholders and minorities. In some cases, highly concentrated shareholders will become controllers and take primary control of the company (G. Jiang & Lee, 2009; Kimber & Lipton, 2005; Ma & Khanna, 2016). By taking advantage of this condition, there is uncertainty in company tax reporting regarding tax avoidance planning. There are several views stating that the act of planning tax avoidance falls into the realm of ethics in the business world (Lenz, 2020) and is legally legal (Khuong et al., 2020). However, taxes themselves are the main source of national fiscal revenue which is important for the country. Another bad impact of tax avoidance is that the costs incurred are actually greater than the benefits for shareholders, agency costs and sacrificing the interests of other parties (Desai & Dharmapala, 2006; Edwards et al., 2016; Bauer et al., 2020).

One of the causes of tax avoidance is influenced by corporate governance factors, including the ownership structure and composition of the board of directors (Wang et al., 2020; Duhoon & Singh, 2023). Concentrated company ownership will have an impact on the low proportion of public ownership so that internal control is more optimal in the governance monitoring function (Duhoon & Singh, 2023).

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Based on the research results of Athira & Lukose (2023), it shows the importance of monitoring and internal control instruments to suppress tax avoidance activities, one of which is by looking at the character of the company's ownership structure with institutional ownership (IO). Supervision of companies that are not highly concentrated in share ownership will increase discipline regarding earnings reporting through supervision of earnings management, financial reporting, and earnings manipulation (Ramalingegowda et al., 2021).

Current financial literature is still limited and there is still debate in examining the relationship between corporate tax avoidance activities and IO ownership structure from an agency theory perspective. So this research is interested in examining tax avoidance and IO ownership structure. This research will focus on banking companies in Indonesia, where financial institutions should be examples and role models for other industrial sectors regarding ethics in tax avoidance activities. It is hoped that this research will enrich the literature related to the debate regarding the relationship between tax avoidance and IO ownership structure, as well as contribute to the development of agency theory.

Literature Review

Agency theory put forward by Jensen & Meckling (1976) states that the root of corporate governance problems will always arise if there is a conflict of interest within a company. Meanwhile, conflicts of interest are caused by an imbalance of "power" between the various parties involved, so that there will be parties who will be sacrificed for the interests of certain parties.

Majority shareholders have a tendency to protect their interests at the expense of minority shareholders. In general, controlling shareholders take substantial primary control in company operations such as the appointment of the CEO and directors (Jiang & Lee, 2009; Kimber & Lipton, 2005; Ma & Khanna, 2016). A shield for tax avoidance is used by majority shareholders through their appointed agents by reporting low profits, ultimately sacrificing the interests of minority shareholders. Therefore, highly concentrated ownership is an important factor in tax avoidance activities. A more optimal internal monitoring function is needed (Duhoon & Singh, 2023).

Institutional share ownership (IO) is the ownership of a block of shares in a company by institutional owners (Ramalingegowda et al., 2021). Institutional in this case can be from an organization, institution, or institution such as insurance companies, banks, investments, mutual funds, securities, insurance, pension funds, financial institutions, and other institutional ownership. Some of the latest financial literature discussing IO and tax avoidance is still debated. The IO structure in the company plays its role in agency conflict well. IO is able to prevent minority takeovers by controlling owners and limiting the tax aggressiveness of jointly owned companies by using an efficient supervisory role (Athira & Lukose, 2023; Chyz & White, 2014). On the other hand, the positive relationship between IO and tax avoidance activities (Bird & Karolyi, 2016; Khan, Srinivasan, & Tan, 2017), occurs because of the high concentration of share ownership of IO so that it has the power to exert its intervention influence in tax avoidance activities. In Indonesia itself, empirical evidence shows that institutional investors tend to influence and pressure managers in the interests of share owners, pursuing short-term rather than long-term profits (Wicaksono et al., 2024).

Research has shown that the presence of independent directors in a company can effectively reduce instances of corporate tax avoidance, as highlighted by Lee & Kao (2020). These independent directors bring a fresh perspective to the boardroom, ensuring that decisions are made in the best interest of the company and its stakeholders. For example, when independent directors closely monitor financial transactions and tax planning strategies, they can identify potential loopholes that might lead to tax avoidance and take proactive measures to address them.

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Moreover, the role of supervision and monitoring within a company has been found to significantly impact its performance, particularly in non-centralized organizational structures, as emphasized by Jiang et al. (2019). In such structures, where decision-making is distributed among various departments or teams, effective supervision becomes crucial to ensure alignment with the company's overall goals. For instance, regular performance evaluations and feedback mechanisms can help employees stay on track and contribute to the company's success.

Other empirical evidence from Ramalingegowda et al. (2021) also states that IO is also a function of shareholder monitoring of earnings management and financial reporting discipline. On the other hand, the CEO and board of directors want to maintain a good relationship with the company's shareholders. With these two relationships, institutional owners can influence various strategic decisions of the company (Lewellen & Lewellen, 2022). However, these two studies have not tested tax avoidance activities.

Some financial literature regarding the relationship between tax avoidance and plural or non-concentrated share ownership structures shows that the monitoring effect of plural shareholders will reduce tax avoidance activities (Ouyang et al., 2020). The existence of non-single concentrated shareholders encourages companies to avoid taxes (Francis et al., 2022). The governance function for internal company supervision is of particular concern in the practice of financial decisions, especially to prevent tax avoidance activities by companies (Athira & Lukose, 2023). The relationship between tax avoidance and plural shareholding structure tends to be negatively correlated (Athira & Lukose, 2023; Francis et al., 2022).

Hypothesis 1: IO ownership structure has a negative effect on tax avoidance activities in Indonesian banking companies.

Some financial literature on the relationship between tax avoidance and plural or unconcentrated shareholding structure shows that the monitoring effect of multiple shareholders will reduce tax avoidance activities (Ouyang et al., 2020).

The governance function within a corporation is vital for overseeing financial decisions, with a particular focus on preventing tax avoidance practices by companies (Athira & Lukose, 2023). Research has shown that having independent directors in place can effectively curb instances of corporate tax avoidance (Lee & Kao, 2020). Additionally, the role of supervision and monitoring within a company has been found to have a positive impact, especially in non-centralized organizational structures, ultimately leading to improved company performance (Jiang et al., 2019). These findings underscore the importance of strong governance mechanisms in ensuring ethical and responsible financial practices within corporations. Overall, the presence of independent directors and the implementation of robust supervision and monitoring mechanisms play a vital role in enhancing corporate governance and driving performance improvements within organizations. By fostering transparency, accountability, and ethical behavior, companies can build trust with investors, regulators, and the public, ultimately leading to long-term sustainability and success.

Hypothesis 2: The moderating function of independent directors has a positive effect on the relationship between IO and tax avoidance activities in Indonesian banking companies

Methods

This research uses the Refenitif Eikon panel database of 47 banks listed on the Indonesia Stock Exchange (BEI) from 2013 to 2022. At a minimum, companies publish annual reports and financial reports from 2013 to 2022 and do not experience consecutive losses throughout that period. The total research sample was 430 company-year observations.

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The dependent variable in the research is Tax Avoidance (TA), using two proxies, namely the first Effective Tax Rate (ETR) by calculating the tax burden divided by profit before tax (Ouyang et al., 2020). Second, The book-Tax Difference (BTD) by calculating profit before tax minus profit after tax divided by total assets of the previous year (Athira & Lukose, 2023).

The independent variable in the research is Institutional Ownership (IO). In accordance with research by (Athira & Lukose, 2023), the IO proxy is measured by the total percentage of shares owned by all institutions in a company, one institution has a minimum share ownership of >5% of the shares outstanding in the company. The second proxy for IO in this research is IO_NUM, the number of institutional shareholders in one company.

The moderating effect of independent directors in this research is to strengthen tests related to the function of internal supervision from a governance perspective and conflicts of interest related to tax avoidance activities. Board of Independent Director (BIND) is the proportion of the number of independent directors to the number of directors in the company.

This research uses several control variables that might influence the relationship between TA and institutional ownership, namely company age (AGE), company size (total assets), total assets less liabilities ratio (LEVERAGE), Return on Assets (ROA), number of Board of Director (BOD), and number Board of Commissioner (BOC).

To examine the effect of institutional ownership on tax avoidance, this research uses OLS (Ordinary Leas Square) estimation using STATA version 13 software. The following is the construction of the research specification model:

$$TA_{i,t} = \alpha_0 + \alpha_1 IO_{i,t} + \sum Controls_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$TA_{i,t} = \alpha_0 + \alpha_1 IO_{i,t} + \alpha_2 IO_{i,t} * BIND_{i,t} + \sum Controls_{i,t} + \varepsilon_{i,t} \quad (2)$$

*Where, TA_(i,t) is tax avoidance from company-i in year-t and IO_(i,t) is institutional ownership from company-i in year-t. BIND_(i,t) is the independent director of company-i in year-t. IO*BIND is the moderating effect of independent directors. Controls are the research control variables and ε is the standard error of the regression.*

1. Descriptive Statistics

Table 1 shows the results of descriptive statistics of research using pool data types and actions have been taken for all variables that can cause the effects of extreme data, including natural logarithm (Ln) transformation on the IO, AGE and TA variables.

Table 1. Research Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ETR	430	0.222	0.554	-8.418	4.973
BTD	430	0.003	0.005	-0.035	0.022
LnIO	430	4.164	0.792	0.000	4.605
IO_NUM	430	2.167	1.372	0.000	6.000
BIND	430	0.203	0.125	0.083	1.000
LnAGE	430	3.626	0.533	1.099	4.691
LnTA	430	24.216	1.801	20.303	28.320
LEVERAGE	430	0.837	0.084	0.330	1.286
ROA	430	0.004	0.022	-0.181	0.041
BOD	430	6.414	2.680	2.000	12.000
BOC	430	4.779	1.984	1.000	10.000

Source: STATA data processing results

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Table 2 shows the results of the Chow and Hausman tests for model selection. Each ETR dependent variable in the LM test shows a probability value > 0.05, which is more suitable for using the Common Effect Model (CEM). Meanwhile, BTD in the Hausmaan test has a probability value of <0.05, so it uses the Fixed Effect Model (FEM). However, in testing heteroscedasticity, testing the CEM model using the Breusch-Pagan test, and FEM using the Wald-Test, both dependent variables have a probability value of <0.05. This means that there is a heteroscedasticity problem in the data model. To overcome the problem of heteroscedasticity in this panel data regression model, a robust and generalized least squares approach was used (Gujarati, 2012) .

Table 2. Research Regression Model Test Results

Variabel	Chow Test	Hausman Test	LM Test	Model	Breusch-Pagan	Wald-Test
	Prob>f	Prob>chi2	Prob>chi2	Conclusion	Prob>chi2	Prob>chi2
ETR	0.382	-	1.000	CEM	0.000	-
BTD	0.000	0.000	-	FEM	-	0.000

Source: STATA data processing results

In table 3, the test results show the level of correlation between independent variables (multicollinearity) using the Variance Inflation Factor (VIF) test. From table 3, it shows that there is no multicollinearity problem with a tolerance value > 0.10 and a VIF value < 10 (Long & Freese, 2006).

Table 3. Multicollinearity Test Results

Variable	VIF	1/VIF
BOD	6.410	0.156
LnTA	6.220	0.161
BOC	3.390	0.295
BIND	1.800	0.554
LnAGE	1.360	0.733
IO_NUM	1.260	0.795
ROA	1.210	0.823
LnIO	1.200	0.836
LEVERAGE	1.180	0.846
Mean VIF	2.670	

Source: STATA data processing results

1. Baseline Regression

Based on the results of the GLS regression test in table 4, institutional ownership (LnIO) has a negative and significant effect on tax avoidance activities (TA). The ETR proxy has a significance level of <0.001 or less than 1%. The results of this evidence are in accordance with hypothesis 1 which shows that IO ownership structure has a negative effect on tax avoidance activities. However, LnIO on the BTD proxy has no effect at all.

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Table 4. Results of GLS Regression Analysis

	ETR	BTD
LnIO	(0.052)***	(0.000)
	-0.128	0.000
IO_NUM	(-0.038)	(0.000)
	-0.040	0.000
LnAGE	(0.290)**	(0.002)
	0.709	0.000
LnTA	(0.076)***	(0.000)**
	-0.286	-0.001
LEVERAGE	(0.394)***	(0.003)
	1.933	-0.001
ROA	(1.420)	(0.009)***
	-0.439	0.069
BOD	(0.033)	(0.000)
	0.014	0.000
BOC	(0.036)	(0.000)
	0.001	0.000
Constant	(1.369)***	(0.009)***
	3.618	0.033
Hausman Test	-	0.000
LM Test	1.000	-
Breusch-Pagan Test	0.000	-
Wald Test	-	0.000
Mean VIF	2.67	2.67
Number of Obs.	430	430
R2	0.086	0.353
Adj.R2	0.069	0.341
F-Stat.	0.000	0.000

Notes: *,**,***Significant 10, 5 and 1 per cent levels, respectively. Standard error in the parenthesis

Source: STATA data processing results

2. Robustness Test

To test the consistency of the analysis results and to avoid the possibility of endogeneity problems arising from the existing regression model, the generalized method of moments (GMM) was carried out. Table 5 shows the results of the endogeneity test using the GMM approach with two stages (System-GMM). The Arellano-Bond (AR1) test value < 0.05, Arellano-Bond (AR2) > 0.05, and Hansen test > 0.05. The number of research observations for ETR was 295 and BTD was 245, with 69 and 35 instruments used respectively. The Sargan and Hansen test values were >0.05.

Panel data regression results for the two approaches GLS and System-GMM can be concluded that there is no significant difference between the two models in displaying the LnIO and IO-NUM relationship. The stronger the indication to prove that IO has a negative and significant influence on tax avoidance activities, the ETR and BTD proxies have a significance below 5% when testing robustness using System-GM

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Table 5. Robustness Test Results

	ETR	BTD
LnIO	(0.042)**	(0.123)
	-0.080	-0.070
IO_NUM	(0.020)	(0.03)**
	-0.006	-0.081
Constant	(0.303)***	(0.948)***
	-0.593	-2.519
Controls	Yes	Yes
Year FE	Yes	Yes
Firm FE	Yes	Yes
Arellano-Bond test for AR(1)	0.015	0.028
Arellano-Bond test for AR(2)	0.650	0.335
Sargan Test	0.143	0.054
Hansen test	0.996	0.299
Number of Instruments	69	35
Number of Observation	295	245
F-Stat.	0.000	0.000

Notes: *,**,***Significant 10, 5 and 1 per cent levels, respectively. Standard error in the parenthesis

Source: STATA data processing results

3. Moderating of Independent Director

The results of proving the moderating effect of independent directors (BIND) can be seen in table 6. BIND on the ETR and BTR proxies has no significant effect, indicating that independent directors have no influence at all on tax avoidance activities. The interaction between IO ownership and tax avoidance activities is used to measure the moderating effect of director independence. The analysis results show that the interaction coefficient is not very influential, the significance is at the 10% level. The moderating effect of the internal monitoring function of independent directors' governance is not very effective in strengthening the relationship between IO ownership and tax avoidance activities.

Table 6.
Results of Analysis of the Moderating Effects of Independent Directors

	ETR	BTD
LnIO	(0.150)	(0.001)
	0.089	-0.000
IO_NUM	(0.085)**	(0.001)
	-0.164	0.000
LnIO*BIND	(0.498)*	(0.003)
	-0.823	0.001
IO_NUM*BIND	(0.322)*	(0.002)
	0.554	-0.002
BIND	(2.017)	(0.013)
	2.474	0.006
LnAGE	(0.292)**	(0.002)
	0.635	-0.000
LnTA	(0.077)***	(0.001)*
	-0.271	-0.001

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	ETR	BTD
	1.882	-0.002
ROA	(1.420)	(0.009)***
	-0.529	0.070
BOD	(0.037)	(0.000)
	0.0223	0.000
BOC	(0.036)	(0.000)
	0.001	0.000
cons	(1.498)**	(0.010)***
	2.824	0.029
Hausman Test	-	0.000
LM Test	1.000	-
Breusch-Pagan Test	0.000	-
Wald Test	-	0.000
Number of Obs.	430	430
R2	0.095	0.357
Adj.R2	0.072	0.340
F-Stat.	0.000	0.000
Notes: *,**,***Significant 10, 5 and 1 per cent levels, respectively. Standard error in the parenthesis		

Source: STATA data processing results

Discussion

The findings of this research prove that the IO ownership structure in Indonesian banking has an important role in suppressing tax avoidance and plays a role in monitoring internal governance in accordance with previous research (Athira & Lukose, 2023; Chyz & White, 2014). On the contrary, according to research by Bird & Karolyi (2016); Khan et al. (2017) stated that the high concentration of IO share ownership has the power to use its intervention influence to increase tax avoidance activities. This is not proven, in fact IO has a central role in suppressing tax avoidance activities. This is because IO has better monitoring capabilities over corporate governance. so this reduces tax avoidance practices which tend to be detrimental to owners.

In Indonesia itself, empirical evidence shows that institutional investors tend to influence and pressure managers in the interests of shareowners, pursuing short-term rather than long-term profits (Desiyant et al., 2024; Wicaksono et al., 2024; Linda et al., 2023). The results of our research prove that, specifically for the banking sector, the IO ownership structure has a negative impact on conflicts of interest of shareowners, in this case tax avoidance actions that benefit majority shareholders at the expense of the interests of minority shareholders.

The results of our research also develop research that has been stated by Ramalingegowda et al. (2021) that IO is also a function of shareholder monitoring of earnings management and financial reporting discipline and has an influence on the company's strategic decisions (Lewellen & Lewellen, 2022). The IO structure turns out to be able to reduce tax evasion in the banking sector. In this research, IO ownership structure also measures total ownership shares and the number of institutions in a company. The results also strengthen the results of previous research (Francis et al., 2022; Ouyang et al., 2020). that the plural or unconcentrated share ownership structure shows that the monitoring effect of plural shareholders will reduce tax avoidance activities, so that the IO ownership

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structure becomes a governance function for internal company supervision (Athira & Lukose, 2023).

Conclusion

In general, the results of empirical research evidence show that one of the actions to reduce tax avoidance activities by companies is the corporate governance function of institutional ownership. This function plays a very good role, especially in the Indonesian banking sector, by carrying out internal company supervision so that it will increase discipline in earnings reporting through supervision of earnings management, financial reporting, and earnings manipulation (Ramalingegowda et al., 2021).

Internal monitoring and control instruments are important to suppress actions that are detrimental to the interests of minority shareholders. Companies that have a plural IO composition tend to play this role well in terms of tax avoidance. It is necessary to pay attention to companies that have a high share concentration because of the potential for intervention in financial strategic decisions through directly appointed directors. The results of this research have not been able to show the role of independent directors in the relationship between IO and tax avoidance. This means that the director's independent role has no influence in monitoring tax avoidance. These findings contribute to the development of agency theory. Especially in looking at the relationship between tax avoidance and IO ownership structure, especially for banking companies.

For further research, it is necessary to further study the governance function other than independent directors to see indications of intervention by the company's majority shareholder. Apart from that, the characteristics of companies in terms of governance, such as family companies, need to be studied to see the intervention of directors held by family relatives. Companies based on size (total assets) need to be studied more deeply because the results of the evidence show that other factors that can cause a decrease in tax avoidance are total assets and leverage. With a deeper investigation into the company's character, it will be clearer how companies with large assets have good governance and are far from tax avoidance, so they are an example for other companies.

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