The Influence of Site Investigation by Institutional Investors on Family Business Tax Avoidance

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Abstract. Family businesses, as the main body of the private economy, have played an essential role in promoting the development of China's economy. Because the income tax expenditure is directly involved in the wealth distribution, the tax avoidance by the family business is common in the world. Scholars have studied the influencing factors of family business tax avoidance from various aspects, but the site investigation by institutional investors, which is an essential way to obtain private information, has not received attention. Therefore, this paper intends to study whether the site visits of institutional investors can play a role in governance from the perspective of modern tax theory.

Keywords: Institutional Investor · Family Corporate · Income Tax Avoidance

1 Introduction

Generally, tax avoidance is deemed to be positive for companies from the perspective of cash flow saving, but it can be negative in agency view proposed by Desai et al [1]. Due to the separation of ownership and management, managers tend to maximize their own interests rather than shareholders' interests, and it is easy to use tax avoidance activities to obtain private gains [2, 3]. In addition, complex and hidden tax avoidance activities will aggravate the degree of information asymmetry of the company and further induce the opportunistic behavior of the management [4]. The research of Kim et al. [5] and Jing Wang et al. [6] also supported that tax avoidance activities will indeed provide opportunities for managers to transfer corporate resources.

For family businesses, the proportion of family shares is high and the ownership and management rights are not completely separated. Therefore, compared with the first type of agency conflict, the conflict of interest between the controlling family and minority shareholders is very prominent. Controlling families have the ability to use complex and vague tax avoidance activities to carry out rent-seeking activities such as related transaction and managerial perk consumption, which will damage the interests of minority shareholders.

The existing studies have proved the governance function of institutional investors' site visits from various aspects such as promoting corporate information disclosure [7],

mitigating underinvestment [8], Improving audit quality [9] and so on. Directly, Ding F et al. [10] has verified the inhibitory effect of site visits on tax avoidance with text analysis. But the family businesses have not been focused. Since voluntary disclosure is rare in family businesses, site visits provide investors a good way to obtain private information. We tend to test if site visits of institutional investors can inhibit corporate tax avoidance.

2 Hypothesis and Research Design

2.1 Research Hypothesis

Several previous studies document that sites visits are informative [11, 12]. Through the information gained from sites visits, the institutional investors are more likely to identify self-benefit behaviors of management hidden in complex tax avoidance activities.

On the other hand, Site visits show institutional investors' attention, which also puts pressure on the surveyed enterprises invisibly. Family enterprises have to consider the negative effects of tax avoidance, such as reputation loss, so as to reduce the level of tax avoidance. In this way, supervision will be formed virtually. Accordingly, we propose hypothesis H1 as follows.

H1: Site visits by institutional investors can inhibit family businesses' tax avoidance.

More and more family enterprises have hired professional managers for standard management mode. Compared with family members, the actions may be more complex and hidden when experienced and professional managers take tax avoidance actions. In addition, because the good reputation relates to their remuneration [13], the managers may make tax avoidance plans more prudently to avoid scandals.

Thus, as the degree of information asymmetry increases, it is more difficult for institutional investors to identify the self-interest behaviors of management and then the inhibitory effect is reduced. Accordingly, we propose hypothesis H2 as follows.

H2: The inhibitory effect is better in companies where the CEO is a family member rather than a professional manager.

2.2 Research Design

Sample, Data and Variable.
Since 2013, the companies listed in Shenzhen Stock Exchange have been compulsively required to disclose the information of investor investigation. And the data of site visits are abnormal because of COVID-19 after 2019. Therefore, we selected listed family enterprises in Shenzhen Stock Exchange from 2013 to 2019 as samples.

Using Wind and CSMAR database, we obtained 1680 valid observations after the following data processing: (1) Samples marked ST and ST* were removed; (2) Excluding financial industry samples; (3) Samples with effective tax rate greater than 1 and less than 0 and total pre-tax profit of the current period less than 0 are excluded. (4) All the continuous variables were reduced at 1% and 99%.

Similar to others [14], we take book-tax differences and CV/CV1 as key variables. The detailed definition is listed in Table 1.

Table 1. Variables

	Variable	Definition
Dependent variable	BTD	Degree of corporate tax avoidance, measured (total profit-taxable income)/total assets of last year, where taxable income = (income tax expense - deferred income tax expense)/nominal tax rate
Independent variable	CV	If the fieldwork arises for the company, take 1, otherwise take 0
	CV1	Log of 1 plus the number of fieldwork in the year
Control variable	Size	Log of total asset
	Lev	Leverage for firm, measured as total debt/asset
	Growth	Revenue growth rate
	ROA	Return on assets, measured as net profit/total asset
	Cashflow	Measured as cashflow from operating activities/total asset
	Top1	The first big shareholder shareholding
	Industry &Year	dummy variable

Model Design.

To test the above hypothesis, the empirical model constructed is as follows:

$$BTD = \beta_0 + \beta_1 CV/CV1 + \beta_2 Size + \beta_3 Lev + \beta_4 Growth + \beta_5 ROA + \beta_6 Cashflow + \beta_7 Top1 + \sum year + \sum industry + \varepsilon \tag{1}$$

3   Empirical Results

3.1   Basic Descriptive Statistics

Table 2 lists the descriptive statistical results of variables in the model. The results show that the average of BTD is -0.001, and the median is -0.002, indicating that the pre-tax profit of most enterprises in the sample is lower than the taxable income. Additionally, there are large differences in the degree of tax avoidance among the sample family enterprises with the standard deviation of 0.025.

CV averages 0.787 and CV1 averages 1.373, which means that more than half of the sample have received institutional investors site visits and frequency is about 3 times a year on average. So institutional investors are enthusiastic about site visits. The large standard deviations of CV1 denotes that the number of site visits by institutional investors may become a factor affecting corporate tax avoidance behavior.

3.2   Regression Results

Table 3 shows the empirical results corresponding to institutional investors' site visits and family business tax avoidance. Using the fixed effect model according to Hausman

Table 2. Descriptive Statistics

Variables	BTD	CV	CV1	Size	Lev	Growth	ROA	Cashflow	Top1
N	1680	1680	1680	1680	1680	1680	1680	1680	1680
Mean	−0.001	0.787	1.373	22.089	0.359	0.321	0.059	0.057	31.997
SD	0.025	0.409	0.948	1.051	0.179	0.344	0.052	0.062	17.256
Median	−0.002	1	1.386	21.974	0.338	0.159	0.055	0.056	30.132
Min	−0.144	0	0	19.629	0.008	−0.675	0.006	−0.248	8.72
Max	0.122	1	4.29	26.263	0.917	2.1	0.335	0.327	85.23

Table 3. Preliminary Regression

	CV	CV1	Size	Lev	Growth	ROA	Cashflow	Top1
BTD	−0.004**		0	−0.010*	0.000	0.198***	−0.026**	−0.000*
	(−2.46)		(−0.11)	(−1.94)	−0.52	−11.31	(−2.29)	(−1.86)
BTD		−0.003***	−0.003	−0.026***	0.000	0.225***	−0.022*	−0.000**
		(-2.84)	(−1.45)	(−3.33)	−0.49	−11.49	(−1.86)	(−2.55)

Note: *, **, and *** indicate significance at the 10%, 5%, and 1% levels.

test, the results show that the regression coefficient of CV and CV1 are both negative, respectively passing the significance test at the 5% and 1% level, which indicates that with the increase of site visits by institutional investors, the degree of tax avoidance of family enterprises will be reduced. Then the first hypothesis is verified.

Table 4 shows the regression results of the two groups of data respectively. Considered that it is no longer statistically significant in the group where CEO is not a family member, the site visits of institutional investors have no obvious governance effect. Then the second hypothesis is verified.

Table 4. Grouped Regression

		CV	CV1	Size	Lev	Growth	ROA	Cashflow	Top1	N
CEO is a family member	BTD		−0.004***	0.001	−0.029***	0.000	0.214***	−0.008	−0.000**	898
			(−3.73)	−0.41	(-2.62)	−1.51	−7.24	(−0.45)	(−2.52)	
	BTD	−0.004*		0.000	−0.029***	0.000	0.223***	-0.01	−0.000**	898
		(−1.78)		−0.11	(−2.68)	−1.47	−7.57	(−0.57)	(−2.36)	
CEO is not a family member	BTD		−0.002	0	−0.030**	0.000	0.189***	−0.012	0.000	782
			(−1.46)	(−0.10)	(−2.54)	(−1.55)	−6.51	(−0.67)	(−1.33)	
	BTD	−0.003		0.000	−0.030**	0.000	0.192***	-0.011	0.000	
		(−1.04)		(−0.18)	(-2.54)	(−1.47)	−6.59	(−0.64)	(−1.18)	782

Note: *, **, and *** indicate significance at the 10%, 5%, and 1% levels.

Table 5. Robustness Check

	CV	CV1	Size	Lev	Growth	ROA	Cashflow	Top1
DDBTD	−0.004***		0.000	−0.026***	0.000**	0.125***	0.017	−0.000
	(−2.66)		−0.14	(−3.35)	−2.39	−6.36	−1.41	(−1.52)
DDBTD		−0.004***	0.001	−0.026***	0.000**	0.131***	0.017	−0.000
		(−4.42)	−0.46	(−3.42)	−2.33	−6.67	−1.39	(−1.64)

Note: *, **, and *** indicate significance at the 10%, 5%, and 1% levels.

3.3 Robustness Check

By replacing the key variables, we use DDBTD to substitute BTD for robustness testing. DDBTD can be calculated from Model 2:

$$BTD_{i,t} = \alpha TACC_{i,t} + \mu_i + \varepsilon_{i,t} \tag{2}$$

where TACC is total accrued profit, equal to (net profit - net cash flow generated from operating activities)/total assets. DDBDT $= \mu_i + \varepsilon_{i,t}$, represents the accounting tax variance after deducting the impact of accrued profit, ui represents the average residual of firm i over the sample period, and $\varepsilon_{i,t}$ represents the deviation between the annual residual and the average residual μ_i.

The regression results in Table 5 show that DDBTD is negatively correlated with explanatory variable CV/CV1 at the significance level of 1%, and the regression coefficients are both -0.004, which is little different from the original results, and the main conclusions of this paper remain unchanged.

4   Conclusion

Under the background of widespread corporate tax avoidance and high enthusiasm for institutional investors', we study the role of institutional investors' site investigation on corporate tax avoidance from the perspective of family firms based on the agency view of tax avoidance. Empirical results show that the governance effect exists and is more obvious in firms where the CEO is a family member.

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