

**Investigating the relationship between corporate tax avoidance and corporate culture in large South African companies**

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# Investigating the relationship between corporate tax avoidance and corporate culture in large South African companies

## Abstract

Not all companies are equally aggressive in their pursuit of corporate tax avoidance, which explains intensive research on the determinants of tax avoidance. Many determinants have been investigated, but the process of tax avoidance, and the relationships between corporate tax avoidance, long-termism (indicative of a stakeholder-orientated corporate culture), and CEO characteristics (informed by upper-echelon theory), are not yet fully understood. Much of previous research is conceptualised from theories such as principal-agent theory. This study investigates the influence of stakeholder orientation, using corporate culture, on corporate tax avoidance, in response to calls for more research using stakeholder theory. A mixed-method approach is used. The quantitative stream uses regressions to investigate the relationship between corporate tax avoidance, corporate culture, and tax-knowledgeable CEOs, based on a sample of 112 large, listed South African companies, studied over a period of 15 years. The South African setting allows the operationalisation of a tax-knowledgeable CEO, based the homogenous nature of CEOs' qualifications in South Africa, where many are chartered accountants. The results suggest that long-term oriented companies pay more tax on average. The results further suggest that tax knowledgeable CEOs are associated with more tax avoidance. The qualitative stream conducts eleven interviews with corporate tax advisors, showing the influence of corporate culture and CEO characteristics on corporate tax avoidance processes, but also how corporate culture and CEO-characteristics mutually inform each other. Altogether, the evidence indicates that the effect of corporate culture is less static than expected, and that the influence of corporate culture on tax avoidance can transcend the influence of CEO-characteristics, as an upper-echelon effect. The interviews suggest mechanisms used by CEOs to influence tax culture, such as the creation of a company-wide awareness of the strategic importance of low effective tax rates. These results also indicate the ethical dilemma faced by executives of large companies when considering the use of tax-deductible corporate social responsibility initiatives, not to benefit shareholders or agents, but rather to benefit society as a corporate stakeholder, when governments would not.

## Keywords:

Corporate tax avoidance; corporate culture; CEO-effects; Corporate Social Responsibility; Upper-echelon Theory; Tax knowledge; Mixed Method Research Methodology; Interviews.

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### **Plagiarism declaration:**

This thesis represents my own work, both in concept and execution.

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Pieter vd Spuy

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## **Terms**

AETR	Accounting Effective Tax Rate
CA (SA)	Chartered Accountant (South Africa)
CEO	Chief Executive Officer
CETR	Cash-effective Tax Rate
CFO	Chief Financial Officer
CSR	Corporate social responsibility
EPS	Earnings per share
ETR	Effective tax rate
ESG	Economic, social and governance
FE	Fixed-effect
MCHI	McKinsey Corporate Horizon Index
MM	Mixed method methodology
OLS	Ordinary Least Squares
QUAN	Qualitative research stream
QUAL	Qualitative research stream
ROA	Return on assets
SAICA	The South African Institute of Chartered Accountants
SARS	South African Revenue Service
TSR	Total shareholder return
YOY	Year-on-year

## **Acronyms for industry classification of companies used in the sample**

cgs	Consumer goods and consumer services industry
Financials	Financial industry
hti	Healthcare, Telecommunications and IT
industrials	Industrial operations industry
mmnr	Minerals, mining and natural resources industry

# 1 Introduction

## 1.1 Background to the problem of tax avoidance

If governments have become adept at the art of taxation, then it would seem as if corporates all over the world have responded by becoming skilful at corporate tax avoidance. Corporate taxes often constitute a significant portion of a government's total budget, which is used to provide public services to society. Therefore, society is negatively affected if their government's income is reduced by corporate tax avoidance. Consequently, this may encourage governments to reduce their spending on projects which could have benefitted society; for example, the development of infrastructure that could stimulate economic growth or address social needs. Alternatively, governments may resort to imposing an increase in tax rates to cover shortfalls due to a shrinking tax base; this puts even more pressure on the existing tax base, which could provide even more incentives to avoid tax in a self-destroying circle. Also, this could reduce spending power, therefore suppressing economic growth, which may also harm society. Indeed, the South African Revenue Service (SARS) states that:

*“the harms caused by impermissible tax avoidance are varied and pervasive. They include short-term revenue loss, growing disrespect for the tax system and the law, increasingly complex legislation, the uneconomic allocation of resources, an unfair shifting of the tax burden, and a weakening of the ability of Parliament and the National Treasury to set and implement economic policy”* (South African Revenue Service, 2005:9)

The problem of corporate tax avoidance is exacerbated by the size of the companies involved, which arguably makes them more skilful because they have at their disposal more resources than smaller ones to achieve successful corporate tax avoidance. Reuters (2013) reports that large international companies such as Apple, Google and Amazon, which generate significant amounts of revenue in the UK, pay almost no tax in the UK, because they tend to structure their affairs to allow low or no tax in other jurisdictions. When this became public knowledge, Margaret Hodge, Chair of United Kingdom Committee on Public Accounts admonished these large companies that *“We're not accusing you of being illegal, we're accusing you of being immoral”* (The BBC, 2012). The immorality may be further contextualised by reference to the way in which the costly development of the electronic *transistor*, which is considered to be the pivot making possible the business models of Apple and Google, was indirectly financed by taxpayers, and for that matter, the US government. Development of the transistor was indirectly funded by the US taxpayers because the US government gave AT&T's subsidiary “Bell-Labs,” a monopoly to run telecom services; Bell-Labs has been described as one of the largest and most successful state-owned technology research laboratories in the world during the 20<sup>th</sup> century (Gertner, 2012: 1-2 ). As such, this scenario explains how societies may be deprived of significant developments and benefits if tax avoidance is not addressed.

### **1.1.1 The severity of corporate tax avoidance is unknown**

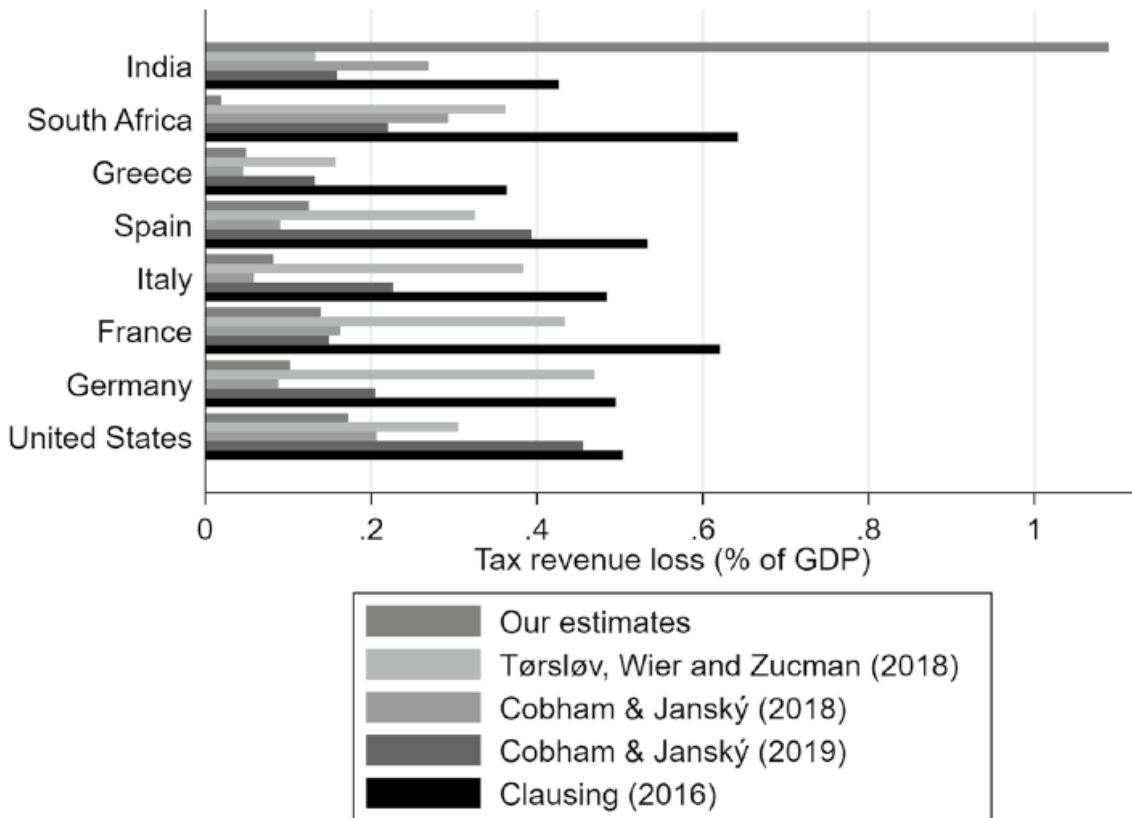
Part of the problem of tax avoidance relates to the difficulty in measuring the size of the problem; for example, in terms of any quantification of the amount of corporate taxes at stake. The International Finance Corporation (2016) reports that the quantum of the problem, in terms of untaxed dollars of corporate revenue, remains difficult to estimate. The revelation of the Panama-papers, in which the names of thousands of wealthy individuals who were engaged in tax avoidance by using tax havens and the obfuscation of beneficial interests in companies, were leaked to the public, may provide an idea of the significance of the problem (Chohan, 2016). The World Economic Forum estimates the global size of profit shifting from countries, a form of corporate tax avoidance in which corporate profits are diverted to low-tax jurisdictions, such as tax-havens, to be in the order of \$420 Bn per year; this figure provides some quantification of the size of the problem (The World Economic Forum, 2019). Jansky and Palansky (2019:1074) estimate that South Africa could be losing as much as 40% of its potential annual tax revenue to foreign tax jurisdictions because of profit shifting, as indicated in Figure 1-1 below. Comparatively, the graph in Figure 1-1 suggests that the South African tax loss problem is no less severe than the one faced by the US and French governments, which are in developed economies. The problem is comparable with India, which is a developing economy similar to South Africa. Figure 1-1 below also shows the difficulty in quantifying the size of the problem. That Figure depicts estimates made by five different researchers regarding the tax revenue foregone by each of the respective countries, expressed as a percentage of each country's GDP. The variance in each country's estimations attests to the difficulty in quantifying the size of the problem, and also possibly indicates the number of possible assumptions and inputs in economic models which are necessary to arrive at an estimate. Arguably, adequate management of problems can be advanced more effectively if the severity of the problem can be measured more accurately; this suggests that tax avoidance is a problem exacerbated by measurement complexity.

The OECD's (Organisation for Economic Co-Operation and Development [OECD], 2013) Base Erosion and Profit Shifting ("BEPS") in response to tax avoidance attests to the urgency and severity of the corporate tax avoidance problem world-wide, particularly pertaining to the strategies of multinational companies aimed at avoiding taxes in their home countries. The strategies include exploitation of loopholes created by the digital economy, for example to have profits taxed in countries with no or low taxes, excessive interest deductions, abuse of arms length transfer pricing principles (especially where the use of intangible assets are involved), opaque tax strategies, and limited obligation on taxpayers to disclose aggressive tax planning, to mention but a few examples.

Nevertheless, tax avoidance scandals involving the names of familiar corporates such as Apple or Google, may shadow the effect of corporate tax avoidance on smaller developing economies, which can scarcely afford revenue losses which may exacerbate the severity of social challenges. In this regard, Wang, Xu, Sun & Cullinan, (2020:806) calls for more tax avoidance research in developing countries, especially as far as the influence of the institutional environment on corporate tax avoidance is concerned.

**Figure 1-1 Extent of tax revenue lost, as % of GDP due to foreign direct investment**

The legend below the graph indicates the source of these estimates from the research of the respective authors.



Source: Jansky & Palansky, (2019:1074)

### **1.1.2 Contextual aspects regarding South African corporate tax avoidance**

South Africa has some large multinational companies listed on the Johannesburg Stock Exchange, which suggests the presence of corporate tax avoidance through profit shifting, which can erode the South African tax base. Furthermore, the problem in developing countries such as South Africa may be exacerbated by a lack of institutional strength, which may be exacerbated by the complexity of the tax structures and transactions that often involve corporate tax avoidance. The so-called “*curse of natural resources*” which developing countries suffer if they are richly endowed with mineral resources, seems to add another dimension to the corporate tax avoidance problem. UNCTAD, (United Nations Conference on Trade and Development, 2016) reports on significant under-invoicing at mining companies involved in the export of gold and iron ore from South Africa, which means that there are discrepancies between the value reported for exports and the value reported by the importer for the same goods. This suggests that ‘value’ leaves South Africa which may not be accounted for as revenue by the South African entity exporting the goods at full market-related sales prices. UNCTAD (2016:6) reports that “*The case of gold exports from South Africa is also strikingly peculiar. Imports of nonmonetary gold reported by trading partners vastly exceed exports recorded by South Africa.*” This may mean that the South African fiscus sacrifices customs revenue and other tax revenue.

Multinational companies may indeed be responsible for a significant percentage of global corporate tax avoidance, as indicated in Figure 1-1 above, but this problem is not confined to multinationals. For instance, Dyreng, Hanlon, Maydew and Thornock (2017: 441) report on a decline in effective tax rates of multinational firms in the USA, not only pertaining to international profits, but also concerning effective tax rates on local operations. Of further interest is these authors’ finding that declining foreign statutory tax rates explain little of the overall decrease in effective tax rates: this provides further evidence that corporate tax avoidance is not only attributable to companies exploiting opportunities to shift profits to jurisdictions with no or low tax rates.

### **1.1.3 Corporate tax morale may be influenced by individual tax morale**

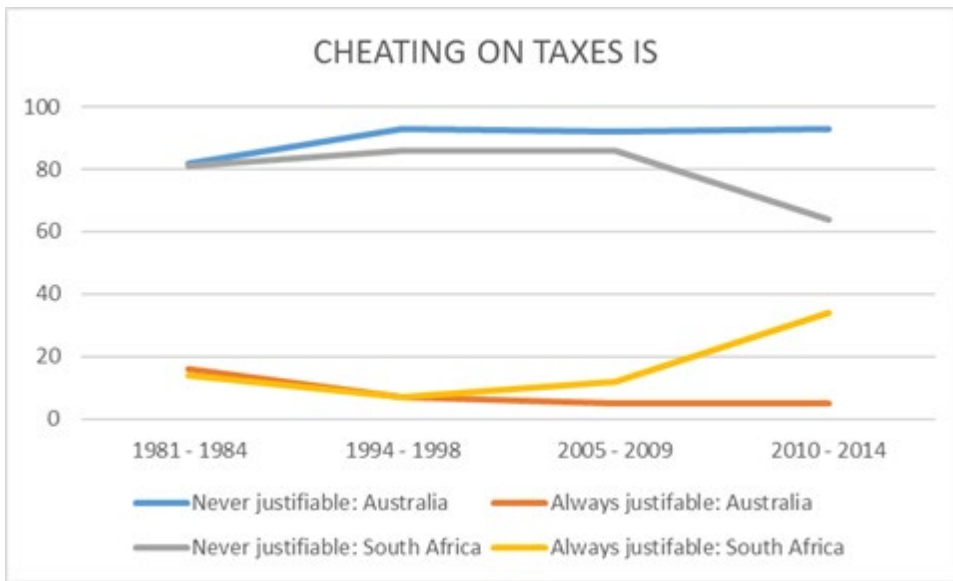
The problems of corporate tax avoidance and low tax morale are exacerbated by difficulties in identifying tax avoiders, mainly because it is difficult to profile them. Torgler (2002:657) posits that:

*“problems with tax morale is a societal phenomenon that is difficult to explain. Questions about tax compliance are as old as taxes themselves and will remain an area of discovery as long as taxes exist. To understand the impact of a tax system, it is important to know who complies with the tax law as well as who does not. Tax evasion is a large and growing problem in almost all countries. Unfortunately, we know very little about tax morale behaviour”.*

This suggests the need to understand more about the characteristics of individuals and companies which attempt to reduce their tax obligations through tax avoidance and tax evasion. Tax morality has an important bearing on the disposition of individuals regarding matters concerning tax avoidance. However, changes in the value judgements

and opinions of individuals may extend to corporate views through institutional processes as well, because the human nature under the corporate veil cannot be ignored. Tax morale may well be linked to societal trust, indeed Kanagaretnam, Lee, Lim & Lobo, (2018:1588) find that tax avoidance increases when societal trust in governments decreases. Wang, Xu, Sun & Cullinan, (2020:801) argues that a society's institutional framework, which includes societal values - argued to be subject to government's adherence to the social contract - influence corporate behaviour and therefore, as argued in this study, also corporate tax avoidance. Figure 1-2, below, depicts the results of a survey regarding the acceptability, to South African and Australian citizens, regarding a disposition to "cheat" with taxes; that survey was conducted by the World Values Survey (The World Values Survey, 2014). The graph suggests an upward slope in the percentage of South Africans who feel that cheating with tax is always justifiable; in comparison, the trend for the Australian citizens' opinion moves sideways, or even declines. Conversely, the percentage of South Africans who feel that tax evasion is never justifiable appears in a steep decline, in contrast to the Australian case, which is more stable. The graph illustrates the South African citizens' significant deviation from the Australian opinion; this is particularly noticeable from the period 2005-2009. It would seem as if South Africa's institutional views or disposition towards taxes is changing, which possibly coincides with the appointment of President Jacob Zuma as South African president, a presidency that is associated with egregious corruption and mismanagement; South Africa still struggles to recover from this period (The Economist, 2019). The evidence presented in this graph suggests that South Africa is possibly experiencing a fall in tax morale, perhaps driven by a tax-paying public who have lost confidence in the South African government that has failed to improve the livelihood of millions of poor South Africans although billions of Rands have been squandered to no effect. It is possible that the same disposition towards taxes may be carried by corporations as well, although tax avoidance may be more difficult to implement successfully, in comparison to individuals, because of more government scrutiny and public visibility that large corporations are subjected to. Whether all companies subscribe to new '*Zeitgeists*' as an institutional framework, in response to evidence of government's breach of the social contract, is not certain, however.

**Figure 1-2 Cheating on taxes: Comparing opinion between South Africa and Australian survey respondents**



Source (World Value Survey, 2014)

#### **1.1.4 Effective tax rates as an imperfect indicator of corporate tax avoidance**

The improved understanding of tax avoidance as a problem is impeded further by difficulties to identify tax avoiders, since frequently used measures such as effective tax rates (Hanlon & Heitzman, 2010) are not necessarily good measures. Notably, effective tax rates cannot capture tax avoidance which involves the non-declaration of income which is not accounted for in financial statements. Also, an effective tax rate may be distorted due to accounting mechanisms. For example, Drake, Hamilton and Lusch, (2020) analyse accompanying tax notes, particularly the tax rate reconciliation, and report that low effective tax rates may be attributed mostly to unrecognised tax losses related to prior periods. Regardless, anecdotal evidence suggests that effective tax rates are closely monitored, not only by regulators, but also by an investment public who seem to use the assessment of effective tax rates as an indication of social responsibility in companies: Investec Bank, which is one of South Africa's largest listed banks, issued a trading update announcement in which it explains reasons for a drop in earnings per share; one of the many reasons cited was a process of *"effective tax rate normalisation"* (Investec Bank, 2020). This explanatory note could be interpreted as providing evidence that some listed companies may be trying to actively manage low effective tax rates upward, not only to appease the South African Revenue Service, but also to avoid negative publicity and negative consequences for their reputations. Any criticism against using effective tax rates as a measurement of corporate tax avoidance should therefore be considered in the light of evidence suggesting that effective tax rates are also actively managed.

Difficulties in identifying corporate tax avoiders are exacerbated by strategies used by companies. For example, ESG programmes and initiatives may be used to legitimate corporate behaviour, diverting unwanted attention from the public and regulators regarding aggressive tax behaviour. The CEO of Blackrock, the world's largest asset manager, specifically refers to research by the Financial Times suggesting an almost perfectly inverse correlation between companies' ESG ratings and effective tax rates. Larry Fink, Blackrock's CEO comments that *"Big tech's profits are so massive that a small increase in tax compliance would do more social good than all the remarkable initiatives touted in their glossy corporate social responsibility reports."* This comment is relevant to this study, because evidence regarding the relationship between CSR as a determinant of tax avoidance is found to be mixed and inconclusive, based on a thorough literature review conducted on this aspect by Bruehne & Jacob, (2019:32), suggesting scope for further research in this regard. Moreover, Bruehne & Jacob, (2019:32) also calls for more research on the mechanisms used by companies to avoid tax. CSR is argued to be such a mechanism used in South Africa, although not necessarily influencing effective tax rates, used as proxy of tax avoidance, because CSR expenditure is an accounting expense which is also tax-deductible.

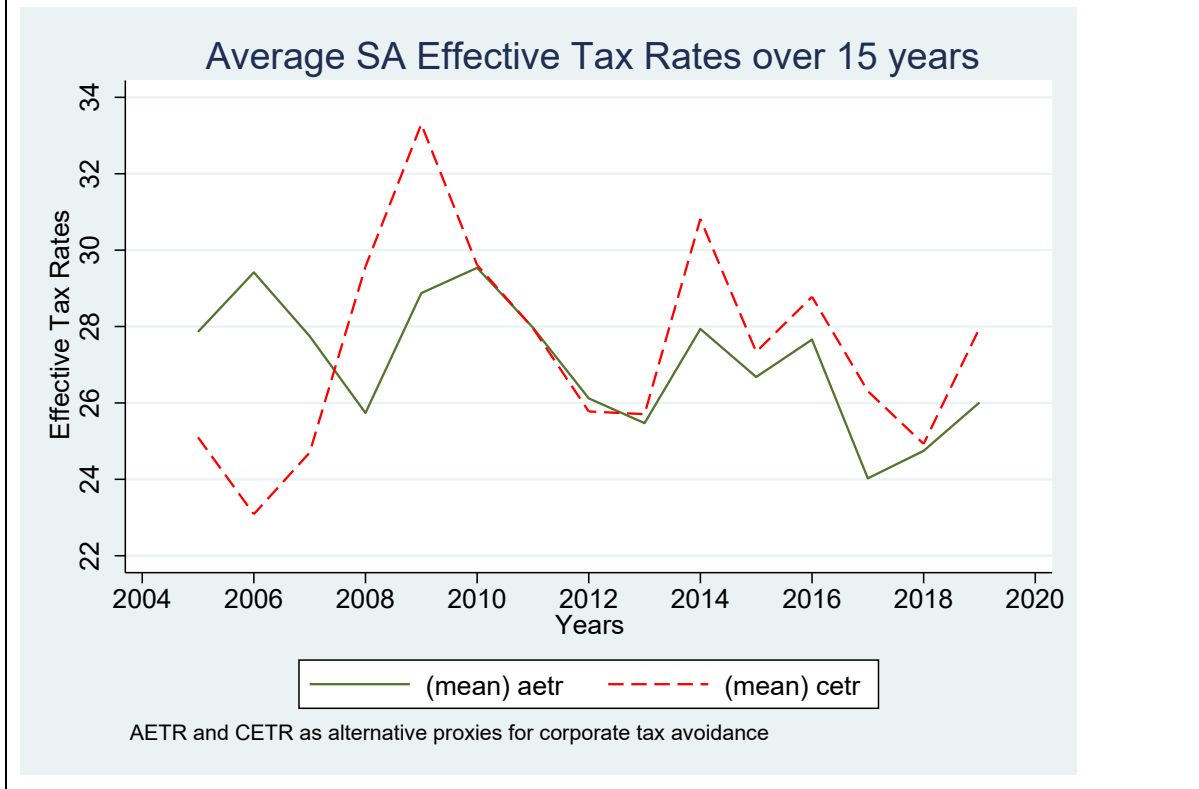
#### **1.1.5 Moving with the times: fluctuating effective tax rates in South Africa from 2004 to 2019**

Figure 1-3, below, depicts the effective tax rates (AETR and CETR) of 112 of South Africa's largest listed companies, for the period 2004 to 2019<sup>1</sup>. A review of these effective tax rates may provide some insight into the severity or quantum of tax avoidance in South Africa during this period. Accounting Effective Tax Rates (AETR) reached a maximum value of 29% in 2010 (statutory tax rates were then 28%) and a lowest point of 24% in 2017 (statutory tax rates 28%). This shows that the extent of tax avoidance, measured in terms of the gap between the statutory tax rate and the effective tax rate, reached a 4% spread in 2017. Conversely, cash effective tax rates (CETR) reached a maximum of 27% in 2006 (statutory tax rates then 28%) and a lowest point of 25% in 2018 (statutory tax rates then 28%), suggesting a gap at that stage of 3%. South Africa is a developing country and therefore even a low percentage of tax avoidance, based on measurement of this gap, may be significant enough to indicate a problem; this applies especially if one bears in mind the extent of structural problems and the pressure on government to provide public goods and services. The movements in the series over this period show a steep drop in both series from 2009 to 2013 to 26% for both AETR and CETR; this means that the period 2009-2013 may be described as one in which tax avoidance in large South African companies increased. Effective tax rates subsequently increased briefly until 2016: both series reached almost 28% (the statutory tax rate ruling at the time) in 2016, before both series again dropped significantly to almost 24%. The significant decline from 2009 corresponds with the drop in tax morale which is captured in the World Values Survey depicted in Figure 1-2 and discussed on page 18 above.

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<sup>1</sup> South African corporate tax rates were 30% until 2005. They then decreased to 29% until 2008 and then decreased further to 28% from 2009. Since then, rates have not changed up to the date on which this thesis was submitted. (SARB, 2017)

**Figure 1-3 Average effective tax rates in South Africa (SA)**



The short-lived upward trend in effective tax rates during the period 2013-2016 does not mirror the declining trend in tax morale as depicted in Figure 1-2. However, there may be other factors that also influence effective tax rates, as described below with reference to the extant literature on the determinants of corporate tax avoidance.

Years of governmental mismanagement in South Africa, especially during the period 2009-2017, before President Cyril Ramaphosa became president, may also be indicative of more and persistent tax avoidance in the future. This would impact South Africa negatively at a time when the country is least able to tolerate it. The popular media frequently reports on a brewing tax revolt (News24, 2016). Businesstech, (2021) reports on the results of a South African survey, in which 88% of respondents confirmed that they would support a coordinated campaign to avoid tax if they could. Although it may not be directly feasible for companies to participate, this finding may provide an idea of the growing resistance to government and taxes, not only by individuals but by corporates. However, this does not preclude more drastic corporate measures that some companies are taking to avoid South African taxes permanently. For example, in 2020, AngloGold-Ashanti, a pioneer in the South African gold mining industry, sold all of its South African assets and operations, citing incommensurate political risk, labour strikes and unreliable electricity supply due to mismanaged state-owned utilities as the main reasons for exiting South Africa (Business Insider South Africa, 2020). Although this situation is arguably not considered as being corporate tax avoidance in the normal sense, the outcome remains the same for the South African fiscus; after all, the chances of receiving taxes from AngloGold Ashanti in future is nil, although perfectly legal from the latter's perspective.

The preceding discussion has depicted corporate tax avoidance as a problem which negatively affects societies worldwide, and also in South Africa. It is a problem which is difficult to measure as there are many dimensions in which it can manifest, not least because a widely-used indicator such as effective tax rates captures but one dimension. Also, it would seem as if any interpretation of tax avoidance as being unethical behaviour may not be universally acceptable. Torgler (2002:657) argues that we do not know much about the effect of morals on tax avoidance. There are arguments that the political environment or circumstances, such as unethical governmental behaviour in the form of corruption and waste of taxpayers' money, could influence people's and possibly also corporations' views on whether tax avoidance is unethical or not. However, the following section argues that empirical research on the relationship between different ethical dispositions of companies and tax avoidance is limited, which presents a literature gap for more empirical enquiry, which is the focus in this study.

### **1.1.6 Challenges in the literature to improve understanding of the determinants of corporate tax avoidance**

Not all companies are equally aggressive in avoiding tax and many determinants of corporate tax avoidance are investigated in the literature to explain which companies, with which characteristics are more amenable to engage in corporate tax avoidance. Much of this research use regressions in which the relationships between effective tax rates, as measure of tax avoidance, and determinants are investigated. For example Rego (2003: 828) and Richardson and Lanis (2007:689) investigated relationships between company size and effective tax rates: a widely used proxy for tax avoidance. Rego (2003: 828) and Mills *et al.* (1998:1) investigated relationships between corporate tax avoidance and companies' classification as multinational companies. Richardson and Lanis, (2007:689), Gupta and Newberry (1997:1) and Stickney and McGee (1982:125) investigated the influence of financial gearing. Richardson and Lanis (2007:699), Gupta and Newberry (1997:1) and Markle and Shackelford (2011:415) all report the existence of relationships between the intensity of different asset types and effective tax rates. Richardson and Lanis, (2007:699), Gupta and Newberry, (1997:1) and Kim and Limpaphayom, (1998:47) investigated the relationships between varying profitability levels as a determinant of corporate tax avoidance. Many of these studies derive their empirical expectations from the theory of rational utility maximisation.

Principal-agent theory, under the umbrella of shareholder value maximisation theory, is another theory that guides the expectations of various relationships with tax avoidance among aspects such as corporate social responsibility and corporate governance. For example, Lanis and Richardson, (2012a:86) and Davis, Guenther, Krull and Williams, (2016:47) report the existence of relationships between corporate social responsibility and tax avoidance. However, a comprehensive literature review conducted later by Bruehne & Jacob, (2019:18) concludes that the evidence on this relationship is mixed, with most quantitative papers reviewed for this purpose showing no relationship with corporate tax avoidance. Furthermore, the literature is devoid of any reference to the possibility that corporate social responsibility could be used by companies to pay less tax, but where the purpose of doing so is not to enrich shareholders or agent-managers, but rather to benefit society directly through omittance of corrupt governments. Last, the literature review in Chapter 2 shows doubt regarding the extent to which contemporary measures of CSR

performance and CSR disclosures really capture a company's CSR performance, and more specifically whether a company is subscribing to a complete stakeholder orientation, as is espoused, but not guaranteed by CSR engagement through CSR initiatives. This necessitates a look for other constructs to capture a fuller extent of a company's stakeholder orientation, such as long-termism as a corporate culture, which this study investigates as a determinant of corporate tax avoidance.

Inconclusiveness and mixed evidence also manifest in studies that investigate the relationship between various mechanisms of corporate governance and corporate tax avoidance. For example, Gaertner (2014:1079) reports strong evidence in support of the influence of after-tax CEO incentives (a corporate governance mechanism) and tax avoidance, while Armstrong, Blouin, Jagolinzer & Larcker, (2015:1) find no relationship between corporate tax avoidance and corporate governance. In contrast is Kovermann and Velte (2019:1) who reports no relationship between corporate governance mechanisms and tax avoidance at the conditional mean, but yet, a strong influence at the high ends, and at the very low ends, of the tax avoidance distribution. The authors argue that the effects of corporate governance is selective in its intensity given circumstances to *"steer tax avoidance to its specific optimal level"*. Important to this study's focus is the authors claim that the principal-agent theory fails to fully explain corporate tax avoidance, and their call for more comprehensive research where all stakeholders are accounted for. This presents a gap, addressed in this study, when long-termism as a corporate culture is argued to be indicative of consummate stakeholder orientation, which is investigated in this study as a determinant of corporate tax avoidance. This study also incorporates quantile regression when measures of tax avoidance are regressed on CEO-characteristics. The CEO is a corporate governance role player, and therefore this study extends research on the effects of corporate governance related mechanisms on the lower and upper ends of the tax avoidance distribution, as performed by Kovermann and Velte (2019:1) before.

Bruehne & Jacob, (2019:6) report a dearth of research regarding the relationship between management characteristics - such as management skills – and tax avoidance, claiming that the theory that guides expectations in this domain are ambiguous, and in need of qualitative research to understand how tax avoidance decisions really work inside companies<sup>2</sup>. In this regard the authors suggest more research on the specific mechanisms that executives use to effect tax avoidance. Last, Wang , Xu, Sun and Cullinan (2020:807) says that the 'black box' of how tax choices are made within organisations is unknown, also suggesting calling for more qualitative enquiry. In sum, this discussion provides credence to Dyreng's statement, saying that: *"There's a lot of research, but we don't have a very*

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<sup>2</sup> The influence of CEO characteristics is an important strand of literature. Dyreng, Hanlon and Maydew, (2010) find that individual CEOs are associated with tax avoidance, related to Upper-echelon theory that predicts the importance of the CEO and other members of top management in influencing or determining corporate behaviour. Garcia-Meca, Ramón-Llorens and Martínez-Ferrero (2021) report that narcissistic CEOs are associated with tax avoidance, although the effect is mediated by a strong audit committee. However, Chahin and Fang (2021) suggest that in the case of ethics, CEO effects are the overriding factor for less accounting fraud: they argue that the CEO sets the tone in corporate ethics.

*good understanding of the causes of variation in effective corporate tax rates.*" [quoted in Duke University (2015)]. This sentiment is also captured by other authors who highlight other problems to understand the black box and the limits to quantitative enquiry. Holland (2019:6) argues that *"tax data reported in financial statements often represents aggregated summaries of potentially conflicting or contrasting effects"*, encouraging more qualitative inquiry, an approach which is impeded due to difficulty to access high-profile tax experts for interviews (Rogers and Oats, 2022:93). Indeed, Mulligan & Oats (2016:64) argue that the growing view of tax as a social and an institutional practise, makes interpretive research methodology, such as interviews, indispensable to move the tax avoidance literature forward, especially regarding the actors involved and the nature of the respective roles that they play in corporate tax avoidance, inside and external to the company.

### **1.1.7 Summary of contribution**

The previous paragraph indicated that corporate tax avoidance literature, especially as far as quantitative methodology is concerned, has reached an impasse of sorts: Quantitative inquiry shows mixed and inconsistent results in important areas, as far as stakeholder-related determinants of tax avoidance are concerned, whereas qualitative inquiry is limited for many reasons, which prevents theory-building and understanding of the mechanisms and processes used towards tax avoidance in companies. The main contributions of this study centres therefore around its identification of corporate culture, and specifically a corporate culture indicative of a long-term orientation, as consequential for corporate tax avoidance. The literature review positions and argues corporate culture to be a higher-order, multi-dimensional, and yet, values-laden construct, one that reflects the actual corporate values and ethical aspirations of a company, in short, more reflective of the true level of stakeholder orientation that a company exhibits and subscribes to. Corporate culture<sup>3</sup> is argued to be an invisible, yet consequential organisational pivot against which all important decisions in a company are taken and evaluated against. In this regard, the study operationalises a corporate culture of long-termism, using the McKinsey Corporate Horizon Index (MCHI) for the first time in an academic setting, and evaluates whether long-term oriented companies pay more tax as expected, to discharge its obligation to broader society's benefit under the umbrella of stakeholder theory. This part of the study adds to the literature regarding the influence of broader stakeholder-interests, corporate ethical dispositions, and corporate morals on corporate tax avoidance, which are not clearly understood.

In this regard, this study acknowledges the influence of the CEO on corporate culture, and in this instance, the study adds to the body of literature concerning the influence of CEO-skills sets as an executive effect, on corporate tax avoidance. This part of the study finds a novel way to operationalise tax knowledge attributed to the CEO, because it

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<sup>3</sup> Homburg and Pflesser (2000) argue that corporate culture manifests as shared values, norms, artefacts and behaviours. Johnson (1992) and Johnson, Whittington, Scholes, Angwin and Regner (2014) conceptualise corporate culture as a set of overlapping organisational components, which together, create a paradigm of belief on how companies operate, which is construed as a 'cultural web.' This web includes components such as the corporate control systems, the organisational structures, the power structures, corporate symbols, stories, corporate rituals, and corporate routines.

exploits a feature unique to the South African corporate landscape where a significant number of the CEOs of large companies are chartered accountants, a feature that this study argues is an indicator of tax knowledge and expertise, attributed to those CEOs. This suggests a homogenous group of CEOs, which is unique to the South African setting. In this regard, the literature on skills of CEOs as determinants of tax avoidance is carried forward.

Changes in the political landscape in South Africa during the period under observation in this study, involve periods of political scandal and government corruption, which provides a setting to explore the influence of institutionalism on corporate tax avoidance. It is argued that a decline in societal trust should result in more tax avoidance, as society's changing values become institutionalised, also having an influence in the corporate setting. Also, this study's uses the South African setting and data from South African companies, in this way responding to calls for more tax avoidance research in developing countries.

With regards to plenty of references in the literature (as discussed before) to prevailing black-box qualities of tax-avoidance processes and mechanisms in companies, this study responds to frequent calls for more qualitative inquiry in the form of semi-structured interview, when it secures interviews with eleven external tax advisors to large corporate companies. The author conducts interviews with these experts in which the author tries to understand their views about the influence of corporate culture, the CEO, and corporate governance, all on tax avoidance, as well as the relationships between them.

## **1.2 Thesis statement**

This thesis investigates how elements related to corporate culture may be influencing corporate tax avoidance. Thus, it investigates the influence of long-termism as a particular type of corporate culture on corporate tax avoidance, although it is assumed, and reported in the extant literature, that CEO effects also influence tax avoidance and corporate culture. The following thesis statement suggests that corporate culture has a static, inherently stable quality which allows for its influence on corporate tax avoidance, regardless of the CEO's impact on such tax avoidance. As such, the thesis statement of this study is formulated below:

*“Corporate culture exerts a long-term influence on corporate tax avoidance that is not merely a reflection of the CEO’s characteristics”*

## **1.3 Research questions**

Answers to the following research questions should be found:

### **1.3.1 Research question 1**

How severe is the problem of corporate tax avoidance in large, listed South African companies?

#### ***Sub research question 1***

Do fluctuations in corporate effective tax rates mirror political developments during the period under observation?

### **1.3.2 Research question 2**

What are the determinants of corporate tax avoidance in large South African listed companies?

### **1.3.3 Research question 3**

To what extent is corporate culture, and more particularly long-termism as a particular type of corporate culture, associated with corporate tax avoidance?

#### ***Sub research question 3***

Which measure may be used to measure long-termism as a corporate culture?

### **1.3.4 Research question 4**

To what extent are CEO characteristics, particularly tax knowledge and tax awareness, attributed to the CEO of a company, associated with corporate tax avoidance?

#### **Sub research question 4**

Which measure may be used as a proxy for above-average tax knowledge and tax awareness attributable to a CEO?

### **1.3.5 Research question 5**

Do developments in the political environment influence corporate attitudes towards tax avoidance and specifically corporate tax avoidance?

### **1.3.6 Research question 6**

What are the views of corporate tax advisors of large South African companies, based on their lived experience regarding the influence of corporate culture on tax avoidance, the prospects of CEO-characteristics to influence corporate tax avoidance, as well as the relationship between corporate culture and CEO-characteristics?

## **1.4 Research objectives**

The following research objectives are stated:

- A. To obtain an understanding of the average effective tax rates for the large, listed South African companies during the period 2004-2019, including whether tax avoidance mirrors any changes in the institutional environment.
- B. To obtain an understanding of the determinants of corporate tax avoidance in large South African listed companies.
- C. To identify a measurable proxy for measuring long-termism as a corporate culture, and then to calculate a long-term score for each company-year observation in the selected sample.
- D. To investigate the relationship between long-termism, as a particular type of stakeholder-driven corporate culture, and corporate tax avoidance.
- E. To investigate the relationship between corporate tax avoidance and the tax knowledge and tax awareness of a CEO.
- F. To conduct interviews with corporate tax advisors to understand the severity of corporate tax avoidance in large, listed South African companies; understanding the influence of corporate culture on tax avoidance, as well as to obtain their impressions about the CEO's influence on both corporate tax avoidance and corporate culture.
- G. To obtain an understanding of the mechanisms that CEOs of large South African corporations may use to effect corporate tax avoidance.

## **1.5 Delineations of this study**

The investigation described in this study concerns the relationship between corporate culture and tax avoidance and the effect of a CEO's knowledge and awareness of taxation on both these factors. The literature review indicates that corporate culture entails potentially limitless types or dimensions, which can often be used to describe corporate culture. For example, some corporate cultures are described as "good" or "bad" or "ethical or unethical" or "innovative" to mention but a few of the dimensions that might exist. It is not possible to articulate and

operationalise all those types of corporate cultures in one study for the purpose of this investigation. Therefore, in order to demarcate, practically, the scope of this study, the author identifies the temporal orientation of a company in terms of whether it is more short-term oriented or more long-term oriented. The author argues that this orientation is an important dimension of corporate culture, which is closely connected with an ethical disposition. This view is investigated in this study and the outcome is expected to explain why some companies avoid more tax than others.

## **1.6 Limitations to this study**

The research is subject to limitations which are briefly discussed below under separate headings for those limitations relating to data, as opposed to methodological limitations. A more detailed discussion of limitations is provided in Chapter 3, Research Methodology.

### **1.6.1 Data limitation**

The research makes use of data on the 112 largest companies listed on South Africa's Johannesburg Stock Exchange. The sample is limited because South Africa has relatively few large, listed companies, when compared to the US or UK, for example. Another aspect concerns extrapolation of results. The South African context, for example national culture and classification as a developing economy, may have an influence on results; this suggests that findings should be extrapolated to other contexts with caution. The data from the qualitative stream of this research is based on interviews with corporate tax advisors in South Africa. It is possible that those South African tax advisors' opinions may be biased to some extent by political developments in South Africa, such as criticism of government's weaknesses as discussed above [see 1.1.4].

### **1.6.2 Methodological limitations**

Methodological limitations proceed from a lack of theory, as well as imperfect identification strategies regarding the measurement of constructs. For example, the investigation concerns tax avoidance, but effective tax rates, used as the proxy variable for tax avoidance, are not a perfect measure; one reason is that they only capture tax avoidance originating from transactions that are reported on either the balance sheets or income statement. Also, the measure for a long-term corporate culture, based on the McKinsey Corporate Horizon Index, may also not be perfect, as that measure was developed for commercial purposes. The same limitation applies to the use of an academic qualification as the measure for tax knowledge and tax awareness attributed to a CEO as a CEO effect. There may be other academic qualifications that may also be related to tax knowledge, which the proxy used in this study admittedly does not incorporate.

The use of statistical methods such as regression analysis suggests an inherent methodological limitation. For example, in contrast to scientific experiments where random assignment of samples into treatment and control groups can be organised, the same approach is difficult to implement in social research where observational data is

used. Regression analysis can control for some differences between observations, through control variables, but ultimately, endogeneity due to omitted variables in specifications cannot be fully excluded from the findings of this thesis; this can bias results. Although fixed-effect regressions are used in this thesis to control for omitted, time-invariant variables in regression specifications as a source of endogeneity, there are only limited opportunities to use other mechanisms, such as natural experiments, instrumental variables, or regression-discontinuities. Instead, the author extends the quantitative investigation with interviews which may corroborate the validity of quantitative findings.

A final limitation concerns the limited amount of theory available to explain corporate tax avoidance. Here, it would seem that corporate tax avoidance is driven by a mixture of theories which are not mutually exclusive. For example, agency theory, shareholder maximisation theory, stakeholder theory and others not mentioned here may all help to explain corporate tax avoidance, but the conditions under which they are considered valid or applicable, are unclear.

## **1.7 Chapter outline of this study**

This section provides a layout of the study and explains how the various chapters advance one's understanding of corporate tax avoidance. This study follows a mixed-method methodology approach as explained in Chapter 3. That chapter explains the rationale for using mixed methods, and provides a roadmap to show how the results of the two methodologies are integrated.

### **1.7.1 Chapter 2 Literature review**

The literature review examines salient papers focussing on the determinants of corporate tax avoidance, with particular reference to quantitative empirical work. The literature shows that company-level determinants of corporate tax avoidance, such as company size, profitability and financial gearing, have been explored in the extant literature; nevertheless, corporate tax avoidance is not yet fully understood. In this chapter it becomes evident that empirical research, that considers ethics and corporate values as stakeholder-driven determinants of tax avoidance, have not been emphasised much in the literature. The literature review highlights the nature of different types of corporate cultures as consequential constructs in companies, which are expected to influence corporate tax avoidance as well. The review expounds upon the values-laden nature of corporate culture which suggests that the link to corporate ethics is an influencing factor for corporate behaviour. The review argues that corporate culture may be related to corporate social responsibility; this issue has been investigated before in detail and the literature review shows that corporate culture may be more indicative of the actual corporate values systems that are subscribed to in companies, while CSR performance scores may be more indicative of espoused or proclaimed values. The literature review briefly identifies and discusses the nature of the McKinsey Corporate Horizon Index (MCHI) as an instrument to operationalise corporate culture. The review shows how companies with a long-term orientation are truly sustainable with regards to all stakeholders, which leads to the expectation that such companies should be more stakeholder oriented. The literature review organises its discussion of tax avoidance literature along the dominant

theories used in the conceptualisation of those papers. Here, it is shown that economic, positivistic theories such as shareholder value maximisation and agency theory have been intensively used to investigate corporate tax avoidance. In contrast, the constructivist, or more subjective theories such as the stakeholder theory of the firm, have received less attention, especially from an empirical perspective. Consequently, this helps to explain the gap which this thesis addresses, as far as it advances the tax avoidance discourse to corporate culture: a more complex, values-laden construct. The literature review contextualises long-termism as a corporate culture, as determinant of tax avoidance which captures a consummate stakeholder orientation.

### **1.7.2 Chapter 3 Methodology**

Chapter 3 depicts, evaluates and justifies the mixed-methodology approach ('MM' hereafter) used in this thesis to collect the data needed to answer the research questions. This chapter contextualises the use of MM in this thesis, where the quantitative methodology stream is the dominant one, while the application of qualitative methodology constitutes the secondary stream of research. The chapter justifies the use of qualitative methodology as well in this thesis, because it helps to address some limitations related to and inherent to quantitative methodology in this thesis, as indicated briefly before. Chapter 3 explains that the use of quantitative methodology in this thesis is to a degree constrained by small data samples because, as explained above, South Africa has relatively few large, listed companies. Also, there appear to be limitations regarding the use of imperfect proxy variables for constructs such as long-termism, corporate tax avoidance, and also, pertaining to the proxy for a CEO to whom is attributed above-average tax knowledge and tax awareness. Therefore, this chapter explains that the use of qualitative data, obtained from interviews with corporate tax consultants, is suitable to augment the findings of the quantitative methodology because it helps to support the plausibility of the quantitative results. Qualitative data provides richer data which can yield some insight into the mechanisms used to pursue tax avoidance; it can also help one to understand what companies' attitudes are regarding corporate tax avoidance in the South African milieu. This chapter also evaluates concerns regarding subjectivity and bias at the use of qualitative methodology. Some misconceptions are discussed, while measures are identified which are taken to mitigate bias. The chapter ends with a diagram which assists ease of reference and navigation in the study, showing how and where the components of the two methodological streams (qualitative and quantitative) are performed and where the findings of each are integrated into a whole, in order to enhance coherency.

### **1.7.3 Chapter 4 Long-termism and corporate tax avoidance**

This chapter is the first of two chapters that constitute the quantitative research stream of this MM study. Chapter 4 introduces the concept of long-termism, as a type of corporate culture indicative of a stakeholder orientation, when it contextualises and evaluates the use of the five-factor McKinsey Corporate Horizon Index (MCHI) to measure long-termism. The chapter then applies regression analysis to examine the relationship between corporate tax avoidance and long-termism. The evidence from the results indicates support for the expectation that long-term oriented companies pay more tax on average because they are more sensitive to the interests of stakeholders, including

government and society. The evidence also indicates that some dimensions of corporate culture in companies may not be as stable, over time, as assumed before.

#### **1.7.4 Chapter 5 The association between the level of tax knowledge attributed to a CEO and corporate tax avoidance**

This chapter investigates the relationship between corporate tax avoidance and the degree of tax knowledge attributed to the CEO, as a CEO effect. The expectation in this chapter is that a CEO effect (CEO characteristic) will influence corporate culture in accordance with the concepts contained in Upper-echelon theory. The bulk of this chapter is formatted as an academic paper to ensure rapid publication. This chapter uses regression analysis to examine the relationship between corporate tax avoidance and CEO-tax knowledge attributed to the CEO, and the findings indicate evidence that supports the expectations. The results also provide some evidence that CEO effects do not necessarily always sterilise the impact of corporate culture as an independent driver of corporate culture beyond the CEO's influence. Chapter 5 is the last chapter of the quantitative stream of this study, before Chapter 6 reports on qualitative research based on interviews with corporate tax advisors.

#### **1.7.5 Chapter 6 Corporate tax avoidance and corporate culture: Tax advisors' views**

This chapter constitutes the application of qualitative research methodology in this MM study. Interviews are considered to be necessary in order to augment the research findings of the quantitative streams in the previous chapters, and to provide richer data which improve understanding of some of the reported black-box qualities of the tax avoidance process. As such, the interview process helps to satisfy research objectives and to answer the research questions. Chapter 6 explains the interview process, aspects of bias and then provides a critical account of the results of the interviews. The chapter categorises the interviewees' feedback in terms of four themes, each of which is linked to research propositions thought to be relevant for understanding tax avoidance. The results of the qualitative research indicate support for the findings of the quantitative research and provide more understanding of the process of corporate tax avoidance.

#### **1.7.6 Chapter 7 Integrating quantitative and qualitative findings**

The integration of quantitative and qualitative findings is an important phase in a MM study and is performed separately in this chapter to enhance coherence of the research. This chapter evaluates the evidence of quantitative research findings, as the dominant research stream, in comparison to the qualitative research findings. This chapter shows how experience, as related by the interviewees, indicates support of the influence of corporate culture on corporate tax avoidance, as well as their experience of the influence of CEOs on corporate culture and corporate tax avoidance.

#### **1.7.7 Chapter 8 Conclusion**

This chapter concludes the thesis. It provides a summary of findings pertaining to the research objectives of this study and refers to the salient findings of this study to evaluate the thesis statement. It also discusses some limitations to this research and provides an outline of opportunities for future research. Finally, it summarises the contributions of this study.

## 2 Literature Review

### 2.1 Introduction

The previous chapter broadly contextualised the research problem, the contribution, and a summary of the research questions to this study, which entails an investigation into the relationship between corporate tax avoidance and corporate culture. This chapter presents the deeper context from which those research questions were developed. To this end, this chapter positions the need to consider value-laden constructs, such as corporate culture, as determinants of corporate culture to advance understanding of corporate tax avoidance. More specifically, the literature review presented in this chapter shows that the relationship between ethical dispositions of companies and corporate tax avoidance has not been fully investigated before, with the sole exception of studies that investigated the relationship between corporate tax avoidance and corporate social responsibility (CSR).

The literature review is structured as follows. It starts with a depiction of the ethical quandary inherent to the obligation to pay tax, which suggests that ethical choices have to be made by individuals and corporate taxpayers alike. The discussion then examines literature on corporate tax avoidance with a focus on empirical research, which often uses finance theories such as shareholder value maximisation theory, agency theory and stakeholder theory, to classify the literature. Papers on corporate tax avoidance that are conceptualised from shareholder and agency theory are discussed first in section 2.5. This section shows that corporate tax avoidance is sometimes used successfully to benefit shareholders; nevertheless management, as agents, may sometime benefit more from tax avoidance depending on the corporate governance arrangements in place. The next stream of research is discussed in section 2.6 and explores the link between stakeholder theories and corporate tax avoidance. This discussion focuses particularly on papers that investigate the link between CSR performance and corporate tax avoidance, which the review finds to be largely inconclusive. The discussion on legitimacy theory in section 2.8 then finds that the inconclusive findings on the link between CSR and corporate tax avoidance may stem from practices where companies use CSR performance more for ulterior ends rather than from an intention to advance a true spirit of an ethical concern for the interests of stakeholders. Section 2.9 examines papers on determinants of corporate tax avoidance from the theory of institutionalism, which posits that corporate behaviour in companies, including tax avoidance behaviour, becomes institutionalised, or part of the standard operating processes in a company; this can be attributed to influences from elements such CEO effects, trends imitated from peer companies and other external forces. This section indicates the particular relevance of corporate culture as a determinant of corporate tax avoidance, which is positioned in section 2.11. Before continuing with the review of literature in the realm of corporate culture, the literature review first documents a brief synopsis of other literature regarding other company-level determinants of corporate tax avoidance in section 2.10. This is necessary not only for a comprehensive discussion of determinants of corporate tax avoidance, but also for the identification of other determinants of tax avoidance for control-variable purposes in regression analysis. Section 2.11 then extends the discussion about

corporate culture; it highlights the consequential nature of this construct, while views and research concerning corporate values as a source of corporate culture, and the determinants thereof, are explored. The discussion in this section identifies opposing views on the circular nature of determinants or influences of corporate culture, particularly regarding the hierarchical levels at which corporate culture manifests. Section 2.12 then presents the concept of long-termism as a higher-order, ethical type of corporate culture, indicative of a corporate ethical disposition that transcends CSR, and which the literature shows may have consequences for corporate tax avoidance. Finally, section 2.13 provides an exposition of the salient research questions of this study.

## **2.2 To pay or not to pay taxes: An age-old ethical quandary**

There is much literature, regarding rhetoric relevant to tax avoidance, that predates modern times. When Jesus Christ was asked by the Pharisee regarding one's moral obligation to pay tax, he answered "*Render therefore unto Caesar the things which are Caesar's.*" (King James Version, Matthew 22:21) Taxation appears to be a sensitive topic. It concerns aspects of ethics, values, rights, and the social contract between people and their government. Whether taxes benefit society is the subject of endless debate; for example, American Judge Oliver Wendell Holmes famously said "*I like to pay taxes. With them I buy civilisation.*". Also: "*Taxation is the price we pay for our social, civil and political institutions, for the security of life and property, and without which we must resort to the law of force*" (1851) both quoted by Bird and Davis-Nozemack<sup>4</sup> (2018:1009). Wars and revolutions were fought because of contentious views about taxes. For example Lepore (2018:81) explains how America's revolutionary war for independence from Great Britain was precipitated by the unhappiness of American colonists in paying taxes to the British crown, in the absence of alleged representation in the British legislature. It would seem as if the American colonists who vehemently opposed those British taxes had conveniently forgotten that some of those taxes were in fact applied by the British government to enable colonists to settle in America. They were applied, for instance, to protect American soil against Indian, Spanish and even French encroachment; this example indicates how subjective taxpayers' interpretation of their rights as citizens and obligations towards tax could be.

America's transition from an agrarian economy of small farmers to an industrialised one of mass production and mass employment, *circa* 1870, coincides with a growing societal expectation to companies to sacrifice a portion of their profits to society's benefit through paying taxes; this expectation can be interpreted as a *quid pro quo* for society's sacrifice of personal freedom to big companies. Lepore (2018: 336-377) explains how rapid industrialisation put many people, especially farmers, out of work, often forcing them into squalid working environments as labourers with little economic freedom for large, successful American companies such as Bethlehem Steel (founded by Andrew Carnegie) and Standard Oil (founded by John, D. Rockefeller). However, it would seem to be a long and contentious road before corporations were eventually taxed in 1913 after much pressure from society, when the Sixteenth Amendment Bill

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<sup>4</sup> Despite best efforts, the author could not obtain access to this very old document.

came to pass. Before this, attempts to tax corporations were met with fierce resistance. For example Lepore (2018:338) writes that “*when state legislature tried to tax the railroads, such as California did, federal judges eagerly entertained arguments that such taxes were unconstitutional... accepting the argument that such laws [about corporate taxes] violated the rights of corporations as ‘persons’.*” Thus, there was vehement corporate reaction in the distant past against the imposition of corporate taxes, despite society’s expectation that companies would act responsibly towards society; this attitude foreshadowed the problem of corporate tax avoidance as experienced today.

### **2.3 Views and definitions of corporate tax avoidance**

Definitions relating to tax avoidance seem pluralistic at best. The approach in this study follows the rather wide definition of corporate tax avoidance provided by Dyreng, Hanlon and Maydew (2008); however, a brief discussion of some other definitions is provided for various reasons. In terms of the context in the South African jurisdiction, tax avoidance (Stiglingh *et al.*, 2017:797) is defined as “*a situation in which the taxpayer has arranged his affairs in a perfectly legal manner, with the result that he has either reduced his taxable income or has no income on which tax is payable.*” The authors cite case law such as *Duke of Westminster v IRC (1953 at 520)* as:

*every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he can not be compelled to pay an increased tax.*

It is important to note the use of English case law in a South African tax textbook in its section that discusses tax avoidance. This reference to the case law of another legal jurisdiction may be seen as a first example of the nature, power and pervasiveness of the theory of institutionalism between countries that dictates and explains corporate behaviour. In particular, it illustrates how a definition, such as tax avoidance, that was developed, articulated and accepted in Britain, a country almost 12 000 kilometres away from South Africa, could, nevertheless, have become institutionalised into the vocabulary and behaviour of South African governments and corporates. More recently the UK tax authority defined tax avoidance as those transactions and activities that minimise taxable income, but qualified the nature of such activities as those that follow “*the letter of the law but not its spirit*” (HM Revenue & Customs, 2016). The recent reference to the phrase “*spirit of the law*” indicates that the dichotomy between evasion (illegal) and avoidance (acceptable) is contextually dependent. It is possible that the social acceptability (legitimacy) of tax avoidance has declined over time, thereby leading to a shift to moral and ethics underlying a company’s tax affairs (whether it is legal or not).

Hanlon and Heitzman (2010:137) define tax avoidance very broadly as any action, plan or strategy that can reduce explicit taxes, while admitting alignment with Dyreng, Hanlon and Maydew’s (2008) definition that includes anything that may reduce a company’s effective tax rate; these latter authors concede that their definition does not imply any action of wrong-doing. Clearly these definitions are devoid of any reference to values or ethics, possibly because

decisions on whether alleged avoidance is 'good' or 'bad' are subjective and difficult to make. Also, this definition clearly includes the most benign forms of tax avoidance, but may also include those that are illegal, for example tax evasion. For this reason, the pluralistic nature of the Hanlon and Heitzman (2010:137) definition also explains why "tax-management" is sometimes used interchangeably with tax avoidance as a broad definition, assuming that amount of taxes payable that can be managed downwards: see, for example Minnick and Noga (2010:703). The contrast between the HM Revenue and Customs (2016) description of tax avoidance and the other definitions is striking for two reasons. First it would seem as if the UK tax authorities' definition introduces scope for ambiguity and subjectivity from the outset with the use of the word "spirit," when compared to the Hanlon and Heitzman (2010) definition that, although broadly construed, is clinical. Second it would appear as if HMR & C's definition is value-laden insofar as the word 'spirit' is left open for a subjective interpretation in which values could possibly play a role.

Steuerle (1985:78)<sup>5</sup> cited in Slemrod and Yitzhaki (2002:1446) compares tax avoidance to a game with revenue authorities; a game in which participation or level of participation is dependent on people's level of risk aversion. The authors explain that:

*Less risk-averse households will gain more from the availability of a gamble with given positive expected value. In contrast, common parlance would ascribe any horizontal inequity to variations in honesty, with the honest, or dutiful, citizens left holding the bag by the dishonest.*

The authors argue that the economic utility model for tax avoidance or evasion assumes no such thing as honest or dishonest taxpayers, only room for economic actors all optimising their utility. However, the authors do concede that some people 'play the game' while others do not, ostensibly for other reasons. Some companies avoid more tax than others, a phenomenon which may be explained by factors beyond risk appetite, or positivistic economic optimisation theory; these factors may well include corporate values, ethics and moral disposition. Put differently, some agents choose not to avoid tax, even in the corporate agency-principal relationship where economic optimisation acts like a golden rule for corporate decisions. For example, Stiglitz (1985:33) argues, assuming a perfect capital market, that tax avoidance levels in the US just before the enactment of the Tax Reform Act in 1986 were actually still surprisingly *low*, bearing in mind the powerful opportunities for tax avoidance available to the 'astute' tax payer. Stieglitz's conclusion precedes and mirrors the Slemrod (2004:895) paper's view regarding the limits of the economic utility model to explain tax avoidance in its entirety.

Hanlon and Heitzman (2010:137) refer to the existence of terminology differences applicable to terms such as tax evasion, tax sheltering and tax non-compliance; they suggest that these differences are perhaps all of a semantic

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<sup>5</sup> Access to the original source could not be obtained despite best efforts being made.

nature and relate to subjectively-construed differences in the observed level of aggressiveness regarding tax avoidance. They then liken the different terms to being positioned on a line that presents a continuum, stating that

*If tax avoidance represents a continuum of tax planning strategies where something like municipal bond investments are at the one end (lower explicit tax, perfectly legal), then terms such as “noncompliance”, “evasion”, “aggressiveness” and “sheltering” would be closer to the other end of the continuum.*

Even so, the authors admit that any attempt at classification of ‘aggressiveness’ seems subjective, analogous to the saying of *“beauty is in the eye of the beholder.”*

The following table presents possible viewpoints regarding the semantic differences between terms related to tax avoidance.<sup>6</sup>

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<sup>6</sup>For more information on different views regarding distinguishable differences between the definitions offered here, see Payne and Raiborn (2018: 470). Discussing the *“Fair-share ethical”* debate regarding the payment of the fair share, to invoke the words of St Aquinas *“Bad laws do not bind the conscience,”* is interpreted as meaning it is acceptable to break a law deemed to be unjust. A characteristic of such civil disobedience, which is viewed as an ethical position, is that the breaking of the law is done openly rather than clandestinely. Countries with corrupt governments may ultimately force normally law-abiding citizens to avoid or evade tax to starve their corrupt government of the means to pursue its corrupt governance processes.

**Table 2-1 Semantic differences between terminology used for types of aggressive tax behaviour**

<b>Term</b>	<b>Description</b>	<b>Main characteristics</b>	<b>Abides by the letter and/or the spirit of the law?</b>
<b>Tax evasion</b>	Illegal actions to reduce tax liability.	Dishonesty is involved.	The letter of the law is not honoured.
<b>Tax avoidance</b>	Holding on to corporate value in the absence of legal claims to pay tax, with reference to interpretation of the law.	Value optimisation based on sound business principles, subject to full disclosure to authorities.	Adherence to both the letter and spirit of the law.
<b>Aggressive tax avoidance</b>	Favourable interpretation of the law is stretched to exploit loopholes inherent to legislation.	<i>Mala-fide</i> interpretation of legislation.	Probable that the letter of the law is honoured, yet to the detriment of the spirit of the law.

Adapted from Payne and Raiborn (2018:471)

The preceding section indicates the ambiguous nature of the definitions and descriptions of the various forms of tax behaviour related to tax avoidance. This ambiguity helps explain the difficulties experienced by regulators in trying to capture the essence of tax avoidance in legislation, while it also suggests a tension between regulators who implore taxpayers to follow the ‘spirit’ instead of the ‘letters’ contained in tax legislation. This ambiguity, together with different views of tax avoidance, seems to leave room for some taxpayers to exploit weaknesses in legislation to reduce tax, while it allows others to be led by their internal moral or and ethical convictions as a guide to corporate conduct in dealing with tax issues. The availability of free choice invokes logical reference to morals and values as a guide to choosing between aggressive and less aggressive degrees of tax avoidance.

#### **2.4 Determinants of corporate tax avoidance: A theoretical approach**

The determinants of corporate tax avoidance seem to be the subject of a significant body of research, in the area of corporate tax avoidance. This section therefore examines and discusses papers that investigate determinants of tax avoidance because research on this topic appears to be deterministic in nature. The discussion is developed along the dominant theories in the domain of finance, economics and financial management to structure and categorise the literature; this approach is followed because an overview of underlying theory helps to position certain theories relating to corporate culture as being relatively neglected, in comparison to others. A theory-by-theory approach

responds to a call by Hanlon and Heitzman (2010:127) for researchers in the tax avoidance domain to proceed from theory. Reference to theories used in accounting theory may seem strange, but similarities between tax avoidance and accounting choices and disclosure show some overlap as both concern an interplay between shareholders, management as agents, and other stakeholders.

The following diagram maps the dominant theories suggested by Deegan (2014) to underpin financial accounting policies and related disclosure behaviour in companies.

**Figure 2-1 Theories for inter-stakeholder behaviour**

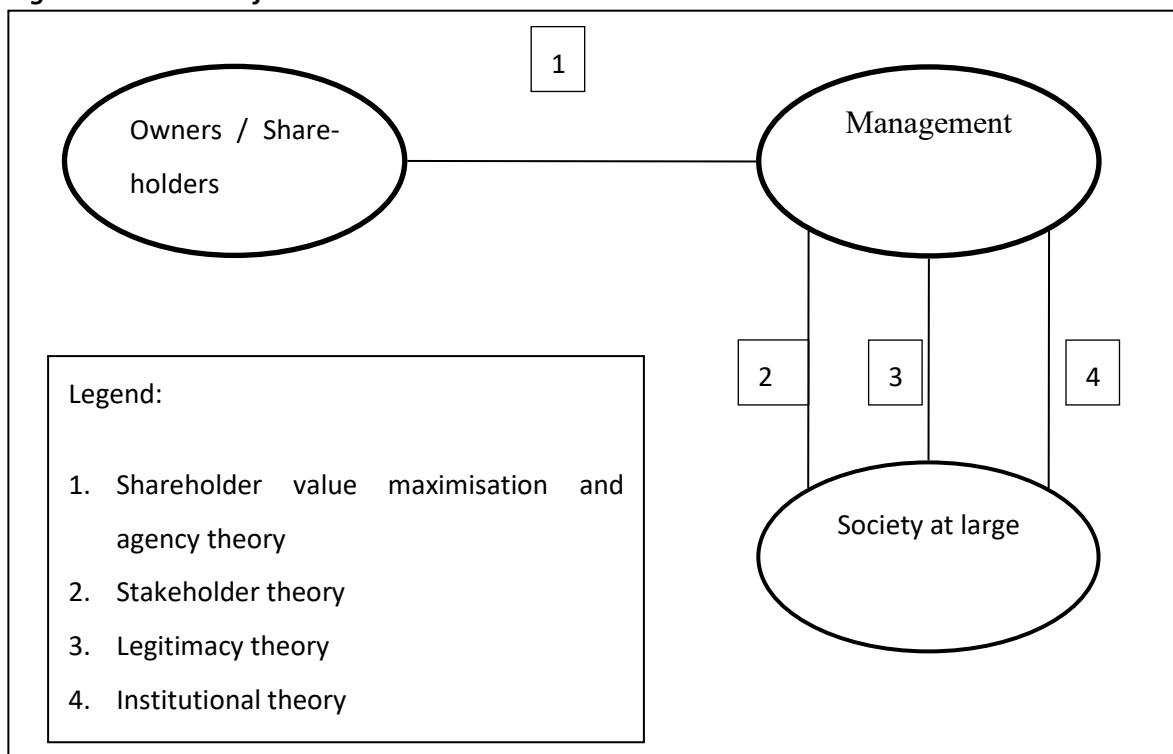


Figure 2-1 depicts groups of corporate stakeholders in ovals: the lines connecting the ovals represent finance theories that are often used to explain or predict the behaviour between those stakeholder groups. This literature review of corporate tax avoidance is structured in terms of those theories. This Figure 2-1 is repeated at the end of the literature review but with some additional information: thus, it also includes an indication, for each theory, of whether that theory has been used extensively, or less so, to explain corporate tax avoidance behaviour. Note that the lines do not indicate causality or relationship. The next section of this literature review considers these theories on a one-by-one basis and discusses relevant research related to corporate tax avoidance for each theory.

## 2.5 Shareholder value maximisation theory and agency theory

The shareholder value maximisation theory proposes that the shareholders' interests in the form of maximising shareholder wealth represent the paramount corporate objective and as such, allow an explanation and interpretation of much corporate behaviour. The central idea of this theory is that the value of a company is

maximised when future cash flows are maximised under circumstances which reduce risk for shareholders (Correia, 2018:6-2). Its relevance to corporate tax avoidance is intuitively simple; after all, corporate tax is a business expense which reduces distributable profits to shareholders, which are pursued to maximise shareholders' utility. Against this background, it is argued that tax avoidance is an instrument to enhance shareholder value. However, there are other considerations. A higher cost of capital reduces shareholder value, which is maximised when overall corporate risk is limited (Correia, 2018:6-2). Donohoe (2015:1) argues that risky corporate behaviour in specific areas, as indicated in a case study regarding the intensive use of derivatives, may also extend to risky, more aggressive behaviour in other areas of corporate behaviour. The study found strong empirical evidence that the use of derivatives in US companies is associated with lower cash and effective tax rates, which are proxies for corporate tax avoidance as indicated before. Donohoe's (2015:1) finding can be interpreted as providing tentative evidence for the view that a corporate culture that encourages excessive risk taking in one area of a company manifests at other hierarchical levels or departments in a company: this also includes the tax environment. Tax avoidance aimed at increasing shareholder value through increased free cash flow may be a zero sum game if persistent corporate tax avoidance coincides with overall increase in risk. Guenther, Matsunaga and Williams (2017) find that low effective tax rates tend to be more persistent than high effective tax rates; more importantly they find that lower effective tax rates, as a proxy for tax avoidance, are negatively related to one-year-ahead stock return volatility, as a proxy for overall firm risk. Links between indicators of tax avoidance and future dividends are also relevant. Amberger (2017:1) found that companies with greater tax uncertainty have a lower probability of dividend pay-outs; this writer also found evidence that the relative amount distributed is negatively associated with an uncertain tax position as an indicator of tax avoidance.

Tax avoidance is also suspected of having other unintended shareholder costs, which makes it difficult to assess who benefits from tax avoidance. Hanlon, Maydew and Saavedra (2017:1200) report that increased levels of tax uncertainty are positively associated with higher cash balances, which means that shareholders may be sacrificing better yields on assets if cash balances are kept high to enable the company to settle uncertain tax positions. However, Lee and Shevlin (2016) have used a future cash flow-based model to measure the cost of equity, and found a negative relationship between tax avoidance and cost of equity: this means that shareholders benefit from more corporate tax avoidance.

Agency theory posits that the providers of capital and the managers who act as the custodians of assets entrusted to them, may have different or diverging interests. This tension may introduce misalignment between the objectives held by shareholders and by management. Shareholders or owners manage this tension through the development and implementation of corporate governance control systems such as remunerative incentives for managers to align corporate behaviour and decisions with the interests of shareholders (Deegan, 2014:273). The managers' utility function is often described as weighing up the benefits of responsibility to their principals' interests with the rewards and effort for doing so. Deegan (2014:273) sees agency theory as one that is based on the central economics-based assumption that any individual's actions are primarily driven by *self-interest* alone, which suggests that people as

agents generally act in an opportunistic manner to increase their own wealth. One particularly important aspect of this theory, as far as the central tenet of this study is concerned, is that in its purest form, the theory almost entirely dismisses or negates the likelihood that moral and ethical views of agents could dominantly account for managers' behaviour in their capacity as agents.

Agency theory is frequently used to pose arguments regarding the expected behaviour of management as agents when facing decisions concerning corporate tax avoidance. It should be remembered that agents make decisions regarding tax strategy and tax behaviour, not shareholders directly. Arguably, the nature of agency theory also suggests the relevance of corporate governance as far as it aims to act as a control to ensure that management acts in the best interests of shareholders. In accordance with this argument, papers that concern the relationship between corporate governance and tax avoidance are also discussed under this section.

Deegan's (2014:278) bonus-hypothesis suggests that agents may be incentivised to disclose higher net profits if bonuses are linked to net profit after tax; this suggests a relationship to tax avoidance principles as well. Indeed Phillips (2003) investigated whether compensation structures based on after-tax profit measures are associated with measures of tax avoidance; that investigation found a strong positive relationship between performance indicators using after-tax profit and tax avoidance, when compared to instances where compensation structures depended on before-tax profits. Phillips' findings therefore provide evidence to support the more intuitive expectation: thus, agents may use tax avoidance as a means to increase personal wealth in the agency setting. Gupta and Swenson (2003) provide more evidence to support the same expectation; they found a positive relationship between incentive compensation of management and the extent of tax lobbying activities, an activity arguably closely related to corporate tax avoidance.

Corporate governance and corporate tax avoidance are related. Thus, Desai and Dharmapala, (2006) modelled the interaction between tax sheltering activity (a form of corporate tax avoidance) and the diversion of rents. They argued that there are strong positive feedback effects between these two activities. They based their argument on the viewpoint that tax sheltering may obfuscate the existence of corporate profits from shareholders, which subsequently may never be disclosed to shareholders. In that paper the authors argued that more stringent governmental enforcement of tax compliance, which may lead to less tax avoidance, could improve a firm's value, or be seen as an unintended corporate governance mechanism to the benefit of shareholders, despite higher tax liabilities as a result. Evidence supporting this viewpoint is reported in a Russian experiment (Desai, Dyck & Zingales (2007). Here, the authors' findings seem to support those of Phillips (2003), discussed above. However, Desai and Dharmapala (2006) found that in the case of firms with *poor or weak* corporate governance arrangements, the use of increased high-powered incentives for management actually *reduces* corporate tax avoidance. Evidence regarding the relationship between corporate governance and tax avoidance is of interest. Thus, it often defies the notion that tax avoidance always benefit shareholders; instead, the taxes saved may be syphoned off to agents where corporate governance is weak.

Some corporate ownership types, such as majority family-owned companies, seem to have very specific corporate governance characteristics which can provide opportunities for tax avoidance. Chen, Chen and Cheng, (2010:41) find that family-owned companies (or companies characterised by a significant family presence as shareholders) are less tax aggressive than non-family-controlled companies. The authors argue that family owners may be willing to sacrifice the tangible benefits of a lower tax expense in return for a smaller chance of share-price discounts imposed by other shareholders, who might be worried about family rent-seeking through tax avoidance schemes. Hanlon and Heitzman's (2010:144) review of corporate tax avoidance research invokes the temporal view of a company in terms of a long-term horizon to explain why family-controlled companies seem less aggressive tax avoiders than others. They suggested that *“these firms may avoid fewer taxes because these long-term concentrated holders have a longer horizon and may be more sensitive to the total costs of avoidance arising from reputation effects.”* These papers provide some evidence that the temporal orientation of a company pertaining to the longer term may influence, positively or negatively, the propensity for corporate tax avoidance.

Other attributes of shareholders are also investigated in terms of possible determinants of corporate tax avoidance; for example, the level of institutional ownership in companies. Khan, Srinivasan and Tan (2016) find that the level of institutional shareholding is positively related to corporate tax avoidance, perhaps through pressure to reduce effective tax rates; it is also characteristic of higher profit margins, and associated with a higher likelihood to meet analysts' expectations<sup>7</sup>.

The issue of corporate tax avoidance also includes debates about the inclination of agents to divert scrutiny from the public and regulators. For instance, Gupta and Newberry (1997:4) investigated the relationship between company size and effective tax rates as a proxy for tax avoidance, to identify firms not sharing an equal tax burden. Those authors then used a political, cost-based hypothesis study, to argue that larger companies, which are more visible to the public and regulatory eye, would endeavour to increase effective tax rates to avoid public attention. These authors found an insignificant relationship between company size and effective tax rates measured in the long term, although this finding is contradicted in Rego, (2003:828) who reports a positive relationship; thus, Rego found that company size and effective tax rates are positively correlated. One may have expected larger firms to be associated with lower effective tax rates because they arguably have more financial resources to employ tax consultants to reduce their tax liability. Evidence suggests that some companies consider, carefully, the trade-off between tax savings and the political cost of damage to reputation, before engaging in tax avoidance.

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<sup>7</sup>A company's inclusion in the Russel-index is used as the proxy for institutional ownership. Khan, Srinivasan and Tan (2016) conclude that managers “deliver” tax avoidance when institutional ownership increases; however, institutional owners do not explicitly and specifically demand tax avoidance. Of interest in this paper is its use of inclusion in the Russel-index as shock, which is used to control for endogeneity. The authors argue that there are many companies that almost meet the criteria to be included in the Russel-index, however, the companies included immediately behaved differently once they were included, which allows for quasi-randomised assignment.

## 2.6 Towards systems-based theories of the company to understand corporate tax avoidance

Rational maximisation of economic utility is an important underlying principle for attaining the maximisation of shareholder value, as discussed in the previous section. It suggests that corporate decisions are made by agents, including decisions concerning tax, but that these decisions are mostly calculated, or rationally evaluated and accompanied by careful assessment of payoff structures, risks, and particularly, agency costs. This notion is relevant as far as companies are described as a “nexus of contracts” in Jensen and Meckling (1976:311); here, the company is perceived as nothing more than a vehicle used to enable the efficient coordination of the interests of an exclusive group of contractually connected stakeholders. Economic optimisation theory appears to be unable to explain all corporate behaviour, including corporate tax avoidance behaviour. Importantly, it appears to be silent on normative, ethical considerations or values-based characteristics from agents, who are humans and as such, unavoidably allow value-laden or irrational behaviour to be part of the corporate behavioural mix. Aasland (2004:7), a Keynesian economist, identifies flaws in the prominent progression of the rational economic utility theory which ascribes little consequence to ethics as an economic precondition. He argues that we cannot explain the rationale of economic transactions and corporate behaviour by sole reference to economic theory alone, to the exclusion of ethics; thus, Aasland states that ethics provide the fundamental impetus or rational for transactions between humans in the very first place. These inter-human transactions constitute the economy. Indeed, the totality of economic theory is never complete without the inclusion of ethics, or values; these are both terms for which economists have no algorithm to model, and so they are conveniently excluded from economic theory. For example, Aasland (2004:8) argues that the term ‘ethics’ deals with the extent to which humans recognise and assume responsibility for what is referred to as “*the other.*” Without an awareness of the interests of each other we cannot transact, which precludes the existence of any economy. Aasland's (2004:7) comment regarding the need to consider the ‘*other*’ suggests a link not only to system-based theories to explain corporate behaviour, but also corporate tax avoidance. According to Aasland, governments as fiduciary custodians for broader society's interests are an important ‘other.’ The next section considers the prospects of so-called ‘system-based’ theories for corporate tax avoidance as far as they incorporate elements of values and ethics to explain and understand corporate behaviour, which includes corporate tax avoidance. This discussion is appropriate against the background of this study's investigation into the relationship between corporate values and ethics as determinants of corporate tax avoidance.

### System-based (“Political theories”) of the company

Stakeholder theory, Legitimacy theory, and Institutional theory are described as system-based theories and centre around the idea that “*society, politics and economics are inseparable and that economic issues [such as corporate tax behaviour] cannot meaningfully be investigated in the absence of considerations about the political, social and institutional framework in which economic activity takes place*” (Deegan, 2014:341). Gray Owen and Adams (1996)<sup>8</sup>

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<sup>8</sup>Original sources inaccessible to author despite best efforts to obtain.

cited in Deegan, (2014:341) define political economy as the social, political and economic framework within which human life takes place. This system-based view of the firm, as opposed to the view of the firm as merely a nexus of contractual obligations with key stakeholders, suggests a more pluralistic view of the firm; one that introduces the role of values and ethical dispositions as drivers of corporate behaviour. For instance, it makes it possible to suggest that agent behaviour (management-behaviour) is not summarily explained by agency theory alone, and that corporate values and ethics of agents may also influence corporate behaviour. This necessitates and introduces the importance and relevance of value-laden constructs such as corporate culture and ethics which may be indicative of companies' behaviour towards stakeholders.

## **2.7 Stakeholder theory of the firm**

Stakeholder theory suggests that corporate behaviour and phenomena are explained or predicted by an awareness of the expectations of a pluralistic group of stakeholders which includes, but importantly also extends beyond, shareholders as key stakeholders. Deegan (2014) distinguishes between ethical-normative and stakeholder-management views to interpret the relevance of stakeholder theory in predicting corporate behaviour.

The ethical-normative component is unpractically idealistic in terms of Deegan's interpretation of this theory, which is one that attempts to achieve fairness to all stakeholders in a corporate's operations, regardless of the relative power, influence or interests of each group of stakeholders. According to Deegan (2014), this view assumes the company to be *"a vehicle for coordinating all stakeholder interests with a high focus on management's fiduciary duty to find an optimal balance for all stakeholder conflicting interests in the affairs of the company."*

Stakeholders are defined by Freeman and Reed (1983:89) as *"any identifiable group or individual who can affect the achievement of an organisation's objectives or is affected by the achievement of an organisation's objectives."* This may be compared to the Stanford Research Institute's more succinct definition of the term in 1963 as *"those groups without whose support the organisation would cease to exist."* [See Stanford (1963), cited in Freeman and Reed (1983)] However, both definitions clearly emphasise the mutual dependence between companies and societies for long-term sustainability.

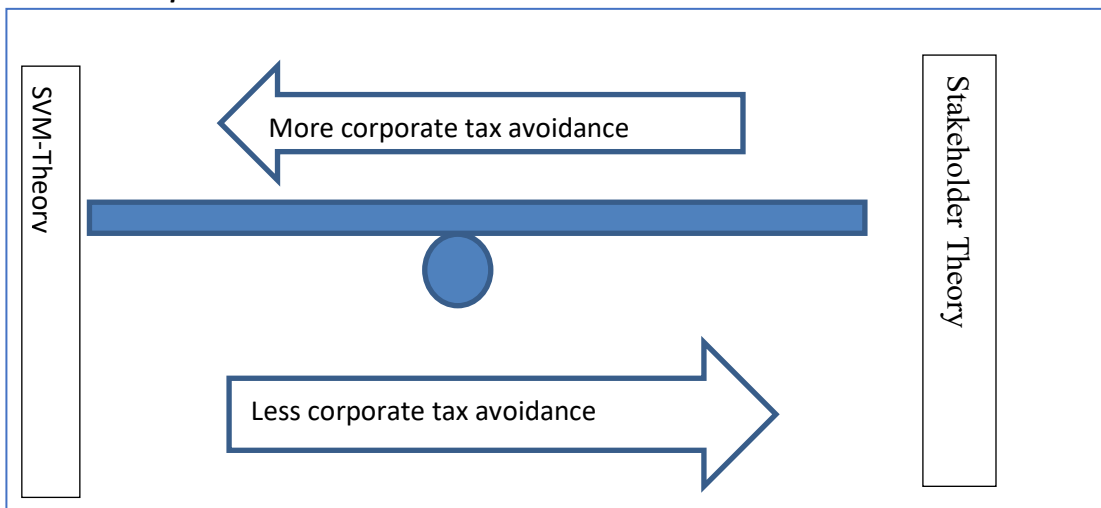
Arguably, a stakeholder-management view of stakeholder theory suggests a more realistic approach for the identification of stakeholders and subsequent prioritisation of their claims, interests, and concerns. In other words, not all stakeholders are created equal, and so companies tend to evaluate many aspects of stakeholders as criteria to develop a suitable response to stakeholder interests. Mitchell, Agle and Wood, (1997:853) suggest that stakeholder power, the legitimacy of stakeholder claims (interests) and the urgency of those interests, are the criteria used by corporates to guide their behaviour towards stakeholders. It follows that a corporate's classification of stakeholders, based on these simple criteria may have consequences for tax behaviour too, if revenue authorities are considered to be a stakeholder.

The definitions of stakeholders, discussed above, suggest some intuitive implications for corporate tax avoidance. A further analysis of those stakeholder definitions, as well as closer scrutiny of the views of stakeholder power, views on the legitimacy of a stakeholder’s interest and the urgency of a stakeholder’s demands, may suggest some subjective, qualitative determinants of tax avoidance. For example, the extent to which a government’s revenue authority satisfies or fails to satisfy the elements of the three criteria, mentioned in the previous paragraph, may well affect the level of tax avoidance in respect of the tax collector if classified as a stakeholder. Thus, one may expect higher levels of corporate tax avoidance whenever management’s subjective assessment of government’s legitimacy to collect taxes is low or doubtful. Tax avoidance may also be more severe when management assesses that the government is unlikely to exercise any punitive measures.

**Stakeholder theory versus shareholder value maximisation theory: Opposite sides on a continuum**

The preceding discussion identified and contextualised the significance of the stakeholder theory and the shareholder value maximisation (“SVM”) theory as two prominent theories in corporate finance that contextualise the primary objectives of a company. The main difference between these two theories is the extent to which the interests of equity shareholders, as primary stakeholders, have precedence over those interests of all other stakeholders; this precedence can only be established by the exclusion or subordination of the interests of wider stakeholder groups. Figure 2-2, below, depicts SVM- and stakeholder theories on opposite sides of a continuum regarding the extent to which the interests of stakeholders are acknowledged. The extent to which a firm displays a more balanced view of the importance of stakeholders other than shareholders, will find that company positioned more towards the right of the continuum below, and vice versa. The position that a company assumes on this continuum is probably not absolute, and even a single position may have multiple dimensions. The literature review has indicated that the stakeholder- and shareholder-orientations of companies may have consequences for corporate tax avoidance; if so, then a company’s position on the continuum depicted in Figure 2-2 below may also be indicative, by extension of the argument.

**Figure 2-2 Shareholder value maximisation- and Stakeholder Theory: Opposite sides of a continuum of stakeholder importance**



### 2.7.1 Corporate social responsibility as a determinant of corporate tax avoidance

The extent to which a company's so-called corporate social responsibility initiatives acknowledge that company's wider stakeholder obligations has attracted a significant amount of attention in the corporate tax avoidance literature. The extent to which a company's social responsibility extends beyond the mere satisfaction of the monetary interests of shareholders is the subject of endless debate and investigation in the literature. Two opposite arguments at the far ends of the spectrum seem to represent two seminal viewpoints. First, Friedman (1970) argued for the salience of shareholders' interests as the primary legitimate objective of businesses. On the other side of the spectrum is Freeman's (1993:76) plea to businesses, cited in Kretzschmar, Prinsloo, Prozesky and Rossouw (2015), to acknowledge and assert the relevance and dependence of businesses on a wide range of stakeholders for their current and future sustainability.

Before commencing with a discussion of the academic literature in the CSR-corporate tax avoidance space, it is necessary to describe the intuitive context in which taxes and CSR are related. Economic theory suggests that taxes are generally levied by a government on the citizens and corporations and these taxes are used to fund the public debt, finance public infrastructure, fund social security nets in the form of welfare pensions, public healthcare services, education, and police services to mention but a few. CSR initiatives may overlap with some of those social responsibilities that are normally assumed by governments and funded through taxes. The issue that arises from a corporate tax avoidance perspective is whether CSR performance is perhaps related in some ways to corporate tax avoidance; after all, one could argue that both achieve the same ends, but through a different channel. For example, one might suppose that those firms carrying relatively large tax burdens might alter the extent of their CSR initiatives to reflect the notion that they are discharging their social responsibility through the tax channel, with government acting as the conduit. Alternatively, a company might perceive a government as corrupt and inept in fulfilling its basic purpose, or ineffective and inefficient in collecting taxes to discharge responsibilities. Such a company might argue that tax avoidance benefits society if the company compensates for avoiding tax by pursuing CSR. Business ethics deals with moral dilemmas in situations of right or wrong, applied in a business context (Laasch & Conaway, 2015). Management may believe that the "*greatest amount of good*" is achieved when management opts to use the CSR channel, rather than the tax channel to distribute the 'good.' Arguably, studies that investigate the relationship between CSR and corporate tax avoidance represent the closest that the literature comes to investigating aspects of ethics and corporate values and corporate tax avoidance.

Bird and Davis-Nozemack (2018) argue that the corporate tax avoidance problem may be perceived and addressed through the business sustainability concept, because government is considered to be a key stakeholder. These authors argue that taxes are the price that members of civilisations pay to nurture and maintain civilised practices, without which the economy cannot function. The authors explain how modern civilisations are characterised by trust-instilling mechanisms such as legal systems, legal institutions and courts with honourable adjudicators who instil

environments of mutual trust; all these are indispensable imperatives for the long-term sustainability of modern corporations. If companies benefit from a healthy civilisation as a common resource in the short term, then they may presumably be more willing to accept responsibility for its replenishment and nourishment in the form of corporate taxes. Other companies may absolve themselves from further responsibility for societal stakeholders through compliance with baseline CSR practices only.

Lanis and Richardson (2012a) conducted an empirical study that examined the association between CSR and corporate tax aggressiveness, using regression techniques on 408 Australian listed companies. They found that better and more extensive CSR disclosure is negatively related to tax avoidance (tax aggressiveness). In other words, better CSR disclosures in financial statements (used as a proxy for actual CSR performance) are associated with less aggressive tax avoidance. Those authors argue that the ethical mind-set of firms is the overarching explanatory factor for this behaviour. Also, it would appear as if stakeholder theory may also be relevant to explain this behaviour. Thus, while society is regarded as an important stakeholder and as such, is prioritised in terms of voluntary acts of goodwill, the revenue authorities are not neglected either. In contrast, Davis, Guenther, Krull and Williams (2016), in a subsequent paper, examined US data and found a substituting relationship between CSR and corporate tax avoidance; in other words, more tax avoidance is associated with more CSR investment or better CSR performance. These authors point out that this result may be interpreted as indicating that firms do not necessarily see tax responsibilities as part of a corporate social responsibility towards its wider stakeholder interests. Arguably, differences in national culture between these two countries, Australia and the USA, may explain the different behaviour reported from the Australian and US settings. Regardless, the seemingly conflicting results may also indicate an inconclusive understanding of the relationship between the two concepts. Lanis and Richardson's (2012a) finding regarding the complementary nature of CSR and tax avoidance is argued to support the stakeholder (or normative-moral) theory of the firm; according to this, a firm with an active social conscience towards its stakeholders and society at large, is expected to mirror that ethical stance in its view of tax matters as well. Another interesting observation is the close link that the authors make regarding ethical conduct in general and CSR as a manifestation of ethical conduct. For example, extending the argument, the authors argue that firms may even justify corporate lobbying for lower tax rates as socially beneficial, because lower tax rates generally encourage more entrepreneurship from which societies could benefit. The authors use the Mcgee (2006:41) argument for tax avoidance pursued to *"keeping resources in the private sector results in benefits to society because the private sector utilises resources more efficiently than the public sector."* This may be interpreted as showing that a company that exhibits relatively aggressive tax avoidance behaviour, while exhibiting relatively good CSR performance may nevertheless regard itself as being stakeholder oriented.

More investigation is needed into the influence of ethics and values in an attempt to explain variations in levels of corporate tax avoidance, if one considers evidence of inconclusiveness regarding the CSR-tax avoidance relationship. Moreover, some writers refer to the possibility that CSR disclosures, used to operationalise actual CSR behaviour,

may not be indicative of a corporate's underlying values or ethical disposition. For example Cho, Laine, Roberts and Rodrigue (2015) argue that corporations' sustainability disclosures could be interpreted as '*organised hypocrisy*' as a pragmatic response to the many conflicting and often unreasonable pressures and expectations imposed on them by stakeholders and society. This argument is interpreted as being closely related to legitimacy theory, discussed in the next section. For example, Hummel and Schlick (2016) argue that CSR and legitimacy present two concepts on different sides of the same coin, in a process where the two concepts dovetail with each other.

## 2.8 Legitimacy theory

The discussion in the previous section ended with a brief reference to the possible use of CSR disclosures to manipulate stakeholder perceptions in a company's favour; this could be done for many reasons. It is possible, as this section shows, that corporate tax behaviour may also have links to legitimacy theory. This discussion follows immediately after the preceding discussion of CSR and tax avoidance because of legitimacy's relevance to CSR, as indicated in the previous section. As shown, CSR engagement or the disclosure of a company's alleged responsible and munificent behaviour towards wider social interests, may at best be interpreted as a strategy that forms part of a social appeasement process, characterised by company behaviour which continuously legitimates its corporate behaviour through the eyes of its constituent stakeholders. It can be argued that legitimation may also extend from the way in which the company manages its tax bill. For instance, a company that voluntarily pays more tax when it follows the 'spirit' as opposed to the 'letters' of tax legislation, may be doing so to enhance a favourable reputation among its stakeholders and society as a whole. Legitimacy is described as:

*a condition or status which exists when an entity's value system is congruent with the value system of the larger social system of which the entity is part. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy,"* or seen as a strategic resource "*that is conferred upon the organisation by society for survival and which is consistently pursued by corporate as part of a strategy to continually gain, maintain and repair legitimacy*" (Deegan, 2014:343).

The very use of words such as 'strategy' may be perceived in Machiavellian terms as something done with ulterior motives. Suchman (1995) makes an interesting statement regarding a difference between *actual* corporate legitimacy and *perceived* legitimacy, noting that endowed legitimacy does not disappear immediately because misaligned behaviour does not necessarily draw public attention immediately. It is possible that companies may continue with aggressive forms of corporate tax avoidance before society notes this and responds with actions which may be damaging to its reputation.

Lanis and Richardson (2012a:75) use legitimacy theory to explain empirical results in a CSR disclosure study that analyses the relationship between CSR disclosure and effective tax rates of aggressive tax avoiders; this entailed a matched pair study of twenty Australian companies. The authors found support for their hypothesis that aggressive tax avoiders should be associated with better and more complete CSR disclosures because those firms avoiding tax

emphasise suitable CSR disclosure to obtain legitimacy for unacceptable corporate behaviour such as aggressive tax avoidance.

D'Arcy (2011:17) examines the relationship between legitimacy and taxes from another point of view: that of citizens towards their government. The author argues that a favourable attitude of individual citizens towards taxes may be symbolically interpreted as a token of legitimacy that the citizens grant to their government, perhaps as indication that the social contract is honoured. Empirical evidence from the South African setting (albeit based on a measurement on perceptions instead of actual value of taxes paid) offered by Fjeldstad (2004) shows that tax non-compliance by citizens to local governments in South Africa is not only attributed to an inability to pay or 'a culture of entitlement', but also depends on whether citizens perceive the government to act in their interest. Although this research considers the relationship between the state and individuals in terms of the social contract or the principles of the rights to tax and consent to be taxed, the basic premise of this expectation is equally relevant to corporate tax avoidance. In terms of stakeholder management theory, a corporate could covertly assign a lower priority to the needs or interests of a regime that it perceives as being unerringly inept through the eyes of society. It would seem as if legitimacy could be applied from government's perspective as well, by arguing that tax avoidance may be pursued when a government fails to earn legitimacy to govern with attending rights to tax. Moreover, this possibility supports those findings by Davis *et al* (2016) who find a positive relationship between corporate social responsibility and corporate tax avoidance.

## **2.9 Institutional theory and corporate tax avoidance**

Deegan (2014:382) explains that "*Institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life*". The importance of the cultural construct is further highlighted by Meyer, Boli and Thomas (1987)<sup>9</sup>, cited in Deegan (2014:383), who view the corporate culture of organisations as being the rules that provides collective meaning and value to entities and their activities, helping those business activities to integrate meaningfully into larger schemes. Consequently, Deegan (2014) interprets the regulative pillar as those rules and regulations determined and enforced by society on institutions to dictate institutional behaviour, with punitive consequences for non-compliance. The normative pillar is described with reference to those seemingly softer, higher-order concepts which include values and norms (expected behaviour) that are demanded by society. Deegan (2014) refers to the influence of professional accreditations of employees, professional education, and other sources of formal education as determinants of those patterns of behaviour that become institutionalised in a company. This argument supports the influence of the type of educational or professional backgrounds of those employees in key leadership positions to influence corporate culture, explained here as the normative pillar or the cultural-cognitive pillars of institutionalism. The cultural-

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<sup>9</sup>Inaccessible original source despite best efforts by author to obtain access.

cognitive pillar is most relevant to the discussion later, which investigates corporate culture. Deegan (2014) explains this pillar as the 'taken-for-granted assumptions' which are often the core of social activity, regardless, whether they are difficult to see, touch or measure. The cultural-cognitive pillar that complements the institutional theory suggests a direct link to corporate culture if the 'patterns of behaviour' definition of corporate culture is considered (Deal & Kennedy, 1982).

The literature search that preceded this study did not yield any papers that specifically use institutionalism as the theory to explain, predict or interpret directly, any corporate tax avoidance phenomena. However, scrutiny of the corporate tax avoidance literature in general revealed papers concerning tax avoidance which could be interpreted through this theory by taking into account factors, such as CEO characteristics, that may influence or mould corporate cultures which then may become institutionalised. The influence of CEO effects or management effects on corporate tax avoidance have been investigated in the literature. For example, Dyreng, Hanlon and Maydew (2010) investigated the idiosyncratic personal attributes of CEOs, to see whether these had any influence or effects on corporate tax avoidance. That study tracked the corporate sojourn of CEOs from one company to the next in their capacity as CEOs. It found evidence that the companies where the CEO tenured in the past, display similar tax behaviour. This may provide evidence that the CEOs carry over their behaviour from one company to the next, or it may be evidence that a specific CEO's characteristics may influence institutionalised behaviour, also in the realms of corporate tax avoidance. Other papers find less evidence to support this view. Phillips (2003) investigates the relationship between management incentives and corporate tax avoidance. The author reports stronger effects of remuneration incentives on business unit managers, compared to the effects of the CEO's remuneration incentive and corporate tax avoidance. However, this finding does not mean that other CEO effects such as the CEO's values or other characteristics have no influence on propensity for corporate tax avoidance. Phillips (2003) argues that the reason for this empirical result could be that CEOs have other incentives to focus on; for example, ensuring job security by maintaining the degree of profitability expected by shareholders. Dyreng, Hanlon and Maydew (2010:1164) studied the possible influence of a CEO's level of formal education in taxation, as a determinant of corporate tax avoidance behaviour. They argue that CEOs are hardly ever tax experts, and that any CEO influence on tax avoidance is rather a matter of the CEO setting the general 'tone at the top;' this situation may include imposing certain values and ethical dispositions on the whole company.

Another paper considers the effects of having a CEO or chief financial officer (CFO) with an accounting background, in terms of showing an association with corporate tax avoidance (Chen, Chang & Lee, 2019). In this paper the authors argue that accounting expertise is closely related to corporate tax planning, and therefore CFOs with accounting experience should possess tax planning knowledge; such knowledge possibly sets the scene for a more aggressive tax culture. The findings support their hypothesis showing that CFOs with accounting experience are negatively, and significantly so, associated with corporate effective tax rates. The results of this study may also be interpreted through institutional theory. According to that theory, it would seem as if an accounting background is indicative of

particular executive characteristics which influence corporate culture to become the standard institutionalised behaviour. To conclude, the literature concerning the influence of the CEO- and other top management team-effects on corporate tax avoidance, can be viewed through the expectations that derive from 'Upper-echelons' theory, as posited by Hambrick and Mason (1984). This theory posits members of top management have highly personalised lenses which affect top-level decisions, and the framing of decisions at lower organisational levels. In this regard this study also extends the outcomes of upper-echelon characteristics to influence and form part of corporate culture, as explained in section 2.11.1.

DiMaggio and Powell (1983:147) applied the theory of isomorphism to explain why there appears to be a high degree of similarity (homogenised behaviour) between some organisations' institutionalised behaviour. The authors argue that three distinct types of mechanisms explain how companies apply similar strategies, processes, and techniques as part of a survival processes. Further discussion of these processes is relevant for this literature review because the methods through which tax avoidance strategies, methods and patterns permeate companies may be interpreted through the theory of isomorphism. DiMaggio and Powell (1983:147) define isomorphism as the process that causes one unit of a population to resemble other units in the population that face the same set of environmental conditions; they argue that isomorphic processes are influential when organisations become increasingly homogenous within given domains and conform to expectations of the wider institutional environment.

Isomorphism may be broken down further as follows. Thus, coercive isomorphism suggests that an organisation may change its internal behaviours in response to pressure by society and powerful stakeholders, which suggest a link to stakeholder theory's management branch. Mimetic isomorphism suggests how organisations change their way of operating, often copying peers, in order to obtain a competitive advantage when they copy what other organisations are doing, especially in times of higher amounts of environmental change and uncertainty, with ambiguous objectives. Lastly, normative isomorphism suggests group pressure of various sorts in which the company, when perceived as being part of a contextual group, would have to succumb to "group think" in terms of practices regarded as normatively expected to become institutionalised (Deegan, 2014).

In line with Dyreng *et al.*, 2010, Ge, Matsumoto and Zhang (2011:1141) suggest the need to consider management effects; the former writers address tax avoidance while the latter examine accounting choices. It is argued that corporate behaviour, such as tax avoidance or certain accounting policies, could become institutionalised in a company when executives carry across particular behaviours when their careers take them from one company to the next. Ge, Matsumoto and Zhang (2011:1141) then refer to such individual management attributes or characteristics as indicative of an umbrella term which they refer to as 'CFO-styles.' In that research, the authors track the tenures of a selection of CFOs as they move from one company to the next; the authors find that accounting choices at the present employer company mirror those of the CFO's preceding employer. This may be an example of how corporate behaviour of one company is spread to other companies through isomorphic processes. Palmer, Jennings and Zhou (1993) find that CEOs who attended similar types of elite business schools were likely to introduce similar

organisational structures and hierarchies in their companies. This may be an example where the normative (group think) type of isomorphism may be invoked to explain the phenomenon of homogeneity among firms in this regard. In another paper, Custódio and Metzger (2014:125) examined the financial management policies of financially-expert CEOs policies with regard to cash holdings, dividend payments, share repurchases and general ability to communicate with lenders and analysts; they found that these differ significantly from those at companies where CEOs lack pure financial expertise. The authors report that on average, companies with financially expert CEOs, when compared to those where the CEO is not a financial expert, hold less cash, pay more dividends, and find it easier, even in difficult times, to tap capital markets for finance. This paper suggests further evidence of the general effect of academic qualifications on corporate culture, but also, it indicates that financial expertise may be particularly associated with a more aggressive corporate culture.

The preceding section has shown how corporate policies and behaviour are possibly pollinated, through isomorphic processes by top executives, as they move from one company to the next. Research suggests that the pollination of corporate behaviour may even transcend between companies from different nationalities, if shareholder groups act as the pollinating agent that perpetuates tax avoidance cultures from the shareholders' home country into companies registered in a foreign country. DeBacker, Heim and Tran's (2015) study provides evidence on how a culture of tax evasion, which may be a form of an extreme and explicitly illegal form of tax avoidance, permeates US corporations when majority shareholders are domiciled in corrupt foreign countries. In this situation it would seem as if internal tax cultures of the US company became more aggressive in response to mimetic forces from the foreign shareholders in countries overseas with a corrupt culture. The authors conclude that cultural norms appear to be a significant impediment to local legal enforcement. They also find reduced levels of tax evasion in foreign-controlled companies in the US after the implementation of the Sarbanes-Oxley legislation, which has required CEOs of public companies, since 2002, to sign off physically on the companies' tax returns. This provides an example of where legislation as a normatively regulatory mechanism could change institutional behaviour in a process characteristic of coercive isomorphism. Findings by Kubick, Lynch, Mayberry and Omer (2016:1751) provide further evidence of the effectiveness of influences related to coercive isomorphism on changes in corporate tax culture. Their paper investigated the influence of tax-related comment letters issued by the SEC regarding corporate tax avoidance and the degree of corporate tax avoidance at those companies that received these letters, before and after the letters were issued. The authors found a significant decrease in tax avoidance after the companies in their sample received those tax-related letters from the SEC, when compared to others which did not receive those letters.

While corporate tax avoidance may attract fierce criticism from society and government, it may well win the acclaim of boards of directors at some companies. Lanis, Richardson, Liu and McClure (2018:463) consider the possible explanatory power of the degree of tax avoidance on the reputation of the board of directors, as the dependent variable in this instance. The authors' findings, based on regression techniques, suggest a positive association between measures of tax avoidance and the number of board seats that directors hold at other companies; that

number of seats was used as the proxy measurement for directors' reputation. On the basis of this finding, the authors then argue that in some instances, evidence of successful tax avoidance may signal to other company boards that certain directors have "tax savviness" which makes them attractive for recruitment. As a result, a board that lacks an effective proponent of aggressive tax avoidance may seek to recruit directors from other boards, which then propels a tax avoidance culture to other companies. However, the manner in which the CEO is influenced to act in a specific way is not clear. Chahin and Fang (2021) investigated the relationship between the likelihood of accounting fraud at a company and the CEO's reputation among peers. The authors find that the likelihood of accounting fraud at a company with a CEO with a high reputation among peers, is lower in general than in instances where the CEO's reputation or network centrality was lower. This suggests that a CEO's effects on corporate behaviour may be complex and conditional, and this also pertains to corporate tax avoidance.

The papers discussed above could arguably have been inserted into the agency theory section of this literature review; after all, they investigate the effect of directors, as agents, on tax avoidance. For example, in an agency setting, one could expect that an agent would, all else being equal, engage or encourage more tax avoidance in the companies where they exert their influence, in order to derive a personal benefit beyond the normal direct and indirect remuneration incentives normally encountered in the principal-agency model. In this situation, more tax avoidance may yield benefits to agents. For example, proven experience as a skilled tax avoider perhaps deserves noting on an agent's curriculum vitae which increases that director's popularity and value. The reason why the papers and their findings are, however, interpreted from an institutional-isomorphic viewpoint is to show how the process described by Lanis *et al.* (2018) may also be an example of isomorphic processes of behavioural patterns propagated from one company by another, and *vice versa*. In this case, tax avoidance is spread through a process of automatically propelled director-driven cross-pollination.<sup>10</sup>

Corporate tax avoidance behaviour may also become institutionalised through pollination by powerful stakeholders such as large accounting firms. The entrepreneurial nature of accounting firms plays an important role in corporate tax avoidance (Sikka & Hampton, 2005). These authors argue that accounting firms have started to develop tax planning strategies and structures as products sold to companies, helping them to avoid tax. They claim that one possible reason for this development was the accounting profession's move to diversify their service offerings from merely rendering accounting and auditing services to other services such as tax consulting. Payne and Raiborn (2018) also explain the seemingly pervasive role of accountants in corporate tax avoidance. They posit that accounting firms

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<sup>10</sup>Of further importance in this paper is the authors' comments supporting the use of an ETR as a proxy for tax avoidance that includes both deferred and current taxation expense. The authors note that this measure (among others such as unrecognised tax benefits ("UTB") or tax sheltering as proxies) is more suitable to measure tax avoidance of the more common and less aggressive sort; they refer in this instance to the same comments made by Hanlon and Heitzman (2010). An iteration of the basic regression model using ETR as the dependent variable and proxy for tax avoidance, suggests that CEOs who engage in less-aggressive tax avoidance actually improve their reputation, while for independent directors the opposite is true, meaning that more aggressive tax avoidance is associated with enhanced reputations in their case.

have a significant vested interest in selling successful tax avoidance schemes or advice to clients, which supports this argument. Accounting firms are entrepreneurial businesses with an incentive to sell as many of their services as possible to maximise their profits. However, evidence indicates that companies (clients of accounting firms) are sometimes budget-constrained when looking to buy tax-advisory services such as those that entail compliance-related or opinion-related work. Especially in difficult economic circumstances it is plausible to expect that accounting firms should have a better chance of selling services if the economic logic or business case can be proven. This applies especially when those services could result in immediate and significant cost savings or in tax savings: a concept commonly referred to as “selling services that pay for themselves.” The networking effect within a corporate tax advisor’s corporate network looks like a useful cross-pollinating vehicle for the network effect to permeate tax-avoidance thinking throughout the network, allowing such thinking to become institutionalised in the companies in the network.

### **2.9.1 Decoupling and ‘institutionalised’ behaviour of companies**

Institutionalism suggests that companies may become very similar in terms of practices and structures through isomorphic processes. Decoupling processes provide a reason why practices among companies may only seem similar from the visible, outside perspective, while underlying practices may be different. It would seem as if this phenomenon is particularly useful in understanding companies’ involvement in activities related to corporate social responsibility. Decoupling suggests that companies assimilate many practices due to isomorphic processes and institutional pressures that may not be best suited for the organisation in terms of being efficient and maximising profits. However, many companies then carry on practices that differ from what is portrayed in the visible domain; this is also sometime termed “window-dressing” in common parlance (Meyer & Rowan, 1977).

**Figure 2-3 A decoupling gap may explain some forms of corporate tax avoidance despite CSR performance and CSR disclosure.**

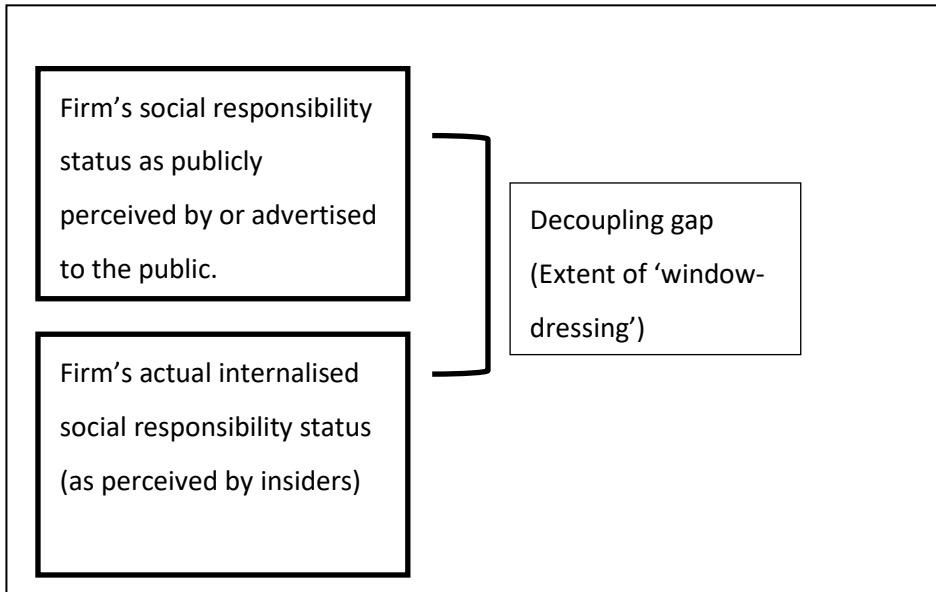


Figure 2-3, above, suggests that decoupling may be responsible for companies that seemingly incorporate CSR principles and behaviour although they may not actually subscribe to the underlying spirit of CSR; they possibly maintain this façade in pursuit of legitimacy. This decoupling gap may have implications for corporate tax avoidance too, and further investigation of this issue may also bear fruit with regard to CSR studies. It has been documented in this literature review that the relationship between the extent of a firm's CSR disclosure and performance, and the extent of that firm's corporate tax avoidance, has been shown to be inconclusive. As the evidence from empirical papers discussed before indicated, CSR and corporate tax avoidance may be used as substitutes (i.e., firms with better CSR performance seem to be more tax aggressive on average), but there also appears to be evidence to the contrary. However, measures of CSR performance may be subject to construct validity and content validity which may convolute findings. Although the measurement of CSR may be contentious as far as accuracy or validity is concerned, evidence also exists to support the functional use of CSR ratings. Chatterji, Levine and Toffel (2009) examine how well *Kinder, Lydenberg, Domini Research and Analytics*, ("KLD" hereafter), a widely cited CSR ratings agency, provides transparency about past and likely future environmental performance. The results suggest that KLD provides fairly good summaries of those past ratings indicative of a 'concerning' nature, and that companies with more KLD concerns have "slightly, but statistically significantly, more pollution levels or compliance violations." The authors find, however, and caution that rating agencies do not optimally use publicly available data, and conclude that measuring CSR is "difficult to do well". Chatterji *et al.* (2009:164) argue that their results suggest "limited validity of the measurement of management systems." With reference to the importance of the social and environmental performance of companies for many stakeholders, the authors call for more research to measure the CSR construct. Perhaps this call for research can also be interpreted as a call to find new ways to identify the gap between CSR performance, as it is portrayed to the public by the company, and actual commitment to the spirit of CSR. Persistent corporate tax avoidance, in the light of adequate CSR performance may be indicative of a decoupling gap.

The next section complements the literature review through a discussion of other company-level attributes and concepts which have been evaluated as determinants of corporate tax avoidance. Some of these may suggest useful control variables in the use of regression analysis, although these variables are not necessarily directly relevant to the main argument in this study. As such, these are not classified together with the research discussed under the theories mentioned above.

## **2.10 Other company level attributes as determinants of corporate tax avoidance**

This section of the literature review entails discussion and reference to papers that are important as far as a more complete discussion of the determinants of corporate tax avoidance is concerned, but which are nevertheless difficult to classify strictly under any specific theory, as attempted in the previous section. Gupta and Newberry (1997:1) investigate the relationship between a list of company-level attributes and corporate tax avoidance, using a multivariate method with US panel data, obtained from Compustat. The results of this study show that company size is not associated over the long term with effective tax rates, used as the proxy for corporate tax avoidance. This finding seems interesting as one might expect sizable companies to have more resources, which may suggest larger tax departments or more leeway to engage expensive corporate tax consultants. The results also suggest however that debt-levels (gearing) and capital intensity (asset mix) are positively related to tax avoidance while profitability is negatively related with tax avoidance; however, the results appear mixed depending on the use of accounting effective tax rates or cash effective tax rates. The explanation that the authors provide for the effect of interest deductibility appears strange, and the same applies to the use of accelerated tax-depreciation (wear and tear) on tangible assets. It is posited that these reduce the effective tax rate. However, this argument can only be true as long as the current-tax portion of total taxes is used as the nominator. Under current accounting standards there would not have been permanent differences between accounting earnings and taxable income. Richardson and Lanis (2007:691) investigate determinants of variability in effective tax rates and report a significantly negative association between firm size (which contradicts Gupta and Newberry's (1997:1) finding of no association), capital structure (leverage), capital (asset) intensity, as well as R&D intensity and measures of corporate tax avoidance. This study used Australian company data while the tax expense used in the calculation of the ETR has the qualities of a 'current-tax ETR' because the Australian reporting regulations did not require deferred taxation at that point in time. Gupta and Newberry's (1997:1) findings are based on long-term effective tax rates as the proxy for corporate tax avoidance, which may explain some element of the contradictory results.

Geographical locations or the location of physical infrastructure, as well as the location or national culture of a company's majority shareholders, have also been explored for implications on tax avoidance. Rego (2003:805) investigated the tax avoidance activities of US multinational companies. The results show that US multinational companies with extensive foreign operations have lower world-wide effective tax rates than purely local firms. The availability, to a multi-national company, of many different tax avoidance methods is plausibly offered as an

explanation in this regard. These options may include manipulation of transfer prices to shift profits to low tax jurisdictions or exploiting the benefits of jurisdictions with low tax rates.

The discussion on institutionalism suggests the importance of corporate culture regarding corporate tax avoidance. To this end the next section investigates literature regarding the nature and determinants of corporate culture. It shows how particular types of corporate culture may have consequences for certain types of corporate behaviour and for corporate outcomes in general.

### **2.11 Corporate culture and implications for corporate tax avoidance**

The previous section of this literature review aimed to identify and discuss a synopsis of salient, mostly empirical research on the determinants of corporate tax avoidance, interpreted through commonly-used finance theories. It has shown that the research conceptualised through the various lenses of shareholder value maximisation theory, agency theory, and also stakeholder theory, does not provide a full understanding of corporate tax avoidance. Particularly, it has shown how the ethical-normative leg of stakeholder theory may have been neglected as far as research into corporate tax avoidance is concerned. With regard to research from the angle of stakeholder management theory, it has been shown that an extensive body of research exists that aims to understand, better, the relationship between corporate social responsibility (CSR) and corporate tax avoidance. It has been shown how the hypotheses developed in this body of research refer to the functional purpose of CSR in ensuring that the wide-ranging interests of other stakeholders beyond equity shareholders, are also considered in a balanced approach. However, the discussion has also highlighted that CSR performance, as currently measured, may not necessarily be indicative of a company's underlying commitment to the spirit of CSR, and that a company's CSR initiatives may be pursued as part of a legitimisation process; this attitude may be difficult to identify because companies may be "decoupling" regardless of observed CSR behaviour, CSR performance and CSR disclosure. Therefore, the following section explores corporate values and corporate culture as a basket of combined values that manifest in companies.

The previous section has also shown how the ideas contained in institutional theory's cognitive-normative pillar suggests a close link to corporate culture as a determinant of corporate tax avoidance as far as certain tax behaviour could become part of corporate culture or "institutionalised." This suggests a new topic for research on the determinants of tax avoidance. To this end, the ensuing discussion first establishes corporate culture as a construct that is universally significant for corporate outcomes, which may also extend to corporate tax behaviour. Finally, the discussion positions this study's expectations regarding a long-term corporate culture and its expected association with less corporate tax avoidance.

### 2.11.1 Corporate culture: definitions, manifestation level and impact

Various definitions and descriptions of corporate culture exist, but it would seem that reference to corporate values and ethics is common to most of these. Deal and Kennedy (1982) define corporate culture as the behavioural regularities and shared values of the firm; this is extended by O'Reilly (1989) as an omnipotent social control system which sets the norms and values that are widely shared and strongly held throughout the organisation. Kitchell (1995) suggests that corporate culture functions as a transforming agent to ensure system survival through innovation. Reference to survival is important because it may be interpreted as a link that some cultures may be more sustainable or resilient in the long term than others. Despite the intangible and invisible nature of corporate culture, Sinclair (1993:64) claims that:

*Cultural forces still seem to explain, better than anything else, why people in organisations behave, ethically and unethically, as they do," explaining further that corporate culture is "what people believe about how things work in their organisations and the behavioural and physical outcomes of these beliefs."*

Homburg and Pflesser (2000) explain that corporate culture manifests along four layers, which are shared values, norms (rules or policies), artefacts and behaviours. Johnson, (1992) and Johnson, Whittington, Scholes, Angwin and Regner (2014) describe corporate culture as a set of overlapping organisational components, which together, create a paradigm of belief on how companies should operate; this is construed as a "cultural web". This web includes components such as the corporate control systems, the organisational structures, the power structures, corporate symbols, stories, corporate rituals, and corporate routines.

These definitions seem to attest to the importance of corporate culture as a consequential, yet accretive, cumulative concept, possibly because it encapsulates a multitude of virtuous concepts: ambiguous to articulate, and difficult to measure. Perhaps this explains why this literature review finds relatively few quantitative studies that operationalise corporate culture to investigate its different forms of corporate behaviour and different corporate outcomes.

The literature shows different opinions regarding the nature of corporate culture and how it manifests in companies. For example, Sinclair (1993:65) describes a debate regarding the nature of corporate culture in which one side maintains that corporate culture is something that an organisation "has" and which can be actively managed and manipulated as a lever to support an organisation's mission. Others argue that corporate culture is little more than a management figment: in other words, some management ideology imposed by management as an elitist group in a company [Drake and Drake (1988) \*<sup>11</sup> cited in Sinclair (1993)]. Sinclair (1993) argues that corporate culture is composed of many subcultures in a company, and that actual insight into the drivers of corporate behaviour comes

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<sup>11</sup> \* Original source inaccessible to author.

from an improved understanding and appreciation of these subcultures' corporate values and belief systems. In other words, it posits that an organisation's ethical conscience is far more complex than sometimes thought, and is not necessarily located at the management apex only, but also in many different *subcultures* which may also be repositories of the values and norms that constitute the overall corporate culture, [see Martin and Siehl (1983); Wilkins and Ouchi (1983)\*cited in Sinclair (1993:68)].

### **2.11.2 Measuring corporate culture in extant literature**

Research that operationalises corporate culture is found mostly in the industrial psychological domain. Here, it would appear that Likert-scale questionnaires completed by company employees are mostly used to compile composite scores to measure the strength of particular corporate values as they manifest. Hogan and Coote, (2014), for example, use this component approach in a study regarding innovative corporate culture.

### **2.11.3 Relationships between corporate culture, leadership styles and corporate performance**

Ogbonna and Harris (2000) investigated the relationship between corporate culture, corporate leadership and corporate performance, and confirmed the relationship between leadership style and corporate performance. They found that the relationship between leadership style and company performance is mediated by the type of corporate culture *ex ante*. This suggests that leadership characteristics in a firm do not necessarily change corporate culture, which provides some support for the notion that corporate culture is a concept on its own as well, meaning that it is not only influenced by the CEO. However, Giberson, Resick, Dickson, Mitchelson, Randall and Clark (2009) performed a survey-study with CEOs and their subordinates, reporting evidence of a strong relationship between the CEO's personality and the cultural values of the whole company, as it is perceived by the employees who report to them. A consideration of the evidence as a whole possibly suggests the combined effect, meaning that corporate culture is informed by leadership, but also is informed by other factors, such as the company's history, its development trajectory and a series of CEOs who have held tenure at the company.<sup>12</sup> This finding further supports the findings of Dyreng *et al.*, (2010), discussed earlier in the first tax avoidance section of the literature review: they also report a direct relationship between individual CEO characteristics and corporate tax avoidance. However, it is unclear whether the CEO effect is a result of the CEO influencing corporate culture, after which corporate behaviour is affected.

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<sup>12</sup>Ogbonna and Harris's (2000) research approach first identifies different types of corporate cultures (based on Desphande's library of cultures) and then measures the intensity of each at different organisations using Likert-scales in questionnaires to employees. Thereafter, factor analysis and path analysis is used to ensure construct validity and hence ensure the Likert-statements indicate what they purport to indicate and measure. Once cultures were measured, path-analysis is used to depict the relevant variables in a mapped network-diagram, after which regression-based techniques are employed to confirm whether each predictor-variable's effect is statistically significant and (or) indirectly or directly associated with the ultimate dependent variable.

#### **2.11.4 Arguments concerning the malleability of corporate culture**

One can argue that because of its importance, it should be beneficial to enforce strong or appropriate corporate cultures. Conversely it should be useful to change unsuitable corporate cultures into more appropriate ones in order to result in better corporate behaviour and outcomes. Kilmann, Saxton and Serpa (1986) argue that culture generally does not change rapidly or easily, and add that the degree of difficulty of changing corporate culture is dependent on the number of sub-cultures, and also depends on how entrenched the existing corporate culture is. The assumption that corporate culture is difficult to change perhaps suggests stability, and consequently perhaps supports the use of corporate culture-variables as a fixed-effect in companies, such as a time-invariant variable for the purpose of regression analysis. However, it would seem as if stability of corporate culture is conditional at best, which also allows room for a more dynamic view of corporate culture. Oliver (1999:147) finds that *“as one could expect with personal values, statistical tests reveal that even with dramatic changes in the business environment the overall personal values structure has not changed over the three decades.”* Whether corporate cultures are actually dynamic or not (i.e. changing) may be difficult to assess, as it would seem that extant studies on corporate culture mostly measure corporate culture as it is at a specific point in time. For example, if values-questionnaires completed by employees only capture a type of corporate culture at a specific point in time, then it would seem as if changes in corporate culture have not yet been the focus of quantitative research.

The emphasis on corporate values as a building-block of corporate culture suggests a closer examination of corporate values as well: this point is discussed in the next section.

#### **2.11.5 Corporate values as building blocks of corporate culture**

The close link between corporate culture and corporate values is established in the literature. For example, Hunt, Wood and Chonko (1989) describe corporate values as a major dimension of corporate culture, one that *“define[s] the standards that guide the external adaptation and integration of organizations”* and *“corporate values influence organizations’ product and service quality, pricing policies, treatment of employees and relationships with customers, suppliers, communities, and the environment.”* Padaki (2000) describes values as those core convictions of the organisation that guide its endeavours and the ways in which it goes about its work; once these have become relatively *enduring*, they can be referred to as an organisation’s values, which in the end become corporate culture. This also appears to be the reason that most studies of corporate culture operationalise a specific corporate value as proxy for corporate culture. For instance, the intensity in which a particular corporate value manifests in corporate environments is sometimes used as the unit of analysis to operationalise or analyse corporate culture. It would seem as if corporate culture is not frequently evaluated at the aggregated level, possibly because it is difficult to articulate and measure a construct such as corporate culture which is constituted from many corporate values. In empirical research, corporate culture is seldom analysed in its aggregated, holistic form, arguably to avoid construct validity and measurement issues that exist at the higher aggregated level. Research tends to isolate a specific corporate

culture component (i.e. a corporate value as a building block) to circumvent or mitigate the problem of construct validity and measurement. For example, the title of Guiso, Sapienza and Zingales's (2015) paper is "*The value of Corporate Culture*," which clearly suggests an investigation of corporate culture as a construct's influence on value creation. However, closer scrutiny of this paper reveals a study that explores only the relationship between employees' assessments (measurement) of their management's ethical conduct (which forms part of values as components of corporate culture) together with the level of trust in management. However, in the development of the paper's methodology, the authors focus on the values of integrity and trustworthiness as an implicit proxy for the overarching corporate culture construct. A benefit of this approach is that construct validity concerns are reduced, which may be a solution to the notion that corporate culture is possibly irreducibly complex.

Donker, Poff and Zahir (2008) develop a corporate value index based on content analysis of corporate Codes of Ethics as the input data in a model. The index is compiled from references to specific corporate values of interest in the specific company's Code of Ethics. The authors then correlate the calculated score (i.e., the extent to which reference is made to certain key words which are linked to certain values) with some measure of corporate performance, making the claim that there is a statistically significant relationship between corporate values and the firm's performance. This finding may be extended to apply to corporate culture as well, on the assumption that corporate culture is a collection of corporate values.

However, the actual values or behaviour entrenched in a firm are not necessarily aligned to those values that are *espoused* and which manifest in corporate documents, such as a Code of Ethics or integrated reports. Indeed, Guiso *et al.* (2015) explored the association or alignment between the espoused values shown in public company documents and the actually-observable values; they then examined the association between both, individually, with measures of corporate performance. They found little evidence of any relationship between actual corporate performance and those advertised or proclaimed values which were based on content analysis of disclosures on corporate websites. The ideas of legitimacy theory discussed in the first section are supported by this finding, as far as disclosures may be used to obtain a certain reputation through the eyes of outsiders. In the same study, measurements were made of management integrity as a corporate value, as perceived by employees; here, use was made of Likert-type statements as provided to the authors by consultancy "Great Place to Work" developed during its Culture Audit Survey (CAS) and Trust Index Employee Survey (TIES). Analysis of those measurements provided strong statistical evidence of an association with corporate performance.

A research challenge appears to exist in aiming to determine the way in which corporate culture manifests in organisations, for use in empirical studies. As alluded to previously, there appears to be misalignment, or tension, between those cultures or values *espoused*, as opposed to the actual cultures or the actual behaviour in organisations. Klenke (2005) supports the argument that corporate values and beliefs are instrumental determinants of corporate culture while also positing that organisations and leadership systems are governed as much by beliefs or values as by rational processes. This comment is interpreted to indicate and reinforce the claim that organisational

behaviour is explained as much by rational processes (along the lines of economist's rational utility optimisation theory) as it is complemented by values and ethics. A literature study on the nature of corporate values conducted by Klenke (2005), finds and emphasises three characteristics related to corporate values. First, he finds that corporate values are *latent constructs*; in other words, these appear to be invisible before an act or behaviour through which they manifest. Second, they have a *general* instead of a specific nature, and third, they apply to *many levels* in a corporation. The same paper highlights some important core values in companies: trust, humility, stewardship, and interestingly, also corporate social responsibility. Klenke (2005) then comments that an organisation's values are the standards by which employees make priority decisions. The significance of tax expenses suggests that Klenke's conclusions apply to tax-related decisions as well. The next section discusses the nature of ethics, showing how corporate ethics depend on those corporate values that are used to classify behaviour as ethical or not.

#### **2.11.6 Corporate ethics: a function of corporate values**

The discussion of corporate values in the preceding section is incomplete without a discussion of ethics. Values are perceived as the lens through which behaviour is evaluated as ethical or not. This suggests that values have a mediating impact on behaviour in terms of an ethical classification. For the corporate business setting then, by extension of this argument, it may be said that ethical behaviour can only be evaluated with reference to corporate values.

Laasch and Conaway (2015:113-154) argue that the development of business ethics, as a distinct part of general ethics, can be traced to the 1960s, when the latter had evolved from classical moral philosophy; a concept that originated from theology. From the 1990s however, "*business ethics began to add to the moral considerations about right and wrong by studying the ethical decision-making process of individuals and groups in organisations.*" Laasch and Conaway (2015:118) define business ethics as the interdisciplinary study of ethical issues and opportunities in business: ethics as business practice aims at making the right decision and behaviour in a certain ethical issue, dilemma or situation. Arguably, tax avoidance suggests such an ethical dilemma as far as companies and individuals alike are continually faced with the option to comply with the 'letter' or to the 'spirit' of tax legislation with the choice of the former often leading to tax savings, as explained earlier in this literature review. It follows that organisational values, and therefore corporate culture, may be indicative of a company's choices in this situation, supporting the argument that considerations beyond mere economic optimisation theory may be the driver for certain tax behaviour.

Laasch and Conaway (2015:118) posit that business ethics manifest at three different levels in companies. These are the individual level, the organisational level and the systemic level. This suggests complexity for corporate ethics as well, because it shows that people's own values, corporate values of the company, and the values dictated by a larger system of economic participants, all have an influence on how a company determines what constitutes ethical behaviour. This view may be interpreted as showing that the influence of leadership, employees (as people) and the

corporation itself, all have an influence on behaviour; moreover, the influence of these three sources may not be mutually exclusive.

Assessments regarding ethical or unethical behaviour may have a subjective element to them. Nevertheless, the literature is well-supplied with empirical research regarding the relationship between ethics and corporate outcomes: this research provides support not only for the importance of ethics as a consequential construct, but also for corporate culture as well. For example, Beltramini (1984), cited in Ford and Richardson (1994:208) studied students majoring in business degrees and found that they are more concerned with ethical issues than other students. Evidence to the contrary, however, is found in Hawkins and Conanougher (1972) as cited in Ford and Richardson (1994); here it was found that students majoring in business subjects are more tolerant of questionable practices. The findings of these two papers seem to contradict each other, which may suggest the need for further investigation of whether and how certain qualifications or technical skills-sets may influence ethical views. Two studies report significant association between managers who exhibit high levels of Machiavellian values and unethical corporate behaviour [See Hergarty and Sims (1978); Singhapakdi and Vitell (1990), both cited in Ford and Richardson, (1994:209)]. The influence of the behaviour of top managers on corporate behaviour as a whole, has also been investigated. Brenner and Molander (1977) and Baumhart (1961), cited in Ford and Richardson (1994) report how a significant number of employees in a survey indicated how the behaviour of their superiors influenced their own ethical behaviour. Akaah and Riordan (1989), cited in Ford and Richardson (1994), report that the absence of top management action against unethical behaviour resulted in stronger approval of questionable practices in the rest of the organisation.

Akaah (1992) as reported in Ford and Richardson (1994) found that employees with a stronger identification with the organisation were associated with more ethical behaviour. Perhaps this can be interpreted to mean that the level of employee happiness may be an indicator of ethical corporate behaviour. The organisational level at which employees are working may also help shed light on ethical behaviour. Here, Delaney and Sockell (1992) report that lower-level managers perceive a greater need to be unethical in order to ascend the corporate ladder. However, this finding is contradicted by Chonko and Hunt's (1985) previous finding as cited in Ford and Richardson (1994:215); they found that higher-level managers are less likely to identify ethical problems. In the last analysis however, Ford and Richardson (1994) conclude that *"as an employee's level in the organisation increases, that employee's ethical beliefs and decision-making behaviour decreases."* The fact that a CEO has attained the organisational apex does not bode well for corporate behaviour, although a CEO's behaviour may be influenced by many other factors as well. However, this finding may still support an expectation that a CEO, faced with a 'grey' ethical tax matter, may be inclined, if equipped with technical skills in a certain discipline, such as Taxation, to make tax decisions which may be interpreted as immoral by some. Therefore, one can deduce that CEOs with formal tax or accounting backgrounds may even exacerbate a propensity to make 'unethical decisions' regarding tax behaviour if the CEO effect is accompanied by a particular academic skill or academic qualification such as technical tax knowledge; after all, this knowledge would

make it easier for the CEO to make a better risk assessment of whether certain tax decisions would be investigated by regulators.

Evidence indicates that company size, as an organisational attribute, is negatively associated with ethical behaviour; in other words, employees of bigger companies appear less ethical; this finding was reported by Browning and Zabriskie (1983) and Murphy (1992) both cited in Ford and Richardson (1994:214).

One finding of the literature review provides justification for the existence of corporate codes of conduct. Arguably, codes of conduct set out the values and behaviour expected of or encouraged from employees. Thus, Ford and Richardson (1994:216) found that *“for the most part, the existence of a code of conduct has been found to be consistently and significantly related to ethical behaviour.”* This explains the tendency of some researchers to investigate CSR performance, ethics and corporate values based on content analysis of corporate codes of conduct, mission statements and other policy-based corporate documentation. It also shows that codes of conduct may not necessarily be used solely as part of initiatives to obtain unmerited corporate legitimacy.

Hitt (1990), cited in Klenke, (2005:51) suggests that an ethical environment causes ethical leadership; likewise, ethical leadership is conducive to the creation of an ethical corporation, and therefore an ethical environment. This argument can be interpreted to mean that there is an inherent endogeneity with regard to the constructs involved. Eisenbeiss, van Knippenberg and Fahrback (2015) find that the CEO's ethical leadership is related to the firm's performance, assuming the existence of an organisational ethics programme; this possibly suggests that the CEO's values are only the consequence of company performance, assuming an ethical environment, as mediating factor.

Ethical cultures seem related to the development of intellectual capital (Yann-Su, 2013), which is needed for long term sustainability; this view strengthens the argument regarding the importance of ethics to the development of long-term culture.

The preceding section has shown that the determinants of corporate ethical behaviour are complex. By extension, this means that corporate culture is also complex insofar as it is informed by corporate values. The complexity here stems from subjectivity in the way in which ethical behaviour is construed. For example, it would seem that a company is not acting unethically if it lies to its customers, provided that it does not subscribe to integrity as a corporate value. Complexity in the determinants of ethical corporate behaviour is further suggested by evidence showing that the relationship between CEO characteristics such as leadership style, qualifications, or other personal CEO attributes and corporate culture may be circular. For example, evidence suggests that ethical CEOs may promote ethical corporate conduct; at the same time, ethical corporate conduct may result in CEOs behaving ethically. Regardless, this section offers evidence that corporate culture and ethics have consequences for corporate outcomes. For example, evidence suggests that corporate ethics are associated with happier employees, more innovation and better adaptation to changing environments and also, higher profits. By extension, this suggests that corporate

culture could be associated with other corporate outcomes as well, such as corporate tax avoidance. The next section contextualises the idea of a company having a long-term temporal orientation as a particular type of corporate culture. That section also shows how long-termism as a corporate culture may be described as a proxy for the overall ethical disposition of a company.

## **2.12 Long-termism as a corporate culture: prospects for tax avoidance**

### **2.12.1 Introduction**

The preceding section has shown that corporate culture, interpreted as a collection of corporate values, has consequences for corporate behaviour and outcomes, such as profitability. These outcomes may extend to tax behaviour and tax decisions. It has been shown that it is difficult to measure corporate values, which means that researchers often resort to the use of content analysis on company-produced artefacts such as corporate reports, mission statements, or policy documents to measure these values. These reports, documents and the like may not necessarily reflect the “real” values of the company, because companies often use annual reports, Integrated Reports and mission statements, amongst others, as part of legitimisation strategies to create certain impressions. With this in mind, this section explores the concept of a long-term corporate orientation as a loaded, consequential type of a corporate culture that encapsulates and assumes a combination of many values including integrity, adherence to corporate social responsibility, trust, fairness, and transparency.

### **2.12.2 Long-termism as an ethical corporate culture**

Guiso *et al.* (2015) refers to a definition of integrity as one that concerns the “*the quality or state of being complete, in an unbroken condition, sound.*” Companies that manage for the short term only could be described as broken if they neglect those imperative activities that yield their return in the long term; for example, creating a happy and committed workforce and investment in innovation and research. Such an attitude is not indicative of integrity. It would seem that short-term oriented companies may willingly and unknowingly be in a “broken” state, because of the negative consequences that will accrue to future stakeholders as a result of short-sighted behaviour in the present.

It would appear that short-termism, as the opposite of *long-termism*, is better defined than long-termism. Marginson and McAulay (2008) argue that short-termism is a characteristic of a general preference for actions in the short term (with short-term outcomes) and as such, has detrimental consequences for the long term. It would seem as if short-termism is part of an organisational phenomenon referred to in the literature as a ‘suboptimal intertemporal trade-off’ or “corporate-myopia.” Marginson and McAulay (2008:274) refer to the definition of short-termism as “*actions to secure short-term results that preclude long-term achievement*” and “*decisions and outcomes that pursue a course of action that is best for the short term but suboptimal over the long run.*” Demirag (1995:248) describes short-termism, at the level of the firm, as the application of a time rate of discount which exceeds the firm’s opportunity cost of capital, and/or the foreshortening of the time horizon to exclude relatively distant revenues, while Williams (1991) in

Demirag (1995:248) defines short-termism as “*a propensity for short-term gains at the expense of longer term benefits*”. It is argued that long-termism, as the opposite of short-termism, is related to companies whose activities also show concern for stakeholder interests in what has been described as a stakeholder approach. Ultimately, if the legitimate concerns or interests of key stakeholders in the long term are neglected, then such behaviour may indeed be beneficial for a short period, while precluding long-term corporate sustainability, which may impact other stakeholders as well.

Anecdotal evidence suggests the benefits of a long-term corporate outlook but empirical evidence of this is scarce. Arguably this lack of evidence may be as a result of problems in defining and measuring ‘long-termism’ accurately. The question of how long is ‘long,’ for example, is a self-evident problem in this regard; bear in mind that a company as a legal entity could exist indefinitely, therefore outliving most human stakeholders. The universe is approximately 13.7 billion years old and biological life probably more than 3.85 billion years old (Bryson, 2003) and against this background, then “old” or a “long time” is relative at best. The Merriam-Webster Dictionary defines the long term as a period exceeding ten years (Merriam Webster, 2020:734). From whose perspective should we be measuring a long term? How long a planning horizon merits a classification as a long-term orientation? These awkward questions may help explain why relatively little quantitative empirical research could be identified for this literature study.

### **2.12.3 Corporate long-termism: indicators and beneficial outcomes**

Flammer and Bansal (2017) find empirical evidence for a causal relationship between corporate behaviour associated with long-term orientation and increasing company valuations. Furthermore, their research reports a positive association between these firms’ long-term orientation and investment in strategic assets such as innovation, and improved stakeholder relationships. In their study the authors use a regression discontinuity design where the impact of exogenous changes in executives’ long-term compensation plans as implemented via shareholder voting (as the shock) are evaluated; here, firm-value is regressed on a proxy for long-term orientation. The authors operationalise ‘long-term’ orientation through development of a composite index that depends on quantitative content analysis of discourse (choice of certain words) based on corporate filings.

Indicators of long-termism have been investigated with a view to identifying possible relationships with corporate performance. For example, Maldonado, Vera and Ramos (2018) introduce the concept of a humble corporate culture as a key success factor and source of competitive advantage. The authors find that humility is strongly correlated with extraordinary success in the marketplace. The authors suggest that a humble corporate culture encourages the following six values and norms: employee development; tolerance of mistakes; transparency; accurate awareness; recognition; and, openness. Moreover, the authors find that a humble corporate culture is associated with three characteristics which may be indispensable for integrated strategic management and long-term success. These three characteristics are: better hindsight, insight and foresight. The authors explain that hindsight is explained in terms of a company’s truthful awareness of its strengths and weaknesses, where creativity is encouraged, and mistakes

tolerated to foster a learning environment. Insight is described as an environment where constructive feedback is given and appreciated, and importantly, actively sought from as many sources as possible. There is a culture of continuous truth and fact finding, where blame is accepted instead of shifted. Foresight is described as an environment where employees are developed and receive appropriate recognition for what they do. Their paper suggests significant empirical evidence of a correlation between companies having this type of culture and corporate well-being; this may extend to long-term corporate cultures as well, bearing in mind how closely the underlying idea is related. Corporate humility may suggest a company's acknowledgement that it is ultimately dependent on stakeholders, and possibly government as well, for long-term sustainability.

Another approach to operationalise long-termism is through the use of questionnaires administered to management or employees of companies with Likert-scale questions and statements, as in the study by Marginson, McAulay, Roush and Van Zijl (2010). This study uses a survey approach with a six-scale Likert instrument. The instrument includes statements which intuitively capture temporaneous attitudes such as :

*“I prefer to sacrifice long-term benefits in order to achieve short-term results” or “I am willing to sacrifice long-term performance in order to achieve short term results” or “I prefer to deviate from financial targets where this leads to innovations which are likely to be beneficial in the long term” or “I concentrate my attention on issues which will impact my targets beyond the next 18 months”.*<sup>13</sup>

This approach is similar to Lawrence and Lorch's (1967)<sup>14</sup> method, as described in Marginson and McAulay (2008), where survey respondents were asked to indicate the percentage of their time devoted to issues impacting financial results. This measuring method is arguably more rigorous to ensure construct validity, because, for example, Laverty (2004) argues that using a single indicator as a proxy for long-termism such as a company's research and development intensity alone, is inadequate to measure a more complex construct such as corporate culture. That author's argument also supports the use of the McKinsey Corporate Horizon Index (MCHI); indeed, a broader literature search also identifies the MCHI as being appropriate to measure long-termism. The MCHI is seemingly used for strategic analysis for commercial consulting purposes but it appears unutilised in academic research; this is even though this instrument has a composite, or multi-dimensional characteristic because it is composed of five financial indicators (McKinsey, 2017). Scrutiny of the index's composition reveals similarity to the items used in Kappes and

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<sup>13</sup> Interestingly, the authors find no support for the commonly-accepted assumption that emphasis on financial performance indicators should be associated with short-termism in a company. However, this finding is based on a survey that was only distributed to employees of a single telecommunications company, and as such does not refer to cross-sectional analysis of the experience in different companies or in different sectors.

<sup>14</sup> Access to original source not accessible to author.

Schmid's (2013) measurement approach which suggests an academic support-framework for the validity of the instrument.

#### **2.12.4 Other indicators related to a corporate culture of long-termism**

The following section documents and discusses research that explores variables related to long-termism although, as already discussed, a single variable may not be adequate to comprehensively measure a culture of long-term orientation.

Tehrani, Travlos and Waegelien (1987) report that long-term compensation plans act as a corporate governance mechanism tool to encourage top management to make better decisions using a long-term mind-set. By studying a sample of firms that announced disposals of divisions, the authors found that the market responds more favourably to firms where top management are tied to long-term remuneration plans, when compared to those companies where top management incentives are largely short-term based.<sup>15</sup> This finding may provide evidence that the market perceives types of remuneration structures as indicating the temporal view of top management. Gopalan, Milbourne and Song (2014) record vesting periods of executive remuneration plans as a proxy for the long-term temporal nature of executive compensation; they found a positive relationship to Research & Development intensity, lower risk, better stock performance, as well as a negative association with earnings management.<sup>16</sup> Arguably, these findings suggest that vesting periods in executive compensation plans, R&D intensity and less earnings management may be used in further composite scores to measure the temporaneous corporate attitude of companies.

Kitchell (1995) reports a strong statistical association between innovation (measured using Likert statements for the propensity of firms to adopt new technologies), international market penetration and the existence of long-term goals. Of importance is the link between a culture of corporate innovation and long-term orientation as a corporate culture. A culture of innovation may be imperative for corporate survival and long-term sustainability, in the case of those organisations that need to adapt to ever-changing external environments, attributable to political, economic and technological developments.

The link between remuneration structures of top management and CSR performance has also been investigated. Thus, Ji (2015) studied a large panel of US public firms and found a positive association between CSR performance and the long-term variable pay of the members of the top management team. This author also found a positive association between the long-term variable pay of top management and more-equitable remuneration structures for all levels of employees. The *Kinder, Lydenberg, Domini Research and Analytics* CSR rating-scores were used as the CSR

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<sup>15</sup> Compound-average grow rates are used to measure growth.

<sup>16</sup> It is interesting to note that the authors did not find evidence of a relationship between vesting period of remuneration and corporate governance performance, arguing that the relationship is complex and beyond the scope of their paper; this highlighted the need for future research. One would have expected better performance in corporate governance to be associated with longer vesting periods of remuneration.

proxy. The authors report, as expected, a strongly negative association between more short-term variable pay and CSR performance. This research suggests a link between long-term-oriented behaviour (as it manifests in top management-team remuneration structures) and performance in the field of corporate social responsibility.

Organisational resilience is a term which is logically related to corporate long-termism or longevity. Ortiz-de-Mandojana and Bansal (2016) define organisational resilience as the *“incremental capacity of an organization to anticipate and adjust to the environment”* and *“a firm’s ability to sense and correct maladaptive tendencies and cope positively with unexpected situations.”* They explain that resilience is a latent, path-dependent outcome which they operationalise using three indicators measured over a 15-year period: sales-growth, company survival-rates and financial volatility of companies. The results indicate a strong statistical association between CSR practices and those three proxy variables for resilience over 15 years, although the expectation of a positive association on current profits is rejected.

It is plausible to expect a link between employee happiness and long-termism and indeed, this is empirically supported. Edmans (2011) finds empirical evidence that employee happiness and employee satisfaction<sup>17</sup> are both strongly positively correlated with long-run shareholder returns. This is interpreted as empirical support for the theory that employees are key assets in a stakeholder view of the firm, and should not be regarded as expenses, although they are non-recognisable as assets on balance sheets. As the paper shows, happy employees create value by inventing new products and services or when they form new client relationships, all of which increase revenues and decrease uncertainty. It is logical to argue that happy employees might have the necessary incentive to go the extra mile for the company to enhance the company’s long-term sustainability. Employee happiness can result from the knowledge that corporate values regarding stakeholders are aligned to the employees’ personal values. Greening and Turban (2000:254) use social identity theory, combined with signalling theory, and show that firms can use their corporate social performance activities to attract sought-after job applicants. By applying social identity theory, they explain that job applicants have better self-images when working for socially responsible companies than they would if they were working for their less socially responsible counterparts. This can be interpreted to mean that employees expect socially responsible firms to extend their socially responsible culture to their own employees, which in return leads to happy employees as well as the attendant long-run shareholder returns, as reported by Edmans (2011) and discussed previously.

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<sup>17</sup>The authors use Fortune Magazine’s annual “Best Companies-to-work-for” rankings to measure employee happiness. Two-thirds of the score come from employee responses to a 57-question survey created by “Great Place to Work Institute” in San Francisco. The survey measures attitudes toward management, job satisfaction of employees, fairness and camaraderie (Edmans, 2011:625).

Flammer and Kacperczyk (2015:1) investigated the influence of a firm's stakeholder orientation on levels of innovation, which represent an important imperative for economic growth<sup>18</sup>. In acknowledging that stakeholder orientation could possibly be endogenous with respect to innovation, a quasi-natural experiment was set up in which these authors identified an exogenous variation in the degree of stakeholder orientation through the enactment of state-level constituency legislation. By using a difference-in-difference design to isolate causality between stakeholder orientation and levels of innovation, the authors found that stakeholder orientation had a significant influence (measured using KLD's CSR scores on social dimensions) on levels of innovation; here, the level of innovation was quantified in terms of the number of patents registered and patent citations. The authors explain two possible mechanisms through which these findings may be interpreted. First, they argue that employees feel more secure in stakeholder-orientated companies, which encourages them to experiment and even allows them to make mistakes and to learn; this leads to more innovation, which is evident from the higher number of patents generated per employee reported in the study. Second, the authors argue that stakeholder-orientated companies foster innovation by increasing the satisfaction of various stakeholders (notably customers) which improves the employees' job satisfaction; this again encourages them to innovate even more. Arguably employees feel safer if their employers show visible sensitivity to the interests of external stakeholders; presumably, employees assume that this sensitivity would extend to them too.

Of importance to long-termism is the finding regarding the association between company performance and higher stakeholder orientation, proxied by the enactment of state-level constituency legislation. Flammer and Kacperczyk (2015:4) find that company performance improves when stakeholder orientation increases; however, it is important to note that this only happens in the long run. Indeed, the authors emphasise that *"in the short term, operating performance actually decreases. This suggests a temporal trade-off-while stakeholder orientation pays off in the long run, it hurts profits in the short run"* (Flammer & Kacperczyk, 2015:4). Arguably this study gives further support to the validity of stakeholder theory which, over the long term, also yields benefits to shareholders.<sup>19</sup> Finally, the discussion supports the potential use of employee happiness as a composite component for a measuring instrument to measure long-termism in companies, which may be relevant in measuring a long-term corporate culture.

Kappes and Schmid (2013) investigate the association between the family's involvement in family-owned companies and measures of those companies' long-term temporal orientation. The findings suggest that companies actively managed by the family or founders are significantly more long-term oriented than a control group used for comparison. The authors explain that family members are encouraged or incentivised to ensure sustainability in the

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<sup>18</sup>See the research by Aghion and Howitt (1992); Grossman and Helpman (1990 & 1994); Jones (1995); and, Romer (1990). Also, for work on the relationship between innovation and company survival, see Baumol (2002); Porter (1990) and Schumpeter (1942), all cited in Flammer & Kacperczyk, (2015:2).

<sup>19</sup> Shareholder-oriented companies may have classified behaviour which reduces profits in the short term as sub-optimal as opposed to management myopia.

long term, because their offspring's interests are directly at stake. These findings also support those of Chen *et al.* (2010:41), which were discussed in the section on the determinants of tax avoidance. Of particular interest in this study is the development of a measuring instrument for long-termism in the form of a composite index based on three measures: investment behaviour, employee characteristics and financing behaviour. The investment category includes measures such as investment in R&D, capital expenditure as percentage of sales and depreciation as percentage of assets. The authors argue that these may be indicative of a firm's intention to prepare for the future. The 'employees' category includes measures such as changes in employee head-count and changes in salary per employee (per capita, taking head-count into account). The financial category includes measures such as cash balances as percentage of total assets (perhaps suggesting that more conservative working capital ratios are associated with a long-term perspective), liquidity (working capital ratio) as well as measures of debt maturity.

Davies, Haldane, Nielsen and Pezzini (2014:16) developed and suggested a quantitative method to measure evidence of short-termism (the opposite of long-termism), using investor behaviour and companies' dividends. Their model is based on the value of dividends paid and price ratios, to measure implied investor discount rates; these, according to the authors, are indicative of short-term oriented investors. They argue that higher dividend yields may be indicative of market pressure on those companies paying high dividends to continue doing so; this could possibly be at the expense of line items such as investment in R&D projects, which may prevent the company from attaining long-term sustainability.

Empirical evidence indicates that family-controlled companies may generally have a more long-term perspective than other companies, for the reasons discussed. Chen *et al.* (2010:41) report a strong negative correlation between family-owned businesses and tax avoidance. It may not be realistic to conclude that all long-term orientated companies are less aggressive tax avoiders as the findings of Chen *et al.* (2010:41) only pertain to family-controlled firms, although the link to long-termism is suggested. However, there may be other omitted variables that explain the tendency of family-owned firms to exhibit less corporate tax avoidance. Although these findings pose an interesting proposition, confirmation will be subject to empirical investigation; for example, to assess how family-owned firms perform with regard to an index of long-term indicators. Also, Chen *et al.*, (2010:41) interpret their findings from a corporate governance perspective, and not from the perspective of shareholder value maximisation; they argue that lower levels of tax avoidance by family-controlled firms may signal lower levels of profit diversion, which may result in higher price-earnings multiples in the future if they were to cash out to outside shareholders.

#### **2.12.5 Long-termism and CSR**

Arguably, one could expect companies with a long-term orientation to subscribe actively to the principles of stakeholder orientation; after all, such companies may realise that their own sustainability in the long term is intricately related and dependent on the well-being of stakeholders. The discussion of the nature of CSR in terms of stakeholder theory, in section 2.7.1 above, has identified the possibility that companies may apply CSR performance

scores as part of a strategy to legitimate their existence from the perspective of governments; nevertheless, the company might not really be subscribing to the underlying principles and spirit of CSR as an approach to responsible business. The question that invariably arises is whether all companies that exhibit CSR initiatives or other manifestations of CSR, are necessarily and automatically also companies with a long-term culture. Some of the papers discussed in the previous section have indeed reported some evidence of a positive relationship between CSR ratings and some measures indicative of long-termism. There are other examples as well. Cook, Romi, Sánchez and Sánchez (2016:494) investigated the links between CSR, innovation and investment efficiency, all of which are requisite components for long-termism. These authors suggest some empirical evidence for 'enlightened stakeholder theory' which shows how CSR, in the final outcome, comes full circle to benefit shareholders. The authors argue that CSR is the causal factor which results in more innovation, with an attendant improvement in investment efficiency in firms; all this increases equity values of the company, benefitting shareholders.<sup>20</sup> The authors argue that better CSR performance is positively related to investment efficiency, originating from better management decision making which results from the higher degrees of stakeholder scrutiny and stakeholder monitoring that are inherent to CSR. They also argue that these stakeholder monitoring effects are amplified when a diverse set of stakeholders' interests are aligned, which encourages coordination to strengthen corporate governance even further. Finally, the authors argue that better CSR performance improves the quality of accounting information available,<sup>21</sup> which enables management to make better decisions, based on high-quality information. The impact of CSR on innovation, however, appears conditional. According to Cook *et al.* (2016), the high cost of failure in innovation suggests that this can only be successfully pursued within a long-term corporate culture that can tolerate periodic failures in the costly search for excellence. However, in most cases, the long-term variables used were single measures; for example, the long-term variable pay of top management. The amount of such research may not be enough to conclude that CSR and long-termism are positively associated; this lack of clarity arguably calls for more research on the same link, possibly though the use of a composite measure for long-termism.

### **2.13 Conclusion, reflection, and development of research questions**

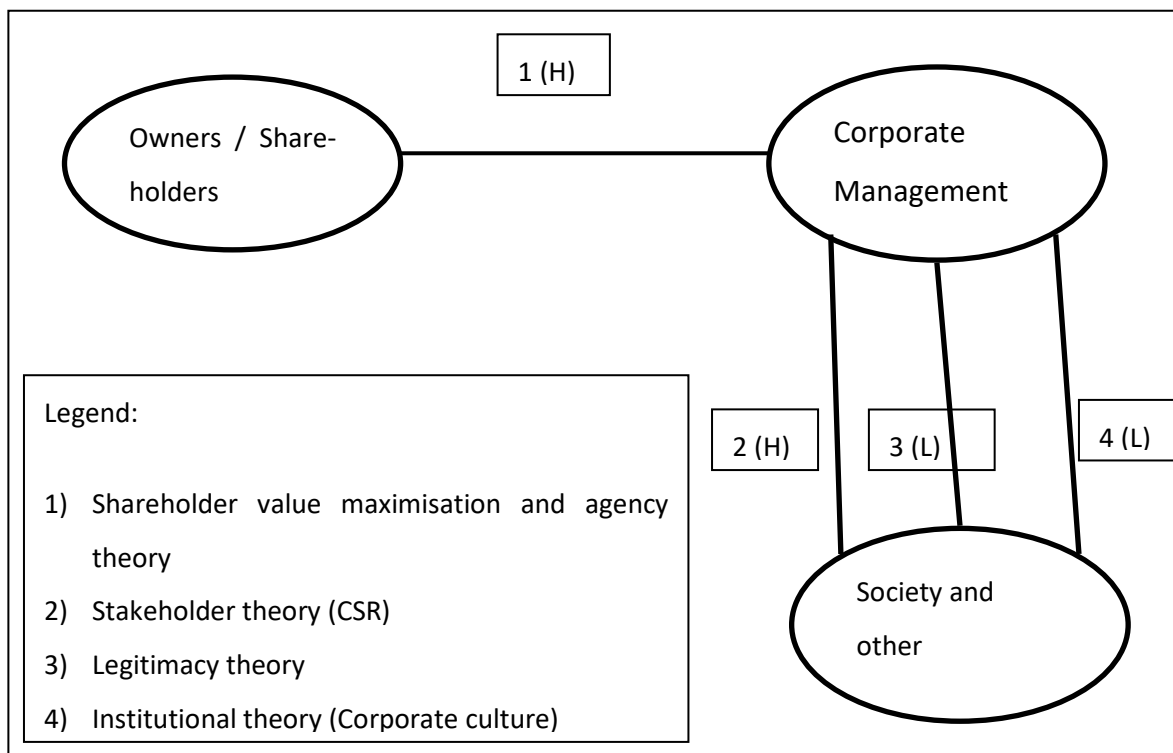
The literature review has considered and evaluated salient research in the body of literature pertaining to corporate tax avoidance. A particular focus was placed on empirical research related to the determinants of corporate tax avoidance. The discussion in the review was structured along the dominant theories encountered in finance research

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<sup>20</sup>Cook, Romi, Sánchez and Sánchez (2016:494) measure CSR performance using the MSCI ESG database (formerly the KLD database). This tracks the CSR activities for a wide set of publicly traded firms and which provides rating for a firm's social performance in a wide range of categories of which the corporate governance score is omitted to use as a control variable that has been shown in previous research to influence investment efficiency.

which include shareholder value maximisation (SVM) theory, agency theory, stakeholder theory, institutional theory, and legitimacy theory. Figure 2-4 below provides a type of heat-map in which shareholders, corporate management and other stakeholders are plotted, with lines between them that depict the financial theories which have been discussed and which are used in the literature to conceptualise tax avoidance studies involving the stakeholder pairs. Tax avoidance could either benefit or place these stakeholders at a disadvantage, depending on the circumstances or conditions that are evaluated in the literature. In this figure, each connector-line is annotated with “H” or “L” depending on whether each theory had been extensively used (“H” indicated for high) or not (“L” indicated for low) in the extant literature on corporate tax avoidance. Figure 2-4 indicates that research into corporate tax avoidance conceptualised along the ideas contained in SVM has received a high level of attention, while the same applies to stakeholder theory; in contrast, the literature review finds only limited use of the normative-ethical branch of stakeholder theory except for research involving the association between corporate tax avoidance and CSR. However, institutional theory and legitimacy theory have been used to a lesser extent in the corporate tax avoidance literature. More specifically, Figure 2-4 suggests that legitimacy theory and institutional theory present opportunities for further research on tax avoidance that investigate how ethical considerations, through corporate culture as a collective term for a company’s ethical disposition, can influence corporate tax avoidance.

**Figure 2-4 Tax avoidance papers conceptualised through various finance theories: A heat-map indicates the extent to which those theories were used in the literature**



The above figure indicates the extensive use of the shareholder value maximisation theory to explain corporate tax avoidance. Against this background, the literature review has shown that tax avoidance is sometimes used to enrich shareholders through incentives to management as agents to do so. The degree of corporate tax avoidance may indicate corporate governance problems, suggesting that the tax savings from corporate tax avoidance may not

necessarily flow to shareholders, but to agents, in a process termed “profit diversion.” The implicit argument for papers discussed under this theory is that agents or shareholders will rationally use opportunities related to corporate tax avoidance in a way that allow them to optimise their own economic utility. For example, if shareholders incentivise management to increase net profits after tax, then it is expected that management may use corporate tax avoidance to achieve such an objective. The review shows the limits inherent to using the SVM and agency theories to explain corporate tax avoidance, since these theories are construed from the overarching principles related to economic theory of rational utility maximisation of economic participants; this mostly ignores the role of ethical attributes and considerations, such as individual’s values and corporate values to explain and predict corporate behaviour.

The literature review indicates that stakeholder theory suggests a link to the role of corporate ethics and corporate values to explain a company’s commitment to CSR initiatives; this suggests a company’s voluntary choices in terms of its management and consideration of its stakeholders’ interests. To this end, the review evaluates papers that explore corporate tax avoidance along the lines of stakeholder theory, particularly focussing on the relationship between corporate tax avoidance and CSR performance, which the review finds to be mostly inconclusive. For example, the literature review highlights an ongoing academic discourse on this issue, with some authors showing empirical evidence of a *complementary* association between CSR and corporate tax avoidance, while others report a *substitution* association between CSR and corporate tax avoidance. Two possible reasons for this uncertainty in the literature are identified. First, the review identifies measurement issues related to CSR performance and CSR disclosures. Secondly, the review identifies attempts and strategies used by companies to enhance their corporate reputation through CSR disclosure and CSR performance, in accordance with the ideas contained in legitimacy theory; this may obfuscate the company’s underlying purpose with its CSR initiatives and associated disclosure. Legitimacy theory and the dominant views highlighted and cited in the literature review above, indicate various links to corporate tax avoidance. For instance, a first link to corporate tax avoidance is the idea that corporate taxes could be interpreted as society’s expectation of a *quid pro quo* from corporates, in return for society’s support or endowing them a licence to operate.

The literature review mentions measurement problems in attempting to use CSR as an indication of the ethical disposition of a company; this problem precipitates the need to look for new constructs suitable for investigating the influence of corporate ethical dispositions on corporate tax avoidance. Therefore, the literature review identifies corporate culture as a values-laden construct, and the review shows that corporate culture is more indicative of the actual ethical tone in the company. This can be different from the proclaimed or advertised values and behaviour often measured through reference to CSR performance and CSR disclosures. In this regard, Institutional Theory postulates that certain patterns of corporate behaviour become institutionalised when these become “the way things are done in the company.” The literature review shows how this idea is closely related to what industrial

psychologists describe as 'corporate culture,' which the review shows to be constituted of corporate values, and which is also consequential for corporate outcomes, such as company profitability or corporate innovation.

Regardless, a company's view and behaviour relating to its corporate responsibility towards larger society, the environment and shareholders that extend beyond the minimum requirements contained in legal frameworks, can also be indicative of a form, or a type of corporate culture. It is argued that this voluntary pattern of behaviour that forms part of CSR may be informed by the company's core values and its interpretation of ethics, aspects that are key to the nature of corporate culture, as indicated in this literature review before. Disclosures about a company's CSR can however be tainted, for reasons discussed, which suggest caution, but not outright dismissal of its potential to be indicative of a corporate culture based on a company's values. Consequently, this study also uses reference to ESG disclosure performance as a proxy of corporate culture, for example, in Chapter 5. However, it is not argued not to be the strongest indicator of a company's underlying or deeper corporate culture necessarily due to the complications that arise due to the underlying reason why a company may pursue those activities.

There are different views on the nature of corporate culture and the places where it manifests, in terms of hierarchical levels; these issues have different implications for the arguments in this study. According to the view of corporate culture being a concept that can be managed and manipulated by management, it follows that corporate tax behaviour in general could be influenced by corporate culture. This view regarding corporate culture's nexus of control suggests the influence of CEO effects and CEO characteristics as factors that mould corporate culture, as discussed later. However, other views suggest 'pockets' of culture, dispersed company-wide; these views suggest that nuanced differences may manifest between divisional corporate cultures and the overall corporate culture. For example, it is possible that a tax department in a company may have different views on the use of tax planning and tax avoidance, compared to top management; those views may cover corporate aspects and decisions which are normally governed by values. This gives rise to an expectation that the idiosyncrasies or personal values of specific persons or small groups of people working in a small functional department of a company could also be indicative of corporate tax avoidance behaviour. The fact that subcultures may exist in a company may be another reason for a dearth of empirical research that investigates corporate culture at the aggregate level. It would seem that the influence of the CEO as a determinant of corporate culture is generally assumed, although it is also accepted that other aspects of corporate culture may be less subject to a CEO's influence. These may be corporate habits, corporate values and beliefs that a company develops over time. The identification of corporate culture as a values-laden, consequential construct precipitates the first overall research question as to whether corporate culture influences the degree of corporate tax avoidance exhibited.

An examination of the literature on corporate culture identifies various aspects that inform research questions in this study. The literature review identifies uncertainty regarding the extent to which the CEO's character traits and leadership style influence corporate culture. For example, evidence suggests that the corporate culture is influenced by the CEO, but other scholars find evidence that the CEO's behaviour is influenced by corporate culture *ex-ante*. It

appears as if a triangle of relationships between a CEO's characteristics, corporate culture as a separate construct, and corporate outcomes, is not yet fully understood. Also, the literature review indicates evidence that the nature of corporate culture is ambivalent as far as it possibly has a fixed, stable element but also a transient element which is more amenable to change; this makes measurement and identification of corporate culture more difficult. With reference to institutional theory, the review shows that the extent of institutionalisation of behaviour is influenced by various factors, which include the educational and professional backgrounds of employees and top management, as well as professional accreditation of these employees. This theory directly suggests the relevance and importance of corporate culture as a construct that encapsulates the institutionalised patterns of behaviour encountered in a company.

The preceding discussion suggests the relevance of a further research question regarding the nature of corporate culture and whether a CEO's character traits, as a CEO effect, have an influence on corporate culture and therefore, on corporate tax avoidance. The literature suggests that CEO characteristics such as the CEO's educational background can be influential in terms of corporate tax avoidance. More specifically, the literature has identified the possibility that a CEO's level of tax knowledge may be influential for corporate tax avoidance; however, there is also literature that argues that the possibility of, and opportunity for, measuring tax knowledge attributable to the CEO is small. This suggests another research question for this study as to whether a suitable proxy for a CEO's technical tax knowledge and tax awareness could be identified and measured in the South African corporate environment.

The literature review finds consensus regarding the notion that corporate culture is constituted by a combination of corporate values and patterns of behaviours, this suggests an element of irreducible complexity inherent to corporate culture as a construct. This makes it difficult to measure and operationalise corporate culture in quantitative empirical research, which offers some further explanation for a dearth of empirical investigation into the relationship between corporate culture and corporate outcomes including corporate tax avoidance. Thus, researchers into corporate culture tend to select, measure, and use dominant corporate values as a proxy in studies about corporate culture, possibly to circumvent some of this complexity in the way in which it is constituted. However, one can argue that corporate culture's element of irreducible complexity is then neglected, which can result in corporate culture not being fully measured as a higher-order construct, in which the 'whole' amounts to more than the sum of the constituting parts. Here, the literature encourages measurement of corporate culture using a composite index approach in order to capture the multi-dimensional nature which makes corporate culture so complex. The literature review identifies a corporate culture typical of a long-term orientation, which is related to corporate values; these values include integrity, innovativeness, transparency, resilience, and humility. In short, the literature review shows that long-termism as a corporate culture may be a useful proxy for the overall ethical disposition of a company, not only towards shareholders' long-term benefit, but also pertaining to its acknowledgement that its sustainability in the long term depends on its mutually beneficial relationship with its wider stakeholder constituency. This suggests the relevance of two research questions. Here, the first question concerns whether and how long-termism can be

operationalised through the use of financial indicators for subsequent use in quantitative empirical research. A second research question concerns whether corporate tax avoidance and long-termism, as a higher-order construct to measure a company's ethical disposition, are associated. Chen *et al.* (2010) find evidence that companies that are majority-owned by families are less tax aggressive, which the authors ascribe to the tendency of family-controlled companies to be more long-term oriented, because they avoid tax planning opportunities as these could signal the existence of poor corporate governance to future investors. It remains open to debate whether a long-term orientation construed from a stakeholder perspective has the same effect on corporate tax avoidance.

The next chapter explains the aspects of methodology and method used in this study to improve understanding of the relationship between corporate tax avoidance, corporate culture and CEO characteristics. The chapter refers to, and explains, the proxies used to operationalise corporate tax avoidance, corporate culture and CEO-knowledge of tax (as a CEO effect). It also explains the use of interviews with corporate tax advisors to obtain a richer understanding of the dynamics between CEO effects, corporate culture and corporate tax avoidance. It also shows why and how a mixed-methodology research approach is necessary as well as suitable for improving understanding of this relationship, because it involves ethics as a subjectively construed construct, as indicated in this literature review.

## 3 Methodology

### 3.1 Introduction

Chapter one conceptualised and positioned this study's overall aim, which is to advance understanding of the relationship between corporate tax avoidance and corporate culture. To this end, chapter one developed and listed the relevant research questions which need to be answered, given the scope of this study, as well as research objectives which need to be satisfied. Consequently, chapter three now sets out to explain and justify the use of the methodology, methods, and data used to collect evidence to answer those research questions. Some of these research questions are best answered using quantitative methodology, while others suggest the use of qualitative methodology. The quantitative methodology approach is used as the dominant methodology to answer questions about the operationalised relationship between corporate tax avoidance and corporate culture, while the qualitative methodology, used as the secondary methodology, is used to understand corporate tax avoidance more from the process level. The process-level focus helps one to understand the role of the CEO and corporate culture in the corporate tax avoidance process. This chapter explains that the use of both quantitative and qualitative methodologies in the same study represents a mixed-method methodology approach ('MM'). This chapter also describes the various regression models used and the observational data used in the quantitative methodological 'research stream.' It is then explained that the limited amount of theory on tax avoidance and possible measurement error in operationalised constructs under the quantitative stream, supports extension of the research using qualitative methodology through interviews. This can complement and enhance understanding obtained from the quantitative research stream of this MM study.

#### 3.1.1 Chapter layout

Section 3.2 below first distinguishes between the nature of quantitative and qualitative methodologies, as background to section 3.3 which explains how both are used in this study which follows a mixed-method ('MM') methodological approach. The rest of the chapter develops along the quantitative and qualitative streams of methodology that are used in this study. Section 3.2.1 below, describes the quantitative research stream while it also explains how it is used to answer the quantitative research questions, explains the data used, as well as the research methods employed to answer them. Section 3.5 below describes the qualitative research methodology stream used in this study; this entails the use of interviews to answer the qualitative research questions developed. The chapter ends with Figure 3-3 which provides a map of the research streams (quantitative and qualitative streams) as they are performed in this thesis. This Figure serves as a quick reference and navigation guide to the different sections and chapters of this study. This Figure also shows at what point integration between the two research streams happens.

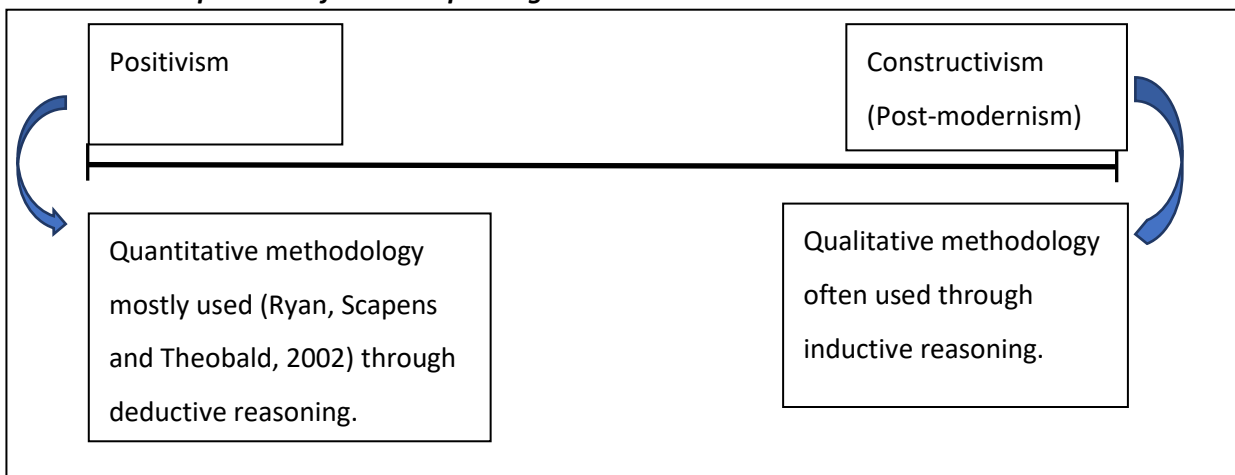
### 3.2 Differentiating between methodologies used in this study

The combined use of quantitative and qualitative methodologies, to gain a better of understanding of corporate tax avoidance, is best explained in the light of a review of the distinguishing characteristics of these two methodologies. The next section first contextualises quantitative methodology, and this is followed by a review of qualitative methodology.

#### 3.2.1 Quantitative Methodology

The paradigmatic difference between quantitative and qualitative methodology can be depicted in the following diagram, Figure 3.1, titled “Research paradigms used in this study: Constructivism and Positivism on opposite sides of the spectrum of research paradigms.”

**Figure 3-1 Research paradigms used in this study: Constructivism and Positivism on opposite sides of the spectrum of research paradigms**



Source: Developed from Quinlan, Babin, Carr, Griffin and Zikmund, (2019:149)

Babbie (2010:32) describes a research paradigm as “a model or reference through which to observe and understand,” and positivism as “a philosophical system that is grounded on the rational proof or disproof of scientific assertions, while assuming a knowable, objective reality or truth”. The statistical examination of relationships between constructs to support or refute a theory, is an underlying concept of quantitative methodology in which measurement is key. Quinlan et al. (2019) define measurement as the:

*“process of describing some property or phenomenon of interest by assigning numbers in a reliable and valid way” and consequently defines quantitative research as “research that is conducted by generating numerical data or data that can be readily coded numerically.”*

Darity (2008) defines quantitative research as:

*“any research that uses numbers as the basis for making inferences about the phenomenon under study” and further says that “control over extraneous in factors, often using experimental*

*manipulations through the use of statistical approaches to sampling, measurement and data-analysis*" is key to quantitative research.

Plano Clark and Ivankova, (2016) define quantitative research as an approach that *"examines the relationships between variables by collecting and analysing numeric data expressed in numbers and scores."*

These definitions underscore the importance, as key characteristics of quantitative research of the following: numerical data; quantification of the strength of relationships among data; and, statistical inference. Thomas, (2003:2) states that:

*"quantitative research uses numbers and statistical methods which are based on numerical measurements of specific aspects of phenomena; it abstracts from particular instances to seek general description or to test causal hypotheses" while "measurements and analyses are easily replicable by other researchers."*

Thomas (2003:2) then argues that quantitative research explains and makes predictions that can be generalised, based on statistical sampling and experiments used to maintain objectivity. The method for answering those research questions in this thesis that examine the relationship between constructs such as corporate tax avoidance, corporate culture and CEO effects, fits the definition of quantitative methodology, as far as the quantum of such relationship and the direction of the relationships are investigated.

One important criterion for quantitative research is a theoretical framework as a starting point for quantitative research methodology. Babbie (2010:525) states that specific expectations or hypotheses are developed, based on theory or general principles. Smith (2003) emphasises the importance of a clear depiction of the theoretical foundation of the behaviour that is investigated in an experimental design. This study's expectations are based on the ideas contained in Upper-echelon theory, stakeholder theory, as well as the theory of shareholder value maximisation,<sup>22</sup> to derive expectations about corporate tax behaviour. Therefore, this study's quantitative methodology and consequent statistical analyses are informed by existing theory, which positions the quantitative analyses in the realm of quantitative methodology. A quantitative methodology is therefore suitable for answering research questions that involve examining the relationships between measurable constructs. In this study, this quantitative examination entails measuring *long-termism* as a corporate culture which is expected to correlate with tax avoidance. It also entails measuring tax knowledge attributable to a CEO, as a CEO effect for which a relationship with tax avoidance is also expected.

The application of quantitative methodology is followed up by the application of qualitative methodology too, with the latter applied for the following reasons. The first reason concerns the underdeveloped status of the tax avoidance

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<sup>22</sup>These theories were discussed in the literature review.

theory, as implied in the literature review: a qualitative approach is useful for making refinements to existing theory. Although the quantitative theory can confirm or refute expectations of relationships between constructs, they cannot map the process of corporate tax avoidance to suggest neglected mechanisms which are not easily observable by the public eye. The second reason is based on the fact that the construct of corporate tax avoidance has a subjective nature, not only in terms of measurement and definitional issues, but also in terms of whether it is considered unethical or not; because of this, corporate tax avoidance is suitable for a more subjective research approach, such as qualitative methodology with its subjectivist paradigm. Qualitative methodology is discussed next.

### **3.2.2 Qualitative methodology**

Corporate tax avoidance is a human social phenomenon performed through the interaction of human actors; this supports the use of a qualitative research approach. It is argued, based on an understanding documented in the literature review, that corporate culture suggests a fluid, subjective construct. Correspondingly, this view of corporate culture suggests the suitability of a more subjective research approach when its influences are investigated. Qualitative research requires moving closer to the human actors and their views; in other words, those people making corporate decisions that eventually result in corporate tax avoidance. Quinlan Babin, Carr, Griffin and Zikmund (2019:63) describe qualitative data as data that *“capture feelings, thoughts, ideas, understanding”* which is used, for example, in research in a paradigm of constructivism which holds that *“social phenomena develop in social contexts and individuals and groups create their own realities”* (Quinlan et al., 2019:59). Ospina (2004:1279) describes qualitative research as *“a form of systematic empirical enquiry into meaning.”* Enquiry into ‘meaning’ is a key concept in qualitative research, a term which that author describes as *“when researchers try to understand how others make sense of their experiences.”* Thomas (2003) argues that qualitative and quantitative research differ from each other, as qualitative research is concerned with the description of types of characteristics of people and events, without comparing events in terms of measurements or amounts. Clark and Ivankova (2016:3) describe qualitative research as *“a research approach that focuses on exploring individuals’ experiences with a phenomenon by collecting and analysing narrative or text data expressed in words of images.”*

Ospina (2004:1279) describes various benefits of qualitative research, ranging from the flexibility to follow unexpected ideas during research (deviation), exploring processes effectively, and also the ability to stay sensitive to contextual factors, which may not always be accurately operationalised in quantitative research due to complexity. The introduction (Chapter 1) indicated that the concept of corporate culture exhibits signs of irreducible complexity, which also supports the relevance of qualitative research, as discussed before. Ospina, (2004) encourages the use of qualitative research to complement quantitative research, especially in those areas that are sensitive to context, such as leadership studies; this approach is also applicable to corporate culture. Constructs such as these may be abstract to the point that they may not be adequately operationalised using singular or composite index variables, in contrast to quantitative research methodologies. A qualitative approach also supposes that process-stability is only an illusion to simplify observation, often assumed in quantitative research approaches. Human behaviour, regardless of whether

it is individually conceptualised or in groups (organisations or institutions), is the subject of social research. This suggests the need for researchers to identify carefully, what the limits are when using quantitative research methodologies by themselves, to produce complete knowledge of phenomena in a situation where complex systems of human behaviour are encountered. Alasuutari (2010:151) argues that the nature of social research is *“more like running commentaries on changing societies than accumulating knowledge about a stable system.”* Societies, including corporations which are instances of micro societies, are often conceptualised as units of analysis in research. The fact that they do not constitute perfectly stable or predictable systems suggests the need for more-subjective forms of enquiry such as qualitative research. Such an approach may be a balanced research strategy aimed at enhancing one’s understanding of corporate tax avoidance. Conversely, however, complex human systems are *not* totally devoid of predictable patterns of behaviour; this observation emphasises the utility and importance of quantitative approaches to augment and complement understanding obtained from qualitative approaches, in order to understand social phenomena. It is posited that corporate tax avoidance, with its links to values-laden concepts such as ethics, corporate values and corporate culture, includes elements amenable to both quantitative and qualitative research approaches, as envisaged in this thesis. The literature review examined the determinants of corporate tax avoidance and went on to make clear the dominant use of positivistic, quantitative methodologies which depend on proxies for corporate tax avoidance and its determinants. However, it is argued that these proxies remain no more than rough measures of outcomes which are the result of complex interpersonal human processes that are mostly hidden under the corporate ‘veil.’ One could conclude that corporate tax avoidance behaviour is constituted of the accumulated decisions of human webs, which are sometimes subjective and at other times rational. This interpretation of the human factor in the corporate entity is often invisible in business research, bearing in mind the omnipresence of the ‘corporate veil’ which neglects and obfuscates the human factor. Research questions that aim to understand the methods or mechanisms that CEOs and companies use to avoid corporate tax are the primary focus of qualitative methodology. Whether, and to what extent CEO characteristics can be of overriding importance in the determination of corporate culture can also be answered using qualitative methodology; for example through interviews, in this study.

### **3.3 Mixed-method methodology used in this thesis**

It is possible to access, in the same study, the benefits inherent to both qualitative and quantitative research methodology, through the use of a mixed-method approach. Plano Clark and Ivankova (2016) define a mixed-methods research approach as one that *“integrates or mix[es] quantitative methods and qualitative methods of data collection and analysis to address a research problem more fully and to obtain the answers to both quantitative and qualitative questions within a single study.”* Guetterman (2017:1) claims that the combination of the two methods results in meta-inferences which are better than what would be possible if either approach were used alone. For example, he explains how an MM study was used to investigate empirically the outcomes of an intervention in education processes, from multiple perspectives. The quantitative data in this study provided statistical evidence of the effectiveness of the intervention, while the qualitative data brought deeper insights from the experiences of

those stakeholders who were affected by the intervention. Guetterman (2017:1) argues that an understanding of all the perspectives produces better science and “*more actionable information to refine the intervention for future use.*” Finally, Alasuutari (2010:139) contrasts the two methodologies as complementing sides of the same coin, that may be used to understand human problems through investigation of human phenomena, claiming that:

*the task of qualitative research is not only to provide contextual information to a quantitative design, or to provide food for thought for theorists. Qualitative methods produce different lenses on social reality, lenses that make society and its phenomena more understandable.*

Alasuutari, (2010:139) also argues that qualitative and quantitative research complement each other and by doing so, improve the validity of research results. The benefit of this complementary function of mixed-methods methodology explains, partly, why this approach is used in this study. It is argued that corporate tax avoidance and corporate culture are constructs with positivistic as well as constructivist dimensions; this suggests the need for a research strategy, such as a mixed-method approach, that benefits from the application of both epistemic paradigms to enhance knowledge regarding corporate tax avoidance. Doyle, Brady and Byrne (2016:624C) note the usefulness of mixed-method methodology in triangulation: here it can corroborate qualitative and quantitative findings. It is also possible that unexpected findings or interpretations can be identified which enhance understanding of corporate tax avoidance. In this regard, qualitative methodology provides a more comprehensive account of that phenomenon.

The application of an MM methodology in this study is based on the argument that a blended methodological approach will result in a better understanding of the problem of corporate tax avoidance than if only a quantitative methodology were used. For example, the measurement and operationalisation of corporate tax avoidance and corporate culture in this study will contribute to enhanced knowledge regarding the existence of the hypothesised relationship between these two constructs; however, that kind of quantitative approach cannot entirely explain how corporate tax avoidance processes work, because the theory that explains corporate tax avoidance is not fully developed, as indicated in the literature review. The use of qualitative methodology brings deeper insight and will help to corroborate the plausibility of quantitative findings, as well as offer new perspectives which can inform the development of theory or refine existing theory. Therefore, the quantitative results of this study are extended and corroborated with data obtained from qualitative interviews. Another advantage of using MM methodology is that the qualitative data can compensate for measurement problems.

The rest of this chapter proceeds as follows. Because this study uses an MM methodology, the ensuing discussion is structured in a way that is in accordance with the nature of these two research streams; it also deals with the quantitative and qualitative research questions that accompany each methodology. Section 3.4 below discusses the quantitative research stream together with the research questions that it answers, while the data and methods are also explained. Section 3.5 below then discusses the qualitative research stream together with the qualitative research questions related to it, and the accompanying data and methods used to answer those questions. The quantitative research stream is discussed first because it is the primary research methodology used in this study;

moreover, the qualitative research methodology is partly informed by some of the results and the nature of those results.

### **3.4 Quantitative research stream**

The quantitative research stream uses quantitative data to answer quantitative research questions. The first research question that is examined quantitatively concerns the extent of the relationship between corporate tax avoidance and corporate culture. The second research question concerns whether, and to what extent a CEO's attributed tax knowledge, as a CEO effect, influences corporate tax avoidance. Both research questions imply sub-research questions to identify appropriate proxies for long-termism and a CEO's tax knowledge, respectively. Other research questions that are addressed using quantitative methodology concern the determinants of corporate tax avoidance in large South African companies, while another question concerns the severity of corporate tax avoidance in large, listed companies in South Africa throughout the sample period.

#### **3.4.1 Quantitative data**

This paragraph describes briefly how the data described in the next paragraph will be used. The research questions described above will be investigated primarily using multivariate regression analysis. In this study, the dependent variable is *alternative forms of effective tax rates* which are the proxies of corporate tax avoidance; this is regressed on the explanatory variables. The explanatory variables are proxies for *long-termism* as a corporate culture, and *tax knowledge attributed to the CEO*. These constructs are not readily measurable but the measurement strategy is discussed in the next section. Control variables used in the regression specifications are also discussed there.

#### **Quantitative Data**

The quantitative data used in this study are observational data that are derived from financial statements and other financial disclosures of the largest 112 companies listed on the Johannesburg Stock Exchange (JSE); these cover the 15-year period between 2004-2019. This data is obtained in aggregated form from Bloomberg's database. This suggests the availability of panel data because data is captured cross-sectionally, between companies, and also includes a time-series component that tracks variation over time for each company in the sample. The number of companies included in the sample may appear small when compared to the numbers used in other studies that concern corporate tax avoidance. However, 112 companies capture a significant portion of the total market value of all companies listed on South Africa's Johannesburg Securities Exchange, because South Africa does not have many large, listed companies [see Raubenheimer, (2010)]. It is appropriate to use the larger companies in the sample to investigate corporate tax avoidance, because those companies have ample resources which position them favourably to engage in corporate tax avoidance; here, they can often use the benefits of their multinational status to shift profits to low-tax jurisdictions, as explained in the literature review. The sample selected for this study includes banks and financial institutions, which are sometimes excluded from other studies that investigate the determinants of corporate tax avoidance. A focus on only the larger companies' behaviour regarding corporate tax avoidance is

further informed by the fact that some variables needed for statistical analyses are mostly only available for the large companies listed on stock exchanges; these include, for example, proxies for corporate social responsibility ('CSR') such as Bloomberg's 'ESG-scores' (acronym for 'Environmental, Social and Governance'). The only companies excluded from the sample of 112 top companies in terms of market capitalisation, are those companies that are classified as property investment companies or Real Estate Investment Trusts ('REITS'). These companies are subject to tax legislation that can result in profits being taxable in the hands of shareholders as opposed to the corporate entity, which can distort findings. Chapters 4 and 5 provide a more elaborate breakdown of the sample composition; reference is also made to other companies that are omitted for specific reasons.

### **Variables**

The dependent variables that are captured for use in regression analysis are proxies for corporate tax avoidance. These are the accounting effective tax rate (*aetr*) as well as cash-effective tax rate (*cetr*). More than one form of effective tax rate is often used in the literature to improve robust results; for example, see Greeff (2019) and Gupta and Newberry (1997). Lanis and Richardson (2012a) also use both accounting effective tax rates as well as the cash-effective tax rate to improve the robustness of their findings. Gupta and Newberry (1997) argue that the use of cash-effective tax rates is more appropriate than accounting effective tax rates as these capture a broader range of tax avoidance activities than the accounting effective tax rate, which the authors argue is more indicative of the company's total tax burden. The choice of Accounting (GAAP) Effective tax rates (AETR) and Cash effective tax rate (CETR) are also in line Dyreng, Hanlon and Maydew (2008) who use these proxies with aims similar to this thesis. These proxies are wide, and are not intended to measure one specific type of tax avoidance-related behaviour, which suits the aims of this study. The only type of tax avoidance that it does not potentially capture is income not reported (understatement of income) which is impossible to measure, except perhaps as part of a forensics investigation. Therefore, the accounting effective tax rates and cash effective tax rates are both used in this study as alternative proxies for corporate tax avoidance.

### **Variables of interest**

The data captured also includes the two variables of interest, namely *lto* and *caceo*, which are the proxy variables used for long-termism and tax knowledge attributed to a CEO, respectively. *Lto* is measured using data from financial statements to calculate the MCHI score which is a long-term composite index score developed by strategy consultant McKinsey. Tax knowledge attributable to a CEO, as a CEO effect, is operationalised using a dummy-variable (1/0), which is allocated based on whether the CEO is a South African Chartered Accountant, or not. This information is not readily available and is hand-captured from data available on Bloomberg and company annual reports, which are verified on SAICA's website's member services section. The rationale for the use of these variables, and their measurement, are discussed later in this chapter with a more comprehensive discussion being presented in Chapters 4 and 5.

## Control variables

The control variables used in this study's regressions are documented in Table 3-1 below, together with references to tax avoidance literature to justify their use. Control variables are included in the regression specifications to isolate, better, the effect of the variables of interest on the dependent variable; this is intended to prevent possibly spurious effects. As far as observational data cannot be randomly assigned into a control group and effect-group, control variables are used to control for differences between observations. A proxy for CSR is used in the regressions (*esg*) in the form of Bloomberg's score for a company's Environmental, Societal and Governance performance. This study argues that corporate social responsibility performance (*esg*) captures some element of a company's ethical disposition towards stakeholders and is related to corporate culture. Although *esg* is related to the principles contained in a corporate spirit of long-termism it is argued that CSR performance and CSR disclosure may not necessarily be indicative of the company's true commitment to CSR principles, which is measured in long-termism. For example, CSR disclosure is increasingly assuming a mandatory nature, and is often used for legitimation purposes, as indicated in the literature review. Therefore, *esg* is controlled for, in regressions. Profitability levels (*roa*) is controlled for, as the literature has indicated some evidence that different profitability levels have an influence on corporate tax avoidance; moreover, it seems also logical to suppose that more-profitable companies want to pay less tax. Levels of financial leverage (*lev*) is controlled for because of evidence in the literature that this is associated with tax avoidance. The same reason is applicable to both company size (*size*), growth (*ptb*) and different industries (*industry\_dummies*). Different degrees of capital intensity regarding the extensive use of property, plant and equipment relative to total assets (*capintens*), together with varying intensity concerning the use of intangible assets (*intangr*) are also controlled for. The following table provides evidence of the use of such variables in corporate tax avoidance literature.

**Table 3-1 Justification of control variables used in regressions of effective tax rates on explanatory variables.**

Variable used in this study	Proxy for company-level attribute:	Corporate attribute used in literature-reference (coefficient sign indicated in brackets)
<i>esg</i>	Corporate Social Responsibility	<ul style="list-style-type: none"> <li>• ‘Lanis &amp; Richardson’, 2012a (+)*</li> <li>• ‘Davis <i>et al.</i>’, 2016 (-)*</li> </ul>
<i>roa</i>	Profitability	<ul style="list-style-type: none"> <li>• ‘Davis <i>et al.</i>’, 2016 (+)</li> <li>• ‘Lanis &amp; Richardson’, 2012a (+) *</li> <li>• ‘Gupta &amp; Newberry’, 1997 (+)*</li> </ul>
<i>lev</i>	Leverage	<ul style="list-style-type: none"> <li>• ‘Davis <i>et al.</i>’, 2016 (-)*</li> <li>• ‘Lanis &amp; Richardson’, 2012a (+)*</li> <li>• ‘Dyreng <i>et al.</i>’, 2017 (-) *</li> <li>• ‘Gupta &amp; Newberry’, 1997 (-)*</li> <li>• ‘Markle &amp; Shackelford’, 2011 (-) *</li> </ul>
<i>capintens</i>	Asset intensity with reference to tangible assets	<ul style="list-style-type: none"> <li>• ‘Davis <i>et al.</i>’, 2016 (-)</li> <li>• ‘Dyreng <i>et al.</i>’, 2017 (-)*</li> <li>• ‘Lanis &amp; Richardson’, 2012a (+) *</li> </ul>
<i>intangr</i>	Asset intensity with reference to intangible assets	<ul style="list-style-type: none"> <li>• ‘Dyreng <i>et al.</i>’, 2017 (+)</li> <li>• ‘Markle &amp; Shackelford’, 2011 (-)*</li> </ul>
<i>size</i>	Size	<ul style="list-style-type: none"> <li>• ‘Davis <i>et al.</i>’, 2016 (-)*</li> <li>• ‘Dyreng <i>et al.</i>’, 2017 (+) * (For domestic companies)</li> <li>• ‘Lanis &amp; Richardson’, 2012a (+)</li> <li>• ‘Rego’, 2003 (+) *</li> <li>• ‘Gupta &amp; Newberry’, 1997 (^)</li> <li>• ‘Kim &amp; Limpaphayom’, 1998 (-)*</li> </ul>
<i>ptb</i>	Growth	<ul style="list-style-type: none"> <li>• ‘Davis <i>et al.</i>’, 2016 (-)</li> <li>• ‘Lanis &amp; Richardson’, 2012a (+)</li> </ul>
<i>industry_dummies</i>	Industry	<ul style="list-style-type: none"> <li>• ‘Davis <i>et al.</i>’, 2016 (Firm fixed-effects used)</li> <li>• ‘Dyreng <i>et al.</i>’, 2017 (Firm fixed-effects used)</li> <li>• L’anis &amp; Richardson’, 2012a</li> <li>• ‘Markle &amp; Shackelford’, 2011</li> </ul>

Coefficient sign (+ or -) indicated in brackets; \* indicates significance; ^ indicates mixed results overall.

### 3.4.2 Measurement of variables of interest: *lto* and *caceo*

Regression analysis presupposes measurable constructs to measure relationships quantitatively. It has been noted that *long-termism* and *tax knowledge attributable to a CEO* are constructs that are investigated for their relationships to corporate tax avoidance. These two constructs are, however, not readily or easily measurable, which explains why significant effort has been expended in this study to operationalise them for use in regression analysis. The following section explains the measurement strategy used in this study to operationalise these constructs.

#### Measuring long-termism (*lto*)

Long-termism as a corporate culture, is an abstract, latent construct and is neither readily observable nor measurable. However, the conceptualisation and measurement of abstract concepts for subsequent use in quantitative studies is a common practice in social research (Babbie, 2010; Quinlan *et al.*, 2019). Thus, Babbie (2010) suggests using a composite index as research instrument to measure and operationalise a construct such as long-termism as a latent construct. The McKinsey Corporate Horizon Index ('MCHI') is used as the proxy-measure (*Its*) for long-termism. The MCHI was developed by McKinsey as a strategy-diagnostic tool (McKinsey, 2017); Chapter 4 explains the MCHI as a composite measuring instrument that comprises five financial indicators to measure long-termism. Chapter 4 evaluates and shows evidence of content validity as far as the respective indicators used in the index are shown to be linked to academic literature on long-term orientations in companies. For example, the index includes reference to earnings management, investment behaviour and tendency to meet analysts' forecasts. Chapter 4 also indicates that McKinsey's reputation as a renowned global strategy consulting group provides further support for the validity of using this instrument to measure long-termism for this study's purposes.

Some industrial psychology researchers use tailored survey questionnaires to develop composite indexes to measure the manifestation or prevalence of constructs such as corporate values: the building blocks of corporate culture. These surveys are administered to employees or the executives of corporations. [See, for example, Kim, Pennington-Gray and Kim (2018); Wang and Bansal (2012)]. These methods indicate the intensive use of resources in terms of time and money, and although such a tailored approach may enhance construct validity, this study has three main reasons for using the MCHI to measure long-termism. First, sending surveys to many listed large companies is costly and the response rates are low, possibly because of the recipients' reluctance to complete surveys that could require the disclosure of potentially sensitive or even privileged information. Second, these types of surveys are often addressed to the CEO, who may ignore them due to other priorities and lack of time. Third, it is argued that companies would be careful in responding honestly with sensitive information about types of corporate cultures that may reflect negatively on the listed company's reputation, especially if a company must provide information on sub-optimal cultures; for example, those cultures that are not indicative of a sustainable long-term orientation. This has been the experience of researchers in corporate social responsibility, who find that advertised practices of corporate social responsibility (CSR) are not always indicative of the true CSR practices present in companies (Chatterji *et al.*, 2009).

#### **Measuring tax knowledge attributed to a CEO (*caceo*)**

The construct *tax knowledge attributed to a CEO* is not readily measurable, which suggests the need to identify a suitable proxy to measure it. Whether a CEO is a South African chartered accountant "(CA (SA))" is used as the proxy in the form of a binary variable ('1' indicates tax knowledge and '0' indicates less tax knowledge). For example, '1' is allocated for a company observation if the CEO of the company is a chartered accountant for more than six months of the applicable financial book-year. This data is obtained from Bloomberg's data base or from company annual reports; registration as a chartered accountant for the CEO is then confirmed on SAICA's website which offers a

verification function for members. Although not a perfect proxy, it is argued that it is useful from a practical perspective as a proxy for a CEO's tax knowledge; this is based on the following argument, which is explained in more detail in Chapter 5. The literature indicates that a significant percentage of CEOs of South African listed companies are South African chartered accountants [CA(SA)]; this situation is different from contexts in other countries where CEOs are mostly educated as lawyers or MBA graduates. Chapter 5 gives an explanation by pointing out that the educational roadmap of a prospective CA (SA) includes intensive and extensive educational training on technical aspects of tax legislation and tax principles over a 4-year training period. Also, registered chartered accountants are obligated to continue professional skills development after qualifying, and this includes continued touch-up training sessions on tax knowledge. Furthermore, it is argued that the combination of the CA's tax knowledge with financial management theory indicates a propensity for such CEOs with the CA(SA) qualification to emphasise, encourage or effect aggressive tax avoidance behaviour in the companies that they lead. Chapter 5 explains the finer nuances of this argument to support the use of this proxy for a CEO's tax knowledge.

### 3.4.3 Methods to analyse quantitative data

Multivariate regressions are mainly used to examine relationships such as the ones implicit to the research questions referred to above. Consequently, the following generic regression specifications are used to test the relationships implied in the two research questions. The first specification examines the relationship between corporate tax avoidance and long-termism, while the second regression specification examines the relationship between corporate tax avoidance and the CEO's tax knowledge.

#### 3.4.3.1 Generic regression specification 1

$$aetr_i \text{ or } cetr_i = \beta_0 + \beta_1 lto_i + \sum Controls_i + \beta_3 industry\_dummies_i + \varepsilon$$

The dependent variable *aetr* or *cetr* is the measure of corporate tax avoidance, used alternatively. *lto* is the variable of interest, measuring long-termism as a corporate culture, based on the MCHI. It is expected that *lto* should be positively associated with effective tax rates, as indicated in the literature review and also in Chapter 4. *Controls* include the control variables identified in the literature review and constitute those referred to before; these are also frequently used in regression specifications that examine determinants of corporate tax avoidance. The inclusion of *controls* in the regression specification provides an opportunity to examine the determinants of corporate tax avoidance in large South African companies, based on the assumption that those determinants should agree to the determinants reported in the literature based on data from other countries.

The ordinary least squares ('OLS') regression model is manipulated for application to various types of regressions. A pooled regression model is first used to estimate *aetr* and *cetr*, to establish whether the coefficient,  $\beta_1$  shows a statistically significant association with corporate tax avoidance. A cross-sectional regression is then run to examine the effect of *lto* between companies. The data used in the cross-sectional regression comprised the average of all variables in the generic specification, taken over the 15-year period under review. The benefit of this approach to a

cross-sectional regression is that outliers in terms of very high or very low effective tax rates, for example, are suppressed. This compensates for temporary low effective tax rates in those financial years when a company utilises an accumulated tax loss, which it had not recognised as a deferred tax asset in the past; this is typically done to maintain a conservative approach for the availability of future profits. Also, using the average of variables over the 15-year period also reduces some of the noise coming from possible measurement error, generally present in most variables, but particularly with regard to the use of a proxy for long-termism, which is a latent construct. The main reason why pooled regression is followed by an averaged cross-sectional regression, and then with fixed-effect regressions, is to establish in which dimension the x-variables are more powerful.

The generic specification is also amended to perform fixed-effect ('FE') regression on the panel data. Panel data comprises a cross-sectional (between company) dimension as well as time-series dimension (variation over time) which is a useful characteristic. For example, in this thesis, companies in the sample have fifteen observations for the fifteen years under observation, as the time-series dimension, but the use of different companies also suggests a cross-section dimension. Fixed-effect regression has specific utility in this study. Because FE regression controls for those time-invariant variables which may not necessarily be specified (i.e. due to omitted variables) it does help to contain endogeneity. Provided that the FE regressions are valid, it makes sense to use FE to control for endogeneity. The time-dimension inherent to a FE transformation controls for time-invariant omitted variables. However, the nature of FE regression gives more emphasis to the 'within-effect' over time, although it does also explain variation between companies. The time-series dimension in panel data is used on panel data to examine the effect of company characteristics on level of financial gearing. [see, for example, He, Hu, Mi & Yu, (2021)].

Quantitative data in the form of descriptive statistics is also available from the data set and is used to examine the severity of corporate tax avoidance in large South African companies; this also addresses a research question. A visual depiction of a graph of average effective tax rates over the sample period should provide some indication of the average deviation of effective tax rates (*aetr* and *cetr*) from the statutory tax rates, which have been relatively stable over the sample period.

### 3.4.3.2 Generic regression specification 2

$$aetr_i \text{ or } cetr_i = \beta_0 + \beta_1 caceo_i + \sum Controls + \beta_{industry\_dummies}_i + \varepsilon$$

The preceding generic regression specification examines the quantitative relationship between corporate tax avoidance and tax knowledge attributed to a CEO. The variable of interest is *caceo*, which is a binary variable, the value of which is determined by whether the CEO of a company is a chartered accountant or not. Chapter 5 argues that a negative relationship with *aetr* or *cetr* is to be expected as one would suppose that a CEO with tax knowledge would be related to the incidence of more tax avoidance. The regression is run as a pooled regression first to examine the relationship between corporate tax avoidance and *caceo*. A cross-sectional regression is then also used to examine the between-company effect. The cross-sectional regression is augmented with the use of quantile

regression to examine whether the *caceo effect* is consistent for all levels of effective tax rates. Brooks (2019) argues that the use of quantile regressions is not only suitable to promote an understanding of the effect of variables on outlier data, but also in instances where data is not normally distributed, because the quantile-regressions use non-parametric processes to estimate effect sizes on the coefficients. Fixed-effect regression is used for the same reason as indicated in the section that examines the relationship between *Ito* and corporate tax avoidance in the previous section. The time-series dimension to the panel data makes it possible to estimate the 'within-effect,' which helps to control for endogeneity that originates from time-invariant, omitted variables in regression specifications.

### **3.5 Qualitative research stream**

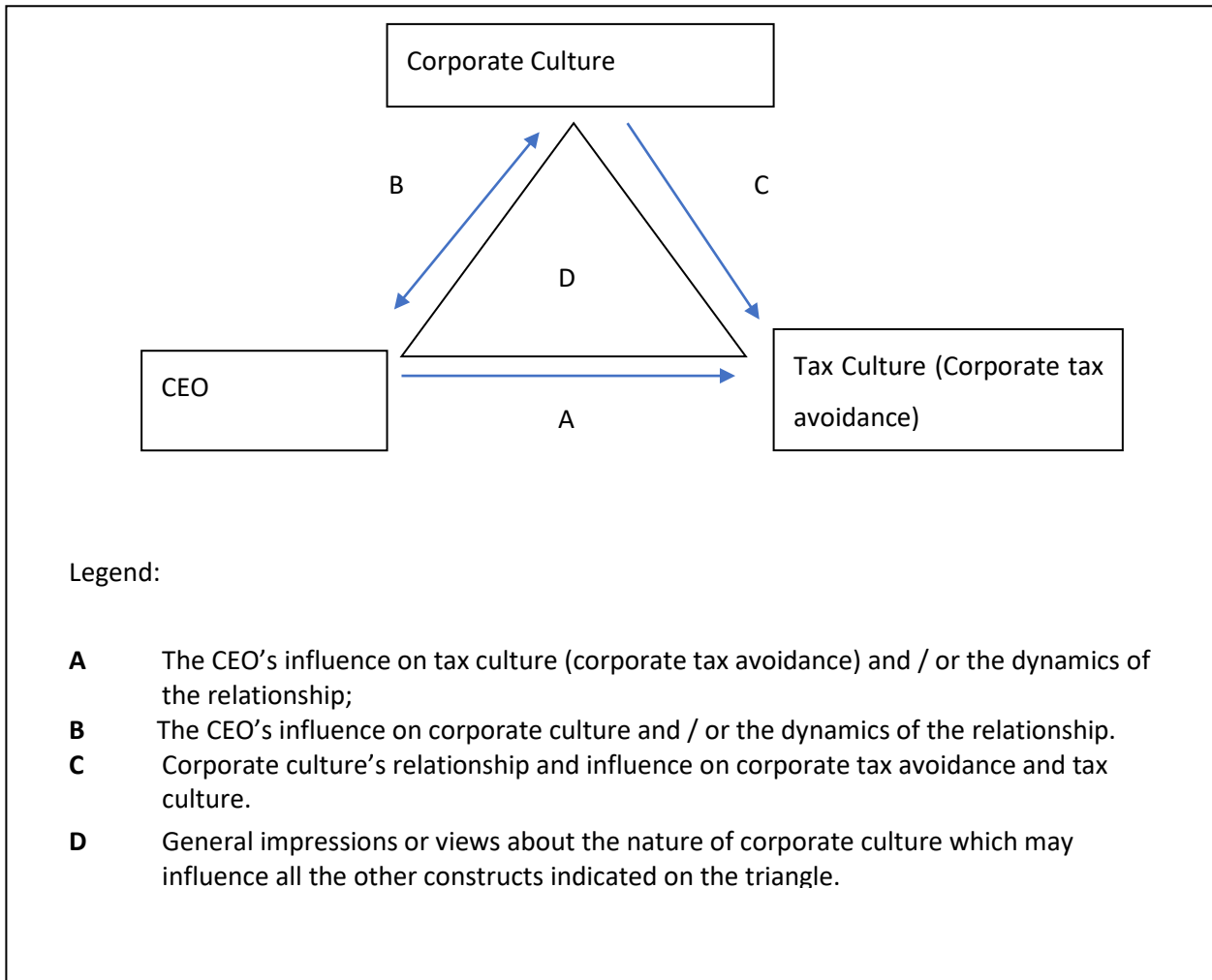
The discussion of the qualitative research stream is structured as follows. The next paragraph contextualises the research questions answered, with interviews used to collect data. Section 3.5.1 below explains the nature of the data collected through the interviews; that section also includes a schedule of the guiding interview questions asked in the interviews. This section exhibits the relevance of the data generated to answer the research questions of this study. Section 3.5.4 below discusses and justifies the use of interviews as the method to collect qualitative data. It also explains why the interviews are conducted with senior tax advisory partners of professional corporate tax advisory firms.

The qualitative research stream aims to answer the research questions that involve understanding the relationship between corporate tax avoidance and corporate culture, and the relationship of CEO characteristics to both these issues. It is clear that some questions overlap with the quantitative research questions, as discussed and explained in section 3.4. However, this overlap is intentional because the qualitative research stream not only augments the plausibility of the quantitative findings, but also extends understanding of the phenomenon of corporate tax avoidance at the process level. A final question that the qualitative stream helps to answer is whether the corporate culture is mostly determined by CEO characteristics or whether corporate culture also exists independently from the CEO's influence.

#### **3.5.1 Qualitative data**

The data used to answer the qualitative research questions was qualitative in nature and in the form of transcribed interview texts that originated from interviews with 11 corporate tax advisors. Figure 3-2, below, depicts the focus of the interviews. It shows that the goal of these interviews was to gain an understanding, from the tax advisors, of their experiences regarding the following: the relationship between the CEO's influence on corporate culture; the influence of corporate culture on corporate tax avoidance; and, the CEO's influence on corporate culture. The discussion themes (A-D) in the interviews concern the circular relationship between the CEO and corporate culture, the influence of the CEO directly on corporate culture and the influence of corporate culture on tax culture (Tax Avoidance).

**Figure 3-2 The discussion-themes (A-D) in the interviews**



The following list of questions served to guide the interviews. The nature of these questions indicates their relevance for understanding the relationship between the CEO, corporate culture and corporate tax avoidance; that understanding is needed to answer the qualitative research questions.

As indicated above, these interview questions were developed as a general guideline for the interviews; however, it was accepted that each interview was unique as far as semi-structured interviews permit flexibility to pursue interesting ideas or examples that arise during the interview.

**Table 3-2 List of possible interview questions to guide the interviews with corporate tax advisors**

- Let us first discuss your view on the nature of corporate culture in general. Do you perceive corporate culture as the mere sum of strong individual personalities in a company, or do you perceive corporate culture as distinctly separate from the individuals in that company?
- Do you experience clear differences between companies' corporate tax cultures (or corporate tax behaviour)? Could you provide more detail, or perhaps provide some examples of different tax cultures that you observe?
- What are your views or opinion on broader **corporate culture's impact on corporate tax behaviour**, or alternatively put, your view on its manifestation in corporate tax behaviour? Practically, how would it work?
- Further to the last question, how often do you experience that companies make tax decisions that seem incongruous to the general corporate culture of the company? I.e. for example, a company behaves aggressively regarding taxes, but very conservative when it comes to taking up debt?
- Normally tax matters are the responsibility of the Chief Financial Officer. However, would you say that CEOs, as top official, directly or indirectly influence corporate tax behaviour?
- Could you perhaps provide examples of the type of mechanisms that a CEO would use to encourage certain tax preferences or tax policies?
- Based on your experience, what type of CEO characteristics (i.e. attributes such as age, education, professional background) might have a significant influence on the extent and nature of a CEO's possible influence on the corporate tax department's behaviour?
- Do you have any rule-of-thumb theories about the general dynamics of corporate tax avoidance in companies? The myths? The rules? The general process? The main actors?

### **3.5.2 Analysis of data**

Interviews were transcribed by a professional transcriber and consequently theme-coded into themes A-D. (see Figure 3-2). This was done in accordance with a suggestion by Miles and Huberman (1994:245), in order to enable interpretation and to link the interview responses to the research questions. The author then numbered all the paragraphs or sentences that were of particular relevance to the research themes and documents; this was done on Excel, to facilitate grouping of themes from all respondents. These techniques included the identification of patterns and themes in interview data, clustering of themes and types of statements, critical evaluation of the plausibility of statements made, the use of metaphors, contrasting and comparison of statements. The author also composed a

reflective essay after conducting each of the interviews, in which he documented the salient points that surfaced in the interviews. These reflective essays are compared to the themes indicated in Figure 3-2 to ensure alignment.

### **3.5.3 Using corporate tax advisors as knowledgeable interview participants**

Qualitative data was collected through interviews conducted with South African corporate tax advisors of large, listed companies in the same country. Thus, interviews were conducted with 11 tax partners working at some of the larger South African consulting firms in the domains of tax, accounting, or law. There were several reasons for using this type of participant profile. Firstly, tax-advisory partners of large consulting firms ought to be knowledgeable and experienced with regard to corporate tax laws, legislation, and practices, with their expertise derived from many years of experience. Arguably, prospective partners are only offered partnerships by their superiors after having consistently shown their mettle, and after having consistently displayed a high degree of professional competence and due care in their dealings with clients. Secondly, the nature of these partners' 'qualified closeness' to upper-echelon members, such as CEOs of listed clients, means that they are suitable sources for the type of evidence necessary in this study. For example, tax partners as corporate advisors should be close enough to their corporate clients to be knowledgeable observers regarding the finer nuances of corporate tax culture, tax practices and tax attitudes. However, although close in some ways, they are still adequately removed from the corporate setting to be able to comment freely on what they observe and experience, and how they interpret it, without too much concern regarding reputation, confidentiality and other constraints normally imposed in the company setting.

There are specific reasons why semi-structured interviews were not held with the executive heads of tax departments of large, listed companies. Thus, it is practically difficult to get privileged access to upper-echelon members of companies because they have limited availability of time. Another reason is that executives may be reluctant to disclose privileged, sensitive information which may reflect negatively on the company. Even if interviews with tax executives could be arranged from a logistical perspective, it is argued that executives might be neutral, defensive, or not entirely honest with regard to the disclosure of sensitive, proprietary information about the specific company. Any such disclosures may suffer from the same issues of credibility which are often encountered by researchers conducting research on corporate social responsibility, which has been discussed in the literature review, Chapter 2. While corporate tax executives might be closer to the corporate tax culture than corporate tax advisory partners, it is argued that the generally sensitive and confidential nature of corporate tax issues, together with the omnipresent risk of investigations or scrutiny by tax authorities, or even reputational damage, may present too high a disclosure risk to large, listed companies to justify participation in meaningful discussions of this kind.

### **3.5.4 Interviews as method to collect qualitative data**

When qualitative interviews are used for the right purposes, then this process is particularly appropriate because it is described as *"the most direct, research focused interaction between research and participant"* (Kazmer & Xie, 2008). The use of interviews to collect qualitative data offers a unique opportunity to obtain a glimpse of the internal

processes of corporate tax avoidance in the corporate arena, as perceived by participants (corporate tax advisors) who are close observers of tax processes in many companies. The purpose of the qualitative research stream, however, is not primarily to reach findings that can be extrapolated, although they can suggest conditions under which some findings can be subjected to empirical testing in other settings. Gubrium, Holstein, Marvasti and McKinney (2012) point out that:

*“quantitative research is in search of large, random samples that are representative of a larger population and can be generalized,” but “qualitative researchers are more interested in a small number of participants who represent the phenomena of interest. Participants or informants are purposefully selected to represent rich knowledge about research questions.”*

A specific benefit of semi-structured interviews is that the interviewer can ask follow-up questions. It is even possible for the interviewee to start asking the interviewer questions, which enables a deeper discussion. Harvey-Jordan and Long (2001:219) state:

*“one of the advantages of using semi-structured interviews is the richness of data they yield. During an interview a subject is free to talk as openly as he or she wishes and the frankness of opinions can get to the heart of the matter. Using original quotes in a study can bring color and life to the research subject.”*

Taking into account these benefits, the more subjective nature of interviews is an acceptable characteristic for this part of the research stream. Thus, the knowledge gleaned from the interviews will not be used to extrapolate findings to other research contexts, but can help the researcher to interpret, better, seemingly confusing empirical results, or suggest theoretical perspectives for what is empirically, or quantitatively observed. In this study, the qualitative stream of the research is intended as the secondary research stream, supplementing the quantitative research stream which is more objective in nature. The interviews with tax experts allow the author to put those questions, which relate to the subject of this thesis, directly to people who are closely involved in or are in a position to observe, closely, corporate tax avoidance in action. This can cast fresh perspectives on a research problem, especially on corporate tax avoidance which has consequences for society. Against the backdrop of quantitative findings, interviews suggest a fruitful method to obtain a practical perspective on those findings. Interviews can also provide a better understanding of the finer nuances of the corporate tax avoidance process, especially with regard to the relationships between employees working for a company; these are generally difficult to operationalise and have hardly any point of manifestation in public corporate communications such as financial reports or other disclosures. For example, the relationship between the CEO and the tax department is difficult to observe through other means.

Qualitative methods such as interviews still produce systematic knowledge. Kvale (2007) states that science *“should produce knowledge, this knowledge should be new, it should be systematic and obtained methodically.”* Therefore, the interviews should build knowledge about tax avoidance not previously obtained and which is relevant for the

purposes of this research stream; this assumes that the interviews are adequately planned as indicated in Chapter 6, and with reference to the guiding interview questions as discussed. For example, it is only through interviews that one can learn more of what happens inside the company, because many events and processes are not normally disclosed to the investor-public through other means.

Researcher bias is sometimes encountered in qualitative research but this can be managed proactively. Thus, careful planning of interviews is imperative as a first-line defence against bias. Quinlan et al., (2019) describe bias as *“anything that contaminates or compromises the research or the data.”* It is argued that the researcher’s cautious attitude and awareness of the possibility of bias surfacing during the interview process, should reduce the risk of bias. There are also other steps that a researcher can take to prevent bias. For example, Kvale (2007) suggests that the researcher should be cognisant of bias in the selection of interview participants, making sure that those interviewees are not in any way selected in a prejudiced way; for example, friends or people sympathetic towards the researcher’s coveted opinions. With regard to this study, the researcher did not know any of the research participants personally; the researcher relied on a combination of snowball-sampling and other methods, such as Googling the contact details of the Heads of Tax Advisory departments at the large accounting-and law-firms. Also, Kvale (2007) suggests that the proposed interview questions should be phrased neutrally to avoid forcing a certain response from participants. Furthermore, there should be closed as well as open-ended questions, bearing in mind that open-ended questions can normally be used to explain or clarify opinions after the interviewee has first given clear answers in ‘yes’ or ‘no’ format. Here, it should be noted that the guiding interview questions presented in the previous section include open-ended questions and that the structure of the questions is neutral, which limits bias. Furthermore, Kvale (2007) stresses how important it is for researchers to know with certainty what they are looking for. It is argued that the diagram provided in the previous section depicts exactly what the researcher is attempting to understand: that is, the interlinked relationship between the CEO, corporate tax avoidance and corporate culture.

Admittedly, the measures taken to limit bias cannot eliminate all forms and sources of bias. However, it is argued that the benefits of obtaining a penetrating view of the corporate microcosm exceed the concerns regarding some traces of bias that are inherent to qualitative research.

### **3.6 Conclusion**

This chapter has provided an outline of the research methodology, methods and data that are used in this study to answer the research questions and to meet the research objectives formulated in Chapter 1. Moreover, it explains that an MM methodology is used in this study because the investigations involve research questions that are addressed more effectively by the use of quantitative and qualitative methodology. The chapter shows that those research questions that concern the examination of the relationship between corporate tax avoidance and corporate culture and CEO effects (in the form of tax knowledge attributed to the CEO) are best addressed through applying a quantitative methodology. This chapter shows how long-termism (as a dimension of corporate culture) and tax

knowledge attributed to a CEO are measured and operationalised with reference to available proxies, to enable examination of the relationships using regression analysis. This chapter then also explains how qualitative methodology, through the use of interviews with corporate tax advisors, is used to address some research questions that are better addressed through qualitative methodology. For example, questions that concern the relationship between the CEO with the tax department, as well as the CEO's influence on corporate culture (and *vice versa*), are best answered by engagement with the experiences of people who are closer to the arena of corporate tax avoidance. This chapter concludes with Figure 3-3 below, which depicts a reference map showing how the quantitative and qualitative research streams are used together to enhance understanding of corporate tax avoidance in South African listed companies.

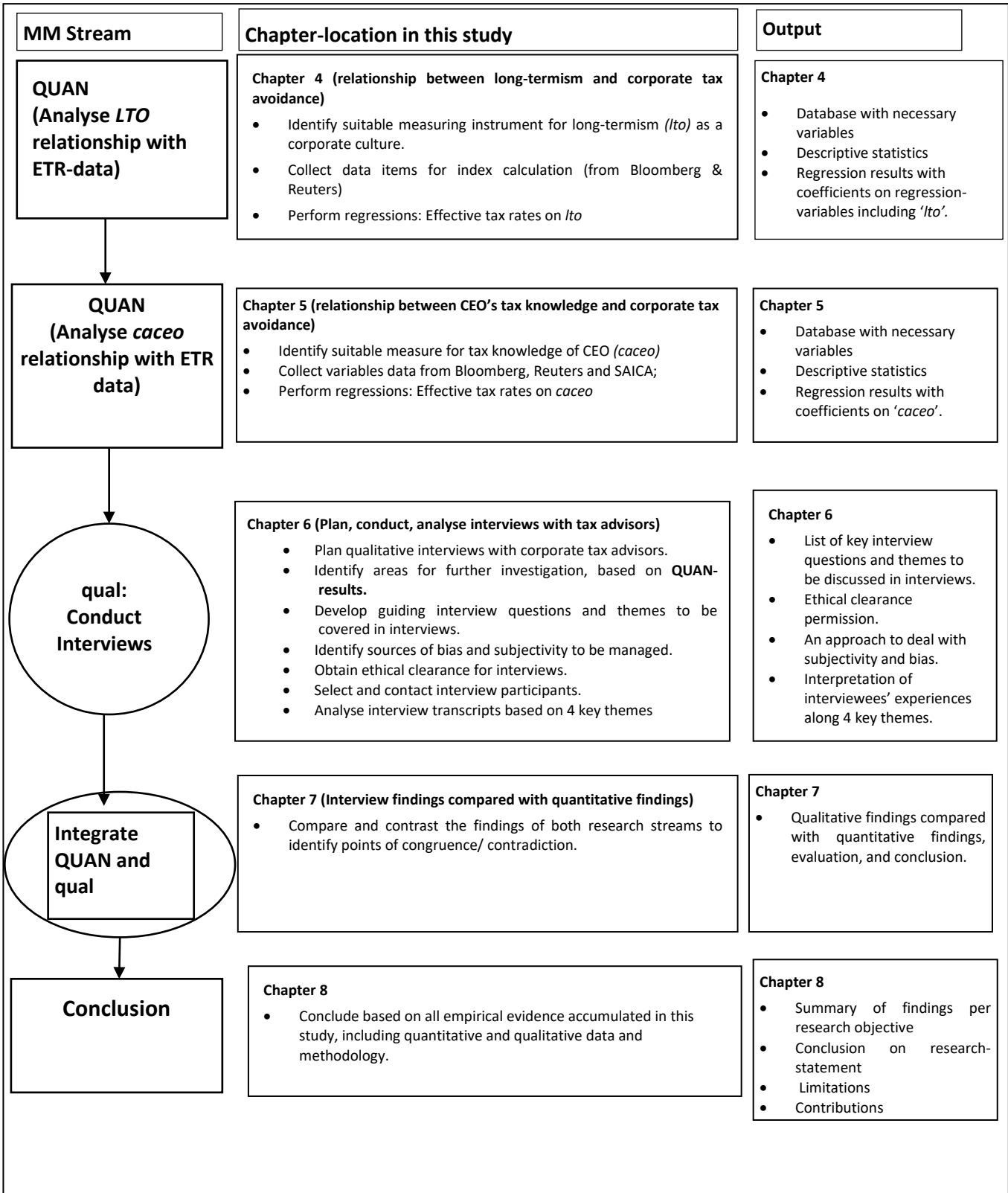
### **Mixed-method research process-flow map**

Guetterman (2017) suggests depicting the research process in a process-flow diagram (Figure 3-3 below), to guide readers through a mixed-method study. The following discussion distinguishes between the 'quantitative stream' abbreviated as 'QUAN' and the 'qualitative stream', abbreviated as 'qual'. Guetterman (2017) indicates the importance of indicating, clearly, which research stream is deemed to be dominant. Note that 'QUAN' is written in capital letters [upper case] to indicate that the quantitative stream is of primary importance in this thesis. In contrast, 'qual' is written in lower case letters, indicating that the qualitative stream is considered to be the secondary research stream. This MM methodology assumes the form of a 'sequential MM approach,' where the results and findings of the quantitative methodology stream partly inform the nature of the research performed in the second, qualitative stream in chronological order.

Figure 3-3, below, provides a useful visual depiction of the steps of the two methodologies as well as the point at which they converge.

### 3.7 Quantitative and qualitative methodologies: research flow diagram

Figure 3-3 Research streams in the MM research design: Quantitative and Qualitative methodologies



## 4 Long-termism and corporate tax avoidance

### 4.1 Introduction

This study examines the relationship between corporate tax avoidance and corporate culture. The literature review explained that corporate culture is multi-dimensional, but that a company's temporal orientation in terms of having a long-term or short-term view on its *raison d'être* is considered to be an important constituent element of corporate culture. The literature review points out that corporate culture is composed of corporate values, while corporate long-termism can also be described as a corporate value; one of the building blocks of corporate culture. In other words, the issue of whether a company is long- or short-term oriented is an important part of its corporate culture, which is the broader topic under consideration in this study. The literature review has explained that a corporate orientation indicative of long-termism is closely related to an ethical corporate mind set, insofar as acknowledgement of the company's mutual dependence on its stakeholders in the long term is concerned. In this regard long-termism is argued to be a corporate culture that transcends, for example, performance in corporate social responsibility; this is because the latter can be used for ulterior purposes, such as legitimation or to build corporate reputation, as shown in the literature review. This chapter measures long-termism using the McKinsey Corporate Horizon Index ('MCHI') and then examines the relationship between long-termism and corporate tax avoidance. It is expected that companies with a long-term orientation will pay more tax, on average, than those with a short-term orientation; this would be empirically supported when effective tax rates are positively correlated with long-termism in quantitative analyses.

### 4.2 Chapter layout

This chapter is structured as follows. The first section provides information on the background of the McKinsey Corporate Horizon Index (MCHI) which is used to measure long-termism. Section 4.4 presents the indicators of the MCHI while section 4.5 discusses the logic and merit of the inclusion of each of the indicators. This is followed by a statistical examination and analysis of the relationship between corporate tax avoidance and long-termism. The first part of this section provides an overview of descriptive statistics for the data-variables used in the subsequent regression analysis. The results of the regressions run are presented next, together with a discussion of those results. Finally, conclusions are made.

### 4.3 Background to McKinsey's Corporate Horizon Index ('MCHI')

A discussion paper issued by McKinsey in 2017 (McKinsey, 2017) explains the increase of corporate short-termism as a corporate ill. Its survey of corporate executives reports that executives feel increasingly pressured to deliver strong short-term results, and as a result, they focus on excessively short-term horizons for strategic planning. McKinsey argues that evidence remain scarce on whether short-termism detracts from corporate performance and economic growth; this scarcity can be attributed to difficulties related to measuring of short-termism. This is the reason for

developing the five-factor MCHI to measure the long-term temporal horizon of companies and its consequences. McKinsey applies its measurement index to 615 US listed companies to distinguish between long-term oriented companies and those with a short-term orientation; McKinsey then reports interesting differences between those classified as long-term oriented and those inclined to the opposite. Here, a notable feature is the long-term oriented companies' significant positive impact on shareholder value creation, accompanied by beneficial consequences for economic and social development. The academic literature regards short-termism as the opposite of long-termism and sometimes terms it 'management myopia'<sup>23</sup> [see, for example, Laverty, (2004)].

McKinsey reported that those companies which it classified as long-term oriented exhibited better creation of shareholder value over the long-term, when compared to those classified as short-term oriented. McKinsey reported not only a higher total shareholder return (TSR) for long-term oriented companies, but also other beneficial social outcomes, such as enhanced job-creation and improved investment, with accompanying beneficial spill-over effects. Over a fifteen-year period, McKinsey reported a 50% greater likelihood that companies classified as long-term oriented would be placed in the top decile pertaining to TSR; they would also make a much higher contribution to job creation than other firms. This finding is supported by other research as well. Flammer and Bansal (2017) use a regression discontinuity to function as a *quasi-random* assignment of companies and find that those companies that have adopted long-term incentive systems for directors' compensation, which is interpreted as a proxy for a long-term orientation, show several beneficial characteristics. These authors report increases in firm value and more effective execution of long-term strategies overall, including higher investment in innovation, better and more trusting relationships with stakeholders such as employees and the natural environment. This indicates a positive relationship between long-termism and commitment to issues concerning corporate social responsibility. The developers of the MCHI subsequently argue in reflection that:

*rampant short-termism should be a concern to all of us because the stakes are so high. We believe that a strategy largely driven by short term thinking , where the desire for quick profits mortgages the future of business, is not sustainable and that the CEOs who engage in such behavior are doing damage to our economy and to society" (Carey, Useem, Dumaine & Zemmel, 2018:xvii).*

The next section lists the five factors included in the MCHI. This is followed by an explanation of the rationale for each indicator's inclusion. A description of the measurement approach as provided by McKinsey is provided in section 4.5.

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<sup>23</sup> The Merriam-Webster Dictionary defines myopia as a lack of foresight or discernment: a narrow view of something. Academic literature on the time-period associated with 'long-term' is not found.

#### 4.4 MCHI indicators

**Table 4-1 The MCHI's 5 indicators: McKinsey's rationale and measurement approach for each**

Indicator	McKinsey rationale or hypothesis regarding long-term orientation	McKinsey measurement approach
1) Investment ( <i>Ltm_capex*</i> )	Long-term firms will invest more, and more consistently, than short-term firms.	Ratio of capital expenditure to depreciation.
2) Earnings Quality ( <i>Ltm_mckeq*</i> )	Long-term firms will generate earnings that reflect cash flow, not accounting decisions.	Ratio of accruals as share of revenue.
3) Margin Growth ( <i>Ltm_sgrowth*</i> )	Short-term firms are more likely to grow margins unsustainably to meet near-term targets.	The difference between earnings growth and revenue growth.
4) Quarterly Management ( <i>Ltm_est*</i> )	Short-term firms will do whatever they can to hit short-term targets, whereas long-term firms are willing to miss them if needed.	The incidence of beating EPS targets by less than 2 cents and incidence of missing EPS targets by less than 2 cents.
5) EPS growth vs. total Earnings growth. ( <i>Ltm_epsnp*</i> )	Long-term firms are less likely to over-index on EPS rather than true earnings and act to boost EPS (e.g. using share-buy backs).	Difference between growth in EPS and true total earnings growth.

*\*Indicates the variable name used in this study's regression specifications*

Source: Adapted from McKinsey, (2017)

#### 4.5 The logic and academic merit supporting the inclusion of the MCHI indicators

This section provides a discussion and evaluation of each of the indicators used in the MCHI. Reference to academic support is provided wherever relevant for the inclusion of each of the indicators, in support of the content validity of the MCHI. The reason for providing an academic link to the indicators measured is because McKinsey developed the instrument not with the view of advancing academic research, but rather as a practical tool. McKinsey does, however, indicate that the constituent elements in the index are based on academic research, and provides references to some academic papers which support a credible scientific basis for the composition of the indicators in the index. The following section examines the rationale for the inclusion of each of the indicators in the index to measure long-termism.

#### **4.5.1 Investment (MCHI indicator nr 1)**

It seems intuitively logical to include 'adequate replenishment of assets' as a long-term indicator. It is impossible for a company to be sustainable over the long term if it does not continuously invest in capacity renewal to support growth in the creation of goods and services. Companies with a short-term orientation may be reluctant to invest in new assets if such investment will trigger higher depreciation charges in the income statement, thereby reducing earnings. For example, a survey of 400 executives of listed companies dealt with the issue of decisions that affect reported earnings and earnings disclosure; the survey results suggested that *"managers would rather take economic actions that could have negative long-term consequences...A surprising 78% of our sample admits to sacrifices of long-term value to smooth earnings"* (Graham, Harvey & Rajgopal, 2005). This study also found that 80% of respondents will opt to postpone discretionary expenditure such as marketing, research and development expenditure or maintenance costs on assets in order to meet earnings targets. This indicates reduced emphasis on the importance of investment and innovation to ensure long-term sustainability.

#### **4.5.2 Earnings quality (MCHI indicator nr 2)**

The MCHI uses an accruals-based measure for earnings quality although MCHI only discloses *"accruals as a share of revenue."* By including and interpreting an earnings quality score in the long-termism index, MCHI aims to involve the importance of cash flow as an indicator of true performance; this approach is preferable to using accounting earnings as an indicator, as these are more amenable to manipulation, because of subjective accounting decisions which can involve estimates and judgement. McKinsey argues that this indicator is a measure of how closely a company realises profits through cash flow actually reported. The literature indicates that earnings quality (also termed earnings management) is a convoluted construct and there is much debate about what it purports to measure. Schipper and Vincent (2003) identify and discuss multiple methods documented over time by accounting researchers. Jones (1991), a pioneer in research into earnings quality, suggests an accruals-based model to calculate an indicator termed 'changes-in-net-accruals.' This model requires access to information regarding specific accruals as opposed to total accruals. It is possible that McKinsey incorporated some of Jones's (1991) ideas in their model of earnings quality. However, this study uses an intuitively simple measure of earnings quality in the form of the quotient of cash generated from operations (CFO) and net earnings. Schipper and Vincent, (2003) classify this measure as an earnings quality construct that is directly derived from the relationship between income, accruals and cash flow generated from operations. It appears widely used in business research [see, for example, Harris, Huh and Fairfield, (2000)]. By including this indicator in their index, McKinsey's view is that companies with a truly long-term orientation would be less concerned about propping up performance through reliance on discretionary accounting estimates and accruals; for example, premature recognition of income. It is unlikely that McKinsey has an accurate prediction of future earnings in mind with this indicator because long-term companies are likely to be less obsessed with the kind of accurate forecasts that would please analysts and the market in general.

The concept of earnings quality is well documented in academic accounting literature. Dechow and Schrand (2004:1) state that *“high earnings quality will do three things: It will reflect current operating performance; it will be a good indicator of future operating performance; and it will accurately annuitize the intrinsic value of the firm.”* A company that resorts to the manipulation of reported earnings by using accruals to conceal evidence of weaker than expected operating performance, does not seem to act in accordance with the principles of a long-term oriented firm. Low earnings quality may occur when corporate management feels compelled to use accounting mechanisms to hide poor short-term performance from investors.

Thompson-Reuters-Eikon is another renowned provider of financial data for investors and corporate decision-makers; they also include an earnings quality measure in their menu section, designated as ‘long-term performance’ (Reuters, 2020). This provides further support for the practice of including an indicator of earnings quality in a composite score for long-termism.

#### **4.5.3 Margin growth (MCHI indicator nr 3)**

The MCHI includes a measure of the extent to which a company endeavours to increase earnings by emphasising efficiencies made through cost-cutting. This is measured as the incidence of year-on-year (YOY) revenue growth exceeding YOY earnings growth and is recorded as a binary variable score of ‘1’ or alternatively ‘0’ if this requirement is not met; this provides an indication of long-term oriented behaviour. The same score is also included in Thompson-Reuters-Eikon’s disclosure in its menu *‘long-term management’* (Reuters, 2020); this supports the relevance of such a measure in a long-termism score. It is not the intention to penalise a company for the prudent pursuit of efficiencies through attempts to cut costs; however, one can argue that sustainability is only indicated if revenue growth, which indicates a growing market share and customer appeal, is focused on an important source of value creation. Admittedly, increasing margins should increase net profit and therefore create shareholder value. However, increases in margins are not indefinitely sustainable, and therefore margin improvements cannot be the only source of shareholder value creation in the long term. Moreover, temporarily lower margins can indicate some level of organisational slack, which is necessary for corporate resilience. Academic literature supports the idea that obsessive emphasis on margins may indicate sustainability problems as far as corporate slack is concerned. For example, March and Cyert (1963)<sup>24</sup> cited in Bourgeois III, (1981:30) explain the importance of some level of organisational slack. They define organisational slack as:

*that cushion of actual or potential resources which allows an organisation to adapt successfully to internal pressures for adjustment or to external pressures for change in policy as well as to initiate changes in strategy with respect to the external environment.*

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<sup>24</sup> The author had not been able to obtain an electronic copy of the source for this reference, hence the indirect quotation.

This statement indicates that some level of 'inefficiency' is needed for a company to innovate, to renew itself, and to adapt to changing markets and circumstances. It acknowledges that corporate success (effectiveness) and degree of slack are positively correlated, up to a point, after which the relationship becomes negative. This finding supports MCHI's inclusion of a measure that indicates an excessive emphasis on margin growth as opposed to revenue growth to create shareholder value in the long term. It is argued that profit growth, which continuously exceeds revenue growth to the exclusion of other factors, can indicate problems with declining market share, poor products or low levels of customer satisfaction. This viewpoint can also be linked to the notion that a long-term culture encourages innovation and experimentation, while showing tolerance for employees who make mistakes as they learn; this will be impossible in an environment with zero tolerance for experimenting and mistakes.

#### **4.5.4 Quarterly management (MCHI indicator nr 4)**

MCHI's methodology evaluates the incidence of a company beating or missing quarterly analyst forecasts for reportable earnings per share (EPS) by a relatively small amount. McKinsey argues that a company's inclination to meet short-term profit targets in an attempt to please the market can be an indication that such a company's focus is not on the creation of long-term value. To meet those targets a company can, for example, postpone certain costs or investments and thereby improve short-term earnings, but to the detriment of the long-term prospects of the company. McKinsey's argument is that a company that frequently misses or beats analyst forecasts by a larger margin is not greatly concerned with the short-term expectations of the market; instead, it focusses on activities and initiatives that create long-term value. This view is supported by Bhojraj, Hribar, Picconi and McInnis (2009) who point to the spread between reported and estimated EPS as being an indication of myopic behaviour of managers, who feel they need to beat benchmarks because their ability to do so is being closely watched by the market.

#### **4.5.5 EPS-growth versus total Earnings-growth (MCHI indicator nr 5)**

This score is based on an assessment of whether total earnings growth (YOY) exceeds the percentage growth in earnings per share (YOY). This indicator provides evidence of excessive management concern about indicators such as EPS which are closely watched by the market, analysts and the media; this is in a manner similar to the one described in 4.5.4 on quarterly management. The underlying rationale for this indicator is related to possible manipulation of EPS by management with reference to the weighting of the number of shares used in the calculation of EPS, which may influence the number reported for EPS. A lower number of issued shares used as the denominator of the calculation of EPS provides a higher level of EPS. The argument is that a company with a long-term strategy should be less concerned with short-term performance indicators if the long-term strategy delivers sustainable returns to shareholders over the long term.

The next section explains how the MCHI is applied in this study to calculate the long-termism scores.

## 4.6 Application of MCHI principles in this study to calculate long-termism scores

McKinsey does not completely disclose its full methodology pertaining to each of the indicators; perhaps McKinsey's intention is to protect its commercial interests based on the proprietary nature of its methodology. For example, it is not perfectly clear from its guidance document (McKinsey, 2017:9) just how it calculates the long-termism indicators, because McKinsey only reveals that *"all companies were scored on the MCHI relative to industry peers as 'long-term' or 'short-term' in a given year based on whether they were above or below their industry median for that year"*. McKinsey's indicators are converted into a binary variable ('0/1') for each year, depending on whether the score for a specific company for a specific indicator is above or below the median for the industry. This method is also used in this study, where necessary, to transform continuous data into a binary score. Scores above the median for the industry are allocated a score of '1' with '0' allocated for scores below the median. This is the strategy that Thompson-Reuters-Eikon (Reuters, 2020) takes when it flags binary variables of '1' as evidence of long-termism in its menu option that provides McKinsey-based indicators in its section designated 'Long-term management.' The scores for all the binary indicators are then summarised to provide a score out of 5 as the long-termism score.

### 4.6.1 Calculation of the long-term indicators in this study

The following variables are calculated in this study to represent the indicators used in the MCHI.

#### ***Ltm\_capex* (MCHI indicator nr 1: Investment)**

A binary proxy variable for a long-term orientation, based on a company's commitment to invest and to replenish assets as they depreciate, is indicated for this variable. The ratio of capital expenditure (data obtained from Bloomberg, based on data sourced from the statement of cash flows) to total depreciation (sourced from the income statement) is calculated for the sample. Industry averages and medians are calculated: scores above the industry median are assigned a value of '1' while '0' is assigned for scores below the industry-sector median; this is in line with McKinsey's general approach.

#### ***Ltm\_mckeq* (MCHI indicator nr 2 : Earnings quality)**

This binary proxy variable for a long-term orientation is based on a company's commitment to earnings quality; the idea of "closeness to cash" is used as an indication of earnings quality. The ratio is calculated as cash flow from operations (CFO), obtained from the statement of cash flows, expressed as percentage of total earnings, in line with MCHI. Industry averages and medians are calculated with scores above the industry median being assigned a value of '1' as an indication of long-term orientation, while scores below the industry median are assigned the value '0,' in line with McKinsey's general approach for non-event data.

### ***Ltm\_sgrowth* (MCHI indicator nr 3: Margin Growth)**

This binary proxy variable for a long-term orientation reflects the extent of a company's focus on disclosing impressive profit figures. This variable is assigned a value of '1' if the revenue growth percentage (YOY) exceeds total profit growth (YOY) and a value of '0' is assigned if it does not.

### ***Ltm\_est* (MCHI indicator nr 4: Quarterly Management)**

This binary proxy variable for a long-term orientation reflects the degree of a company's focus on meeting analysts' forecasts for EPS. This variable assumes a value of 0 if the absolute difference between expected and reported earnings per share is less than 30 cents, and 1 if otherwise. The original MCHI uses a value of 2c [US] for the calculation of this criterion; however, this amount is multiplied by a factor of 15 in the South African context to reflect the fact the average exchange ratio between the Rand and Dollar often exceeded this value in the period under observation for this study. Also, quarterly estimates and disclosure of EPS are not mandatory or even customary in South Africa, and therefore annual EPS and analysts' estimates for EPS are used in this regard.

### ***Ltm\_epsnp* (MCHI indicator nr 5: EPS Growth vs. Total Earnings Growth)**

This binary proxy variable for a long-term orientation is based on a company's focus on disclosing 'impressive-looking' EPS to the stock market. This variable is assigned a value of '1' if total earnings growth as a percentage (from year to year) exceeds growth in EPS as a percentage (from year to year) and assumes a value of 0 otherwise.

The following section explains the other data used in this study.

## **4.7 Data**

### **4.7.1 Sample composition**

This sample used in this study consisted of all public companies listed on the Johannesburg Securities Exchange (JSE) on 31 December 2014, with a market capitalisation exceeding R4bn. This was the date when the author started with this study. Companies classified as Real Estate Investment Trusts ("REITS") are excluded from the sample because this type of company is subjected to a separate tax regime which differs from that of the other companies and as such, could distort the calculation of effective tax rates. Banks and financial institutions are retained in the sample, contrary to many other reported studies, because these companies are also obliged to pay tax; also, research suggests the significant role that financial institutions such as banks often play as facilitators of corporate tax avoidance (Gallemore, Gipper & Maydew, (2019). Data were collected for the period from 2005 to 2019. This fifteen-year period included a world-wide economic recovery after the global financial economic crisis in *circa* 2008. In the case of South Africa the period marks the start of widespread governmental mismanagement and corruption after Jacob Zuma's appointment as president in 2009; this has resulted in deteriorating public trust in the South African government and a decline in tax morality (Visser, 2020).

The table below indicates the number of observations used in the regression models.

#### 4.7.2 Sample generation

The generation of the sample used in this study is presented as follows.

**Table 4-2 Sample selection**

	Cross-sectional regression	Fixed-effect regressions
Companies with a market capitalisation exceeding R4bn on 31 December 2014.	112	112
Less companies in sample with too many missing variables for use in regression.	(9)	(9) <sup>25</sup>
Number of companies in sample	103	103
Number of firm-year observations	N/A	1 545 <sup>26</sup>

#### 4.7.3 Missing data on variables

It is important to clarify the seemingly inconsistent fluctuations in the number of observations between variables. Theoretically “N” should be 15 years multiplied by 112 companies, equaling 1 680 firm-year observations. However, some observations have data missing for some of the variables which explains why the number of observations is not consistent between variables. However, firm-year observations with missing variables are not deleted summarily, in order to keep data available for regression specification of models or analyses that do not necessarily use all the label-names provided as depicted in Table 4-2 above. For example, some missing data on variables is tolerated in cross-sectional regressions which are run on meaned variables which can be calculated in some instances despite some missing variables. Regardless, the Stata-statistical software used to perform the regressions is programmed to ignore any observations with missing data on variables in the specification.

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<sup>25</sup> Tickers CLI SJ; CVH SJ; KST SJ; MTP SJ;NT1 SJ;PGR SJ; REI SJ; MTA SJ EMH SJ are excluded because of missing data on key data variables necessary for the purposes of this study.

<sup>26</sup> This represents the maximum number of possible firm-year observations used in analyses in this chapter, because missing data on some of the variables for these companies has the effect of reducing the number of observations used in the regressions, with the reduction depending on the demands of the respective regression models’ specifications.

#### 4.8 Variables used in regression specifications.

A high-level description of the variables and control variables used in this study's quantitative examination was given in section 3.4.1 of Chapter 3. Moreover, that description also referred to the use of these variables in other quantitative research. The following table 4-3 provides more information on the source and nature of the variables that are used in this chapter.

Table 4-3, below, lists and describes the variables used in the regression specifications in this chapter. It starts with the two dependent variables (used as alternative forms of the proxy for corporate tax avoidance). This is followed by various forms of the *Its* which are alternative forms of the variable of interest, and then the control variables used in the regression specifications.

**Table 4-3 Variables used in this chapter's investigation**

No	Variable Abbreviation	Description and source of data	Expected sign of correlation coefficient with <i>aetr</i> and <i>cetr</i>
1	<i>aetr</i>	Accounting Effective Tax Rate ( <i>aetr</i> ) is a dependent variable in regressions, and is used as the proxy of corporate tax avoidance in this study. Calculated as the total tax expense (net of deferred tax) per the income statement as percentage of total profit before tax. The variable is truncated, therefore capped at a maximum of 100% and limited to a minimum of 0%. ( <i>Data source: Bloomberg</i> )	N/A
2	<i>cetr</i>	Cash Effective Tax Rate ( <i>cetr</i> ) is a dependent variable in regressions, and is an alternative proxy of corporate tax avoidance used in this study. Calculated as the total taxes paid per the statement of cash flows, as percentage of total profit before tax. The variable is truncated, therefore capped at a maximum of 100% and limited to a minimum of 0. ( <i>Data source: Bloomberg</i> )	N/A
3	<i>Its5</i>	An acronym for "long-term-score" based on MCHI: a variable of interest, calculated as the average of the MCHI indicators listed in section 4.6.1 which explains how this variable is calculated. ( <i>Source: Bloomberg and Thompson-Reuters-Eikon</i> )	(+)
4	<i>Its4</i>	An acronym for "long-term-score" an alternative MCHI variable of interest, in which composite indicator <i>ltm_est</i> is excluded (listed in Section 4.6.1) to evaluate the effect of measurement error on this indicator ( <i>Source: Bloomberg and Thompson-Reuters-Eikon</i> )	(+)
5	<i>esg</i>	The Bloomberg Environmental Social & Governance score (ESG) as an indication of a company's reported commitment to aspects of corporate social responsibility and corporate governance. ( <i>Data source: Bloomberg</i> ).	(+ or -)
6	<i>roa</i>	Return on assets, calculated as the ratio of net profit before tax expressed as percentage of total assets per balance sheet. ( <i>Data source: Bloomberg</i> )	(+ or -)
7	<i>lev</i>	The ratio of total long-term liabilities to total assets, per the balance sheet. ( <i>Data source: Bloomberg</i> )	(-)
8	<i>capintens</i>	Total value of property, plant and equipment taken as a percentage of total assets per the company's balance sheet. This measure captures capital intensity of the business model. ( <i>Data source: Bloomberg</i> )	(+ or -)

No	Variable Abbreviation	Description and source of data	Expected sign of correlation coefficient with <i>aetr</i> and <i>cetr</i>
9	<i>intangr</i>	Intangible assets as a percentage of total assets on a company's balance sheet, as an indicator of the relative extent to which the company uses intangible assets in its business model. ( <i>Data source: Bloomberg</i> )	(-)
10	<i>size</i>	The natural log of total market capitalisation, obtained from Bloomberg. ( <i>Data source: Bloomberg</i> )	(+ or -)
11	<i>ptb</i>	Market value of equity, as ratio of the book value of the equity. This variable is used as a proxy for company growth. ( <i>Source: Bloomberg</i> ).	(+ or -)
12	<i>stc</i>	A dummy variable of '1' that serves as an identifier for those company observations in years during which STC (Secondary Tax on Companies) was still classified as a corporate tax, as opposed to a shareholder tax since 2012. It was levied at 10% on net dividends declared during the transition rate. (SARB, 2017)	(+)
13	<i>ptc</i>	A dummy variable of 1 that serves as identifier for those company observations that precede the year 2008, before which the statutory tax rate had exceeded 28%, and 0 otherwise.(SARB, 2017). This aspect is controlled for as it may influence effective tax rates which are the dependent variables in this study.	(+)
14	<i>inds</i>	Industry dummy variable for companies involved in the industrial sectors. See Table 4-4 below for more information on industry classification. ( <i>Source: Bloomberg</i> )	N/A
15	<i>cgs</i>	Industry dummy variable for companies involved in consumer goods and consumer services sectors. See Table 4-4 below for more information on industry classification. ( <i>Data source: Bloomberg</i> )	N/A
16	<i>mmnr</i>	Industry dummy variable for companies involved in the minerals, mining, and natural resources sectors. See Table 4-4 below for more information on industry classification. ( <i>Data source: Bloomberg</i> )	N/A
17	<i>fin</i>	Industry dummy variable for companies involved in financial services, including banks and insurance sectors. See Table 4-4 below for more information on industry classification. ( <i>Data source: Bloomberg</i> )	N/A
18	<i>hti</i>	Industry dummy variable for companies involved in healthcare, telecommunications, or IT sectors. See Table 4-4 below for more information on industry classification. ( <i>Data source: Bloomberg</i> ).	N/A

Variables 1 and 2 in Table 4.3 above are the dependent variables, while variables 3 and 4 are the alternative forms of the MCHI (*Its5 and Its4*): the long-term orientation variable which is the variable of interest in this study. The remaining variables in the table, those listed in numbers 5 to 18 are control variables in regression specifications, which have been identified in the tax avoidance literature described in Chapter 2 and Chapter 3 which concerns methodology. The intention of including industry dummy variables is to control for differences that may derive from characteristics inherent to specific industries; for example, *mmnr*, which is very capital intensive. The presence of positive and negative expected directions of correlation, at the same variable (i.e. *esg*), indicates inconclusiveness

pertaining to the nature of these variables' associations with *aetr* and *cetr* as indicated in the literature review in Chapter 2.

It has been noted elsewhere in this study that there are relatively few large listed companies in South Africa. Long-termism scores are allocated by reference to industry-medians, and therefore the list of 20 industries classified in accordance with the *Global Industry Classification Standard* ('GICS') groupings have been reallocated into only 5 industries to allow for a more meaningful comparison to medians. The following Table 4-4 indicates how GICS-industries have been grouped into only 5 sectors as indicated below for the purpose of this study; this information is intended to allow reperformance by other researchers.

**Table 4-4 Reclassifying GICS industry allocations**

	<b>GICS classification per Bloomberg</b>	<b>Sector reclassification and abbreviation in this study (Variable's abbreviation in brackets)</b>
1	Automobiles & Components	Industrials ( <i>inds</i> )
2	Banks	Financials ( <i>fin</i> )
3	Capital Goods	Industrials ( <i>inds</i> )
4	Commercial & Professional Services	Consumer Goods and Services ( <i>cgs</i> )
5	Consumer Durables & Apparel	Consumer Goods and Services ( <i>cgs</i> )
6	Consumer Services	Consumer Goods and Services ( <i>cgs</i> )
7	Diversified Financials	Financials ( <i>fin</i> )
8	Energy	Minerals, Mining and Natural Resources ( <i>cgs</i> )
9	Food & Staples Retailing	Consumer Goods and Services ( <i>cgs</i> )
10	Food, Beverage & Tobacco	Consumer Goods and Services ( <i>cgs</i> )
11	Health Care Equipment & Services	Healthcare, IT and Telecoms ( <i>hti</i> )
12	Insurance	Financials ( <i>fin</i> )
13	Materials	Minerals, Mining and Natural Resources ( <i>mmnr</i> )
14	Media & Entertainment	Consumer Goods and Services ( <i>cgs</i> )
15	Pharmaceuticals, Biotechnology	Consumer Goods and Services ( <i>cgs</i> )
16	Retailing	Consumer Goods and Services ( <i>cgs</i> )
17	Software & Services	Healthcare, IT and Telecoms ( <i>hti</i> )
18	Technology Hardware & Equipment	Healthcare, IT and Telecoms ( <i>hti</i> )
19	Telecommunication Services	Healthcare, IT and Telecoms ( <i>hti</i> )
20	Transportation	Industrials ( <i>inds</i> )

## 4.9 Summary statistics and discussion

The following Table 4-5 presents descriptive statistics for the variables used in this study.

Variable	Obs	Mean	Std. Dev.	Min	Max
<i>aetr</i>	1604	27.023	16.527	0	100
<i>ctr</i>	1543	27.421	19.551	0	100
<i>lts5</i>	1604	.514	.251	0	1
<i>lts4</i>	1604	.519	.279	0	1
<i>esg</i>	1504	34.71	14.493	5.785	66.529
<i>roa</i>	1611	11.013	17.537	-132.741	344
<i>lev</i>	1599	11.331	12.884	0	80.698
<i>capintens</i>	1600	28.333	24.579	0	92.606
<i>intangr</i>	1574	9.1	12.953	0	84.742
<i>size</i>	1553	9.91	1.53	4.017	14.472
<i>ptb</i>	1561	3.166	3.951	-5.99	69.582
<i>stc</i>	1680	.533	.499	0	1
<i>ptc</i>	1680	.267	.442	0	1
<i>ltm_capex</i>	1170	.501	.5	0	1
<i>ltm_mckeq</i>	1603	.5	.5	0	1
<i>ltm_est</i>	1291	.476	.5	0	1
<i>ltm_epsnp</i>	1402	.634	.482	0	1
<i>ltm_sgrowth</i>	1410	.477	.5	0	1

**Table 4-5 Summary statistics for variables examined in this chapter.**

The mean, standard deviation, minimum and maximum in the range are provided as indication of dispersion.

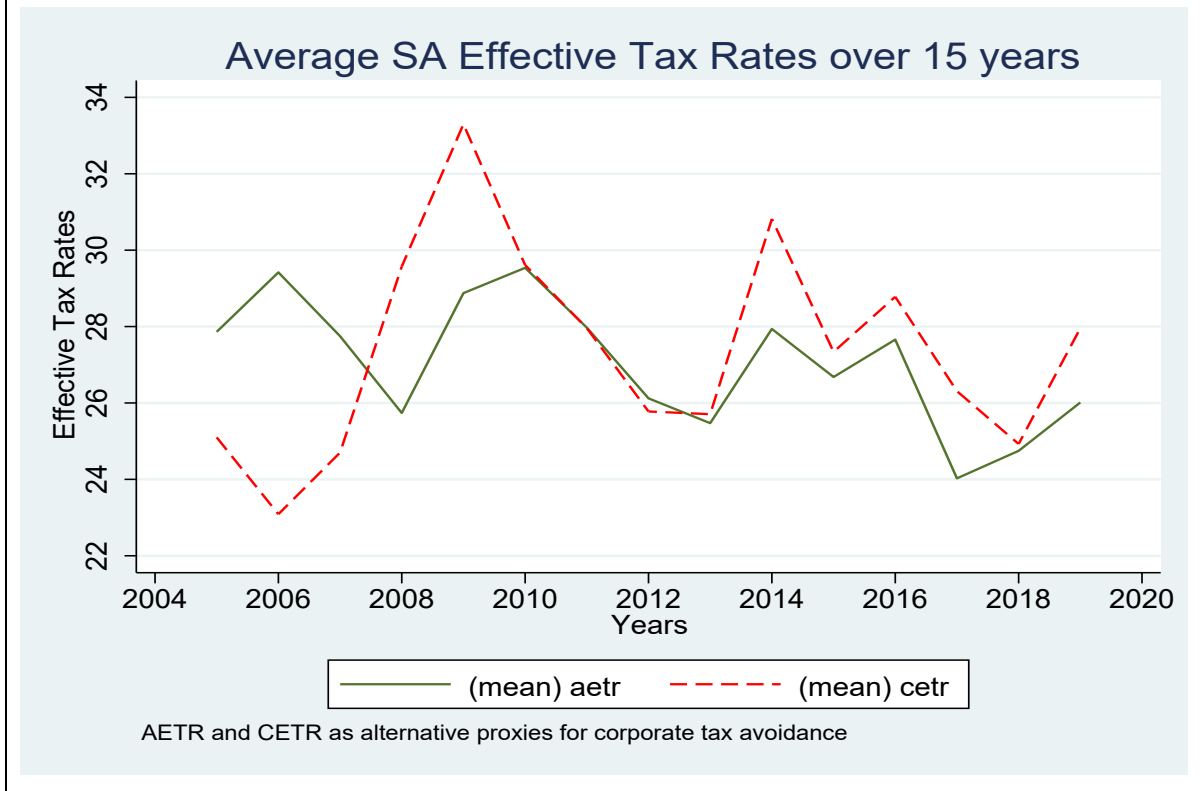
### 4.9.1 Discussion

This section starts with a detailed and descriptive discussion of the performance of *aetr* and *ctr* as alternative dependent variables: both proxies for corporate tax avoidance; it is appropriate to discuss these first, because the topic of this study concerns determinants of corporate tax avoidance, which are proxied by these two variables.

Also, it should be noted that the South African corporate landscape had been exposed to political and economic developments during the sample period, which may have had an influence on these indicators.

The following graph, Figure 4.1, depicts the average effective tax rates of both forms of the proxy variable (*aetr* and *ctr*) during the period under review: 2005 to 2019.

**Figure 4-1 Fluctuations in average effective tax rates over the sample period**



When looking at the period from 2005 to 2009, it is important to note that 2009 marks some important events in South Africa. It marks the end of a period of four years in which the statutory tax rate for companies had gradually reduced from 30% in 2005 to 28% in 2009<sup>27</sup>. The year 2009 may also be seen as the end of the world-wide financial crisis that started in *circa* 2006 and ended in 2009, although some are of the opinion that South Africa largely escaped the worst economic devastation because of the high reserve requirements of South African banks. Some of these elements may have brought about reductions in effective tax rates. In South Africa, 2009 also marks the start of President Jacob Zuma’s tenure which has proved to be contaminated with widespread corruption, culminating in what many termed “state-capture” by Zuma and accomplices, such as the Gupta-family; this lasted until the end of 2017 when the presidency of Cyril Ramaphosa commenced. The steep decline in *aetr* apparent in Figure 4-1, for the period 2005 to 2008, reflects the reduction in corporate tax rates as mentioned. Also, factors such as the economic crisis, starting in 2006, may have provided more incentive for companies to curb expenses, including taxes, as a plausible response to economic austerity.

It is interesting to note the inverse response of *aetr* and *cetr* series in the beginning of the time series in 2005; at that point, *cetr* drops immediately from 2005-2006 while *aetr* increases. This indicates lagging tactics to reduce physical cash payments to the revenue authorities, before pressure on cash flow due to economic hardship manifests in lower

<sup>27</sup>South African corporate tax rates were 30% until 2005, then 29% until 2008 and 28% from 2009. There has been no change since 2009.(SARB, 2017)

*aetr*. In the period 2007 to 2010, *cetr* significantly exceeds *aetr*, which is possibly because of taxes finally becoming unavoidably payable after they might have been lagged or even avoided during the period 2005-2007, when *cetr* had been much lower than *aetr*.

The years between 2010 and 2013 reflect a significant drop in both series *aetr* and *cetr*, of approximately 200 basis points (2%). This reduction can be explained by two contextual factors. From a legislative point of view, it should be noted that Secondary Tax on Companies (STC) ceased to be classified as a company tax at the beginning of 2012. This was levied at a rate of at least 10% (12.5% until 2007) on net dividends declared; in other words, the net result of dividends declared and dividends received. Companies have not been equally exposed to the liability to pay STC, because dividend amounts and dividend-income differ very much from one company to the next. Nevertheless, the practical termination of STC as a company-level tax could account for some of the drop in *aetr* reflected in the graph. The second explanation for a drop in effective tax rates during this period can be related to the presidency of Jacob Zuma which coincided with a time in which South Africa suffered a remarkable drop in tax morale, possibly due to consistent reports of governmental mismanagement, corruption, nepotism and fraud. It is interesting to note, however, the closer proximity of the *aetr* and *cetr* series to each other; contrast this to a period before 2010, when those two series deviated significantly from each other, sometimes even moving in opposite directions.

Although the effective tax rates were volatile from 2013 until 2018, both measures of corporate tax avoidance moved lower, on average, from 26% in 2013 to 24% in 2017. This may indicate declining tax morale in South Africa at a time when Pres. Jacob Zuma's presidency reached its nadir, before President Cyril Ramaphosa's appointment as president of South Africa at the very end of 2017. Evidence of an increase in effective tax rates after then may reflect an improvement in tax morale and restoration of trust in the South African government.

A corporation can be viewed as an inanimate, hypothetically conceptualised construct, that can be reduced to nothing more than a nexus of contracts. However, companies are run by human beings, whose human personal views can influence the decisions that they take as agents in the corporate setting. The following figure, Figure 4-2, is relevant here as it depicts the attitudes of people towards cheating with taxes; it is based on a survey by the World Values Survey. (The World Values Organisation, 2014).

**Figure 4-2 South African tax morale pertaining to individuals is in decline**



In the survey, a sample of the adult population in both Australia and South Africa were asked about their general disposition towards cheating with taxes. An increasing trend is evident, as far as South Africa is concerned, from 2005 until 2014. This increasing trend in South Africa mirrors the decreases in *aetr* in Figure 4-1 during the same period. This relationship is not coincidental. Thus, it is possible that an individual's attitude towards taxes and tax behaviour can influence decisions at the company level because a company is operated and managed by people, although companies, themselves, are sometimes described as inanimate objects. The use of the words "cheating" in the survey's questions to respondents refers to 'tax evasion;' however, this study concerns tax avoidance which is the practice of legitimately reducing taxes. The results of this survey are still relevant here as the literature review has indicated that tax evasion and tax avoidance can be depicted as opposite sides of a continuum.

Regardless, Figure 4-1 provides evidence of an increase in corporate tax avoidance, by reference to the decline in effective tax rates over the period under review. High standard deviations for both *aetr* and *cetr* in Table 4-5 indicate variability in the measure for tax avoidance. Although the average for both forms of effective tax rates is declining, it is evident from the standard deviation, and from the minimum and maximum values, that some companies are more aggressive than others in corporate tax avoidance.

The next section discusses descriptive statistics for the *lts5* and *lts4* ; in this study, these are the variables of interest as the proxy variables for long-termism, which is an important component of corporate culture.

#### ***Lts4* and *lts5*: movement over the period under observation**

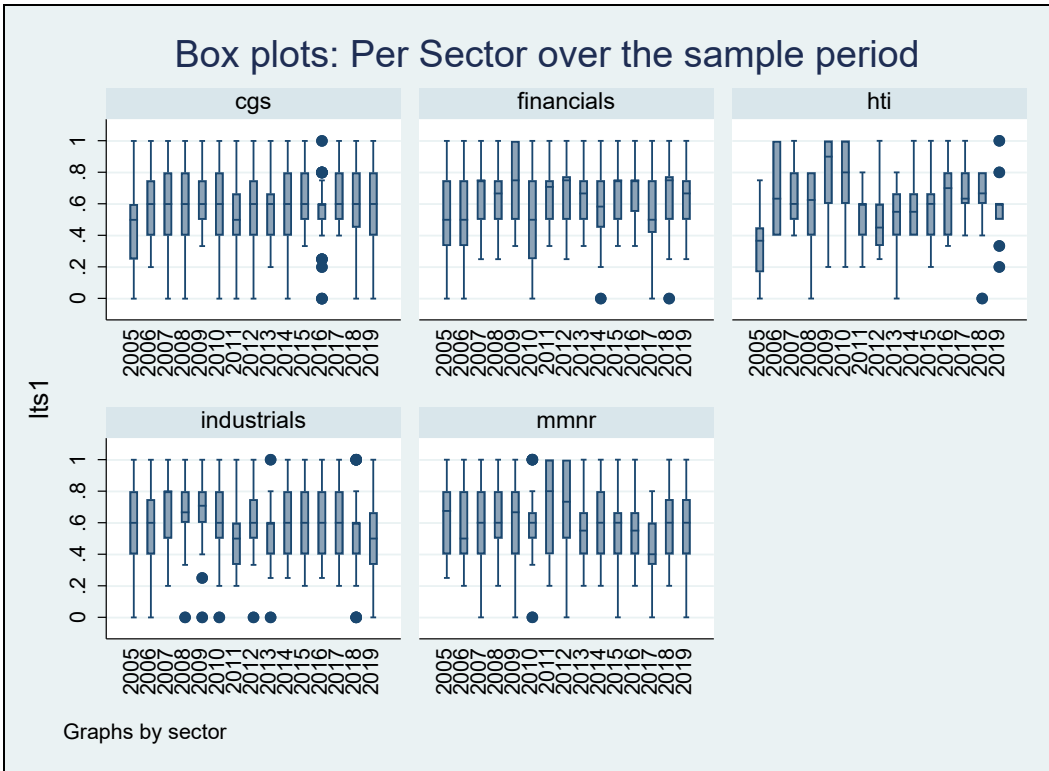
*Lts5* and *Lts4* are the variables of interest representing the long-termism scores, as calculated following the guidance provided by McKinsey in its MCHI, discussed before. *Lts5* is calculated by reference to all the indicators used by McKinsey while *Lts4* is based on four indicators, while *Ltm\_est* is left out to evaluate the impact of possible

measurement error in this indicator. The minimum and maximum scores of '0' and '1' respectively indicate that some companies are considered to be 100% long-term oriented, while others score 0 on the long-termism calculation. The average score of 0.514 and 0.519 for *Lts5* and *Lts4* respectively indicates that more than half the observations in the sample are classified as being long-term oriented if 50% is considered to be the benchmark. The standard deviations for *Lts5* (0.251) and *Lts4* (0.279), as reported in Table 4-5, are relatively high, taking into account the respective means, which indicate variability in the long-termism score.

The following boxplots are presented in Figure 4-3 and Figure 4-4, and are constructed and included to show how the averages of the long-termism scores (*Lts5* and *Lts4*) are dispersed along the means and medians, over time and over the 5 industries. The scores are depicted for each of the 5 industries. Overall, it shows considerable variation with respect to industries, and it is of interest to note the existence of some outliers in the data which invokes the relevance of winsorisation later in the chapter. The interquartile range is wider in industries such as *cgs*, *financials* and *mmnr*, while narrower for *industrials* pertaining to *Lts5* in Figure 4-3 below. Figure 4-4 below depicts the dispersion and variation *Lts4* as the alternative long-termism score. Here, one should note the inconsistent distribution of averages and means in industry *hti*, as well as the presence of some outlier data in most industries. Overall, these two figures indicate substantial variation in long-termism (*Lts5* and *Lts4*) between industries and throughout the years in the sample period. The variation is useful to examine the relationship between varying long-termism scores and varying effective tax rates.

The graphical depiction of long-termism scores below indicates that long-termism as a corporate culture is less stable than assumed initially. The graphs indicate significant variation in long-termism scores from year to year. Moreover, such variation indicates that some elements of corporate culture can be subject to other influences; for example, leadership effects, as envisaged in Upper-echelon theory.

**Figure 4-3** Box plot of *Lts5* long-termism score over sample period, per industry



*Cgs*, *financials*, *hti*, *industrials* and *mmnr* represent the 5 different industries. The graphs provide the median, average and interquartile distribution of the long-termism score over the 15-year sample period that includes the period 2004-2019. The graph indicates variation in the long-termism score from year-to-year, but also between industries.

**Figure 4-4** *Lts4*-score: Variation over 15-year sample period over industries



#### 4.9.2 Other control variables used in this chapter

The average of the *esg* scores, as the proxy variable for a company's commitment to principles of corporate social responsibility and corporate governance, is 34%; scores range between a low of 5% and a high of 66%, while a relatively high standard deviation of 14 indicates variability between the observations. The average of 34% indicates low commitment to the principles of corporate social responsibility in South Africa's largest companies. Nevertheless, *esg* scores are interpreted as a percentage out of 100 and compared against a level of 50%, the most general of benchmarks.

The variable *roa* represents return on assets and is calculated using profit before tax is deducted. The mean at 11% (7.92% after tax) for the sample under observation compares reasonably well with research by Greeff (2019) although this author only investigated some industries in South Africa, covering the period from 2009 to 2017. The statistic of dispersion exhibits some indication of a non-normal distribution, however, while the existence of outliers should be noted: here, bear in mind that some companies achieve 344% return on assets. A relatively high standard deviation of 17% also indicates variability between the observations in the sample.

The use of debt, according to the statistics for variable *lev*, indicates a low level of gearing; this averaged only 11% during the period under review. The maximum reflects evidence that some companies have gearing as high as 80%, expressed as debt as a percentage of total assets.

The mean of *capintens* as a proxy variable for the intensity of the use of fixed assets in business models is 28%. Note that the standard deviation is high at 24.57, with a low of zero and a maximum of 80%. These findings can be compared to the average percentage of intangible assets (*intangr*) used in the business models of the largest companies, which is 9.1%, ranging from a low of zero to a high of 84.74%. Overall, comparison of these two variables indicates moderately low investment in intangible assets compared to the use of fixed assets in the business models of large South African companies. This can be explained by the fact that South Africa is largely a developing economy in which the mining industry, with its focus on tangible assets, and other capital-intensive industrial companies, play a significant role. This comparison of variables also indicates that investment in the use of intellectual property, such as patents, is comparatively less than investment in tangible assets. Also there appears comparatively less investment in goodwill, often an indication of merger or take-over activity.

The average price-to-book ratio, *ptb*, for companies in the sample is 3.166; this ranged from a low of -5.99 to a maximum ratio of 69.58 of the book value of a company, with a standard deviation of 3.95.

The *stc* variable's mean of 0.53 indicates that 53% of observations are subject to a regime in which secondary tax on companies (STC) was levied on companies and as such, was designated as a company tax; this ought to result in a higher effective tax rate for these observations. However, the effect of STC may be absorbed in the case of those

companies that received significant dividend income, which is allowed as a deduction in the calculation of STC; this can result in STC having no impact on effective tax rates.

The average of the *ptc* variable, 0.267, indicates that about 26% of the observations in the sample were subject to the higher statutory tax rates regime of 29%, compared to the statutory tax rates applicable to observations in later periods when government decreased tax rates to 28%.

#### **4.9.3 Descriptive statistics for indicators used to calculate *Its5* and *Its4***

The descriptive statistics for the indicator variables are presented next. These variables were calculated in accordance with the guidance provided by McKinsey (McKinsey, 2017) in its MCHI. It should be borne in mind that these variables are all presented in binary format: in other words, either '1' or '0' with the former indicative of long-termism as opposed to the latter which is indicative of short-termism. This explains the maximum and minimum scores depicted in the summary statistics.

The first long-termism indicator, *ltm\_capex*, has a mean of 0.501 which indicates that more than 50% of the observations in the sample were attributed to a long-term orientation. This is also the case with *ltm\_mckeq*, which is the proxy variable for earnings management, where 50% of the sample's observations are attributed to a long-term orientation. The third indicator, *ltm\_est*, shows an average of 47.6% of observations in the sample being considered long-term oriented, at least as far as this particular indicator is concerned. This indicator is a proxy for a company's concern about pleasing analysts by being on target with forecast EPS. *ltm\_epsnp* captures the occurrence of incidences where companies report changes in net profit (YOY) exceeding the percentage change in EPS (YOY); this provides an indication of a company's lack of undue concern about performance in EPS being regarded by the market as a closely-watched short-term indicator. The average of this score (out of 1) indicates that 63% of observations are indicative of long-term orientation as far as this indicator is concerned. The standard deviation of 0.48 indicates a fair amount of deviation from the mean which implies variation: useful in further statistical analysis as envisaged. The last indicator used in the calculation of long-termism, *ltm\_sgrowth* shows an average of 47%; thus, 47% of the observations in the sample are classified as having a long-term orientation as far as sustainable growth in revenue *vis-à-vis* profit margins is concerned, relative from year to year.

#### 4.10 Correlation table

The following table presents a pairwise correlation table which presents the partial correlations between variables used.

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
(1) <i>aetr</i>	1.000											
(2) <i>cetr</i>	0.730***	1.000										
(3) <i>lts5</i>	0.094***	0.037	1.000									
(4) <i>lts4</i>	0.140***	0.061**	0.901***	1.000								
(5) <i>esg</i>	0.067***	0.055**	0.040	-0.011	1.000							
(6) <i>roa</i>	0.045*	0.052**	-0.033	0.008	-0.096***	1.000						
(7) <i>lev</i>	-0.027	0.007	0.022	0.037	0.043*	-0.122***	1.000					
(8) <i>capintens</i>	0.019	-0.022	0.083***	0.075***	0.241***	0.056**	0.341***	1.000				
(9) <i>intangr</i>	0.025	0.054**	0.017	0.058**	-0.038	0.001	0.302***	-0.115***	1.000			
(10) <i>size</i>	0.006	-0.029	0.090***	0.075***	0.485***	0.024	0.104***	0.072***	0.084***	1.000		
(11) <i>ptb</i>	0.060**	0.032	0.035	0.079***	-0.053**	0.598***	0.046*	0.055**	0.052**	0.066***	1.000	
(12) <i>stc</i>	0.054**	0.001	0.007	0.032	-0.338***	0.215***	-0.100***	0.009	-0.059**	-0.200***	0.095***	1.000
(13) <i>ptc</i>	0.022	-0.053**	-0.008	0.002	-0.296***	0.194***	-0.116***	-0.028	-0.047*	-0.172***	0.100***	0.564***

**Table 4-6 Correlation table showing multivariate correlations between the variables**

*Aetr* and *cetr* are the proxy variables for corporate tax avoidance and the multicollinearity in this regard is both expected and acceptable since these proxies are not used in the same regression specification. The correlation coefficient on variables *lts5* and *lts4* are both positive relative to both forms of proxy variables *aetr* and *cetr*, which is in line with the expectation that long-termism should be correlated positively with effective tax rates as evidence of lower tax avoidance.

\*, \*\*, \*\*\*, significant at the threshold of 10%, 5% and 1%, respectively (t-test)

#### 4.10.1 Discussion of correlation table

The correlations depicted in Table 4.6, above, are discussed at this point, before more-advanced statistical analysis in the form of regression analysis is performed.

The correlation between *aetr* and *cetr* as the alternative proxy variables for corporate tax avoidance is positive and statistically significant, as expected. This provides univariate evidence of the positive relationship between corporate tax avoidance and corporate culture as proxied for by effective tax rates and long-termism scores, respectively. However, there may be other reasons for this positive relationship, which why this evidence is followed up, later, with multivariate tests using regression.

The strong positive correlation between *aetr* and *cetr* is logical as both these variables are alternative proxies for corporate tax avoidance, measuring the same underlying concept. This strong correlation provides evidence of the validity of these proxies for tax avoidance. The fact that the correlation between these variables is strong does not pose a collinearity problem as they are never used simultaneously in the same regression specification.

There is a positive correlation between *esg* and both measures of corporate tax avoidance, *aetr* and *cetr*, and that positive correlation is statistically significantly. This means that companies with a higher regard for aspects of corporate social responsibility and elements of corporate governance are likely to be associated with less corporate tax avoidance. This is in line with the findings of Lanis and Richardson (2012a) who also found that a company's social responsibility extends to displaying responsible behaviour regarding corporate tax. The correlation between *esg* and both forms of long-termism (*lts4* and *lts5*) is not statistically significant; this finding differs from what was expected. However, the literature review indicated that the use of corporate social responsibility initiatives and disclosures may be pursued to legitimate companies; in other words, create a positive image; this ulterior motive provides a reason for the absence of correlation.

Correlations between *roa* and the dependent variables *aetr* and *cetr* are positive and also statistically significant in both cases, although the literature review indicates mixed inconclusive results. The positive correlation provides evidence that more-profitable companies pay more tax on average. It is possible that more-profitable companies attract more scrutiny from regulators; this might explain why more-profitable companies avoid the unwelcome attention that could arise from paying low effective tax rates. The correlation between *roa* and *esg* is negative and statistically significantly. It can indicate that subscription to the principles of corporate social responsibility and good corporate governance can be expensive for companies in the short term, thereby reducing profits and subsequently return on assets.

Leverage (*lev*) is negatively correlated with both dependent variables, but not significantly so. During the literature discussion it was shown that the mere deductibility of interest expenses on debt does not necessarily and directly influence effective tax rates; this is because interest expenses are deductible not only for tax purposes but also as a

recognisable expense for accounting purposes in the income statement, therefore constituting a temporary difference only.

*Capintens* does not show any statistically significant correlation with the dependent variables (*aetr* and *cetr*). However, a statistically significant and positive relationship was found between *capintens* and the long-termism scores (*Its4* and *Its5*); this finding can be interpreted as evidence that long-term oriented companies show a higher inclination to invest in physical assets as a form of commitment to the future growth of the business.

*Intangr* shows no relationship with *aetr* but there is some evidence of a statistically positive relationship with *cetr*. The literature reports instances where investment in intangible assets is related to corporate tax avoidance; here, it is argued that intellectual property registered in tax havens or countries with low tax rates can help companies to avoid tax through transfer-pricing manipulation. However, intangible assets also include investment in goodwill, which is not associated with tax avoidance, and which can suppress the expected correlation.

*Size* and the dependent variables *aetr* and *cetr* are not significantly correlated, although it is frequently used as a control variable, as indicated the discussion of methodology in Chapter 3. The literature review indicates a lack of consensus regarding the association between size and tax, in the light of strong arguments on both sides. Larger companies have more resources to engage better tax advisors to avoid tax; at the same time, those larger companies are also more careful not to draw unwelcome attention to unethical behaviour, which could damage reputations.

A higher price-to-book ratio (*ptb*) is positively correlated with *aetr*, but not with *cetr*. The price-to-book ratio is statistically and positively correlated with *Its4* as a measure of long-termism; this may indicate a relationship in the case of long-term oriented companies, that are more likely to be growing faster. Furthermore, the relationship between *ptb* and *esg* is negative which can be indicative of faster-growing companies being less inclined to regard corporate social responsibility as a key priority; those companies probably have more urgent priorities that directly concern the growth of the company. Last, the positive relationship between *ptb* and *roa* can be interpreted as evidence that South African companies with more efficient use of assets are also high-growth companies.

The last two variables discussed here, *stc* and *ptc* are dummy variables used to indicate periods of time when different tax legislation was in force. A statistically positive correlation between *stc* and *aetr* is logical since the variable indicates a time when secondary taxes on companies were levied as a company tax as opposed to a shareholder-level tax. Thus, *ptc* differentiates a period when statutory tax rates were higher. The correlation between *ptc* and *aetr* is statistically insignificant although one would have expected it to have been strongly positive since *ptc* indicates a higher statutory tax rate. However, the lack of correlation may indicate tax avoidance to the extent that the average company was able to find ways to mitigate the impact of higher statutory tax rates. The significantly negative correlation between *ptc* and *cetr* indicates a corporate reaction to higher tax rates. It suggests that

companies find ways to minimise actual cash payments of tax; after all, there is a greater incentive to save tax when those statutory tax rates are high.

The next section discusses the various regression analyses conducted in this study and includes reference to the regression specifications that were run on the sample's data.

#### 4.11 Regressions

Regressions are used as a method to examine, quantitatively, the relationship between corporate tax avoidance and corporate culture. This process was outlined in Chapter 3, which explains the methodology and methods followed in this study. Thus, pooled regressions, fixed-effect regressions and cross-sectional regressions are used to examine this relationship between long-termism scores (*lts5* and *lts4*) and the proxy variables for corporate tax avoidance, being *aetr* and *cetr*. The general specification for the regression models involves proxies for corporate tax avoidance being regressed on proxy measures for corporate culture, as explained earlier in this chapter. The examination starts with pooled models to understand the relationship between corporate culture and tax avoidance without acknowledging that the sample is composed of groups of companies; the time-dimension is therefore ignored. *Aetr* is alternated with *cetr* as a general robustness check, while the long-termism score *lts5* is alternated with *lts4* to evaluate the impact of possible measurement error as previously discussed.

##### 4.11.1 Pooled regression

Pooled regression is performed first to obtain an idea of the expected association between the long-termism scores and effective tax rates, but without emphasis of the group-component or time-series component in the sample. The pooled models ignore the fact that groups of observations refer to the same time-period.

$$aetr_i = \beta_0 + \beta_1 lts5 + \beta_2 esg_i + \beta_3 roa_i + \beta_4 lev_i + \beta_5 capintens_i + \beta_6 intangr_i + \beta_7 size_i + \beta_8 ptb_i + \beta_9 ptc_i + \beta_{10} stc_i + \beta_{11} industry\_dummies_i + \varepsilon \quad (\text{MODEL 1})$$

$$aetr_i = \beta_0 + \beta_1 lts4 + \beta_2 esg_i + \beta_3 roa_i + \beta_4 lev_i + \beta_5 capintens_i + \beta_6 intangr_i + \beta_7 size_i + \beta_8 ptb_i + \beta_9 ptc_i + \beta_{10} stc_i + \beta_{11} industry\_dummies_i + \varepsilon \quad (\text{MODEL 2})$$

The repeat of the regression models described above, but with *cetr* as the dependent variable, follows next:

$$cetr_i = \beta_0 + \beta_1 lts5 + \beta_2 esg_i + \beta_3 roa_i + \beta_4 lev_i + \beta_5 capintens_i + \beta_6 intangr_i + \beta_7 size_i + \beta_8 ptb_i + \beta_9 ptc_i + \beta_{10} stc_i + \beta_{11} industry\_dummies_i + \varepsilon \quad (\text{MODEL 3})$$

$$cetr_i = \beta_0 + \beta_1 lts4 + \beta_2 esg_i + \beta_3 roa_i + \beta_4 lev_i + \beta_5 capintens_i + \beta_6 intangr_i + \beta_7 size_i + \beta_8 ptb_i + \beta_9 ptc_i + \beta_{10} stc_i + \beta_{11} industry\_dummies_i + \varepsilon \quad (\text{MODEL 4})$$

#### 4.11.2 Fixed-effect regressions

Fixed-effect (FE) regressions are specified below, in which the focus of investigation is on the possible effect that a long-term orientation has within companies over time. The specifications generally follow those used in the previous section. The FE models follow generally the same specification although the panel-data element is emphasised in FE regression where a time-series as well as a cross-sectional element are present. Fixed-effect regressions are useful in controlling for an element of endogeneity because they control for time-invariant, omitted variables. Normally one would perform a Hausman test to ascertain whether a random effects model is the more appropriate estimator. However, the assumptions of random effects that include random selection and continuous replacement of values are not satisfied, which renders the random effects model estimator inappropriate. This explains why the random effects models are not performed.

$$aetr_{it} = \beta_0 + \beta_1 lts5_{it} + \beta_2 esg_{it} + \beta_3 roa_{it} + \beta_4 lev_{it} + \beta_5 capintens_{it} + \beta_6 intangr_{it} + \beta_7 size_{it} + \beta_8 ptb_{it} + \beta_9 ptc_{it} + \beta_{10} stc_{it} + \varepsilon .$$

**(MODEL 5)**

$$aetr_{it} = \beta_0 + \beta_1 lts4_{it} + \beta_2 esg_{it} + \beta_3 roa_{it} + \beta_4 lev_{it} + \beta_5 capintens_{it} + \beta_6 intangr_{it} + \beta_7 size_{it} + \beta_8 ptb_{it} + \beta_9 ptc_{it} + \beta_{10} stc_{it} + \varepsilon .$$

**(MODEL 6)**

The regressions are repeated using *cetr* as the alternative proxy for corporate tax avoidance.

$$cetr_{it} = \beta_0 + \beta_1 lts5_{it} + \beta_2 esg_{it} + \beta_3 roa_{it} + \beta_4 lev_{it} + \beta_5 capintens_{it} + \beta_6 intangr_{it} + \beta_7 size_{it} + \beta_8 ptb_{it} + \beta_9 ptc_{it} + \beta_{10} stc_{it} + \varepsilon .$$

**(MODEL 7)**

$$cetr_{it} = \beta_0 + \beta_1 lts4_{it} + \beta_2 esg_{it} + \beta_3 roa_{it} + \beta_4 lev_{it} + \beta_5 capintens_{it} + \beta_6 intangr_{it} + \beta_7 size_{it} + \beta_8 ptb_{it} + \beta_9 ptc_{it} + \beta_{10} stc_{it} + \varepsilon .$$

**(MODEL 8)**

#### 4.11.3 Cross-sectional regression

The following section describes the cross-sectional OLS regression performed, in which mean values of all the available data pertaining to dependent and independent variables are used, in respect of the entire 15-year period under review. The purpose of this approach is to investigate whether the effect of corporate culture on corporate tax avoidance is dominant between companies or not. The regressions in the previous section (pertaining to FE regressions) may show some evidence that a company may indeed exhibit behaviour with a long-term orientation in one year, followed by a change subsequently. Some literature argues that certain elements of corporate culture are relatively immune to dramatic changes; this could be an argument to be borne in mind in considering the effect of cross-sectional regressions as well. A long-term orientation of a company is measured more appropriately when performance is measured over a longer period than a year or two. The use of mean data for variables to do the cross-sectional regression smooths the data with regards to one-off items, such as a temporary higher return on

assets, for example. The following regressions follow the specifications of those in the previous section; however, all the variables constitute a 15-year average. Models 9-10 use the *aetr* as dependent variable whereas 11-12 use the *cetr* as the alternative form of the proxy for tax avoidance.

$$aetr_i = \beta_0 + \beta_1lts5 + \beta_2esg_i + \beta_3roa_i + \beta_4lev_i + \beta_5capintens_i + \beta_6intangr_i + \beta_7size_i + \beta_8ptb_i + \beta_9ptc_i + \beta_{10}stc_i + \beta_{11}industry\_dummies_i + \varepsilon$$

**(MODEL 9)**

$$aetr_i = \beta_0 + \beta_1lts4 + \beta_2esg_i + \beta_3roa_i + \beta_4lev_i + \beta_5capintens_i + \beta_6intangr_i + \beta_7size_i + \beta_8ptb_i + \beta_9ptc_i + \beta_{10}stc_i + \beta_{11}industry\_dummies_i + \varepsilon$$

**(MODEL 10)**

$$cetr_i = \beta_0 + \beta_1lts5 + \beta_2esg_i + \beta_3roa_i + \beta_4lev_i + \beta_5capintens_i + \beta_6intangr_i + \beta_7size_i + \beta_8ptb_i + \beta_9ptc_i + \beta_{10}stc_i + \beta_{11}industry\_dummies_i + \varepsilon$$

**(MODEL 11)**

$$cetr_i = \beta_0 + \beta_1lts4 + \beta_2esg_i + \beta_3roa_i + \beta_4lev_i + \beta_5capintens_i + \beta_6intangr_i + \beta_7size_i + \beta_8ptb_i + \beta_9ptc_i + \beta_{10}stc_i + \beta_{11}industry\_dummies_i + \varepsilon$$

**(MODEL 12)**

The regression results, processed in STATA, are presented in the next section.

#### **4.12 Regression results**

The regression results are presented in the tables that follow. These results are obtained using STATA statistical analysis software.

#### 4.12.1 Pooled models' results

Regressor	Model 1 <i>aetr</i>	Model 2 <i>aetr</i>	Model 3 <i>cetr</i>	Model 4 <i>cetr</i>
<i>lts5</i>	4.945*** (1.735)		3.032 (2.124)	
<i>lts4</i>		7.695*** (1.560)		4.362** (1.917)
<i>esg</i>	0.127*** (0.039)	0.131*** (0.038)	0.183*** (0.047)	0.185*** (0.047)
<i>roa</i>	0.089** (0.036)	0.088** (0.036)	0.082* (0.046)	0.081* (0.046)
<i>lev</i>	-0.063 (0.039)	-0.059 (0.039)	0.017 (0.048)	0.018 (0.048)
<i>capintens</i>	0.017 (0.026)	0.007 (0.026)	-0.016 (0.032)	-0.022 (0.032)
<i>intangr</i>	-0.015 (0.044)	-0.028 (0.043)	-0.020 (0.053)	-0.028 (0.053)
<i>size</i>	-0.601* (0.362)	-0.646* (0.360)	-0.978** (0.445)	-1.001** (0.444)
<i>ptb</i>	0.423*** (0.156)	0.393** (0.155)	0.207 (0.191)	0.190 (0.191)
<i>ptc</i>	-0.789 (1.204)	-0.706 (1.197)	-3.058** (1.485)	-3.018** (1.484)
<i>stc</i>	1.996* (1.040)	1.836* (1.034)	1.913 (1.271)	1.839 (1.270)
<i>inds</i>	0.293 (1.620)	0.714 (1.614)	-4.178* (2.132)	-4.123* (2.127)
<i>cgs</i>	0.082 (1.673)	0.502 (1.666)	-5.021** (2.026)	-4.969** (2.023)
<i>mmnr</i>	-1.764 (2.042)	-0.900 (2.040)	-9.531*** (2.446)	-9.250*** (2.448)
<i>hti</i>	2.522 (2.127)	2.830 (2.114)		
<i>fin</i>			-5.560** (2.636)	-5.738** (2.632)
Constant	23.453*** (3.628)	22.456*** (3.597)	33.057*** (4.458)	32.769*** (4.443)
Observations	1,403	1,403	1,376	1,376
R-squared	0.037	0.048	0.032	0.034

**Table 4-7 Regression results of Pooled models of *aetr* & *cetr* on long-termism**

Effective tax rates (*aetr* and *cetr*) are the regressands in these results. The data sample consists of the 112 largest companies listed on the Johannesburg Stock Exchange from 2005 until 2019. The fundamental data supplier is Bloomberg. *Lts5* and *Lts4* are alternative forms of the proxy for long-termism and are the variables of interest in this chapter's investigation. *esg* presents Bloomberg's ESG score. *roa* is the return on assets calculated based on profit before tax as a percentage of total assets of company *i*. *lev* is financial leverage defined as the ratio of total debt to total assets for company *i*. *Capintens* is defined as the ratio of fixed assets to total assets for company *i*. while *size* is the natural log of market capitalisation of company *i*. *Intangr* is defined as the ratio of total intangible assets to the value of total fixed assets for company *i*. *ptb* is defined as the ratio of market value to the book value for company *i*. *ptc* and *stc* are dummy variables to control for specific statutory tax regimes for observations for company *i*, while *inds*, *cgs*, *mmnr*, *fin* and *hti* are dummy variables used to control differences in industry classification between observations as explained in Table 4-4.

\*, \*\*, \*\*\*, significant at the threshold of 10%, 5% and 1%, respectively (t-test)

#### 4.12.2 Fixed-effect regression results

Regressors	Model 5 <i>aetr</i>	Model 6 <i>aetr</i>	Model 7 <i>cetr</i>	Model 8 <i>cetr</i>
<i>lts5</i>	6.175** (2.586)		4.552 (2.870)	
<i>lts4</i>		7.785*** (2.247)		5.259** (2.380)
<i>esg</i>	0.012 (0.066)	0.015 (0.065)	0.061 (0.086)	0.063 (0.086)
<i>roa</i>	0.075 (0.073)	0.073 (0.071)	0.084 (0.077)	0.080 (0.076)
<i>lev</i>	-0.052 (0.078)	-0.053 (0.078)	0.094 (0.085)	0.093 (0.086)
<i>capintens</i>	0.004 (0.118)	-0.001 (0.117)	0.062 (0.124)	0.060 (0.124)
<i>intangr</i>	-0.016 (0.073)	-0.030 (0.075)	-0.054 (0.093)	-0.063 (0.094)
<i>size</i>	-1.079 (1.091)	-1.133 (1.080)	-1.422 (1.519)	-1.434 (1.510)
<i>ptb</i>	0.010 (0.239)	0.007 (0.236)	-0.509 (0.451)	-0.510 (0.449)
<i>ptc</i>	-1.702 (1.099)	-1.677 (1.098)	-3.887** (1.551)	-3.869** (1.548)
<i>stc</i>	0.857 (1.461)	0.686 (1.463)	1.067 (2.036)	0.986 (2.036)
<i>lts4</i>				
Constant	34.239*** (12.827)	34.179*** (12.895)	35.672** (16.138)	35.591** (16.227)
Observations	1,403	1,403	1,376	1,376
R-squared *	0.015	0.024	0.021	0.023
Number of companies	103	103	103	103

**Table 4-8 Fixed-effect regression results**

Effective tax rates (*aetr* and *cetr*) are the regressands in these results. The data sample consists of the 112 largest companies listed on the Johannesburg Stock Exchange from 2005 until 2019 (adjusted to 103 companies due to data-inadequacy). The fundamental data supplier is Bloomberg. *Lts5* and *Lts4* are alternative forms of the proxy for long-termism and are the variables of interest in this chapter's investigation for company *i* in time period *t*. *esg* presents Bloomberg's ESG score. *roa* is the return on assets calculated based on profit before tax as a percentage of total assets for company *i* in time period *t*. *lev* is financial leverage defined as the ratio of total debt to total assets for company *i* in time period *t*. *Capintens* is defined as the ratio of fixed assets to total assets for company *i* in time period *t*. *size* is the natural log of market capitalisation of company *i* in time period *t*. *Intangr* is defined as the ratio of total intangible assets to the value of total fixed assets for company *i* in time period *t*. *ptb* is defined as the ratio of market value to the book value for company *i* in time period *t*. *ptc* and *stc* are dummy variables to control for specific statutory tax regimes for observations for company *i* in time period *t*.

\*, \*\*, \*\*\*, significant at the threshold of 10%, 5% and 1%, respectively (t-test)

### 4.12.3 Cross-sectional regression models

Regressor	Model 9	Model 10	Model 11	Model 12
	<i>aetr</i>	<i>aetr</i>	<i>ctr</i>	<i>ctr</i>
<i>lts4</i>		7.851 (8.187)		1.540 (9.688)
<i>lts5</i>	-1.862 (7.854)		-2.179 (9.248)	
<i>esg</i>	0.185* (0.097)	0.185* (0.097)	0.212* (0.115)	0.210* (0.114)
<i>roa</i>	0.020 (0.130)	0.027 (0.129)	-0.021 (0.153)	-0.019 (0.153)
<i>lev</i>	-0.086 (0.112)	-0.058 (0.113)	-0.058 (0.132)	-0.048 (0.133)
<i>capintens</i>	0.019 (0.060)	-0.012 (0.062)	-0.035 (0.071)	-0.046 (0.074)
<i>intangr</i>	-0.013 (0.103)	-0.039 (0.104)	-0.039 (0.122)	-0.048 (0.124)
<i>size</i>	-0.627 (0.839)	-0.675 (0.837)	-0.832 (0.988)	-0.841 (0.990)
<i>ptb</i>	0.440 (0.462)	0.352 (0.467)	0.825 (0.544)	0.801 (0.552)
<i>inds</i>	-2.663 (3.479)	-2.893 (3.446)	-4.326 (4.097)	-4.457 (4.078)
<i>cgs</i>	-2.986 (3.201)	-2.822 (3.190)	-6.112 (3.769)	-6.076 (3.774)
<i>mmnr</i>	-5.990 (3.963)	-5.161 (4.015)	-10.041** (4.666)	-9.816** (4.750)
<i>fin</i>	-2.321 (4.490)	-3.338 (4.466)	-6.587 (5.287)	-6.987 (5.284)
Constant	29.944*** (8.225)	26.453*** (8.154)	34.996*** (9.684)	33.618*** (9.648)
Observations	103	103	103	103
R-squared	0.095	0.104	0.135	0.135

**Table 4-9 Regression results of cross-sectional regression**

Effective tax rates (*aetr* and *ctr*) are the regressands in these results. The data sample consists of the 103 largest companies listed on the Johannesburg Stock Exchange from 2005 until 2019. The fundamental data supplier is Bloomberg. *Lts5* and *Lts4* are alternative forms of the proxy for long-termism and are the variable of interest in this chapter's investigation for company *i*. *esg* presents Bloomberg's ESG score *roa* is the return on assets calculated based on profit before tax as a percentage of total assets for company *i*. *lev* is financial leverage defined as the ratio of total debt to total assets for company *i*. *Capintens* is defined as the ratio of fixed assets to total assets for company *i*. *size* is the natural log of market capitalisation for company *i*. *Intangr* is defined as the ratio of total intangible assets to the value of total fixed assets for company *i*. *ptb* is defined as the ratio of market value to the book value for company *i*. *ptc* and *stc* are dummy variables to control for specific statutory tax regimes for observations for company *i*. All the variables in this regression are based on the average of the respective variables over the 15 years under observation; this reduces the effect of outliers in observations over this time period. *Ptc* and *stc* are omitted due to multicollinearity because of the use of dummy-variables. *Aetr* is the dependent variable in Models 9 and 10 while *ctr* is the dependent variable for Models 11 and 12.

#### 4.12.4 Discussion of results

The results from the Pooled models are reported in

Table 4-7 above. The results reflect a statistically significant and positive regression coefficient on *lts5* and *lts4* pertaining to *aetr*. *lts4* is statistically associated with *ctr* and that association is statistically significant, although *lts5* is not. Overall, the pooled models suggest evidence of a positive association between long-termism as a corporate culture and higher effective tax rates; this suggestion supports the main tenet of this study, that expects companies with a long-term orientation to be less aggressive in avoiding tax. This evidence indicates that not all companies follow lower effective tax rates, and that those having a longer-term orientation are likely, on average to manifest higher effective tax rates as an indication of their less aggressive attitude towards tax avoidance. *Esg*, has a statistically significant and positive relationship to *aetr* and *ctr*, indicating that a higher corporate commitment towards social responsibility extends into the realm of corporate tax behaviour. *Roa* is positively related to *aetr* and *ctr*, but only at the 10% level of significance. *Size* is statistically and negatively associated with *aetr* and *ctr* at the 10% level of significance which implies that larger companies are associated with lower effective tax rates, indicate a more aggressive corporate attitude towards tax avoidance. *Ptb* as the proxy variable used to indicate growth in companies has a statistically significant and positive association with *aetr*, but not *ctr*. This indicates that higher growth is associated with less corporate tax avoidance. *Stc* shows a statistically significant and positive association with *aetr* which indicates that secondary tax on companies had a positive impact on effective tax rates when it was applicable to companies, although the effect is less significant on *ctr*. Industrial companies (*inds*) seem to be more associated with tax avoidance as far as *ctr* is concerned, but less so in respect of *aetr*. Companies involved in mining and extractive industries (*mmnr*) also show a significantly negative association with *ctr*. The results of the pooled models, however, do not discriminate between observations linked to the same company or to the same time-period which is the case for panel data.

The results of the fixed-effect regression are discussed next. These results provide more information on whether the differences between companies, or changes in corporate culture for specific companies, over time, explain variations in effective tax rates as the proxy for corporate tax avoidance.

The results of the fixed-effect regression are presented in Table 4-8. A statistically significant and positive association is evident between *lts5* and *aetr*, and between *lts4* and both *aetr* and *ctr*. The positive coefficient in this instance indicates that changes in a company's long-termism score, over time, are positively associated with a variation in effective tax rates, over time. The nature of fixed-effect regression, however, also indicates a positive association between long-termism scores and higher effective tax rates between companies, although this assessment is not the main emphasis of fixed-effect regression. On the contrary, fixed-effect regression emphasizes the within-company effect of long-termism. It does indicate that long-termism is associated with higher effective tax rates, but also indicates that long-termism scores vary over time, within companies, from year to year. The statistically significant

and positive association between *esg* and *aetr* and *cetr* indicates that corporate social responsibility and corporate governance are positively associated; this applies, regardless, even when long-termism is controlled for. This association is in accordance with the evidence reported by Lanis and Richardson (2012a) using a sample of Australian listed companies; there, those authors found a positive association between levels of corporate social responsibility and effective tax rates. This Australian finding provides evidence that the corporate social responsibility initiatives of South African companies are complementary to responsible corporate tax behaviour.

*Esg* does not reflect a significant relationship with *aetr* or *cetr* in the fixed-effect transformation although the direction of the association remains intact.

The results of the cross-sectional regression presented in Table 4-9, above, indicate no significant association between long-termism (*lts4* or *lts5*) and corporate tax avoidance (*aetr* or *cetr*). This means that the effect of long-termism is mostly evident in the fixed-effect regression which emphasizes the 'within-effect,' over time. More specifically, it indicates that elements of corporate culture such as the temporal orientation can change over time, which is a finding contrary to other reports in the literature which indicate stability in constructs such as corporate culture. Variation in the long-term culture scores within companies over time would not have been observed if long-termism had been more stable as a component of corporate culture. These results mean that companies with a long-term orientation are more likely, on average, to be associated with higher effective tax rates; this is especially noticeable in those periods in corporate history where the company's behaviour is more indicative of a long-term orientation. *Esg* is positive and has a statistically significant association with *aetr* and *cetr* in the pooled models, but not in the fixed-effect models. Industries such as *mmnr* (mining companies) again show a significant negative association with *cetr*.

#### **4.12.5 Robustness**

The descriptive statistics as analysed in

Table 4-5 indicated the presence of some outlier data which could distort results. For this reason, the results reported above are recalculated subject to winsorisation of all the variables at the 2% level. The results with regard to the coefficients in the regressions, run above, survive the smoothing effect of winsorisation of outlier data. This shows that the effect of outlier data is not the only reason for the results reported.

Endogeneity is often a concern in quantitative social research. For example, it is possible that the effects observed on the long-termism variables could be spurious because of unobserved and omitted variables. The use of fixed-effect regression, as performed in section 4.12.2, controls for time-invariant, omitted variables which may have caused such effects. It also controls for other elements that are stationary for each company throughout the 15-year period under observation. Also, the regressions reported in 4.12.1 above are run with and without the variable of interest (long-

termism scores), while subsequent inspection of  $R^2$  of the regression equations indicates an improvement in  $R^2$  in each instance.

The ESG scores used in the specifications of the regression models above as a control variable, are composed of three scores, being a governance disclosure score, an environmental disclosure score, and a social impact disclosure score. The results of the pooled and fixed-effect regressions in section 4.12 suggest a positive association (statistically significant) between the ESG variable and effective tax rates. However, to test whether the observed effect of ESG is not perhaps attributable to the governance score only, a robustness procedure is performed. Some of the ESG scores used in this chapter's regression models are imputed to prevent attrition due to missing variables in the South African context with small samples. The author uses the actual ESG scores from Bloomberg for a smaller sample, whereafter the models are run again, during which the ESG score is first replaced by the Governance score together with the Social-impact score, and thereafter, together with the Social-impact score, to check whether the governance score's effect is subsumed in the total ESG score effect. The results of this test indicate no statistically significant association between any of these three variables (being the Governance disclosure score, the Social impact-score and the Environmental-impact disclosure score) and effective tax rates.

The overall research design of this study, as a mixed-methodology study, also serves a valid purpose regarding robustness. Quantitative results are incorporated as themes in the qualitative stream of this research, which entailed interviews with corporate tax advisors; this provides an opportunity to assess the plausibility of quantitative results.

#### **4.13 Conclusion**

This chapter examines the relationship between corporate tax avoidance and long-termism, which is an important component of corporate culture. The chapter identifies and uses the McKinsey Corporate Horizon Index (MCHI) to measure long-termism, and effective tax rates to measure corporate tax avoidance. It then uses univariate and multivariate statistical analyses in the form of correlation and regression, respectively, to examine the relationship between corporate tax avoidance and long-termism. The results of the Pearson-correlation analysis indicate a statistically significant and positive relationship between both forms of effective tax rates (variables *aetr* and *cetr*) and long-termism scores (variables *lts4* and *lts5*). This provides univariate evidence of a positive relationship, meaning that long-termism is associated with higher effective tax rates and therefore lower levels of tax avoidance at companies that are more long-term oriented.

The results of the univariate statistical analysis also extend to the results of the multivariate regression analysis. The results of multivariate regression in the form of pooled regression and fixed-effect regression provide evidence of a statistically significant and negative association between corporate tax avoidance and long-termism (proxied by variables *aetr* and *cetr*). The pooled models indicate a statistically significant positive coefficient of 4.945 on *lts5* (significant at the 1% level) when *aetr* is regressed on *lts5*. A significant positive coefficient of 7.695 on *lts4* (significant at the 1% level) was evident when *aetr* was regressed on *lts4*. When *cetr* is regressed on *lts5* the results are

insignificant but in contrast, when *ce|
|  |* is regressed on *lts4*, a positive coefficient of 4.362 results (significant at the 5% level). These results are in line with the expectation that long-termism would be positively associated with effective tax rates, although a significant effect on *ce|
|  |* was expected on both forms of long-termism. The results of cross-sectional regression do not indicate any kind of statistically significant association between the *aetr* and *ce|
|  |* as dependent variables and the regressors, *lts5* or *lts4*.

A positive association between effective tax rates and the variables of interest ( *lts4* and *lts5*) would indicate that companies with a long-term outlook are, on average, associated with less aggressive levels of tax avoidance. This would indicate that long-term oriented companies acknowledge their responsibility towards broader stakeholder constituents; this manifests in the form of responsible tax paying behaviour, with the South African Revenue Service (SARS) being perceived, by the company, as custodians for broader society. It is argued that such companies act ethically in terms of a high-level commitment to sustainable practices when they acknowledge their mutual dependence on stakeholders, including government. Conversely, a negative association would mean that companies with a long-term orientation pay less tax, on average. In other words, those companies would not necessarily view the revenue authorities as a stakeholder in a long-term mutually beneficial relationship. A lack of any statistical significance on the variables of interest would have meant that there is no evidence to support the view that long-termism has any influence on the tax behaviour of companies. Alternatively, it could mean that the effect of long-termism is not assimilated in the regression. For example, it may mean that there is a statistical effect related to long-termism, which is not detected by the regression specification.

The results of the pooled regression models and the fixed-effect regressions provide evidence of a positive association between effective tax rates and the variables of interest (*lts4* and *lts5*). This finding supports the notion that long-term oriented companies pay more tax on average. It means that those companies are less aggressive in avoiding tax. There is evidence of a stakeholder-oriented approach attributed to those companies, which includes a concern for government and the interests of society. The results from the fixed-effect models indicate that the 'within-effect' of long-termism is more prominent, when compared to the results of the cross-sectional regression presented in Table 4-9; these indicate that the influence of long-termism between companies is not significant. It is however possible that the effect of long-termism is not detected in the regression specification, for other reasons.

The descriptive statistics performed on the *aetr* and *ce|
|  |* indicate fluctuation, but also a declining trend in both *ce|
|  |* and *aetr* as the proxies for corporate tax avoidance, especially from 2009 onwards. It is argued that the higher incidence of tax avoidance, as indicated by a decreasing effective tax rate, is partially attributable to deteriorating taxpayer morale because of widespread government corruption from 2009 under President Jacob Zuma's presidency. The downward movement in the average effective tax rates indicates that companies have become slightly more aggressive in tax avoidance behaviour, on average, during the period under observation. However, the regression results indicate that companies with a long-term orientation do not necessarily follow the same trend, or that such

companies do not indiscriminately subscribe to the same 'zeitgeist.' This defies the underlying trend in the World-Values survey, meaning that a decline in tax morale is not universally applicable to all companies.

The regression results pertaining to the ESG-score prove not statistically robust, meaning that it provides no evidence of corporate governance's or social-and environmental responsibility's direct influence on corporate tax avoidance in South Africa.

The variation in the long-termism scores (*lts4* and *lts5*) over time (from year to year) indicates that the nature of corporate culture can include a less stable component. It is possible that the less stable part is more subject to changing influences, such as the influence of a CEO. It is also possible that a CEO can influence corporate tax behaviour; after all, there is evidence of the CEO's influence on other elements of corporate culture, which can affect tax avoidance. The next chapter investigates another aspect related to corporate culture: that is, the relationship between corporate tax avoidance and the tax knowledge attributed to a CEO as a CEO effect.

## 5 The association between the level of tax knowledge attributed to a CEO and corporate tax avoidance

### 5.1 Introduction

This chapter examines the relationship between the amount of corporate tax avoidance and the level of tax knowledge attributed to a CEO, as a CEO effect. It is argued that CEOs influence a company's tax culture, which affects the level of corporate tax avoidance. This chapter is formatted as an academic paper to expedite publication upon completion of the study. This chapter operationalises tax knowledge attributed to a CEO using a dummy variable based on whether a CEO is a South African chartered accountant or not, while corporate tax avoidance is proxied by effective tax rates. This chapter finds quantitative evidence that tax knowledge attributed to a CEO is positively related to corporate tax avoidance. This means that CEOs who are attributed with tax knowledge use that tax knowledge in the companies that employ them to reduce the amount of taxes paid. Furthermore, on a broader level, it supports the notion that CEO characteristics influence corporate behaviour in general, but also specifically in the area of corporate tax avoidance.

### 5.2 Paper synopsis

This study examines the relationship between corporate tax avoidance and corporate culture. The paper included in this chapter argues that CEO characteristics, as *upper-echelon* effects, can influence corporate tax avoidance not only directly, but also through their influence on corporate culture, which also influences corporate behaviour. In the previous chapter, Chapter 4, it was found that companies with long-term oriented cultures pay more tax on average than those that are more short-term oriented. Those findings address research objectives B, C and D, which are developed and stated in the introduction to this study. Those research objectives aim to understand, better, the determinants of corporate tax avoidance in large South African companies, through an investigation of the influence of long-termism, as a dimension of corporate culture, on corporate tax avoidance. The paper included in this chapter is related to an investigation into the influence of corporate culture on corporate tax avoidance; this is because the literature review indicates that CEOs can influence corporate culture and corporate behaviour, including corporate tax behaviour. Therefore, this paper advances the examination of the determinants of corporate tax avoidance in large South African companies; thus, the paper investigates the relationship between tax knowledge attributed to a CEO, as a CEO effect, and corporate tax avoidance. This paper addresses research objective 'E' which aims to investigate the relationship between CEO effects and corporate tax avoidance. This research objective is translated in this paper into two testable hypotheses which are investigated through quantitative methodology, using the method of regression analyses. The first hypothesis expects that companies where the CEO has above-average tax knowledge and tax awareness should be positively associated with tax avoidance, compared to companies where the CEO has less tax knowledge. The second hypothesis expects that if there is a rotation between CEOs with tax knowledge and CEOs who lack such knowledge, then this will influence tax avoidance over a period of time. For example, this hypothesis expects that companies will pay less tax in those periods when a CEO with tax knowledge was in control in

the companies, and *vice versa*. Together, these two hypotheses argue that the characteristics of a CEO influence corporate culture, which in turn affects levels of corporate tax avoidance. The literature review (Chapter 2) suggests a dearth of research regarding the association between CEO effects and corporate tax avoidance, particularly concerning a CEO's tax knowledge. This paper argues that there is an opportunity in the South African corporate environment to operationalise a CEO who is attributed with above-average tax knowledge, because a significant number of CEOs of large, listed companies in South Africa are chartered accountants (CAs). The paper explains that this CA qualification is a proxy for tax knowledge attributed to a CEO. It should be noted that a chartered accountants' skills set includes knowledge of corporate finance and corporate financial management, and its focus on shareholder value maximisation; it is argued that, because of this knowledge, chartered accountants as CEOs will be associated with more tax avoidance in the companies that employ them.

The paper employs cross-sectional regression, quantile regression, as well as fixed-effect regression to examine the relationship between corporate tax avoidance and tax knowledge attributed to the CEO (as a CEO effect). The results of fixed-effect regression show evidence of a positive relationship between corporate tax avoidance and this CEO effect, while the results of cross-sectional regression do not. The paper's findings support the evidence in the literature regarding the influence of CEOs on corporate culture and corporate behaviour, which can extend to the tax department, at the divisional level.

Of specific interest in this paper is its investigation into a claim by the chartered accountants' regulator, the South African Institute of Chartered Accountants (SAICA); thus, SAICA claims in an advertisement that the employment of chartered accountants helps save companies tax, which indicates a controversial and sensitive debate which is subject to empirical investigation.

### 5.3 Verbatim copy of academic paper

#### 5.3.1 Abstract

##### *The association between a CEO's tax awareness and corporate tax avoidance*

**Type:** *Research paper*

#### **Structured Abstract**

**Purpose** Corporate tax avoidance is a global problem. The possible influence of a CEO's tax knowledge and tax-awareness as a CEO effect, is investigated, which may help to explain this problem.

**Design** Linear techniques such as cross-sectional regression and fixed-effects regression are used to investigate the CEO's tax knowledge effect between companies, and within companies, over time, respectively. Effective tax rates are our proxy for corporate tax avoidance, while a CEO's status as being a registered South African chartered accountant is our proxy for a CEO's above-average tax knowledge.

**Findings** Cross-sectional regression results do not show a significant relationship between tax knowledge of a CEO and corporate tax avoidance, while results of fixed-effect regressions indicate evidence of a strong positive relationship between tax avoidance and tax knowledge attributed to the CEO.

**Social implications** A better understanding of the determinants of tax avoidance should be helpful to legislators and authorities to curb corporate tax avoidance.

**Contribution** The prevalence of CEOs who are qualified as chartered accountants in South Africa, is exploited to operationalise a CEO with above-average tax knowledge, showing evidence that this CEO effect is related to more corporate tax avoidance. Evidence of CEO characteristics as a influencer of corporate tax and other policies should be of value for regulators.

### 5.3.2 Introduction

An advertisement by the South African Institute of Chartered Accountants (SAICA) claims that South African chartered accountants<sup>28</sup> could help companies to pay less tax. A significant percentage of CEOs of large listed South African companies are registered as CAs (SAICA, 2014), (referred to as 'CA-CEO' hereafter); this is unique to the South African context. We identify an opportunity to operationalise the above-average tax knowledge and awareness of a CEO to test the merit of SAICA's claim. We investigate whether a CEO's tax knowledge or tax awareness is related to corporate effective tax rates as a proxy for corporate tax avoidance, sometimes referred to as tax management.

The effect of corporate tax avoidance is to reduce government's revenue, which often leads to higher tax rates being imposed, frequently leading to negative economic consequences (Feldstein, 1999). This explains the continual efforts by governments worldwide to reduce corporate tax avoidance (Organisation for Economic Co-Operation and Development (OECD), 2013). Understandably, tax avoidance draws criticism of the public when tax avoidance schemes come to light, as they did with the release of the Panama papers in 2016 (The International Finance Corporation, 2016). The determinants of tax avoidance attract the interest of both academic researchers and governments, who are all attempting to understand the problem better and to find possible solutions.

Research into tax avoidance often investigates the effects of CEOs on the levels of corporate tax avoidance. For example, Dyreng, Hanlon and Maydew (2010) investigated the association of individual CEOs and the level of corporate tax avoidance at the companies where they served. Some personal characteristics of CEOs such as their political party preferences were found to be related to corporate tax avoidance (Francis, Hasan, Sun & Wu, 2016). Dyreng *et al.* (2010) found that the idiosyncrasies of CEOs can influence corporate tax avoidance; this finding encouraged further research that investigated whether varying degrees of a CEO's tax expertise may be associated with varying levels of corporate tax avoidance. Dyreng *et al.* (2010) note, however, that CEOs are not usually tax experts, which makes it difficult to operationalise a CEO with tax experience. We argue that the nature of a CA's training in South Africa, which includes deep engagement with financial management and tax theory, is a viable proxy for a CEO with above-average tax knowledge and awareness.

We would expect more corporate tax avoidance, proxied by effective tax rates, for listed companies headed by CEOs who show higher degrees of tax knowledge and tax awareness than other CEOs. Our hypothesis is related to two theories. First, we argue that the South African chartered accountant's education at tertiary level moulds a professional with an inclination to pursue shareholder value creation. The combination of a CA's knowledge of taxation and financial management creates a propensity for that CA to encourage and effect corporate tax avoidance. The second theory involves Upper-echelon theory which posits the pervasive influence of individuals, as top

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<sup>28</sup>South African chartered accountants carry the designation CA (SA), ('CA' hereafter)

executives, on the corporate behaviour of people at lower levels in the hierarchy of the institution (Hambrick & Mason, 1984). We argue that a CEO with an above-average technical knowledge and awareness of tax, in combination with corporate financial management theory, has the propensity and proclivity to emphasise more efficient or more aggressive tax strategies to increase shareholder value. This appears to be the underlying message in SAICA's advert when it encourages companies to employ South African chartered accountants (SAICA, 2015) to save tax (See Annexure A for a copy of this advertisement).

We use South African data from the largest listed companies, in terms of market capitalisation, over the period of 15 years between 2005 and 2019. South African data is used because it allows us to operationalise a CEO with tax knowledge and awareness, as a CEO effect: circumstances unique to the South African setting. Financial data is obtained from Bloomberg's database and we use SAICA's website to verify whether a CEO is a registered chartered accountant. The data are used in univariate statistical techniques and multivariate regression analyses. We specify our regression equations with accounting effective tax rate (AETR) and cash effective tax rates (CETR) as the dependent variables which are both alternative proxies for corporate tax avoidance. It follows that our explanatory variable of interest is the level of tax knowledge (tax awareness) of a CEO, which is operationalised in this study as a dummy variable of '1' if the CEO of a company is in fact a CA-CEO, or a value of 0, otherwise. Lanis, Richardson, Govendir and Pazmandy (2020) also use binary dummy variables based on academic qualifications as an indicator for director-expertise in relevant disciplines; their study investigated the influence of a financial director's expertise on debt levels and tax avoidance.

Our first hypothesis expects an association between the level of a company's corporate tax avoidance and the CEO's level of tax knowledge. Our results provide weak support for this hypothesis as indicated by insignificant coefficients on the variable of interest based on cross-sectional OLS regression. Quantile regression provides some evidence of a significant effect of the CEO's tax knowledge on corporate tax avoidance, in companies with effective tax rates in the lowest percentile. This supports our expectation, but also emphasises the presence of an outlier effect at companies with low effective tax rates. The second hypothesis predicts an association between variations in tax avoidance within companies over time, in situations where CA-CEOs alternate with CEOs who are not CAs. The results of fixed-effect regressions, which consider the time-series dimension in the sample as well, provide some support for this hypothesis.

Our results provide evidence suggesting that CEOs with above-average tax knowledge and tax awareness may influence the corporate tax culture of companies, resulting in more corporate tax avoidance in those companies. This means that a CEO's tax knowledge is used to create shareholder value. The results support SAICA's claim in its advertisement (SAICA, 2015) where it encourages corporations and the public to engage chartered accountants to realise better tax "efficiencies." Our finding also provides some empirical evidence to support sentiments recently established in the South African media which cast doubt on the chartered accountancy profession insofar as it may be associated with aggressive, or even unethical behaviour. Marcus Jooste, a CA (SA), is widely blamed for the demise of

Steinhoff, a global furniture manufacturer and one of South Africa's largest listed companies, in 2017, because of accounting fraud (Bloomberg, 2017). Finally, our paper also contributes to a growing body of research that investigates the effects that CEO attributes have on corporate culture and corporate outcomes.

The paper is structured as follows. It starts with a literature review in Section 5.3.3 that depicts the setting for our paper and culminates in our two hypotheses. Section 5.3.4 describes the data and method. Sections 5.3.6 explains the use of ANOVA and regression, while 5.3.9 provides the results and discussion thereof. 4.13 concludes the paper.

### **5.3.3 Literature background and hypotheses**

The extant literature on quantitative research into corporate tax avoidance covers a range of firm-level and other factors construed as determinants of tax avoidance. Most papers operationalise tax avoidance using various forms of effective tax rates as a proxy. For example, Rego (2003) reports a positive relationship between company size and effective tax rates, while evidence by Richardson and Lanis, (2007) suggests a negative relationship. Yet, Gupta and Newberry (1997) and Kim and Limpaphayom (1998) do not find a relationship between effective tax rates and size. Rego (2003) reports a negative relationship between corporate tax avoidance and classification as multinational company, which appears to agree with the results of an earlier paper by Mills, Erickson and Maydew, (1998) that report a positive relationship between the number of foreign operations of a firm and costs incurred in tax planning. Richardson and Lanis (2007) investigate the influence of financial gearing and found mixed results between effective tax rates and debt levels, depending on the use of different denominators in the measure for level of tax avoidance. Gupta and Newberry (1997) report a negative relationship between effective tax rates and higher debt levels, a finding which supports earlier findings by Stickney and McGee (1982).

The effects of asset allocation are investigated: here, Richardson and Lanis (2007) report a positive relationship, using Australian data, between effective tax rates and the level of capital intensity of business operations. However, an earlier paper by Gupta and Newberry (1997) reported a negative relationship between effective tax rates and capital intensity. Markle and Shackelford (2011) found evidence that excessive ownership of intangible assets is used, particularly by multinational firms, to shift profits to low tax jurisdictions and thus obtain lower effective tax rates. The profitability of firms was investigated as a possible determinant of tax avoidance by Richardson and Lanis (2007) but mixed results were arrived at. However, Gupta and Newberry (1997) reported a positive relationship. Kim and Limpaphayom (1998) reported mixed results in an investigation of whether high-growth companies, proxied by higher market-to-book-values, are associated with more corporate tax avoidance. The investigation also extends to corporate social responsibility, given an ethical dimension to corporate tax avoidance. Corporate performance pertaining to social responsibility and governance (ESG) is the subject of a significant amount of academic debate as determinants of tax avoidance; however, there are mostly conflicting. Lanis and Richardson (2012a) report a negative association between ESG disclosure and tax avoidance based on Australian data, while Davis, Guenther, Krull and Williams (2016) find a relationship indicative of substitution between the constructs, based on US data.

CEO characteristics and other CEO effects are also investigated in the literature as possible determinants of corporate tax avoidance; this issue is related to the focus of this paper. These papers are related to 'Upper-echelon theory,' envisaged by Hambrick and Mason (1984) and positing that members of top management have highly personalised lenses which affect top-level decision making, and framing of decisions at lower levels, as their influence permeates and moulds corporate culture. This theory challenges the neo-classical view that corporate behaviour is mostly driven by positive economic optimisation theory. Kitchell (1995) reports that a CEO's personal views towards the use of technology are associated with a company's innovation rate. Ge, Matsumoto and Zhang (2011) find that a CFO's accounting choices are influenced by their individual characteristics, personal situations and prior experiences. Chen, Chang and Lee (2019) take Upper-echelon theory closer to corporate tax avoidance, arguing that CFOs with accounting experience should have tax planning knowledge and a propensity towards instilling a more-aggressive tax culture; they provide empirical evidence in support of their hypothesis. Dyreng, Hanlon and Maydew (2010) trace the effects of individual CEOs on tax avoidance, over time, from company to company where they served; they found strong evidence for the specific role that those individual members of top management play in corporate tax avoidance, incrementally, compared to other determinants of tax avoidance. Dyreng, Hanlon and Maydew (2010) state that CEOs are seldom tax experts, which is not a good basis for any investigations into relationships between the tax knowledge of the CEO and corporate tax avoidance. We argue, however, that the South African setting offers a unique exception to Dyreng *et al's* (2010) assertion about CEOs rarely having good tax knowledge. A significant percentage of CEOs of South African publicly-listed companies are CAs, and as such, have tax knowledge and a strategic tax awareness (SAICA, 2014). A significant amount of academic time is invested at the university level to educate the prospective CA in technical tax and tax legislative matters, and this knowledge is developed subsequently during the CA's three-year apprenticeship at accounting firms. Indeed, Taxation is one of only four primary courses taken as a key university subject for four years before a candidate CA is ready to attempt SAICA's qualifying exams. Tax-related knowledge and expertise coupled with financial management, auditing and financial accounting, combine in the CA's curriculum to form the cornerstone of the CA's integrated knowledge and skills-set platform (SAICA, 2017). This curriculum puts emphasis on the demonstrated ability of students to integrate acquired knowledge and theory across different subject disciplines; for example between tax and financial management knowledge. Scrutiny of a financial management textbook prescribed by universities who are accredited by SAICA, shows that students are coached comprehensively on capital appraisal techniques, and the overriding goal of maximising shareholder value. This discussion is accompanied with an admonishment to the implications of taxes that reduce shareholder value, together with suggestions regarding the optimal use of debt in capital structures to use the debt-tax shield (Correia, 2018). Conversely, a section of the SAICA-endorsed tax textbook says of tax avoidance that "*every man is entitled, if he can, to order his affairs so that the tax is less than it otherwise would be...*" (Lord Tomlin, in *Duke of Westminster V IRC 1953 (UK)* cited in Silke, 2017).

The prospective CA's journey after university also encourages a disposition towards shareholder value maximisation, and the use of reductions in taxes to achieve that. A significant percentage of candidate CAs enter the so called "big

4” accounting firms for internship. Sikka and Hampton, (2005:325) expound upon the instrumental role that big accounting firms play in tax avoidance. This culture could ‘rub off’ on prospective CAs before they leave their accounting firms having completed their internships, and they then proceed to pollinate that tax avoidance culture at future employers. Furthermore, SAICA obliges all qualified CAs to stay abreast of new developments in the disciplines of tax, accounting, or auditing through monitored participation in continuous professional development (CPD) programmes as a condition for continued registration as a CA (SAICA, 2020).

Arguably there are other lines of tertiary education, such as law, that may also equip a CEO with above-average tax knowledge or awareness. However, the CA’s integrated financial management-accounting and tax knowledge sets it apart from other tertiary education routes as far as propensity for corporate tax avoidance is concerned. Others may argue that the CEO’s influence on corporate tax affairs would be negligible, on the assumption that the CEO’s role is to focus on strategic coordination, and direction of the company, rather than on tax matters which are mostly left to the CFO, who may also be a CA (SA). We argue that the CA-CEO’s tax awareness, in addition to those skills and knowledge sets normally associated with the CEO, will make that CA-CEO more holistically predisposed than other CEOs to emphasise the importance of tax efficiencies as an available lever to create shareholder value. The CEO’s pervasive influence on an organisation’s values and assumptions, as well as on strategic adaptation to the external environment, are well-documented (See Davis, 1984; Quin & McGrath, 1984; Trice & Beyer, 1993 <sup>29</sup> cited in Tsui, Zhang, Wang, Xin & Wu, 2006 and Hambrick & Mason, 1984). The CEO’s responsibility for adaptation also extends to the tax environments, just as the CEO drives strategic adaptation in response to changes in other political, economic, social, environmental and other legislative factors as external environments (Gamble, Peteraf & Thompson, 2015). Therefore, the image of a CEO as a key organisational influencer armed with the integrated toolbox of tax and financial management attributable to a CA-CEO, suggests an ideal opportunity for a CA-CEO to encourage and achieve maximisation of shareholder value by applying corporate tax avoidance practices. We examine the CA-CEO’s influence from two perspectives. In the first hypothesis, that follows, we examine the effect that the level of a CEO’s tax knowledge has, with reference to different companies; this is termed the ‘between company effect.’ In the second hypothesis we examine whether variation over time in the tax knowledge of the CEO is associated with corporate tax avoidance. This is termed the ‘within-company’ effect.

Therefore, our hypotheses are formulated as follow:

### **Hypothesis I**

*H<sub>0</sub>: The CA-CEO effect between companies has no association with effective tax rates.*

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<sup>29</sup> Reasonable attempts to obtain the original papers were fruitless.

*H<sub>a</sub>: CA-CEO companies will be associated with lower effective tax rates.*

## **Hypothesis II**

*H<sub>0</sub>: The CA-CEO within company effect has no association with effective tax rates.*

*H<sub>a</sub>: CA-CEO within company effect is associated with lower effective tax rates.*

### **5.3.4 Data and method**

#### **5.3.4.1 Data**

This sample used as a basis for this study comprised all those public companies with a market capitalisation exceeding R4bn, listed on the Johannesburg Securities Exchange (JSE) on 31 December 2014. It excluded any such companies classified as Real Estate Investment Trusts ('REITS') because they are subjected to specific and individualistic tax regimes which could distort the calculation of effective tax rates. For example, tax legislation permits the taxation of REIT profits in the hands of shareholders as opposed to the company, in some cases. Banks and financial institutions were however retained in the sample, contrary to the practice applied in many other papers dealing with similar issues; they were retained because, we argue, these companies are also obliged to pay tax. Also, there is research suggesting the significant role that financial institutions, such as banks, often play as facilitators of corporate tax avoidance (Gallemore, Gipper & Maydew, 2019). Data were collected for the period from 2005 to 2019. This 15-year period includes a world-wide economic recovery after the global financial economic crisis in *circa* 2008. For South Africa it also marks the start of widespread governmental mismanagement and corruption after Jacob Zuma's appointment as president in 2009, which resulted in deteriorating levels of public trust in the South African government and a decline in tax morality (Visser, 2020). In the case of testing Hypothesis II it should be noted that this 15-year period increases the degree of variability in the variable of interest; this refers to instances when there is an alternation between CEOs in a given company with the CA qualification, and CEOs in that same company without it. The source of all the data is Bloomberg's database, while SAICA's website is accessed to verify the CA qualifications of CEOs.

Table 5-1, below, indicates the number of observations used in the regression models.

**Table 5-1 Sample composition**

	Type of regression	
	Cross-sectional regression	Fixed-Effect Regression
Companies with a market capitalisation exceeding R4bn on 31 December 2014.	112	112
Less: companies in sample with too many missing observations in respect of variables of interest.	(9)	(15) <sup>30</sup>
Number of companies in sample	103	97
Number of firm-year observations	N/A	1 455 <sup>31</sup>

### 5.3.4.2 Variables

Table 5-2, below, lists all the variable-abbreviations used in the regressions and analyses in this study. Expected correlation coefficients are indicated, based on the literature review, related to the dependent variables, AETR and CETR. These two variables are the proxy variables used in this study to measure corporate tax avoidance.

**Table 5-2 Variables description and expected coefficient sign**

Variable abbreviation	Expected sign on coefficient	Description and source of data
<i>AETR</i>	N/A	Accounting effective tax rate, calculated as the total tax expense as percentage of net profit before tax.
<i>CETR</i>	N/A	Cash effective tax rate, calculated as taxes paid as percentage of profit before tax.
<i>RAETR</i>	N/A	The three-year rolling average of AETR.
<i>RCETR</i>	N/A	The three-year rolling average of CETR.
<i>CACEO</i>	( - )	Dummy-variable of interest: "1" indicates companies having a CA as CEO, "0" for companies where CEO is not a CA.
<i>ESG</i>	( +/- )	Bloomberg's score for Environmental, Social and Governance
<i>ESG_CACEO</i>	( +/- )	Interaction term for mediating influence of ESG on CACEO.
<i>ROA</i>	( +/- )	Return on assets: an indicator for profitability, calculated as profit before tax, as percentage of total assets.
<i>LEV</i>	( - )	Leverage, calculated as long-term debt as percentage of total assets.
<i>CAPINTENS</i>	( +/- )	Value of fixed assets as percentage of total assets, as indication of capital asset intensity of the business model.
<i>INTANGR</i>	( +/- )	Value of intangible assets as percentage of total assets, as indication of the intensity of the use of intangible assets in the business model.

<sup>30</sup>More companies were excluded from the sample used for the fixed-effect regression than were excluded for the cross-sectional regression, as a fully balanced sample in terms of number of companies and years under observation is required for the Eviews statistical software.

<sup>31</sup>Fifteen firm-years for 97 different companies translate into 1 455 observations in a panel data setting.

Variable abbreviation	Expected sign on coefficient	Description and source of data
<i>LNMCAP</i>	( +/- )	Natural log of total market capitalisation, as an indicator of company size.
<i>PTB</i>	( +/- )	Ratio of market value of equity to book value of equity.
$\epsilon$		Error term in regression specifications. Contains a fixed element in the F-E regressions.
<i>INDUSTRIALS</i>	( +/- )	Industry dummy variable for companies involved in the industrial sectors.
<i>CGS</i>	( +/- )	Industry dummy variable for companies involved in consumer goods and consumer services sector.
<i>MMNR</i>	( +/- )	Industry dummy variable for companies involved in the minerals, mining, and natural resources sectors.
<i>FINANCIALS</i>	( +/- )	Industry dummy variable for companies involved in financial services, including banks and insurance sectors.
<i>HTI</i>	( +/- )	Industry dummy variable for companies involved in healthcare, telecommunications, or IT sectors.

\* Effective tax rates (AETR and CETR) are truncated between 0% and 100%, in line with Lanis *et al.*, (2020).

### 5.3.5 Descriptive statistics

Table 5-3, below, provides descriptive statistics.

**Table 5-3 Descriptive statistics**

Variables	Obs <sup>32</sup>	Mean	Std. Dev.	Min	Max
<i>AETR</i>	1604	27.023	16.527	0	100
<i>CETR</i>	1543	27.421	19.551	0	100
<i>CACEO</i>	1605	.317	.466	0	1
<i>ESG</i>	1504	34.71	14.493	5.785	66.529
<i>ROA</i>	1611	11.013	17.537	-132.741	344
<i>LEV</i>	1599	11.331	12.884	0	80.698
<i>CAPINTENS</i>	1600	28.333	24.579	0	92.606
<i>INTANGR</i>	1574	9.1	12.953	0	84.742
<i>LNMCAP</i>	1553	9.91	1.53	4.017	14.472
<i>PTB</i>	1561	3.166	3.951	-5.99	69.582

Table 5-4 below describes the distribution of sample over the five different industries studied.

<sup>32</sup>The number of observations is not consistent across all variables, which indicates the presence of missing variables. The cross-section regression is based on the average of available variables over the 15-year time series for each of the 103 companies in the sample, which permits calculation of an average to be used in the cross-sectional regression, despite some missing data points. In the case of fixed-effect regression, the sample of 112 companies is reduced to only 97 companies representing 1 455 firm-years as the Eviews requires a balanced sample to perform the fixed-effect regression. Missing independent variables in the panel data used for regression are imputed as the average of available data for each company in the sample.

**Table 5-4 Sample distribution between industries**

Industry	Industry abbreviation used in Regression Specifications	Number of companies (%)
Industrials	<i>INDUSTRIALS</i>	25 (22%)
Consumer Goods and Services	<i>CGS</i>	35 (31%)
Minerals, Mining and Natural resources	<i>MMNR</i>	18 (17%)
Financials	<i>FINANCIALS</i>	24 (22%)
Healthcare, Telecommunications, and IT	<i>HTI</i>	10 (8%)
<b>Total</b>		<b>112 (100%)</b>

The relatively high standard deviations recorded in Table 5-3 indicate the presence of outliers; in other words, data not perfectly normally distributed. However, these findings are still in accordance with those of Greeff (2019) who also explores South African effective tax rates (ETRs). AETR and CAPINTENS compare well with the averages reported by Greeff (2019). CACEO, at 31%, supports the evidence that a significant number of South African CEOs are CAs.

The developmental status of the South African economy is evident not only from relatively small levels of investment in intangible assets at only 8% of total assets, but also from the relatively strong representation of traditional industries such as *Industrials*, *CGS*, and *MMNR* while in contrast, *HTI* has a smaller presence. The total amount of intangible assets also includes goodwill, meaning that the actual percentage of intellectual assets in South African companies may be even less than the already-low 8% figure would suggest. Physical fixed assets represent, on average, 30% of companies' total assets; this indicates moderate levels of capital intensiveness and is also indicative of lower or more moderate wear-and-tear allowances being claimed by South African companies as tax deductibles. However, the presence of accelerated depreciation for tax purposes does not affect accounting ETRs directly as temporary differences do not influence the total tax expense in income statements. The average ESG score of 35% is low, indicating that South African companies are only moderately concerned with aspects related to corporate social responsibility.

The average AETR of 27% is close to , but still below the applicable statutory corporate tax rate of 28% in 2014. The average CETR of 27.42% is close to the AETR, but still below the statutory tax rate in 2014.

### **5.3.6 Research approach**

We use univariate and multivariate methods to investigate whether the CACEO variable explains variation in effective tax rates; use is made of analysis of variance (ANOVA) and multivariate regression analysis respectively, as described in the following sections.

### 5.3.6.1 ANOVA

We use ANOVA, with the CACEO variable as the explaining factor, to investigate whether differences in the average effective tax rates over the 15-year period are explained by the CACEO factor. We employ normal t-tests to assess whether differences in averages between groups are statistically significant. We present the averages between the two groups over time graphically in Table 5-5.

### 5.3.6.2 Multivariate regressions

Further to the univariate statistical analysis mentioned above, we use regression models to examine the relationship between tax knowledge of the CEO and corporate tax avoidance. Regression models are specified with two alternative versions of the dependent variable, AETR and CETR, because they are frequently used as proxies for tax avoidance (Dyreng, Hanlon & Maydew, 2008; Dyreng *et al.*, 2010; Hanlon & Heitzman, 2010; Lanis & Richardson, 2012b; Mills *et al.*, 1998; Richardson & Lanis, 2007). A CEO who has above-average tax knowledge and awareness is operationalised using the CACEO binary variable of '1', as explained before. Cross-section ordinary least squares (OLS) regression and quantile regression are used to investigate the 'between-company' effect of tax knowledge on corporate tax avoidance, while fixed-effect regression is used to examine the 'within-company' effect.

#### Hypothesis I

This hypothesis investigates the between-company effect of a CA-CEO. This is done using a cross-sectional ordinary least squares (OLS) regression. We calculate the average for each variable over the 15-year period, for use in the cross-sectional regression. This method is partly based on the technique followed by Dyreng *et al.* (2008) and Hanlon and Heitzman (2010). We argue that this approach provides a smoothing effect with regard to outlier data, over time, in which the temporary effect of unusual fluctuations is reduced. We also run a cross-sectional quantile regression to investigate possible outlier effects, considering the effects of the CACEO variable on different levels of the dependent variables.

#### Hypothesis II

This hypothesis investigates the 'within-company' effect of the CACEO variable of interest. A fixed-effect regression is used for this purpose; it is based on panel data that includes a cross-sectional as well a time-series component. This analysis provides evidence of the CACEO effect on effective tax rates within companies over a 15-year period; for example it should provide evidence regarding the outcome when a CA-CEO is replaced by a CEO without the CA qualification and *vice versa*. We use Estimated Generalised Least Square ("EGLS" hereafter), a type of Fixed-Effect ('F-E' hereafter) regression estimator to investigate the effect of a CA-CEO on effective tax rates, over time. The use of panel data involves a choice between either Fixed-Effect or Random Effects models as appropriate estimators. Generally, the Hausman test is performed to assess whether the Random Effects model may be more appropriate. However we proceed with the F-E-models for the following reasons. First, the Random Effects model is not

appropriate in this situation as it assumes random selection of observations and continuous replacement of sample observations; both these assumptions are violated in this study. Also, F-E-regressions as the superior model, help to address endogeneity concerns in estimations because they control for omitted or unobserved time-invariant variables in regression specifications (Bilinski & Eames, 2019). Therefore, we control for stable, but unobservable or unmeasurable company-specific characteristics, such as corporate culture which arguably is less dynamic over time. We use EGLS as our fixed-effect model as it results in more efficient coefficients and also, the technique uses transformed data to satisfy, better, violated OLS-assumptions; for example, heteroskedasticity and non-perfect normal distributions (Brooks, 2019:189). Stata and Eviews are used as statistical software for cross-sectional and F-E-regression, respectively.

The next section presents the models' specifications used in the regression analyses.

### 5.3.7 Cross-sectional regression specification (Hypothesis I)

Cross-sectional regressions are specified below.

$$AETR_i = \beta_0 + \beta_1 CACEO_i + \beta_2 ESG_i + \beta_3 ESG\_CACEO_i + \beta_4 ROA_i + \beta_5 LEV_i + \beta_6 CAPINTENS_i + \beta_7 INTANGR_i + \beta_8 LNMCAP_i + \beta_9 PTB_i + \beta_{10} INDUSTRY\_DUMMY_i + \varepsilon \quad (\text{MODEL 1})$$

$$CETR_i = \beta_0 + \beta_1 CACEO_i + \beta_2 ESG_i + \beta_3 ESG\_CACEO_i + \beta_4 ROA_i + \beta_5 LEV_i + \beta_6 CAPINTENS_i + \beta_7 INTANGR_i + \beta_8 LNMCAP_i + \beta_9 PTB_i + \beta_{10} INDUSTRY\_DUMMY_i + \varepsilon \quad (\text{MODEL 2})$$

These two regression specifications regress AETR and CETR as alternating proxies for corporate tax avoidance on CACEO, the variable of interest, which is the proxy for tax knowledge attributed to the CEO. The other variables are control variables, used as indicated in other studies in the literature review. The specifications could have benefitted from the inclusion of additional control variables; in particular, the multi-national status of companies, or whether the CFO of a company is a qualified chartered accountant or not. We do control for these omitted variables because fixed-effect regressions are used in section 3.6, which control for time-invariant omitted variables, such as multinational status. The qualification of the Chief Financial Officer (CFO) or level of tax knowledge attributed to the CFO is uncontrolled for in the specification. However, we argue that this variable is principally similar in nature to a fixed, time invariant variable across companies and over time, because most of the CFO's of listed companies in South Africa are chartered accountants (SAICA, 2016). This means that we isolate the CEO effect sufficiently.

### Quantile regression

The specifications for Model 1 and Model 2 are also used to perform quantile regressions to test for outlier effects. This is because the CACEO variable may have different effect sizes on different values of effective tax rates: the dependent variable as proxy for corporate tax avoidance. Quantile regressions are becoming widely used in finance

research, and because the technique is non-parametric, we use it in our analysis since our data is not perfectly normally distributed (Brooks, 2019).

### 5.3.8 Fixed-effect regression specifications (Examining Hypothesis II)

$$AETR_{it} = \beta_0 + \beta_1 CACEO_{it} + \beta_2 ESG_{it} + \beta_3 ESG\_CACEO_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 CAPINTENS_{it} + \beta_7 INTANGR_t + \beta_8 LNMCAP_{it} + \beta_9 PTB_{it} + \varepsilon . \quad (\text{MODEL 3})$$

$$CETR_{it} = \beta_0 + \beta_1 CACEO_{it-1} + \beta_2 ESG_{it} + \beta_3 ESG\_CACEO_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 CAPINTENS_{it} + \beta_7 INTANGR_t + \beta_8 LNMCAP_{it} + \beta_9 PTB_{it} + \varepsilon . \quad (\text{MODEL 4})$$

$$RAETR_{it} = \beta_0 + \beta_1 CACEO_{it} + \beta_2 ESG_{it} + \beta_3 ESG\_CACEO_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 CAPINTENS_{it} + \beta_7 INTANGR_t + \beta_8 LNMCAP_{it} + \beta_9 PTB_{it} + \varepsilon . \quad (\text{MODEL 5})$$

$$RCETR_{it} = \beta_0 + \beta_1 CACEO_{it} + \beta_2 ESG_{it} + \beta_3 ESG\_CACEO_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 CAPINTENS_{it} + \beta_7 INTANGR_t + \beta_8 LNMCAP_{it} + \beta_9 PTB_{it} + \varepsilon . \quad (\text{MODEL 6})$$

$$AETR_{it} = \beta_0 + \beta_1 CACEO_{it-1} + \beta_2 ESG_{it} + \beta_3 ESG\_CACEO_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 CAPINTENS_{it} + \beta_7 INTANGR_t + \beta_8 LNMCAP_{it} + \beta_9 PTB_{it} + \varepsilon . \quad (\text{MODEL 7})$$

$$CETR_{it} = \beta_0 + \beta_1 CACEO_{it-1} + \beta_2 ESG_{it} + \beta_3 ESG\_CACEO_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 CAPINTENS_{it} + \beta_7 INTANGR_t + \beta_8 LNMCAP_{it} + \beta_9 PTB_{it} + \varepsilon . \quad (\text{MODEL 8})$$

Models 3 and 4 present the baseline FE-regressions. Models 5 and 6 follow the same specification, but the dependent variables are recalculated to present the rolling three-year average of the dependent variable used in Models 5 and 6 to examine the robustness of AETR and CETR, the proxies for corporate tax avoidance. This provides some assurance to limit endogeneity arising from simultaneity; here it is perhaps possible that the dependent variable may influence the explanatory variables. Furthermore, calculating and using rolling averages provides a smoothing effect to control for excessive fluctuations in effective tax rates which may resolve in future periods. Models 7 and 8 follow the same specification in the baseline models; however, we include one-year lagged forms for the CACEO variable of interest to establish whether the CACEO effect may be carried over from a previous year. The inclusion of the interaction term ESG\*CACEO aims to investigate whether the CACEO effect is impacted by the level of corporate concern for corporate social responsibility and corporate governance. Industry dummy variables are not included, because these are dropped in fixed-effect regressions.

### 5.3.9 Results

#### 5.3.9.1 Differences between group means: (ANOVA)

We calculate the average AETR % and CETR % for the two different CEO groups (CEO and CACEO) for every time period in the data sample and use t-tests to investigate the difference in means. The ANOVA results for differences in

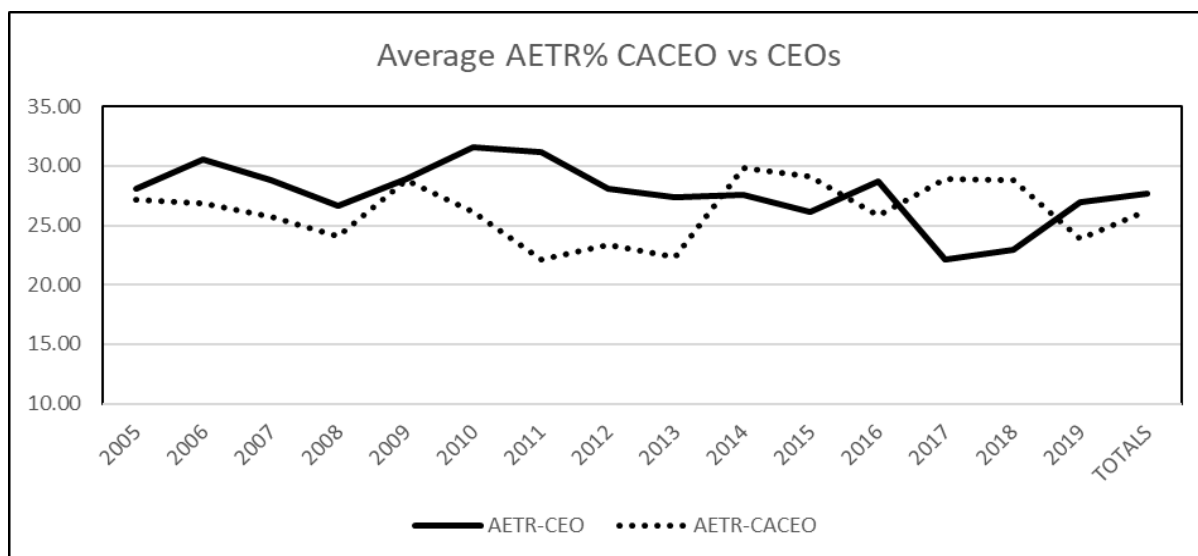
averages in AETR and CETR are presented in Table 5 below. This is followed by Figure 5-1 and Figure 5-2 which present, graphically, the data in Table 5-5 below.

**Table 5-5 Average AETR% and CETR% over time: CACEO vs CEO**

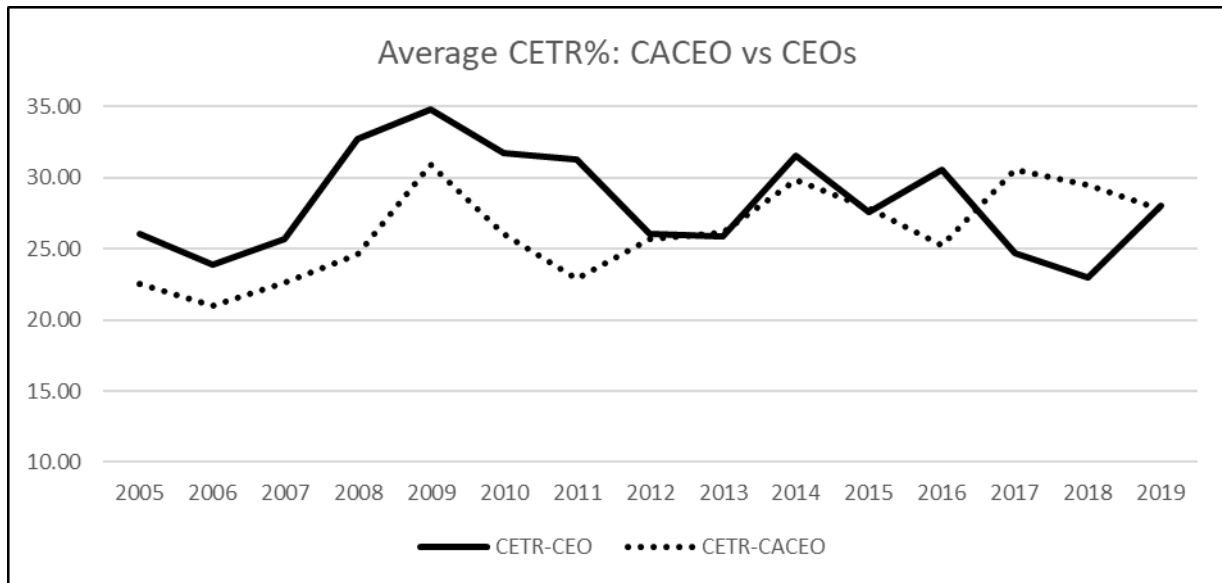
Year	AETR-CEO	AETR-CACEO	CETR-CEO	CETR-CACEO
2005	28.12	27.21	26.06	22.54
2006	30.59	26.87	23.84	21.01
2007	28.81	25.72	25.73	22.62
2008	26.70	24.05	32.73	24.57*
2009	28.90	28.84	34.76	30.88
2010	31.53**	26.14	31.70	26.05
2011	31.20***	22.16	31.26	22.92**
2012	28.13	23.32	26.02	25.68
2013	27.33	22.29	25.83	26.15
2014	27.62	29.88	31.56	29.83
2015	26.16	29.07	27.56	27.82
2016	28.71	25.81	30.60	25.27
2017	22.12**	28.88	24.68	30.52
2018	22.92*	28.83	22.95	29.45
2019	26.96	23.89	28.04	27.77
<b>TOTALS</b>	<b>27.72</b>	<b>26.20</b>	<b>28.22</b>	<b>26.21</b>

\*\*\*, \*\*, and \* denote statistical significance at the 1%, 5% and, 10% levels respectively (t-tests)

The average AETR and CETR for the two groups of CEOs (CACEO and CEO) over the 15-year period under observation are plotted below.



**Figure 5-1 Average accounting effective tax rates % CACEO vs CEO 2005-2019**



**Figure 5-2 Average cash effective tax rates: CACEO vs CEO 2005-2019**

The dotted line represents the effective tax rates of those companies where the CEO is attributed with tax knowledge; this dotted line falls below the solid line for long periods, which indicates more tax avoidance in those periods. Note however that there are some exceptions. With regard to AETR in Figure 5-1, this trend is visibly broken in the period 2014-2016, and again during 2017-2019. In Figure 5-2, the CACEO rate is almost always lower, but higher in the period from 2017-2019. This graphical depiction provides some support for our hypothesis that tax knowledge attributed to the CEO should be associated with lower effective tax rates. The results of the ANOVA analysis are depicted in Table 5 above, but provide less support in terms of our hypothesis in a univariate environment; thus, the differences between group-means are significant only in some years. For example, statistically significant differences between factor treatment groups are evident in 2008, 2010 and 2011 where there is some evidence that CACEO groups have lower effective tax rates than the CEO groups. However, the data suggests lower effective tax rates for CEO groups in 2017 and 2018

This means that lower effective tax rates, as visually observed, can be attributable to other factors, which suggests the use of multivariate statistical methods, such as regression in the next section.

### 5.3.9.2 Univariate analysis

**Table 5-6 Correlation table for variables used in this paper**

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) AETR	1.000									
(2) CETR	0.730***	1.000								
(3) CACEO	-0.049*	-0.046*	1.000							
(4) ESG	0.067***	0.055**	-0.048*	1.000						
(5) ROA	0.045*	0.052**	-0.092***	-0.096***	1.000					
(6) LEV	-0.027	0.007	0.071***	0.043*	-0.122***	1.000				
(7) CAPINTENS	0.019	-0.022	-0.117***	0.241***	0.056**	0.341***	1.000			
(8) INTANGR	0.025	0.054**	-0.015	-0.038	0.001	0.302***	-0.115***	1.000		
(9) LNMPCAP	0.006	-0.029	-0.028	0.485***	0.024	0.104***	0.072***	0.084***	1.000	
(10) PTB	0.060**	0.032	-0.072***	-0.053**	0.598***	0.046*	0.055**	0.052**	0.066***	1.000

\*\*\*, \*\*, \* indicates statistical significance at the 1%, 5% and 10% levels respectively (t-tests)

AETR and CETR are alternative proxies for corporate tax avoidance. CACEO is a dummy variable that indicates whether the CEO of a company is a South African chartered accountant, CA(SA), which is the proxy used in this paper as an indication of a CEO's tax knowledge. ESG is a proxy variable for corporate social responsibility and corporate governance, based on Bloomberg's database. ROA is defined as profit before tax as a percentage of total assets, LEV is defined as the ratio of total liabilities to total debt, CAPINTENS is defined as the ratio of fixed assets as a percentage of total assets, INTANGR is defined as the ratio of intangible assets as a percentage of total assets, LNMPCAP is the natural logarithm of the market value of the company's equity and PTB is defined as the ratio of market price of shares to book-value.

The correlation results presented in Table 5-6 above indicate evidence of moderate to weak correlations between the variables used in this paper. There is evidence of some statistically-significant negative correlations between CACEO, and the proxies for corporate tax avoidance (AETR and CETR). This provides univariate evidence in support of our overall hypothesis that expects more tax avoidance in those instances where the CEO is attributed with tax knowledge, generally speaking. The correlation between LEV and both forms of effective tax rates (AETR and CETR) is negative, as predicted from the literature. The statistically significant negative correlation between ESG and ROA may be indicative of a trade-off between company profitability and concern for ESG aspects which may come at a cost for profitability and perhaps lower effective tax rates to compensate companies for costs incurred. Lastly, our correlation results are similar to those of recent South African research by Greeff (2019) who also reports relatively moderate to weak correlation coefficients.

### 5.3.9.3 Cross-sectional regression

We did cross-sectional regressions on the meaned firm variables to investigate the association between CACEO and effective tax rates between companies. Thus, we calculated the 15-year average for each of the variables used in the specification, which then allowed us to perform cross-sectional regressions to examine the effect between companies. The technique of using averages of variables over 15 years reduces the noise of outlier data but also compensates for some instances of missing data for some observations.

**Table 5-7 Cross sectional regression results: Models 1 and 2**

Regressors	Model 1	Model 2
	AETR	CETR
CACEO	-2.122	-4.606
ESG	0.170	0.176
ESG*CACEO	0.003	0.055
ROA	0.013	-0.023
LEV	-0.064	-0.026
CAPINTENS	0.013	-0.042
INTANGR	-0.008	-0.028
LNMCAP	-0.541	-0.706
PTB	0.437	0.806
CGS	-0.940	-2.807
MMNR	-3.728	-6.420*
FINANCIALS	-0.156	-2.972
	(3.439)	(4.057)
Constant	27.204***	31.200***
Observations	103	103
R-squared	0.095	0.131

\*\*\*, \*\*, and \* denote statistical significance at the 1%, 5% and, 10% levels respectively (t-tests)

AETR and CETR are alternative proxies for corporate tax avoidance. CACEO is a dummy variable that indicates whether the CEO of a company is a South African chartered accountant, CA(SA), which is the proxy used in this paper as the indicator of a CEO's tax knowledge. ESG is a proxy variable for corporate social responsibility and corporate governance, based on Bloomberg's database, ROA is defined as profit before tax as a percentage of total assets, LEV is defined as the ratio of total liabilities to total debt, CAPINTENS is defined as the ratio of fixed assets as a percentage of total assets, INTANGR is defined as the ratio of intangible assets as a percentage of total assets, LNMCAP is the natural logarithm of the market value of equity, PTB is defined as the ratio of market price of shares to book-value of companies. CGS, MMNR, and FINANCIALS are dummy variables indicating specific industry-membership. HTI and INDUSTRIALS omitted due to multicollinearity. All the variables are meaned over 15 years, except for the industry dummy variables.

The results of these regression models do not provide statistically significant support for our main hypothesis, although the negative signs on the CACEO coefficient are consistent with the hypothesis that a CACEO would be associated with lower effective tax rates for both models. The low correlation coefficient in both models suggest a weaker explanatory power of the model; however, this outcome is consistent with other comparable research results in the South African context (Greeff, 2019). A statistically significant and negative coefficient on the CACEO variable of interest would have indicated that the tax knowledge of the CEO is associated with lower effective tax rates as the proxy for corporate tax avoidance. Conversely, a positive sign would mean that CEOs attributed with tax knowledge are associated with companies with higher effective tax rates, on average; this would have meant that those companies experience less tax avoidance. The absence of any statistically significant coefficients on the CACEO variable of interest indicate that there is no evidence to support the position that a CEO's tax knowledge explains variations in effective tax rates between companies. It could, however, mean that the effect is not detected by the statistical analysis because of an inadequate regression model specification. The results of this OLS regression indicate that the 'between-effect' is not pronounced. Quantile regression on OLS results is discussed in the next section to obtain a better understanding of the relationship between tax knowledge of the CEO and corporate tax avoidance.

#### *Quantile regression*

The results of the quantile regressions for AETR and CETR are provided in Appendix A. The presence of outliers in our data, together with the normality concerns described previously, support the use of quantile regression to investigate the effect of the CACEO variable in the tails of the distribution of AETR and CETR as the dependent variables. An outlier effect is present, as suggested in the results of the quantile regression, indicating a strong and statistically significant negative association of CACEO in the lowest percentiles of both AETR and CETR. This means that the effect of having a CEO with tax knowledge is negatively associated, to a degree that is statistically significant, with effective tax rates, especially in those very low ranges of effective tax rates. This evidence provides some support for the hypothesis that CEOs attributed with tax knowledge are associated with lower effective tax rates in some instances; this indicates an increase in levels of corporate tax avoidance.

The following section examines the results of the F-E-regression (Models 3-8), which was applied to examine the effect of CACEO within companies, over time, as CA-CEOs alternate with CEOs.

#### **5.3.9.4 Fixed-effect regression results**

The results of the fixed-effect regression as well as random effects regression models are presented in Table 5-8 and Table 5-9, below. Table 5-9 shows the results of Models 3-8, but run using Random-effects. It also reports the results of the Hausman test used to determine the appropriateness of the FE-models.

**Table 5-8 Fixed-effect regression results (Models 3-8)**

	Model 3		Model 4		Model 5		Model 6		Model 7		Model 8	
	AETR		CETR		RAETR		RCETR		AETR Lag1		CETR Lag1	
Regressors	Coeff	Prob	Coeff	Prob	Coeff	Prob	Coeff	Prob	Coeff	Prob	Coeff	Prob
CACEO (-1)									*-1.00059	0.0859	-1.30501	0.2211
CACEO	** -1.48341	0.0131	-1.29902	0.3486	0.315876	0.7271	***-3.15903	0.0042	-0.75553	0.2532	-0.5883	0.6642
ESG	** -0.05592	0.0159	** -0.05575	0.0439	*** 0.080159	0.0003	*** 0.198962	0.0000	*** -0.07849	0.0000	*** -0.0799	0.0096
ESG*CACEO	** 0.04330	0.0292	* 0.083013	0.1113	* 0.061831	0.0373	*** 0.154394	0.0015	*** 0.044769	0.009	* 0.087122	0.0918
ROA	-0.00660	0.8753	0.055265	0.017	-0.0108	0.6985	0.006447	0.8304	-0.00213	0.9626	0.057365	0.0167
LEV	-0.02294	0.0676	0.068805	0.0809	0.060852	0.0501	0.111058	0.0183	-0.01522	0.2226	0.08369	0.0483
CAPINTENS	0.051799	0.0006	0.052928	0.2288	0.001457	0.9746	0.040803	0.4625	0.046276	0.0044	0.047064	0.2739
INTANGR	-0.04703	0.1019	-0.06712	0.0837	-0.07239	0.0534	-0.10412	0.0008	-0.05649	0.033	-0.05374	0.2015
LNMCAP	-1.17678	0.0000	-0.79676	0.0625	-3.00479	0.0000	-2.92116	0.0000	-1.10002	0.0000	-0.986	0.062
PTB	0.262085	0.0000	-0.55698	0.0000	0.142323	0.0353	-0.54402	0.0000	0.226455	0.0019	-0.49034	0.0043
C	39.52083	0.0000	36.04713	0.0000	60.7389	0.0000	58.06291	0.0000	39.91779	0.0000	38.87501	0.0000
R <sup>2</sup>	0.5546		0.5621		0.7808		0.5259		0.5879		0.561852	
F-stat	0.0000		0.0000		0.0000		0.0000		0.0000		0.0000	
No Obs	1 455		1 455		1 455		1 455		1 455		1 455	
Groups	97		97		97		97		97		97	

\*\*\*, \*\*, \* indicates statistical significance at the 1%, 5% and 10% levels (t-tests) for CACEO; CACEO(-1); ESG; ESG\*CACEO

AETR and CETR are alternative proxies for corporate tax avoidance and are the regressands in the models. CACEO is a dummy variable that indicates whether the CEO of a company is attributed with tax knowledge or not. CACEO(-1) is the CACEO variable, lagged for one year. ESG is a proxy variable for corporate social responsibility and corporate governance, based on Bloomberg's database, ESG\*CACEO is an interaction term on the CACEO dummy variable to assess the mediating effects of the ESG-variable on effective tax rates. ROA is defined as profit before tax as a percentage of total assets, LEV is defined as the ratio of total liabilities to total debt, CAPINTENS is defined as the ratio of fixed assets as a percentage of total assets, INTANGR is defined as the ratio of intangible assets as a percentage of total assets, LNMCAP is the natural logarithm of the market value of equity, PTB is defined as the ratio of market price of shares to book value of companies. C is the constant. The data source is Bloomberg and the sample consists of the 97 largest companies by reference to market capitalisation. All the models are run using EGLS on E-Views. Models 3 and 4 are the baseline models in which AETR and CETR are regressed on CACEO, the variable of interest. Models 5 and 6 use rolling averages of AETR and CETR to assess endogeneity from simultaneity. Models 7 and 8 regress AETR and CETR on one-year-lagged values of CACEO to assess spill-over effects of CACEO from the previous year.

**Table 5-9 Random-effects regression results (Models 3a-8f)**

	Model 3 a		Model 4 b		Model 5 c		Model 6 d		Model 7e		Model 8f	
	Coeff	Prob	Coeff	Prob	Coeff	Prob	Coeff	Prob	Coeff	Prob	Coeff	Prob
CACEO (-1)									-1.7502	0.3716	-3.95775	0.0836
CACEO	* -4.47058	0.078	*** -8.62141	0.0043	-22.3733	0.1833	-15.4878	0.3668	-2.94818	0.3366	-5.60821	0.1184
ESG	* 0.016867	0.7247	0.043265	0.449	0.284112	0.3616	0.562119	* 0.0802	3.59E-05	0.9994	0.023637	0.6916
ESG*CACEO	* 0.122663	0.0706	*** 0.220859	0.0063	** 0.962331	0.0326	0.483216	0.2928	0.111428	0.1195	** 0.216535	0.01
ROA	0.060797	0.0862	0.071642	0.0892	-0.04143	0.8608	-0.32056	0.1824	0.068574	0.0669	0.083196	0.058
LEV	-0.06864	0.124	0.072763	0.1715	0.50761	0.0818	0.430008	0.1517	-0.05118	0.2835	0.10675	0.0577
CAPINTENS	0.050786	0.0959	0.012613	0.7313	0.346506	0.0599	0.469042	0.0173	0.047679	0.1335	-0.00314	0.9342
INTANGR	0.009966	0.8454	0.005147	0.9332	-0.12562	0.6917	-0.23143	0.4895	-0.00809	0.8781	-0.0143	0.82
LNMCAP	-0.87085	0.0483	-1.08705	0.0399	-5.04201	0.0654	-5.47141	0.0583	-0.7501	0.1067	-1.14744	0.0385
PTB	0.269936	0.0663	-0.3295	0.0597	-0.67501	0.4872	-1.39706	0.1595	0.227214	0.1547	-0.32563	0.0826
C	33.2892	0.0000	35.8979	0.0000	59.60774	0.0196	62.42868	0.021	32.97446	0.0000	37.83441	0.0000
R <sup>2</sup>	0.0126		0.01573		0.0182		0.0222		0.01165		0.017019	
F-stat	0.0309		0.00625		0.00158		0.0001		0.0104		0.010067	
No Obs	1 455		1 455		1 455		1 455		1 455		1 455	
Groups	97		97		97		97		97		97	
Chi-square stat	10.44	0.316	16.55	0.0562	8.3264	0.0504	9.1678	0.4219	12.0798	0.2797	16.85078	0.0777

\*\*\*, \*\*, \* indicates statistical significance at the 1%, 5% and 10% levels (t-tests) for CACEO; CACEO(-1); ESG; ESG\*CACEO

AETR and CETR are alternative proxies for corporate tax avoidance and the regressand in the models. CACEO is a dummy variable that indicates whether the CEO of a company is attributed with tax knowledge or not. CACEO(- 1) is the CACEO variable lagged for one year. ESG is a proxy variable for corporate social responsibility and corporate governance, based on Bloomberg's database, ESG\*CACEO is an interaction term on the CACEO dummy variable to assess mediating effects of ESG-variable on effective tax rates. ROA is defined as profit before tax as a percentage of total assets, LEV is defined as the ratio of total liabilities to total debt, CAPINTENS is defined as the ratio of fixed assets as percentage of total assets, INTANGR is defined as the ratio of intangible assets as a percentage of total assets, LNMCAP is the natural logarithm of the market value of equity and PTB is defined as the ratio of market price of shares to the book value of companies. The data source is Bloomberg and the sample consists of the 97 largest companies by reference to market capitalisation. All the models are run using ECLS on E-views. Models 3 and 4 are the baseline models in which AETR and CETR are regressed on CACEO, the variable of interest. Models 5 and 6 use rolling averages of AETR and CETR to assess endogeneity from simultaneity. Models 7 and 8 regress AETR and CETR on one- year-lagged values of CACEO to assess spill-over effects of CACEO on future years. The Chi-square statistic is provided: this indicates that the coefficients of the Random-effects models as supplied above should be rejected in favour of the adoption of the fixed-effect regression in Table 8a, as being valid. Significance of the models overall, in the case of Table 8a, also indicate a more valid representation pertaining to FE models.

### 5.3.10 Discussion of regression results

The F-E-results suggests some support for our main hypothesis, which expects lower effective tax rates in those companies where the CEO is attributed with tax knowledge. The result of Model 3 indicates a statistically significant negative coefficient on CACEO, while Model 5 indicates a statistically significant negative coefficient on the CETR, based on a rolling three-year average. In Model 7, the Lagged CACEO shows a negative, statistically significant coefficient which supports Hypothesis II: that is, a negative association can be expected between the tax knowledge attributed to the CEO and corporate tax avoidance. The coefficients on CACEO are also economically significant, indicating at least a 1% average drop in effective tax rates for those instances where a CA had been the CEO. These results also agree with the visual depiction of effective tax rates in Figure 5-1 and Figure 5-2 above, which implies lower effective tax rates for companies headed by a CACEO. A significant effect on the CACEO proxy variable is not reported on all models, however. A positive coefficient on the CACEO variable would indicate that CEOs with tax knowledge attributed to them are associated with lower tax avoidance, while a negative coefficient indicates an association between tax knowledge of the CEO and more tax avoidance. The absence of any effect indicates that the tax knowledge of the CEO has no influence on tax avoidance.

The ESG variable shows a statistically significant and negative association with effective tax rates for most models: this indicates a substitution effect between tax compliant behaviour and commitment to corporate social responsibility in large South African companies. This evidence seems to agree with the findings reported by Davis *et al.* (2016) based on a sample of large US listed companies. In view of widespread government corruption in South Africa since 2009, this result is perhaps not surprising; it may perhaps be explained by corporates opting to give their support to social causes directly, instead of paying government taxes, which they may regard as an inefficient conduit to benefit the wellbeing of society. This may provide evidence that South Africa mirrors the US experience with regard to ESG's negative association with effective tax rates. This finding deserves to be noted in view of the opposite association reported by Lanis and Richardson, (2012b) using Australian data; Australia is a country with many similar features to South Africa. The CACEO-ESG interaction term is positive and mostly statistically significant. This can be interpreted as evidence that where lower effective tax rates are encouraged or effected by tax-knowledgeable CEOs, this effect is tempered to some extent by a company's commitment towards ESG. It could be interpreted as a push-back by corporate cultures sensitive to principles of social responsibility, against the attempts by tax-knowledgeable CEOs to avoid tax.

In the case of the ROA variable's coefficient, the results of the analysis were mixed with regard to the sign on that coefficient; however, most models provided insignificant findings for this coefficient and the same finding also applied for the coefficient on LEV. The LEV coefficient is particularly insignificant from a practical economic perspective. The coefficients on CAPINTENS are significantly positive throughout, but again appear to be insignificant from an economic perspective.

The coefficient of INTANGR is negative to a statistically significant extent in most models; this finding corresponds to the findings of Markle and Shackelford, (2011); thus, it provides further evidence that companies with higher investment in intangible assets are mostly able to reduce tax burdens, perhaps indicating scope for the use of transfer pricing or profit shifting to lower tax jurisdictions.

The coefficient sign on LNMCAP, as proxy variable for company size, suggests a strong and statistically significant negative association between size and effective tax rates in all the models. This result agrees with Richardson and Lanis (2007) who argue that larger companies may have access to more financial resources that they can use to engage more and better tax consultants. Conversely, corporate size may also be useful in terms of providing opportunities to those larger companies to structure supply chains and locations of operations to derive favourable tax positions globally.

### **5.3.11 Robustness, limitations, and scope for future research**

Our results indicate some evidence of a negative relationship between AETR and CACEO, the variable of interest; this finding is congruent with our overall hypothesis. We employ some measures to examine the robustness and validity of our results; this entails using well-specified regression equations in all our models. These utilise most of the control variables used by other researchers into tax avoidance, as indicated in the literature survey of corporate tax avoidance. In addition to AETR, our dependent variable, we also use CETR as an alternative form of the dependent variable as both aim to measure corporate tax avoidance as the construct of interest. In our study, the coefficients are negative for both forms of the dependent variable, but not significantly so for CETR. However, CETR is negative to a statistically significant degree when we calculate and use the three-year rolling average of CETR; this finding provides some evidence of the robustness of our results pertaining to CETR. We accept that our results may be caused by outlier effects in our data and so we used the process of winsorisation at the 2% level, after which our results still hold. Winsorised results are not provided in this paper because of space constraints.

We also attempted to address endogeneity concerns, which may be present. Thus, we control for the effect of time-invariant omitted variables using fixed-effect regressions, which control for the omitted variable dimension of endogeneity. Also, we control for other company-specific characteristics that are believed to stay constant over time. Furthermore, we calculate rolling three-year averages for AETR and CETR as dependent variables, then run the same regressions using these rolling three-year average values as the dependent variables, to see whether the initial results still hold. The intention is to control for the concept of simultaneity which may be a source of endogeneity. For instance, we aim to test whether the dependent variable is not actually affecting the regressors or *vice versa*. Our results here appear to be robust with regard to rolling CETR (Model 6) but not pertaining to AETR (Model 5)<sup>33</sup>.

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<sup>33</sup> 3-year rolling averages for AETR and CETR are calculated in this section of the study, but not for Chapter 5, which investigates the influence of long-term orientation. The EGLS regression tool used in E-views in this chapter required a perfectly balanced

Furthermore, we determine the effect of one-year lagged values of CACEO, on both AETR and CETR, in which the former retains a significant negative coefficient. Finally, we also test for evidence of stationarity and the absence of a unit root in the time series component in our panel data; here it is possible that a non-stochastic trend may be driving effective tax rates over the 15-year period under review. Various tests for panel stationarity consistently suggest a stationary process for the dependent variables, in the absence of a unit root. Results are not tabulated in this paper because of space constraints.

It is admitted that the statically significant effect reported on the ESG\*CACEO interaction variable (pertaining to the fixed-effect regressions performed) could be attributable to the governance disclosure score which is subsumed in the total ESG score used. However, EGLS regression in E-views requires perfectly balanced samples, which necessitated imputation of some missing ESG scores. When the models are run without the ESG-score in the specifications, the coefficient on the CACEO variable is no longer statistically significant. This result may be attributable to little variation in the CACEO-variable over the available observations, but it could also indicate less robust result in this regard.

The main limitation to our study is its small sample size when compared to other international studies; this is because of the South African setting where there are relatively few large, listed companies. Although our sample is comparatively small, it is nevertheless significantly large in the South African context because it constitutes more than 90% of the total market capitalisation of all listed companies on South Africa's Johannesburg Stock Exchange (Raubenheimer, 2010). Also, the CEO effects that we report may not necessarily be universally applicable to CEOs of companies in other countries. More specifically, national culture may also have an influence on corporate tax avoidance (Tsakumis, Curatola & Porcano, 2007). It is possible that our operationalisation of a CEO with higher-than-average tax knowledge and awareness is not necessarily perfect, which may suggest some noise in the results. However, most proxies are inherently imperfect for latent constructs; this suggests some scope for further research to improve the way of measuring CEO effects.

### **5.3.12 Conclusion**

This paper examines the relationship between the amount of tax knowledge of a CEO, as a CEO effect, and corporate tax avoidance. We measure corporate tax avoidance using effective tax rates, and we measure the tax knowledge of a CEO based on whether that CEO is a South African chartered accountant. We hypothesise that a CEO with tax knowledge is more inclined to effect corporate tax avoidance than a CEO lacking such knowledge. We investigate the effect of a CEO's tax knowledge both 'within-companies' over time using fixed-effect regression, and cross-sectional regression to examine the 'between-company' effect. The results of fixed-effect regression provide some evidence of

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sample, which necessitated that some values were imputed. Rolling averages for AETR and CETR were considered to evaluate the reasonability of imputed values.

a statistically negative association between effective tax rates and the CEO's tax knowledge; this finding supports our hypothesis for lower effective tax rates. The results of cross-sectional regression do not provide evidence of a between-company effect of tax knowledge attributed to the CEO and corporate tax avoidance; therefore, we reject our first hypothesis. It is possible, however, that the effect of the CEO's tax knowledge is not detected by the regression specification. We accept that the proxy used for tax knowledge of the CEO is not perfect, but we exploit an opportunity to measure this CEO effect bearing in mind that a significant percentage of large, listed South African companies are headed by CEOs who are chartered accountants. Our results extend the amount of research dealing with the effect of CEO characteristics on corporate behaviour, as encouraged by Dyreng (2008), who found evidence of the influence of individual CEOs and corporate tax avoidance in the US. The results of the fixed-effect regression provide an interesting insight into an interaction term with ESG and the proxy variable for tax knowledge of a CEO. The regression result provides evidence of a positive association with the interaction term and effective tax rates as the dependent variable. This indicates that the CEO's effect in increasing levels of corporate tax avoidance is tempered or offset to some degree by the ESG effect, which becomes stronger when controlled for in the regression. If one assumes that a company's disposition on ESG is stable, then this finding shows that corporate culture remains influential despite a strong CEO influence on corporate behaviour.

More research is encouraged in order to improve our understanding of the relationship between CEO effects and in particular, tax knowledge attributed to a CEO. A better proxy for tax knowledge of a CEO could be developed and tested, while larger samples could identify relationships which our smaller sample could not.

### 5.3.13 References of this paper

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Regressors	Quantile Regression on cross-sectional results								
	Pctl10	Pctl20	Pctl30	Pctl40	Pctl50	Pctl60	Pctl70	Pctl80	Pctl90
	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>	<i>aetr</i>
<i>caceo</i>	-43.792*** (9.784)	-17.722 (12.651)	-0.918 (9.937)	7.545 (7.502)	7.862 (7.708)	8.235 (7.553)	3.586 (9.530)	2.205 (9.137)	4.179 (11.815)
<i>m_esg</i>	-0.004 (0.147)	0.062 (0.191)	0.171 (0.150)	0.289** (0.113)	0.235** (0.116)	0.241** (0.114)	0.231 (0.144)	0.153 (0.138)	0.111 (0.178)
<i>esg_caceo</i>	0.890*** (0.256)	0.356 (0.331)	-0.037 (0.260)	-0.282 (0.196)	-0.288 (0.202)	-0.300 (0.198)	-0.116 (0.249)	-0.061 (0.239)	-0.115 (0.309)
<i>roa</i>	0.070 (0.178)	0.181 (0.230)	0.204 (0.181)	0.043 (0.137)	0.046 (0.140)	0.043 (0.138)	0.004 (0.174)	0.032 (0.166)	0.093 (0.215)
<i>dta</i>	0.074 (0.158)	-0.113 (0.204)	-0.126 (0.160)	-0.135 (0.121)	-0.090 (0.124)	-0.092 (0.122)	-0.040 (0.154)	0.077 (0.147)	0.162 (0.191)
<i>capintens</i>	-0.126 (0.077)	0.006 (0.099)	-0.022 (0.078)	-0.024 (0.059)	-0.015 (0.061)	0.027 (0.059)	0.035 (0.075)	0.003 (0.072)	-0.016 (0.093)
<i>intangr</i>	0.059 (0.138)	0.093 (0.178)	0.041 (0.140)	-0.091 (0.106)	-0.044 (0.109)	-0.004 (0.106)	-0.013 (0.134)	-0.046 (0.129)	-0.081 (0.166)
<i>lnmcap</i>	-1.220 (1.124)	-0.532 (1.454)	-0.760 (1.142)	-0.466 (0.862)	-0.128 (0.886)	-0.655 (0.868)	-1.189 (1.095)	-0.591 (1.050)	-0.725 (1.358)
<i>ptb</i>	-0.141 (0.628)	0.131 (0.812)	0.019 (0.638)	0.432 (0.482)	0.380 (0.495)	0.563 (0.485)	0.090 (0.612)	0.023 (0.587)	0.688 (0.759)
<i>cgs</i>	-1.339 (3.351)	-1.563 (4.333)	-1.089 (3.403)	-0.625 (2.569)	0.323 (2.640)	0.528 (2.587)	0.820 (3.264)	1.239 (3.129)	-0.795 (4.047)
<i>mmnr</i>	-4.444 (4.386)	-7.233 (5.672)	-8.122* (4.455)	-6.753** (3.363)	-6.367* (3.456)	-4.491 (3.386)	-1.787 (4.272)	4.161 (4.096)	4.990 (5.297)
<i>financials</i>	-2.045 (4.675)	-0.632 (6.046)	-0.958 (4.748)	-2.838 (3.585)	-2.078 (3.683)	0.288 (3.609)	0.267 (4.554)	3.425 (4.366)	8.965 (5.646)
<i>hti</i>	-1.202 (4.702)	0.536 (6.080)	-0.619 (4.776)	1.673 (3.605)	1.330 (3.705)	1.709 (3.630)	5.187 (4.580)	7.265 (4.391)	6.956 (5.678)
Constant	37.506*** (9.541)	26.150** (12.338)	27.820*** (9.690)	24.354*** (7.316)	22.391*** (7.517)	25.523*** (7.365)	33.073*** (9.294)	30.301*** (8.910)	32.112*** (11.522)
Observations	103	103	103	103	103	103	103	103	103

\*\*\*, \*\*, \* denote statistical significance at the 1%, 5% and 10% level of significance respectively (t-tests)

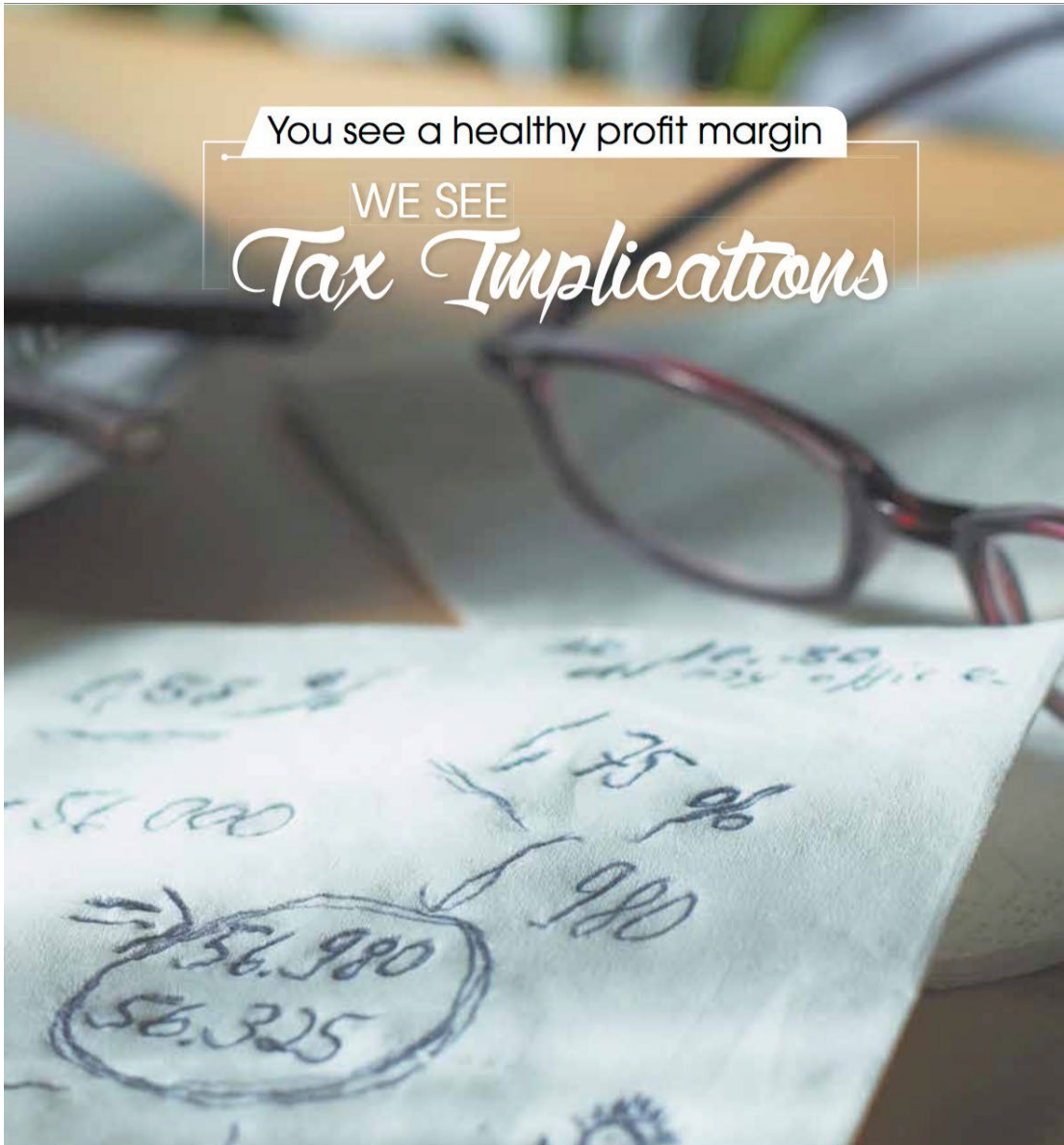
This table provides the results of quantile regression on OLS-regression results to examine the different effect sizes of the CACEO variable of interest (the proxy for tax knowledge of a CEO) on AETR, the proxy for corporate tax avoidance. AETR is regressed on CACEO and other variables as controls. It indicates a strong negative effect on the lowest percentile of AETR which supports the hypothesis predicting that tax knowledge attributed to the CEO is strongly associated with lower effective tax rates to explain variation between companies. PCTL indicates the percentile.

**Appendix A – Table B Quantile Regression on cross-sectional results**

	<i>Pct10</i>	<i>Pct20</i>	<i>Pct30</i>	<i>Pct40</i>	<i>Pct50</i>	<i>Pct60</i>	<i>Pct70</i>	<i>Pct80</i>	<i>Pct90</i>
<i>Regressors</i>	<i>ctr</i>	<i>aetr</i>	<i>ctr</i>	<i>ctr</i>	<i>ctr</i>	<i>ctr</i>	<i>ctr</i>	<i>ctr</i>	<i>ctr</i>
<i>caceo</i>	7.307*** (7.043)	-17.722 (12.651)	3.858 (11.674)	6.561 (10.421)	1.690 (9.131)	-2.582 (7.219)	-5.965 (11.057)	8.901 (13.993)	-2.716 (18.475)
<i>m_esg</i>	0.102 (0.106)	0.062 (0.191)	0.297* (0.176)	0.286* (0.157)	0.231* (0.138)	0.135 (0.109)	0.144 (0.167)	0.152 (0.211)	-0.054 (0.278)
<i>esg_caceo</i>	0.610*** (0.184)	0.356 (0.331)	-0.124 (0.305)	-0.258 (0.273)	-0.133 (0.239)	-0.012 (0.189)	0.133 (0.289)	-0.262 (0.366)	-0.065 (0.483)
<i>roa</i>	0.069 (0.128)	0.181 (0.230)	0.348 (0.213)	-0.076 (0.190)	-0.042 (0.166)	-0.028 (0.131)	-0.015 (0.201)	0.030 (0.255)	-0.178 (0.336)
<i>dta</i>	-0.068 (0.114)	-0.113 (0.204)	-0.051 (0.188)	-0.094 (0.168)	-0.050 (0.147)	-0.065 (0.117)	-0.065 (0.178)	0.049 (0.226)	0.603** (0.298)
<i>capintens</i>	-0.067 (0.055)	0.006 (0.099)	-0.096 (0.092)	-0.049 (0.082)	-0.013 (0.072)	-0.017 (0.057)	-0.016 (0.087)	-0.047 (0.110)	-0.171 (0.145)
<i>intangr</i>	0.112 (0.099)	0.093 (0.178)	0.032 (0.164)	-0.048 (0.147)	-0.028 (0.129)	-0.055 (0.102)	-0.019 (0.156)	-0.054 (0.197)	-0.317 (0.260)
<i>lnmcap</i>	0.202 (0.809)	-0.532 (1.454)	-0.758 (1.341)	-0.881 (1.198)	-1.301 (1.049)	-1.041 (0.830)	-1.370 (1.271)	0.015 (1.608)	0.221 (2.123)
<i>ptb</i>	0.791* (0.452)	0.131 (0.812)	-0.482 (0.750)	0.547 (0.669)	0.511 (0.586)	0.424 (0.464)	0.359 (0.710)	0.453 (0.899)	0.285 (1.186)
<i>cgs</i>	-8.193*** (2.412)	-1.563 (4.333)	-1.817 (3.998)	-0.251 (3.569)	-0.671 (3.127)	-0.588 (2.472)	-2.097 (3.787)	-2.080 (4.793)	3.537 (6.328)
<i>mmnr</i>	-8.527*** (3.158)	-7.233 (5.672)	-6.033 (5.234)	-8.090* (4.672)	-6.214 (4.093)	-5.635* (3.236)	-4.847 (4.957)	-4.075 (6.273)	2.211 (8.283)
<i>financials</i>	-8.114** (3.366)	-0.632 (6.046)	-2.082 (5.579)	-5.702 (4.980)	-3.862 (4.363)	-0.794 (3.450)	-1.621 (5.284)	-2.054 (6.687)	3.180 (8.829)
<i>hti</i>	4.227 (3.385)	0.536 (6.080)	3.768 (5.611)	4.783 (5.009)	3.270 (4.388)	2.741 (3.469)	3.505 (5.314)	5.196 (6.725)	3.275 (8.879)
Constant	16.281** (6.869)	26.150** (12.338)	21.953* (11.385)	30.018*** (10.163)	34.945*** (8.904)	37.595*** (7.040)	41.519*** (10.783)	28.247** (13.646)	38.186** (18.017)
Observations	103	103	103	103	103	103	103	103	103

\*\*\*, \*\*, \* denote statistical significance at the 1%, 5% and 10% level of significance respectively (t-tests)

This table provides the results of quantile regression on OLS-regression results to examine the different effect sizes of the CACEO variable of interest (the proxy for tax knowledge of a CEO) on AETR, the proxy for corporate tax avoidance. CETR is regressed on CACEO and other variables as controls. PCTL identifies the percentile.



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#### 5.4 Epilogue to the paper

This chapter examined the relationship between corporate tax avoidance and the amount of tax knowledge attributed to the CEO, as a CEO effect that influences the amount of corporate tax avoidance. This study has examined the relationship between corporate culture and corporate tax avoidance on the assumption that the CEO influences corporate behaviour and therefore also corporate culture, as predicted by Upper-echelon theory articulated by Hambrick and Mason (1984). This paper finds some evidence that a CEO effect, such as the amount of tax knowledge attributed to a CEO, has a positive association with corporate tax avoidance. This paper provides evidence of a direct influence of CEO effects on corporate tax avoidance. It is, however, possible that the characteristics of a CEO also influence other dimensions of corporate culture such as the temporal orientation of a company; in other words, whether that company is more long- or short-term oriented, as indicated in Chapter 4. That chapter presents quantitative evidence that long-termism is associated with companies that pay more tax, on average. The question of whether the level of a CEO's tax knowledge is also associated with long-termism as a corporate culture, is not examined quantitatively; this is because one can argue that long-termism is less likely to be influenced by a CEO with good tax knowledge. The paper does, however, find quantitative evidence that the effect of CEOs on corporate culture can depend on other elements related to corporate culture. For instance, the paper reports empirical evidence that the efforts of a tax-knowledgeable CEO in avoiding tax can be tempered in certain situations; for example, when a company reports a strong commitment to corporate social responsibility and corporate governance. This paper argues that these are elements that can become institutionalised in corporate culture.

This chapter concludes the quantitative investigation into the relationship between corporate culture and corporate tax avoidance. This, together with Chapter 4, constitutes the quantitative research stream of this study as explained in Chapter 3, which explains the methodology. The following chapter addresses the qualitative research stream of this study, in which the relationship between corporate tax avoidance and corporate culture is investigated qualitatively. It describes the interview process and the results of interviews with corporate tax advisors of large, listed South African companies.<sup>34</sup>

## 6 Corporate tax avoidance and corporate culture: Tax-advisors' views

### 6.1 Introduction

Chapters 4 and 5, examined the relationship between corporate tax avoidance and long-termism as a corporate culture, and the relationship between corporate tax avoidance and tax knowledge attributed to the CEO, respectively. Those chapters followed a quantitative research methodology. The quantitative results from these chapters indicate support for the expectation that long-termism is associated with those companies paying more tax, on average; this in turn supports the expectation that companies with a long-term orientation are more sensitive to the interests of stakeholders, which include tax revenue authorities. The quantitative results from Chapter 5 indicate that tax knowledge attributed to a CEO (examined as a CEO effect) is associated with a more aggressive approach towards tax avoidance in those companies that employ CEOs with tax knowledge. This supports the expectation that individuals in top leadership positions can use their tax knowledge to encourage tax avoidance, and thereby create shareholder value.

This chapter continues the investigation into the process of corporate tax avoidance, with the aim of arriving at a better understanding of the interplay between the CEO, corporate culture, and corporate tax avoidance. This part of the investigation applies a qualitative research methodology which entailed interviews with corporate tax advisors to investigate the process of corporate tax avoidance. The interviews were planned along four themes, not only to guide the interviews but also serve to categorise and analyse the interviewees' feedback. Analysis of these interviews indicates evidence of the CEO's direct influence on corporate tax avoidance and the CEO's influence on corporate culture, as well as the influence of corporate culture on corporate tax culture. The feedback from tax advisors provides new views about the mechanisms that CEOs use to effect corporate tax avoidance; these include techniques involving corporate social responsibility, as well as exerting pressure to reduce effective tax rates on a company-wide basis.

### 6.2 Chapter outline

This chapter proceeds as follows. Basic biographic data of the interview participants is provided in section 6.3; that data indicates the degree of diversity in the pool of interviewees. Section 6.4 briefly provides a description of the interviewee selection process while section 6.5 summarises the interview process. Section 6.6 documents a short account of the expectations that the author had about the outcomes of the interview process and the areas of interest ex-ante, to retain an awareness of possibly preconceived ideas with a view to limiting bias. Section 6.7 categorises the themes of interest which were used to develop the guiding interview questions as well as to guide the analysis of the interviews. This section also develops a qualitative proposition inherent to each theme to show the link to the quantitative research to which each theme is related; this allows for easier integration of the qualitative

and quantitative research streams in Chapter 7. The last section evaluates and analyses each theme (A-D) and concludes with a description of the significance of each theme's distilled meaning.

### 6.3 Interviewees (interview participants)

Table 6.1, below, provides biographic information of the interview participants.

Participant identifier	Contact method	Participant employer type	Participant's educational background
Participant 1	PC	Law firm	Legal
Participant 2	RPC	Accounting Audit Advisory	Legal
Participant 3	Website	Accounting Audit Advisory	Finance & Accounting
Participant 4	Website	Accounting Audit Advisory	Finance & Accounting
Participant 5	Website	Accounting Audit Advisory	Finance & Accounting
Participant 6	Website	Accounting Audit Advisory	Finance & Accounting
Participant 7	UC	Law firm	Legal
Participant 8	UC	Accounting Audit Advisory	Finance & Accounting
Participant 9	PC	Tax Advisory	Finance & Accounting
Participant 10	RPC	Law firm	Legal
Participant 11	JR	Law firm	Finance & Accounting

**Table 6-1 Biographic background information for interviewees**

#### **Legend for contact method**

*PC* Personal contact of author

*RPC* Referred to by personal contact

*Website* Cold called using biographic information on employer website

*UC* Referred to by University Tax Institute at University of Cape Town

*JR* Referred to by a journalist from a reputable news publication.

Table 6.1 indicates some diversity in terms of the method used to contact the interviewee, employer-type and educational background of the interviewees. This diversity helps to ensure that the data obtained from the interviews is a fair reflection of a wide range of experience.

### 6.4 Participant selection process

The author started the selection process by attempting to contact the heads of the corporate tax advisory divisions at the larger accounting and auditing or law firms in South Africa, using the biographic information. This initial approach yielded four contactable references, who responded to the author's e-mails containing the request and background for the interviews. As more than four participants were needed, the author then resorted to two personal contacts, who were former colleagues at the author's previous employer before the author pursued an academic career. These contacts referred the author to two other contactable participants who were willing to be interviewed. The author was then referred to two more participants by the head of a tax research institute at the University of Cape Town;

they both duly agreed to be interviewed by the author. In one instance, the author contacted a business journalist and asked for a reference to a reputable tax practitioner.

The sample of 11 participants is therefore a mix of people selected at random, but the author concedes that selection bias is possible. For instance, four of the participants were approached through personal contact. Nevertheless, there are two reasons for arguing that the composition of the sample does not expose the quality or validity of the data obtained from these interviews to excessive risk of bias. First, the author does not have any close friendship with any of the contacts and they were approached solely for the purpose of the interviews. Secondly, the nature of the interview questions and discussions was neutral; therefore, it is unlikely that the interviewees could articulate their comments in a way that might advance any of the author's expectations or preconceived views. Clearly, the author could only interview those contacts who were willing to be interviewed, which introduces a risk of some bias. For example, it is conceded that people who did not accept the invitation to be interviewed could have done so for practical reasons such as a lack of time; it is also possible that people who implicitly declined to be interviewed may have done so because their experience differed from the experiences of those who agreed to be interviewed. The author concedes that this could mean that the range of experience reported in this study is incomplete. However, it is argued that the results of the interviews indicate diverse experiences concerning the key issues or themes of interest for the purpose of this study. Thus, the results indicate support for the expected behaviour and relationships. However the same results also reveal behaviour that indicates unexpected relationships between CEOs, corporate culture and corporate tax avoidance. This provides some assurance that the extent of possible bias from this source is limited.

## **6.5 The interview process**

The planning for the interview process included reviewing some books about qualitative research techniques and studying selected articles about interviews as a qualitative research instrument. In addition, the planning phase included consultations and discussions with colleagues who have used similar interview techniques before. Some of the more important realisations and reflections arising from this process are documented for the record in Chapter 3, Research Methodology; these aim to enhance the credibility of the evidence collected through interviews, as a method to incorporate a qualitative component to the overall study. The author notes that he became aware of claims that qualitative research is contextual in nature, based on people's subjective interpretation of the world as they go through a process to create meaning of the phenomena that they live through. The author appreciates that the aim of qualitative research is not to extrapolate any of the findings or to claim that they are universally applicable to all cases. Having obtained a better idea of the process and pitfalls of interviews and qualitative methodology in general, the author then started to develop an interview question guide, with a list of possible questions that could be used in the interviews; each of these aimed to cover a specific aspect of interest related to the study. The author uses the themes contained and depicted in Figure 6-1, below, to develop the questions, thereby making sure that the

questions are relevant to the areas of interest for this study. The list of questions is provided in Chapter 3, Methodology, section 3.5.

The author experimented informally with some colleagues and his supervisor, debating the appropriateness of questions, the benefits and disadvantages of following one approach rather than another, and the choice of vocabulary used. For example, a decision was taken to avoid using direct reference to *'corporate tax avoidance'* at first in the interviews, and rather to use terms such as *'aggressive tax behaviour'* or *'corporate tax culture'* or *'tax planning'*; here the intention was to avoid influencing participants to reflect only about certain behaviour. It is argued that the use of such words is slightly less specific, providing the opportunity for participants to discuss their experiences more liberally, leading to a richer discussion.

Ten of the interviews were conducted over a six-week period, which provided enough time for reflection and improvement between consecutive interviews. A last interview was conducted six months after the start of the process. The author documented a reflective account of each interview to capture expectations, frustrations, areas identified for bias and areas for improvement in future interviews. This also provided the author with an opportunity to record the strongest impressions of each interview without the need to consider objectivity at first. It is argued that this step helped the author to direct his more emotionally-laden opinions and interpretations, which left room for the objective interpretation based on the transcribed interviews only at a later stage. From these reflections it became clear towards the end of the process, that a point of data-saturation had been reached, based on the fact that new topics or themes did not reveal themselves, and also that interview responses became familiar or expected to the author, to an extent.

The interview recordings were transcribed by a professional, independent third party. The author allowed for enough time to lapse after conducting the interviews and analysing the responses, to ensure the development of emotional distance between impressions obtained during the interviews and analysis of the interview transcriptions; he felt that this time lapse helped to make his analysis more objective. Having completed the analysis of the transcribed interviews, the author scrutinised his initial observations recorded in the reflective account of each interview, to ensure that contextual truthfulness was maintained. The author also discussed the interviews with his supervisor who acted as a soundboard for evaluating the different views on meaning produced by the interviews. The author also used these sound-boarding events to identify areas of improvement for future interviews. For example, the author found that some of the initial interviewees were relatively dismissive about the recent or ongoing occurrence of corporate tax avoidance. The author subsequently changed his approach to include collecting interviewees' views on *"the way it used to be in the past;"* this created the opportunity for interviewees to recollect their experience in a safer environment and in a situation which removed the participant from any implied collaboration in such tax behaviour.

The author was aware of possible biases regarding his mindset and in order to overcome them, he documented a list of hypotheses or informal expectations that he held *ex ante* about the outcome of the interviews. The sources of the author's personal views about some of the interview statements are diverse. For example, the author concedes that not only his religious views may have resulted in biased interpretation of interviews. Other factors could have included his prior readings of anecdotal, semi-academic literature, academic literature, or other influential sources. Also, the results from the quantitative research stream may have contributed to a possible biased interpretation. By articulating preconceived ideas upfront, the author became more alert to, and cognisant of, the possibility of bias and as a result, could strive to prevent it.

The following section documents statements that relate to the overall topic of investigation in this study. These were documented upfront, and the researcher considered them continually during the interview process, as well as during the analysis of the interviews.

#### **6.6 The interviewer's expectations and preconceived ideas experienced *ex ante***

The author may have been more receptive towards certain views expressed by participants, such as the following ones, that particularly support the tenet of this study:

- The CEO plays an influential role in crafting a specific corporate culture.
- CEO characteristics, as in personal values or academic qualifications, particularly relating to tax knowledge and tax training, directly influence corporate culture, and also corporate tax avoidance.
- Corporate behaviour is the best indication of the nature of corporate culture and corporate values actually ingrained in a company's culture; these can be very different from the advertised or proclaimed values such as those found in mission statements or codes of conduct.
- Corporate culture influences corporate tax avoidance as the focus of this thesis.

The author documents the following views that could be expressed by the interviewees and which run contrary to his own views of the relationship between the CEO and corporate tax avoidance, and concerning the influence of the CEO and corporate culture.

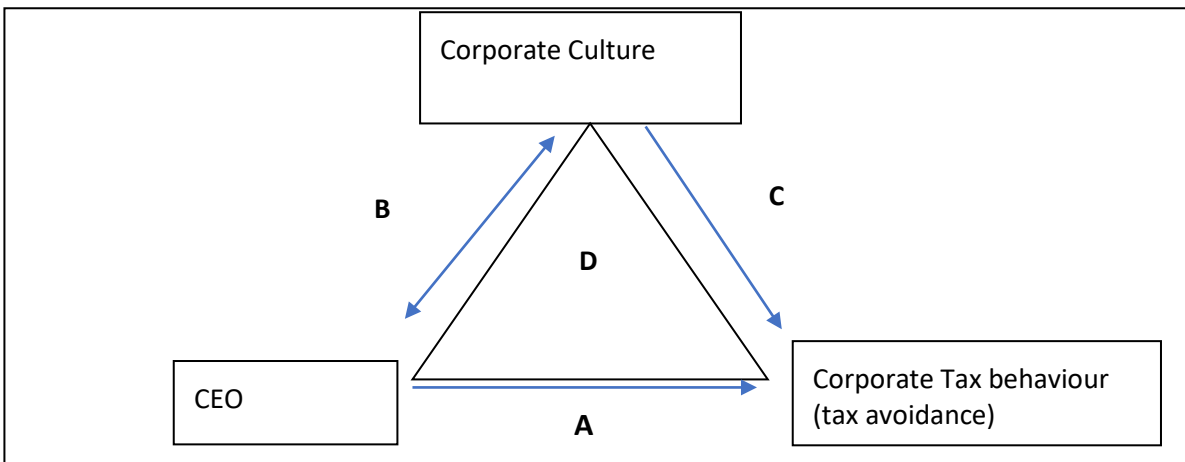
- Corporate culture is largely influenced by, and dependent on, the values and influence of a few top leaders; in other words, it does not exist independently as well.
- Corporate culture is stable over the short term.
- The scope of a CEO's responsibilities limits the CEO's ability to influence corporate tax avoidance directly.
- The prevalence of corporate tax avoidance in large, listed South African companies is exaggerated.

In order to limit the scope for bias, the author kept these statements in mind while conducting and analysing the interviews.

The next section explains the themes that the author uses to categorise the views of interviewees and to guide the interviews. These themes are also used to analyse the interview transcriptions.

### 6.7 Interview themes as discussion points

The list of possible interview questions is provided in Chapter 3. Some of those questions were used to obtain the interviewees' views on the relationship between the themes depicted in the following diagram. The relationships between the constructs involved are depicted in a triangle to emphasise the interrelatedness of the constructs examined in this study.



**Figure 6-1 Guiding interviews with tax advisors: The relationship between the CEO, Corporate Culture and Corporate tax avoidance**

**Arrows indicate direction of influence**

Figure 6-1, above, depicts the expected relationship between constructs of interest in this study. For example, the author is aiming to determine how a CEO can influence tax behaviour directly and therefore influence corporate tax avoidance (presented by Theme A). The author also intends to obtain the views of participants about the influence of the CEO, indirectly, on corporate tax avoidance; in other words, through the CEO's influence on corporate culture (represented by Theme B and C). The author also is seeking to understand how interviewees perceive corporate culture as a construct, which is contained in Theme D. To make the analysis of the interviewees' experiences more specific, the author encapsulates the specific points of interest with regard to each theme, by developing the following qualitative propositions regarding the aspects of interest for each theme. This approach also makes it easier to link and integrate the results of the quantitative research stream with the qualitative findings that originate from the interviews. As mentioned previously, the integration of qualitative findings with matching quantitative findings is an important characteristic of the mixed-method methodology used in this study. Table 6-2 below links the qualitative themes with the quantitative focus points.

**Table 6-2 Qualitative themes (A-D) linked to quantitative research focus points**

Theme	Qualitative proposition to which the theme is related	Quantitative research to which each qualitative theme is related
A	The CEO's influence on tax culture or tax avoidance is sometimes visible and direct.	The effect of tax knowledge attributed to a CEO, on corporate tax avoidance, is examined in Chapter 5. The expectation advanced in that chapter is that a CEO with tax knowledge should be associated with corporate tax avoidance.
B*	CEOs influence corporate culture as the top leaders in companies; this is in accordance with Upper-echelon theory.	Chapter 4 examines the relationship between corporate tax avoidance and long-termism as a type of corporate culture. CEOs are generally expected to influence and form part of corporate culture.
C	Corporate culture influences tax behaviour and therefore corporate tax avoidance. Furthermore, tax culture varies between companies; for example, with regard to differences in risk appetite for aggressive tax planning as an element of corporate tax avoidance.	Chapter 4 examines the relationship between corporate culture and corporate tax avoidance, quantitatively. When it examines the relationship between a long-term orientation and corporate tax avoidance; a negative association is expected.
D*	Corporate culture concerns the patterns of behaviour found in companies and is dependent on corporate values. Corporate culture differs from one company to the next.	The quantitative and qualitative research streams of this study both assume that corporate culture is a measurable construct which impacts on corporate behaviour, including corporate tax behaviour. Construct validity for long-termism as a corporate culture is considered in Chapter 4 where it is measured and operationalised for use in regression.

\* Themes B and D are related but indicated separately, as far as CEO characteristics can be determinants of corporate culture.

It is submitted that qualitative research is more descriptive in its approach, and more focused on how social phenomena are being perceived and interpreted by those who are close observers or role players in the phenomenon or process under observation. However, the themes listed above, which form the lenses through which the results from the interviews are interpreted, are informed by theories as far as expectations of interviewees' experience is

concerned. For example, Theme A, that concerns understanding the influence of the CEO-characteristics on corporate tax avoidance and the mechanisms used, is primarily informed by Upper-Echelon theory and Principal-Agent theory. In this regard Upper-echelon theory explains the importance of top management in all corporate outcomes, which include corporate tax avoidance in this instance. Principle-agent theory, however is expected to explain different reasons why a CEO may engage in corporate tax avoidance. For example, the CEO may encourage tax avoidance because he/she is incentivised sufficiently to maximise shareholder value, or, alternatively, he/she may engage in tax avoidance as an investment to act as compensation for the CEO's assumption of extra risk, for example when part of CEO-remuneration is tied to after-tax profits. The same theories are applicable to Theme B, which assumes the CEO's influence on corporate culture, although it is expected that corporate culture, as a channel or mechanism available to the CEO to effect tax avoidance, may be a slower option because as it will have to overcome organisational resistance to change if it is not already institutionalised or ingrained.

Theme C expects corporate culture to influence corporate tax behaviour. Institutional theory is argued to inform the expectations to this theme, to the extent that past patterns of and nuances of corporate behaviours are institutionalised, as informed by corporate values, legal frameworks, and general expectations from society. It is argued that those patterns that have become institutionalised, will inform where on a continuum of shareholder-value maximisation on one side, and total stakeholder-orientation on the other side of this continuum, a company wants to be positioned. Important in the South African context, with reference to the influence of frameworks, is also the King Code on corporate governance, on patterns of corporate behaviour (corporate culture). This framework was developed in South Africa, and is expected to surface in the interviews when determinants of tax avoidance are discussed. For institutionalised behaviour that has become more shareholder-oriented, more tax avoidance is expected, whereas less tax avoidance is expected from companies exhibiting a stakeholder-orientation.

The purpose of the interviews was to obtain the respondents' views based on their experiences regarding the nature of corporate culture as a construct, its influence on corporate tax behaviour, including tax avoidance, as well as the CEO's relationship with the two constructs.

The next section provides a narrative account of the interviews as the discussion has been analysed in terms of the four themes depicted above. The views of interviewees on the nature of corporate culture (Theme D) are provided first as this construct is the essential construct of focus in this study.

## **6.8 Thematised account and analysis of interviews**

The following sections provide a record of the salient arguments or statements that surfaced during the interviews. These arguments and statements are accompanied by the author's critical evaluation, which is intended to position or interpret the meaning of the interviewees' accounts, based on their experience as corporate tax advisors. Because the nature of qualitative research is not to make absolute claims about any proposition or hypothesis, each category

ends with a concluding comment regarding the plausibility of the underlying propositions, assessed in the light of the evidence obtained from the interviews.

#### **6.8.1 Theme D: Interviewees' conception of corporate culture and tax culture**

This theme documents and evaluates the interviewees' experiences on the nature of corporate culture and determinants of corporate culture. This theme is documented first because an understanding of the interviewees' interpretation of corporate culture is first needed in order to understand how they perceive its influence on, and by, the constructs under investigation. The participants' views on the nature of corporate culture seem, broadly, to match the academic view of corporate culture, especially by reason of references to the importance of values as a recurring theme. Participants use words such as *"values"* and *"ethos, objectives of the place"* to describe corporate culture, which is aligned to the literature on corporate culture. Some participants referred to multiple aspects that combine to form corporate culture such as *"the smell of the place, whether people feel comfortable, is there free speech"* or *"the business strategy"* while others see corporate culture as driven by *"values, the people and the governance structures."* Some participants automatically placed more emphasis on the influential role that leadership plays in the craft or determination of corporate culture:

*"leadership is how you define corporate culture...because it trickles down, it's top-down. So... they enforce a certain way of doing things... then that determines the culture of the entire company. So you can have a set of values and you can put down your objectives, but for me it's the actions of the leadership that actually determine what the culture is of the company."*

Some participants describe corporate culture in terms of *"good and bad cultures"* which shows that they perceive corporate culture as closely related to ethics and morality as well as being value-laden; these attributes also surfaced in the literature review of this study. Other participants describe corporate culture using terms very closely related to the academic terminology discussed in the literature review as far as maximisation of shareholder value and stakeholder views of companies are concerned:

*"I suppose the drivers of corporate culture for me, to a large degree, are determined by let's say the mindset of the board and the C-suite, and from what I've seen, is that it depends largely on what they consider to be their KPIs [key performance indicators or priorities]...and where does shareholder value actually feature on their list of priorities."*

Also:

*"I almost see shareholder value and stakeholder value as two separate things, and only to the extent that they are truly merged, truly merged, do you have a kind of different, less profit-oriented cost-cutting corporate culture"*

This respondent's view is significant in its own right, because of how close it is to the expectation in this study that a corporate culture indicative of a long-term orientation is akin to a stakeholder-oriented company; in other words, a

company where the interests of stakeholders, including the interests of society through the custodianship of government and the revenue authority are considered, above and beyond just the interests of shareholders. That participant's experience not only provides credence to the idea that corporate cultures differ between companies, but also that some are experienced in a similar way, as articulated in this study.

One participant was more sceptical about the prospects for distinctive and unique corporate cultures and their influence on corporate tax culture and tax avoidance. According to that participant, corporate governance frameworks such as King IV, Tax Administration Acts and the Companies Act<sup>35</sup> are mostly applicable universally to all large, listed companies. That participant then argued that, in view of these governance frameworks, corporate cultures across companies are homogenous, with little variability in terms of ethical or unethical corporate cultures; this reduces the likelihood of variability influencing corporate culture. Although some respondents agreed that regulatory frameworks may influence corporate cultures, they mostly seemed to disagree that the influence of mandatory corporate governance frameworks precludes the existence of inherently unique corporate cultures, or variability in ethical corporate dispositions. Thus: *"The King code and other legislation may have changed some of corporate culture, but not the whole culture."* Another participant indicated the conditionality of such a view: *"you can have as many frameworks as you like, the manner in which they implement it, in my experience always turn[s] to people"*. Here, the participant is referring to the importance of people who may act according to their own values, but also according to the company's values; this reference seems to suggest the role of values, or corporate culture in the implementation of any control frameworks. Another participant stated: *"I cannot see that those things [Governance Frameworks] would make companies all the same. Otherwise, we will not talk about differentiators."*

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<sup>35</sup>King IV is a corporate governance framework that is applicable to all listed companies in South Africa, whereas the Companies Act refers to South Africa's Companies Act 71 of 2008, as amended.

According to another participant:

*“so being listed carries some degree of additional governance and responsibility... and you know a greater degree of responsibility and you go from this committee and that committee...but that doesn't stop them doing some really naughty things...”*

This statement provides more evidence of the limited influence of corporate governance mechanisms on corporate culture. Another interviewee referred to corporate culture in terms of corporate tolerance for risk taking, with some being more risk tolerant while others have less tolerance for risk. That participant also distinguished between more entrepreneurial companies and those companies who are perceived as being less entrepreneurial, and often found that the more entrepreneurial companies would frequently be the ones with more risk appetite.

The existence of differences in corporate culture between large, listed companies is important in this study. After all, this study argues that variability in corporate culture is related to differences in corporate tax behaviour, including corporate tax avoidance. The views and experience of interviewees confirm that corporate culture is a discernible construct in companies and that differs from one company to the next. Moreover, the interviewees acknowledged the importance of corporate culture as a driver of corporate behaviour.

The author now proceeds from the assumption that corporate culture has consequences for corporate behaviour, and documents the following perceptions of interviewees regarding the influence of the CEO on corporate culture.

#### **6.8.2 Theme B: The CEO's influence on corporate culture**

The author examined evidence in Chapter 5 regarding the relationship between a particular CEO characteristic (tax knowledge attributed to the CEO) and tax avoidance. In the interviews, the author explored the interviewees' views on whether CEO characteristics can be considered to be the main influence on corporate culture; alternatively, does corporate culture also exist on its own, with evidence of some independence from CEO influence? The results of the interviews indicate widespread support for the view that the CEO has an influence on corporate culture.

The expected influence of the CEO's characteristics on corporate culture is an important presumption in this study. The importance of the CEO, as well as the CEO's values, in terms of influence on corporate culture, are well articulated by the interviews. For example, one interviewee states that:

*“I see the CEO position as the main champion of corporate culture” and “a new CEO with strong and influential personality will change corporate culture if a company's values are not aligned to his (over time) or the CEO will not succeed and will leave.”*

Another says: *“So I think it's really a case on how the people who are in charge, operate. The key thing is the people in charge;”* this was in response to a question that asks the respondent to explain what drives corporate culture.

As expected, some respondents indicated that the CEO is also influenced by the corporate culture; they then added that it is difficult to identify or recall particular examples of this, with one participant predicting that a CEO would leave a company whose corporate culture is misaligned with his or her personal values. Nevertheless, one participant felt that corporate culture could possibly influence the CEO:

*“it also depends how long a specific executive had been in an organisation and how he/she grew up [whether the CEO was hired from outside or not], if I can call it that...many of these executives who have been at a company for years obtain the same culture as his/her predecessor-CEO... so culture is transferred...but as you get new people coming in, then there are different cultures coming in which can change the dynamics in the organisation totally.”<sup>36</sup>*

This comment can be interpreted to mean that CEOs who have been promoted internally and who have come through the ranks over many years, have less impact on corporate culture than one who is appointed from outside the company. One participant explains that CEOs with strong personalities may be more successful in changing corporate culture, while others can be more amenable towards being changed by the corporate culture. For example, one interviewee refers to the overriding, yet deleterious impact that a specific CEO of a large company had in creating a toxic corporate culture despite having the standard corporate governance mechanisms in place; this was because few people in the company had the courage to challenge questionable behaviour, which also extended to more tax avoidance at this particular company.

A consideration of the viewpoints that emerged from the interviews led the author to conclude that the influence of the CEO on corporate culture is uncontested. Nevertheless, interviewees also reported instances of the opposite direction; in other words, the CEO was influenced by the corporate culture. The direction in which the influence works can be influenced by various factors; for example, whether a CEO is internally promoted into the position or hired externally. It is also evident from the interviews that there is much variation in the extent to which the CEO influences corporate culture.

### **6.8.3 Theme C: The relationship between corporate culture and tax avoidance**

The author steered the interviews to obtain the interviewees' views on their experience of differences between companies' tax cultures. The author then tried to understand whether and how they experienced the influence of corporate culture on tax culture. This interviewing strategy allowed unidentified forms of tax avoidance behaviour to surface and permitted richer discussions with those specific participants who were more neutral or dismissive of the idea that corporate tax avoidance was a problem. New types of corporate cultures and tax cultures did emerge. For example, one participant distinguishes between “*tax aware corporate cultures*” compared to “*less tax aware*

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<sup>36</sup>Translated from Afrikaans, home language of interviewee.

*corporate cultures,*” implicitly expressing corporate culture in terms of a corporate attitude towards tax compliance. The same participant also refers to a “*strong tax culture*” versus assumedly weaker tax cultures where the participant experiences less rigorous forms of tax risk management in terms of compliance and tax administration, saying:

*“take a place like Company X, you know, they’ve got a very strong tax department, they take great care in what they do and they don’t want to damage their public perception...so they are actually very risk averse in whatever they do from a tax perspective, you see.”*

Another interviewee interprets different tax cultures through a lens of ability or corporate capacity for excellence, and professional competence, explaining that this is evaluated with reference to “*solid knowledge of tax legislation and accounting frameworks.*” In taking this view, that participant experiences differing levels of professional knowledge or “*expertise-levels*” as different tax cultures, which vary between companies. Thus: “*..... huge variance [in tax culture across companies] in my experience...and among listed companies...you’re almost surprised at the lack of competence in some companies or clients.*” Other interviewees interpret corporate tax avoidance in more neutral terms, preferring to refer to “*conservative*” or “*risk-averse*” tax cultures, as opposed to more “*aggressive*” tax cultures. Another interviewee refers to those companies who “*do naughty things with tax*” while others are not so “*naughty.*” Although a small minority of participants were dismissive towards the fact that tax avoidance happens, most were comfortable in admitting experience of more aggressive tax cultures as opposed to less aggressive ones. One interviewee explained the difference between more aggressive tax cultures and less aggressive ones, as follows, with reference to a pending restructuring of a client company for operational purposes, together with an opportunity to avoid tax using legal channels, although the position might be challenged by the revenue authority:

*“And clients, depending on their risk appetite, will either say I’m prepared to take the risk...and go for it...as long as you [the tax advisor] tell me I’m not breaking the law... and if SARS [The South African Revenue Service] attacks me, I’ll fight it in the end, or others will say... it is better to sleep well than to eat well...”.*

### **The influence of corporate culture on tax culture (Corporate tax avoidance)**

The interviews indicate consensus about the direct influence of corporate culture on the tax culture of companies, and corporate tax avoidance. One respondent reports that:

*“if you take a very institutional culture as opposed to an entrepreneurial culture...so in other words if you take a situation where there is a bank or an insurance company [with a corporate culture which is more formal, or institutionalised]... I would not say that they never take tax risks, but they are far less likely to push the boundaries [compared to]... say an entrepreneur who started a business and built it into a business”.*

However, other respondents were more neutral regarding this issue. Perhaps these respondents’ clients are generally risk averse or conservative, which could explain why these respondents do not experience incidents of tax avoidance as frequently. Possibly, these respondents were not overly observant for broader aspects of corporate culture, or

perhaps did not have the necessary relationships with top management to observe culture from a higher level in the companies. For example, one refers to the relationship between corporate culture and tax culture and states that *“I think there is an impact, but it’s a positive impact, especially listed entities”* which may be interpreted as experience of mostly conservative tax cultures in companies where corporate culture indicates integrity and conservatism. It is however possible that the interviewee’s client base never included more-unethical corporate clients, which may account for this interviewee not observing variation in this regard.

Another interviewee finds that tax awareness is increasingly becoming part of corporate culture; this view is based on the observation that tax issues are increasingly becoming standard board-level agenda points in many companies. Here, the interviewee notes congruence between conservative corporate cultures and risk-averse tax cultures, and possibly less tax avoidance. This interviewee notes that:

*“it is normally the entrepreneurial guys that normally come up with these [tax structuring] schemes”,* noting that *“entrepreneurial companies, they would also have like incentive schemes sometimes for people coming up with ways to minimise tax.”*

This interviewee could have misused the word ‘entrepreneurial’ and could have meant ‘aggressive’ instead, because of later statements in which the respondent refers to conservative cultures as the opposite. This interviewee notes that ‘entrepreneurial’ companies may be inclined towards more aggressive tax behaviour, which may, for example, include proclivity for deals (i.e. mergers or take-overs) merely for available tax benefits, rather than for logical business reasons; she felt that ‘logical reasons’ would include, for instance, streamlining of operations, or *“corporate structure optimisation”* as it is referred to by interviewees. Another participant refers to the existence of ‘conservative’ corporate cultures which are often congruent with more conservative, less tax aggressive tax behaviour in the tax department.

One interviewee shared an interesting experience regarding the relationship between company size and tax avoidance or tax compliance. This interviewee argued that it is often assumed that smaller companies are inherently more entrepreneurial and therefore have a higher tax-risk appetite. This interviewee emphasised that compliance has become so complicated and resource-intensive that smaller companies find it almost impossible to be fully compliant even if they would like to comply as far as possible, merely because they just cannot commit as much administrative resources towards a non-operational function such as tax administration. This may create the impression that they have a higher tolerance for tax risk; this impression would be wrong because they are, in fact, forced by circumstances to be more risk-tolerant as far as tax compliance is concerned.

Other interviewees report less experience of corporate culture having any direct influence or association with aggressive or conservative tax behaviour. For example, one interviewee does not necessarily experience more aggressive corporate tax behaviour at clients that are associated with a culture of product innovation; similarly, the respondent did not experience more-conservative tax behaviour at a mining client which seemingly exhibits a ‘safety-

first' operational culture. Such views may perhaps suggest the participant's limited experience with the true corporate culture of a company. Regardless, this participant's comment may indicate that the link between overall corporate culture and divisional corporate culture may not always be equally strong in all companies. Also, it may indicate that the core corporate values that are the foundation of corporate culture may not always be visible to someone, such as a tax advisor, who may be seen as a bystander, despite a close or intimate business involvement with people in the organisation.

Another interviewee confirms the influence of corporate culture on tax culture but perceives that the elements of corporate culture which directly speak to tax behaviour and tax avoidance are mainly as a result of corporate governance frameworks such as King IV and Tax Legislation, which have changed corporate culture. Thus: *"... and I think that's also dictating [corporate] culture, those regulations."* Other interviewees partially agree with this, but highlight that corporate governance is often principles-based, which leaves room for judgement and subjectivity in interpretation and subsequent application:

*"[corporate governance frameworks] require[s] that you have a responsible and transparent [tax] policy and strategy, but there is no further guidance or requirements or a tangible standard from there... So now, what are companies supposed to do with that?"*

This comment is interpreted as indicating that corporate governance may in theory change corporate culture insofar as it may influence patterns of behaviour. However, other interviewees report that the rules of corporate governance leave some room for interpretation, allowing companies some discretionary choices in how to apply them; this highlights the important influence of values or ethical considerations in guiding interpretation and application of the rules.

The different interpretations of tax legislation create opportunities for tax avoidance, according to one interviewee. The interpretation of tax legislation requires initial training followed by the gradual development of professional knowledge, skills and expertise. That interviewee feels that the amount of status or emphasis that a corporate culture endows on professional knowledge and expertise can be indicative of the level of tax avoidance or tax culture in the tax department of a particular company. Thus:

*"[if] somebody has very little inclination to be an expert in that space, there is a better chance of that person either intentionally or negligently moving into that grey area [grey areas that [are] close to tax avoidance]."*

This interviewee argues that less professional or knowledgeable companies may expose themselves negligently to tax risk when they are unaware of the risk of being ignorant; that unawareness would arise from a lack of appreciation of professional tax knowledge.

One interviewee recalled an interesting relationship between the corporate culture of companies with a very conservative tax culture, that are extremely dependent on government subsidies. The interviewee found that those companies tend to be very careful not to engage in any behaviour, such as aggressive forms of tax avoidance, which may tarnish their relationship of good standing with the government, on which its long-term financial sustainability directly depends. The interviewee was referring, especially, to companies involved in South Africa's motor manufacturing industry where government subsidies are paid to those companies when they use a certain percentage of local content and labour in the production of their product to protect employment in the vehicle manufacturing industry. This is a direct example of where a company acknowledges its direct dependence on the interests of government as a key stakeholder, for its long-term sustainability. The interviewee's experience bears logical testimony regarding the old saying that *'one does not bite the hand that feeds you.'*

This view is echoed by other interviewees as well, indicating that some corporate cultures display aversion to anything remotely obscure in any way. According to one interviewee:

*"I honestly don't know whether the company-group that I mentioned is driven by fear of being stigmatised...it may be part of it...I think it's just genuinely their corporate culture, they don't want to play those kind of games [tax avoidance]."*

The same interviewee also experiences *"struggling company corporate culture,"* which displays a proclivity to engage in aggressive tax avoidance or even tax evasion. The rationale is that such companies suffer from cash flow problems and liquidity concerns, which provide incentives for them to pursue aggressive tax avoidance to improve earnings or to conserve cash. That interviewee also finds that a financially constrained company is more likely to look for opportunities to avoid value added tax (VAT), as an easy method to conserve cash. Such behaviour can easily be extended to income tax avoidance as a measure to protect the outflow of cash in struggling companies.

As reported earlier, one interviewee classifies corporate cultures into two types; *'profit-only'* or *'profit-first'* and those that are more stakeholder-oriented. As previously mentioned, also, this interviewee develops client proposals based on an assessment of the type of corporate culture as described earlier. He states: *"it's one of the first things that you need to understand about client and the organisation...you will typically split your clients into those areas."* This provides support for the view that different corporate cultures, classified into either shareholder-oriented or stakeholder-oriented cultures, extend to the corporate tax culture and possibly influence the extent to which tax avoidance is practised.

A review of the results of the interviews, with a focus on the relationship between corporate culture and tax avoidance (tax culture), indicates support for the notion that corporate culture differs from one company to the next; moreover, corporate culture influences the extent to which corporate tax avoidance is pursued. The review does, however, indicate areas where interviewees have conflicting experiences. For example, one interviewee experiences

a link between an entrepreneurial company and tax avoidance, while another does not experience the same effect when the safety-first corporate culture of a mine is not associated with an overly conservative tax culture.

#### **6.8.4 Theme A: The CEO's direct influence on corporate tax culture**

The discussion of theme B in Section 6.8.2 showed that interviewees encountered instances in which CEOs influenced corporate culture. Moreover, the discussion in section 6.8.3 on Theme C indicated that interviewees have seen instances in which corporate culture influences the degree to which companies practise tax avoidance. It now seems logical to deduce that the CEO's influence on corporate tax avoidance can happen indirectly through corporate culture, as a conduit to affect company-wide behaviour. Interviewees were also asked to share their experiences about CEOs having a more direct influence on the tax cultures and corporate tax avoidance behaviour of large, listed companies.

The following discussion describes evidence and views of corporate tax advisors regarding the CEO's direct influence on corporate tax culture and corporate tax avoidance. The discussion addresses the issue of whether any CEO effects influence the degree of corporate tax avoidance; those effects include, for example, personality, personal values of the CEO or other biographic characteristics such as educational background or skills. Two clear lines of experience emerged from the interviews. One interviewee group experienced more involvement from the CEO in the tax affairs of the company, while the accounts of the other group's experiences indicate less evidence of the CEO's involvement in tax affairs.

A CEO's emphasis or awareness of tax issues can extend to exploring ways to avoid tax. This behaviour often manifests by the CEO consistently monitoring effective tax rates (ETRs); these are often used as a lever by the CEO to influence corporate tax avoidance, or to encourage an aggressive tax culture. The CEO could also emphasise that he or she is not worried about effective tax rates that are too high. In either case, it shows that the CEO can use tacit signalling about an acceptable range of effective tax rates. One interviewee says:

*“you'll have in some groups where it will be clear from the board and from the CEO and from the CEO to the CFO to the tax director...that we are not too concerned about ETR... we just want to ensure that it stays in an acceptable range so that we know we are not paying too much...so that sends a clear message to tax.”*

The opposite attitude is also possible as this same respondent reports that the CEO sometimes instructs tax directors and the operational company divisions to aim to get effective tax rates as low as possible; this may be part of a company-wide directive from the CEO to save money or to create shareholder value. This viewpoint is echoed by another participant who finds that:

*“if the CEO is making it clear in the organisation that, for example cash is king and he's not too interested in hearing about objections and challenges...he would be interested in steering it [tax avoidance]”.*

The same interviewee makes an interesting claim regarding the approach that a CEO would take in this regard, saying that:

*“[CEOs] can be extremely influential individuals obviously in their organisations, and CEOs generally know very little about tax, so it is not though the CEO would deliberately say ‘let’s go out there and commit some tax avoidance’, but a CEO might definitely say to the CFO and the tax team, you know...is it possible to do this [a corporate restructuring transaction with tax consequences] in a way where there is no tax leakage... let’s explore all possible options and then make a call... And I think it would be very hard in that situation for the CFO, let along the internal tax team, to say no.”*

Another interviewee recalls an incident when a CEO explicitly dictated the desired tax conduct to a company’s tax department. This was against the background of an internal dispute regarding the tax treatment of a transaction which could constitute tax avoidance:

*“You see it [CEO dictating terms of tax decisions to the Tax Department] on occasion. Ultimately the risk lies with the CEO if you want to look at it that way...more often than not we see the CEO going ok fine, I can see it from a compliance perspective...but we refuse to do this... we will just take the risk [risk related to fines or disputes]”*

Other participants experienced occasional pressure from the CEO to adjust transfer prices, especially in multi-national environments, to decrease a group’s overall effective tax rate.

Other interviewees experienced less influence of the CEO on tax matters in general, including tax avoidance. For example, interviewees say:

*“but in some organisations it was also different...the CEO not necessarily would bother himself with what is actually going on on the ground in tax”*

This is echoed by another interviewee who says: *“The CEO doesn’t necessarily play such a big role in that [tax matters] because they would generally get a competent CFO.”*

### **CEO’s educational background and other CEO characteristics and corporate tax avoidance**

Interviewees were explicitly asked whether they have observed any relationships between the characteristics of a CEO, such as educational background or qualifications, and the CEO’s level of involvement in tax affairs. The author specifically enquired whether tax knowledge attributed to a CEO has any observed influence on the CEO’s involvement in tax matters or on corporate tax avoidance. One interviewee finds evidence of a more aggressive tax approach by CEOs who are chartered accountants:

*“because if you’ve got a CEO that’s got an accounting background , they’re more likely to be not so much persuaded by their tax team because they know a bit more of the accounting stuff and they’re not just going to go with whatever the tax department is saying, they’re going to question it.”*

This experience is significant and should be compared to another participant's experience that CEOs mostly have "*very little tax knowledge*;" it gives even more support to the view that CEOs with tax knowledge are more confident in challenging the more-conservative views of the tax department, especially regarding tax decisions that can reduce the company's taxes.

Another interviewee expressed the view that the professional qualifications of the CEO, in general, are a reflection of the level of professionalism and formality in the companies that employ them; this is regardless of whether such professional qualifications involves tax knowledge.<sup>37</sup> This interviewee's experience was that the CEO's level of education is an indicator of the extent to which a CEO exhibits, extolls and encourages due care and diligence in all parts of the company; this includes the tax department where professionalism is perceived to be associated with a conservative, compliant approach to tax.

### **Other CEO effects on tax culture**

Some interviewees perceived that a CEO's previous occupation in specific industries, such as banking, can be interpreted as a CEO effect with consequences for tax avoidance. For example, one interviewee felt that "*your kind of male banker kind of environments [pertaining to the CEO] are definitely still far more aggressive, far more looking for the loopholes you know.*" However, another interviewee experienced the opposite, and felt that CEOs of banks are less aggressive in driving tax avoidance agendas when working for a bank, because banks are intensely regulated. This can mean that the banking environment may be producing individuals with a high appetite for risk, but that same risk appetite is not necessarily applied or put to significant use in the banking environment itself; however, if or when the banker eventually resigns and joins a non-banking company in an executive capacity, then the ex-banker duly effects corporate tax avoidance for his or her new non-banking employer.

Some interviewees described apparent relationships between CEO effects and the CEO's involvement in tax affairs of the company; those effects included the CEO's age and tenure in the company. An interviewee experienced the CEO's age as a CEO effect that can be indicative of the extent of a CEO's involvement in the tax affairs of companies. For instance, this interviewee finds that older CEOs exhibit a higher appetite for tax risk because they have more experience in recognising big-impact tax risks and distinguishing them from ones with a lesser impact. Younger CEOs tend to have less judgement about top priority risks from the regulators' historic relationship with the taxpayer company. Another interviewee perceived that CEOs with longer tenure in a company are less involved in tax matters because younger, newly recruited CEOs are more inclined to micro-manage divisions including the tax department; this could be because they may be more determined to "*change things or get things right or clean-up.*" The

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<sup>37</sup>For example, a civil engineer and a chartered accountant are both professional qualifications, although engineers are not automatically perceived as being tax experts.

interviewee also feels that a new CEO may still be more sensitive to criticism and may try his best to do things correctly.

### **CEO's values as a CEO effect on corporate tax avoidance**

One participant invokes personal values as a determinant of a CEO's propensity to engage in tax avoidance, stating that *"there is a bigger picture there of how people's [top executives'] minds work, and what their attitude [is] towards life in general which actually influence what they want to achieve in the tax function."* This triangulates the importance of personal values and moral standards, with the same sentiments also indicated by another participant: *"but I think when we get on talking about tax avoidance, then of course there is an element of ethics involved there [at leadership level] too."*

One interviewee finds that CEOs are likely to stop significant capital expenditure when *"you tell them they [the company] won't get a tax deduction for it [capital expenditure], they won't do the expansion. Full stop."* This experience corroborates experiences from other interviewees about the importance that some CEOs attach to low effective tax rates.

Experience indicates that the CEO's personality or leadership style can be an indication of the way in which they resolve grey tax issues. An interviewee finds that some CEOs are more likely than others to make corporate tax a board-level issue:

*"and then you get the CEO that says, you know what, tax is so important to me, I want my tax executive with me to sit and chat about tax" while another CEO would say "don't worry, if there's tax issues, I will talk to the Board on behalf of your head of tax".*

This interviewee argues that CEOs who insist that important and possibly grey tax matters are discussed at board level, are less encouraging of aggressive forms of tax avoidance because they rather encourage a consensus-based, transparent, and consultation-based approach. This suggests a more risk-averse approach, and therefore less tax avoidance. A CEO's leadership style in this instance may indicate a humble disposition; in other words, one that welcomes transparent discussion, welcomes collaboration on sensitive aspects, one that does not have predetermined conclusions in mind, leaving room for plurality of opinions. The encouragement of discussion about tax matters at board level may reflect less pressure by the CEO on the tax department to commit to a certain outcome, for example tax avoidance or low effective tax rates, regardless of the methods used to achieve them.

### **Views on aspects that suppress the CEO's incentive to effect tax avoidance**

Another participant's experience was that the corporate veil offers increasingly less protection from prosecution, arising from negligence in abiding by laws and regulations; this development affects professional individuals (such as

Chartered Accountants), who have been subjected to the NOCLAR-framework<sup>38</sup> since 2017. This legislation aims to ensure that professionals such as chartered accountants comply strictly with all rules and regulations; it warns that non-compliance may lead to disciplinary action from the regulator, SAICA, which may result in deregistration. According to one participant, the effect of such legislation may be to reduce the likelihood of a chartered accountant's involvement in tax avoidance in the capacity of CEO. However, the same participant notes in another argument that *"tax avoiders tend to follow the acts to the last letter"* which also casts doubt on this legislation as a threat. Chartered accountants have a good knowledge of the nature of tax legislation, where following the 'letter' as opposed to its 'spirit' may still leave the CEO safe because the likelihood of prosecution under this Act may be small.

To conclude: the interviews with corporate tax advisors indicate the involvement of the CEO in tax affairs: this involvement can range from directly to indirectly and from covertly to overtly. For example, the interviewees refer to a CEO's ability to emphasise the importance of target effective tax rates, whether tacitly or transparently. The CEO's leadership style, as it manifests in board activity, also influences tax behaviour. For example, some interviewees report that some CEOs are more encouraging towards the discussion of sensitive tax issues transparently at board level; they aim for resolution of those issues by using the benefits of diversity and consensus that are often characteristics of boards. Interviewees report that other CEOs are less inclined to put forward grey or sensitive tax issue to the board for discussion; instead, they opt to keep them off the radar, especially when they can be seen as aggressive forms of corporate tax avoidance. Other participants share their experiences regarding the influence of a CEO's age or duration in the CEO's chair as indicative of the level of involvement in tax affairs; they explain that younger or newly-appointed CEOs may tend to be more inclined to micro-manage divisions, including the tax department. There appears some support for the view that a CEO who is educated in tax and accounting will be more encouraging with regard to initiatives by the tax department to avoid tax. However, other participants cite other experiences.

### **The CEO's involvement in Corporate Social Responsibility initiatives to divert profits**

Some interviewees cited the CEO's direct involvement in designing the company's CSR strategy. One interviewee reported that the CEOs of some large companies with a significant footprint or direct dependence on local communities, such as mines, stand firmly on requirements for investment in CSR initiatives; in particular, such expenditure should be fully tax deductible, should enhance the company's reputation, and should directly benefit the local community from where the employees are drawn. This behaviour does not directly indicate a form of corporate tax avoidance as measured using effective tax rates, as long as those expenditures are deductible in terms of tax legislation. Therefore, effective tax rates are not affected. However, the company gets the opportunity to divert

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<sup>38</sup>NOCLAR stands for Non-Compliance with Laws and Regulations and it is a new pronouncement that was included in the IESBA Code of Ethics for Professional Accountants from 2017. This has subsequently been included in the SAICA Code of Professional Conduct.

profits (and reduce tax) to benefit the local community upon which it depends; in other words, the company has the opportunity to assume some of government's responsibility to effect wealth distribution on its own terms and led by its own discretion. In this instance, the interviewee states that the company is aware that government wastes taxpayer's money through misadministration and corruption, and this approach gives the company the opportunity to guarantee that society benefits from money which it would have paid over to government in the form of taxes. For instance, the company may establish a school or community centre or fund bursaries for further study; employees have access to all these company-supplied social benefits. There are benefits to the company as well. For example, corporate reputation is improved while costs that were originally not tax-deductible now become tax-deductible. One interviewee reports that a CEO would say in similar instances: *"I'm going to minimise the tax, let's rather build a school, so find a way of getting that [money] into a school."*

## **6.9 Interviewee bias**

An unexpected source of interviewee bias occurred after two interviewees created the impression of being neutral or even dismissive towards the actual existence of corporate tax avoidance in large, listed companies. The impact of such dismissiveness can be interpreted as a source of bias to their answers and comments, during the interviews, regarding their experiences with corporate tax avoidance. Unsurprisingly it was noticed that these participants generally found it difficult to provide specific examples of mechanisms that a CEO would use to influence tax avoidance; they also found it problematic to provide examples of how corporate culture might influence tax culture. Both participants expressed the view that the prevalence of corporate tax avoidance has markedly decreased in the last 15 years (2005-2019). One of those two interviewees attributes a decline in tax avoidance to the diminishing influence of banks, who aggressively used to sell *'tax structuring-vehicles;'* this practice had almost entirely ceased since *circa* 2006, because of punitive measures imposed by SARS. Another interviewee argued that the severity of fines currently imposed on individuals in their capacity as employees of companies, indicates a strong incentive for individuals not to engage in what can be construed as illegal behaviour.

## **6.10 Conclusion**

This chapter is the main section of the qualitative research methodological stream of this mixed-method study. This chapter reports on the results of interviews with corporate tax advisors to large, listed companies in South Africa, regarding their experiences with tax avoidance by corporates. The interviews were conducted in a semi-structured way that was designed to obtain the views of corporate tax advisers regarding the influence of corporate culture on corporate tax avoidance, as well as the influence of the CEO on both constructs. Transcribed interviews were analysed with reference to a classification system based on four main themes of relevance to the author of this study. The author documented the experiences and perceptions of interviewees regarding the nature of corporate culture using Theme D. Their views on the relationship between CEO characteristics and corporate culture were obtained from the results of the analysis of Theme B. The relationship between different corporate cultures and corporate tax avoidance was arrived at, using the results of the analysis of Theme C. Although not intended as hypotheses for

evaluation, the author develops propositions about the nature of the relationship for each of the themes, as documented in Section 6.7.

The results of the interviews provide support for the propositions developed. Thus, interviewees described instances of the influence of corporate culture on corporate tax avoidance, generally finding that risk-taking cultures and profit-focused (shareholder value oriented) corporate cultures are indicative of more aggressive tax avoidance in large companies. Also, interviewees provide clear accounts of instances when CEOs influence corporate culture, with some interviewees experiencing the CEO as the main 'champion' of corporate culture. Those responses of interviewees analysed under Theme A support the proposition that the CEO, and CEO characteristics, directly influence corporate tax culture and therefore corporate tax avoidance. For example, interviewees reported that some CEOs are more willing than others to make tax matters board-level issues, while some CEOs are more likely than others to emphasise the importance of low effective tax rates. Such emphasis can be overt or covert, aimed not only at the tax department, but also at other business divisions. Interviewees report distinctive experiences regarding the influence of a CEO's educational background and corporate tax avoidance: one interviewee found that a CEO with tax knowledge tends to be more confident in challenging the decisions of the tax department, saying that most CEOs generally do not have much tax knowledge.

The results of the interviews support the main propositions developed for each theme, as indicated. However, the nature of qualitative research methodology is not appropriate for proving or disproving those propositions developed. In this regard, the author's interviews also indicated instances when the interviewees' experiences did not necessarily support those propositions; arguably, this can be interpreted as showing that interviewer bias is reduced because the interviews were conducted in a way that allowed different views to surface. For example, some interviewees were dismissive regarding the existence of corporate tax avoidance, which may have made those interviewees reluctant to reflect on past experiences of the CEO's involvement in tax avoidance, or recollection of examples where corporate culture influenced corporate tax avoidance. Also, some interviewees lacked experience of distinctly different corporate cultures. The plausibility, however, of the author's expectation regarding the relationship between a more long-term oriented corporate culture and less tax avoidance was supported by some interviewees, who identified those types of cultures from their own experience.

The interviews provided more context on the influence of widespread governmental corruption and mismanagement in South Africa, on corporate taxpayers' attitudes towards taxes; in some instances, these attitudes influence tax behaviour. Many interviewees reported that their larger clients are becoming disgruntled because they are audited continuously by biased tax collectors who appear blind to reason, resulting in expensive correspondence and appeal processes, which are often settled eventually in favour of the taxpayer. Interviewees say that their large clients see themselves as soft targets from the regulator's perspective while the underlying problem is argued to be a regulator whose incentive systems are unreasonable in an environment which is characterised by a shrinking tax base. However, tax advisors do not expect these circumstances to encourage corporate tax avoidance by their large clients,

mainly because of limited opportunity to do so in large corporations subject to intensive public and regulatory scrutiny. It does, however, provide further credence to the experience of some interviewees that some corporations are using corporate social responsibility initiatives to channel profits to communities on which the corporation depends; this effectively bypasses government as an inefficient, wasteful, or fraudulent distributor of social benefits, although social benefits are one of the purposes of taxes.

The accounts of interviews provide qualitative evidence concerning the CEO's influence on corporate tax avoidance; nevertheless, the varied nature of those responses also indicates that the relationship may be dependent on many other CEO characteristics. Those characteristics include the CEO's age, gender, the tenure of the CEO at the company, whether the CEO's appointment was internal or external, or whether the CEO had been employed in specific industries before; for example, the banking industry. Then there are other CEO characteristics such as the CEO's personality. These characteristics are not controlled for in the quantitative research stream of this study, and this presents opportunities for future research, discussed in more detail in Chapter 8.

The next chapter compares the main findings derived from the quantitative research stream (as reported in Chapters 4 and 5) with the main findings from the qualitative research stream, reported in this chapter. That following chapter then integrates the quantitative and qualitative research streams in accordance with the requirements for mixed-methodology studies.

## 7 Integrating quantitative and qualitative findings

### 7.1 Introduction

This study has used a mixed-method methodology ('MM') research approach to arrive at a better understanding of corporate tax avoidance; this entailed an examination of the relationship between corporate tax avoidance and corporate culture. Therefore, this study uses a quantitative research methodology, which is considered to be the dominant research stream, and a qualitative research methodology, which is considered to be the secondary research stream. The rationale for, and benefits of, using a MM research methodology were discussed in Chapter 3, which explains methodology; there, it was shown how qualitative methodology can augment and complement the quantitative findings. Section 3.6 in Chapter 3 provides a schematic flow diagram (see Figure 3-3, page 98) that depicts how and at what point the findings of the quantitative research methodology are integrated with the qualitative findings. This is termed the point of integration, which is an important functional component of an MM study. The purpose of this chapter is to evaluate and integrate the main quantitative findings emanating from Chapters 4 and 5 with considerations and perspectives derived from the main qualitative findings recorded in Chapter 6. Conclusions are made in the next chapter. The evaluative discussion that now follows aims to show congruency between the quantitative and qualitative research streams, or areas of contradiction, where relevant and to argue for an appropriate interpretation. This discussion proceeds on a chapter-by-chapter basis, in which the main quantitative findings from Chapter 4 and 5 are compared with the relevant findings from Chapter 6, as informed by interviews with corporate tax advisors.

### 7.2 Chapter 4: Examining the relationship between long-termism and corporate tax avoidance

#### *Quantitative results*

The quantitative findings in Chapter 4 are based on the results of regression analysis in which a proxy of tax avoidance is regressed on a proxy variable for long-termism as a dimension of corporate culture. The results of fixed-effect regression show a negative association between long-termism as a corporate culture and corporate tax avoidance, which provides evidence that companies that are long-term oriented are inclined to pay more tax. The fixed-effect regression does, however, indicate that the 'within-company' effect is more pronounced than the 'between-company' effect. The quantitative evidence therefore supports the expectation that companies with a long-term oriented corporate culture pay more taxes on average; this is indicative of such companies' acknowledgement of their mutual interdependence on the well-being of many stakeholders, including the revenue authorities which are custodians of the social wellbeing. It is argued that stakeholder-oriented companies are more ethical than the others, because true concern for the long-term sustainability of the interdependent partners in the corporate ecosystem is the acme of a corporate ethical disposition.

The possible influence of a CEO's characteristics on either long-termism or corporate tax avoidance is not assessed quantitatively in this chapter, although the author acknowledges that the CEO's influence on the temporal orientation of a company, as a corporate culture, is a possibility. This issue is considered from a qualitative perspective in the next paragraph.

### ***Related qualitative findings***

The qualitative propositions relevant here are contained in Theme C, as well as Theme B; both these themes were discussed and analysed in Chapter 6, which involves the propositions that corporate culture influences tax avoidance (Theme C), and that the CEO influences corporate culture (Theme B). The results and analyses of the interviews indicate support for the proposition in Theme C. Those interviewees reported on their experiences, and these supported the view that corporate culture is indicative of the type of tax behaviour, tax culture and corporate tax avoidance. One interviewee finds alternating corporate cultures based on whether companies are oriented as 'profit-only' or 'beyond-profits only.' According to that interviewee, those cultures are so distinctive that the interviewee's choice of sales and marketing strategy, in terms of the type of tax advisory services, are predominantly based on this assessment of corporate culture. The way in which this interviewee articulates the main difference between corporate cultures is closely related to the idea in the premise of this study: that is, long- and short-term oriented companies would differ in terms of their propensity to avoid corporate tax. This is not the only example that interviewees have cited, concerning the existence of different corporate cultures and accompanying variations in corporate tax culture. Other interviewees cite variations in inclination towards corporate tax avoidance, based on whether the company culture is perceived to be more entrepreneurial versus more conservative.

The interviewees report contrasting experiences regarding a CEO's influence on corporate culture. Although most generally believe that CEOs indeed do have an influence, few could recall any striking examples of whether specific parts of a client's corporate culture were changed by a CEO in a specifically observable way. Interviewees mostly indicated that the CEO's values, as far as they could observe, were in accordance with the corporate values; interviewees conceded that is difficult to say whether the corporate culture was influenced by the CEO or whether the CEO influenced the corporate culture. Some interviewees expressed the view that corporate culture is dominantly influenced by the requirements of corporate governance frameworks and other requirements related to compliance ; in view of this, they had difficulty in recalling if and how a CEO influenced corporate culture. The results of the quantitative stream, however, provide evidence that corporate culture is associated with tax avoidance, after controlling for a proxy for ESG, which includes a governance element, although the results pertaining to the ESG-effects are not robust. However, the interviewees' mix of different experiences on this point of interest indicates that the extent and intensity of a CEOs influence on corporate culture, are subject to many factors of which not all directly observable or reportable by interviewees.

## ***Conclusion***

The results of the quantitative evidence indicate a negative association between long-termism (a dimension of corporate culture) and tax avoidance; this is supported by the qualitative research stream's findings based on the experience of corporate tax advisors.

### **7.3 Chapter 5: Examining the relationship between a CEO effect and corporate tax avoidance**

#### ***Quantitative results***

Chapter 5 contextualises and integrates the results of a quantitative study in the format of an academic paper. That paper formed part of this study and it examines the relationship between tax knowledge attributed to the CEO as a CEO effect, and corporate tax avoidance. Regression is used in that paper to examine this relationship in which effective tax rates, as proxy for corporate tax avoidance, is regressed on a CEO effect (tax knowledge attributed to the CEO), using a dummy-variable. The results of fixed-effect regression indicate evidence of the expected positive relationship between tax knowledge attributed to the CEO and corporate tax avoidance. The results of quantile regression on the results of cross-sectional OLS regression confirm this relationship, especially in those companies with effective tax rates in the lowest percentiles. Thus, a higher level of tax knowledge attributed to a CEO (as a CEO effect) is expected to be associated with more corporate tax avoidance; this influence would be in the form of direct pressure exerted by the CEO on the tax departments. However, there is also some evidence that the CEO's influence is not always of overriding importance. For example, the regression specifications used to analyse the relationship between this CEO effect (tax knowledge attributed to the CEO) and corporate tax avoidance incorporates an interaction term as additional control variable. This interaction term is composed of the proxy variable for corporate social responsibility and the CEO effect. The regression results indicate evidence that the CEO's efforts to increase the amount of corporate tax avoidance can be tempered by the influences of stakeholder-sensitive corporate cultures. However, the quantitative result on the interaction term is not robust.

#### ***Related qualitative findings***

Of the four qualitative themes, Theme A is the most relevant to contextualise the quantitative findings highlighted above. Theme A incorporates the qualitative proposition that CEO characteristics influence corporate tax culture and corporate tax avoidance directly. Here, some interviewees recall instances when a CEO would emphasise the need for lower effective tax rates; this message would sometimes be explicit and direct and at other times, more implied. Other interviewees recall instances when a CEO would be extremely cost-conscious and would encourage cost-efficient behaviour in all company divisions, including the tax department for tax savings. Some interviewees recalled that the CEO's expectation about a 'target range' of acceptable company-wide effective tax rates was communicated or signalled tacitly to those who were best positioned in the company to pursue tax-efficient options; on the other hand, other CEOs are less concerned about low effective tax rates as a value-driver. In response to a question by the interviewer on the likelihood of a CEO with tax knowledge having an influence on tax avoidance, one interviewee

replied that those CEOs appear more confident in discussions with their tax departments; as such, they are more likely to challenge conservative tax decisions taken by a tax department. This indicates evidence that CEOs with tax knowledge could influence the degree of aggression with which tax avoidance is pursued.

Other interviewees indicated that the influence of a CEO with tax knowledge, on tax culture, is not directly experienced. Alternatively, interviewees suggested that tax avoidance is influenced by other CEO attributes; for example, the CEO's tenure in the company, whether the CEO was hired externally or promoted, or whether the CEO had a banking background, or the CEO's gender. Some interviewees recalled not having encountered any evidence of a CEO's direct influence on corporate tax avoidance or tax culture. It is argued that this can be interpreted as evidence that some corporate cultures are less influenced by the CEO, especially in those organisations where any attempt by a CEO to encourage corporate tax avoidance is perceived as 'unethical conduct.' This applies especially to a tax department in a company with a corporate culture which is more 'ethically-inclined.' The view of the interviewees who cannot recall vivid examples where a CEO influenced tax culture directly, provide a measure of plausibility to the non-robust quantitative result in this regard.

### ***Conclusion***

The qualitative evidence, based on the interviews conducted, indicates support for the quantitative findings discussed above. These, in turn, support the expectation that a CEO with tax knowledge is directly associated with corporate tax avoidance. The question arises: can corporate culture on its own, as a factor independent from CEO effects, have an overriding effect on tax avoidance? This is answered as follows. Thus, the interaction term composed of the CEO-tax knowledge effect and corporate social responsibility as a construct related to corporate culture, provides evidence that the CEO's effects are suppressed by such a corporate culture; that applies insofar as the corporate culture constitutes an offsetting effect. Furthermore, one should recall that not all interviewees clearly experienced any direct influence by the CEO, with those CEO characteristics, on corporate tax avoidance; the fact that not all interviewees encountered this can be attributed to the push-back effect in existing corporate cultures in those companies that do not allow 'unethical' CEO effects to be exerted on the tax department or other divisions in a company. In some instances, the CEO's personality or other unobserved CEO effects may explain why some CEO effects transcend the corporate culture in some companies and not at others.

The next chapter concludes this study on the relationship between corporate culture and corporate tax avoidance. It shows how the research questions and research objectives were addressed and then discusses the main findings. It also evaluates the evidence gathered in this study in terms of the thesis statement, and then concludes whether the thesis statement can be accepted or refuted. It discusses limitations to the research and identifies areas for future research as well as implications for the authorities.

## 8 Conclusion

### 8.1 Introduction

This chapter provides a summary of the main findings together with the theoretical implications of this study. Conclusions about the thesis statement are also presented, as well as a summary of contributions, a description of limitations to the study and suggestions for further research.

A brief discussion of the main findings follows below.

### 8.2 Summary of findings

In the introduction to this study, seven research objectives were identified; these were denoted A-G. These objectives needed to be achieved to answer the research questions and to arrive at a conclusion on the thesis statement. A summary of the key findings for each research objective is provided below and this is followed by an evaluation of the thesis statement. Each of the seven research objectives is stated in *italics*, and is followed by a brief description of the main findings.

- A. *To obtain an understanding of average effective tax rates for the large, listed South African companies over the period 2004-2019, including whether tax avoidance mirrors any changes in the institutional environment.*

The results of descriptive statistics performed in Chapter 4 indicate fluctuations in effective tax rates which correspond to some political developments during the period under review: 2004-2019. These developments include deteriorating tax morale especially after 2009, when the corrupt presidency of Jacob Zuma started; this coincided with an observable decline in corporate effective tax rates in South Africa which corresponds to declining corporate tax morale. This trend supports the notion of a new *zeitgeist* present in South Africa where some companies are starting to show resistance against paying more taxes, wherever it is feasible to do so. The fluctuations in average effective tax rates during the period under review, and the spread between the statutory tax rate of 28% and average effective tax rates, indicate moderate levels of corporate tax avoidance in South Africa; this is because the spread never exceeded 3%. However, a declining trend in effective tax rates is evident towards the end of the period under observation; this is supported by qualitative evidence from interviewees that large corporates are becoming frustrated and tired of being seen as the milk-cow of the South African Revenue Services in times when a shrinking tax base, widespread unemployment and government mismanagement and waste of taxpayers' money are the more significant problems in the South African corporate milieu. In this regard changes in effective tax rates in South Africa during the period of observation suggest how changes in values become institutionalised in corporate behaviour as well, including tax avoidance.

*B. To obtain an understanding of the determinants of corporate tax avoidance in large South African listed companies.*

The regression specifications used in this study incorporated various control variables: for example proxy variables for CSR- and governance-disclosures, profitability; financial-leverage; capital-asset intensity; intangible asset-intensity; company size; and, price-to-book ratio of companies. Overall, corporate social responsibility and corporate governance, as well as company profitability are factors that are negatively associated with corporate tax avoidance; in other words, those companies with more appreciation of the principles of corporate social responsibility show less inclination towards tax avoidance. From a theoretical perspective, this evidence relates to stakeholder theory with the derived expectation that the behaviour of stakeholder-sensitive companies would show a regard and concern for the interests of a wide array of stakeholders; this would include the obligation to pay taxes to the government, as the custodian of the social interest. The finding that larger companies are more likely to pay less tax suggests that they may be inclined to subscribe to the theory of shareholder value maximisation as the overall purpose of the company. Qualitative evidence suggests the importance of corporate governance as a factor that decreases levels of corporate tax avoidance, while interviewees acknowledge the impact of government corruption and waste of taxpayers' money as external determinants of corporate tax avoidance. The interviews with tax advisors indicated that they experienced instances when companies used investment in corporate social responsibility to reduce corporate profits, and therefore also tax; the benefit of this tax saving is channelled directly to charitable works to benefit those communities on which the company depends for its long-term sustainability.

*C. To identify a proxy to operationalise long-termism as a corporate culture, and subsequently to calculate a long-term score for each company-year observation in the sample.*

The McKinsey Corporate Horizon Index ('MCHI') is identified in this study as a proxy to measure long-termism as a type of stakeholder-driven corporate culture in companies. As mentioned elsewhere, that index includes five factors that capture elements that are indicative of long-term oriented behaviour in companies. Evaluation of the indicators indicates that they are logically related to a long-term orientation. Also, they are all grounded in academic literature which provides credence to their inclusion in a construct to measure long-termism for the purposes of this study. The MCHI-methodology is applied to all the observations to calculate a long-term score for each one. Descriptive statistics on the calculated long-termism scores indicate volatility in the long-termism scores from year to year, which is surprising as it was initially assumed that corporate culture would be more stable from year to year. It is argued in this study that a long-term corporate culture is the acme of a stakeholder-oriented corporate culture. This viewpoint is closely related to the ideas contained in stakeholder theory because an ethical corporate disposition indicates a company's sensitivity to the interests of stakeholders; it acknowledges the company's inter-dependence on those stakeholders for long-term sustainability.

*D. To investigate the relationship between long-termism, as a particular type of stakeholder-driven corporate culture, and corporate tax avoidance.*

The regression analysis performed in Chapter 4 indicates that long-termism is negatively associated with corporate tax avoidance, at levels which are statistically significant; this means that long-term oriented companies pay more tax, on average. This study argues that this association supports stakeholder theory which predicts that the behaviour of stakeholder-oriented companies will be in accordance with the mutual well-being and interests of stakeholders, and more so, if a company has a long-term perspective of its purpose and dependence on stakeholders. Therefore, this finding indicates that companies with a relatively short-term orientation are more inclined to subscribe to the ideas contained in the theory of shareholder value maximisation. This finding shows that short-term oriented companies pay less tax on average than those more long-term oriented; this is an indication that short-term oriented companies have a mindset more in congruence with the theory of shareholder value maximisation, which emphasises the interests of shareholders.

The results of the analysis of qualitative data are in accordance with the quantitative findings discussed in the previous paragraph; thus, some companies are inherently more stakeholder-oriented and as such, they are perceived as less aggressive corporate tax avoiders. This means that not all companies subscribe to a new *zeitgeist* in the South African corporate landscape in the aim of avoiding tax, as suggested by a decline in tax morale and slowly declining effective tax rates. This finding also means that not all companies' behaviour is merely informed by ideas contained in economic theory, such as rational utility optimisation; on the contrary, ethical considerations can play a meaningful role in companies' corporate behaviour.

*E. To investigate the relationship between tax avoidance and tax knowledge and tax awareness of a CEO.*

The quantitative results reported in Chapter 5 indicate that tax knowledge attributed to a CEO (as a CEO effect) is positively associated with corporate tax avoidance. However, this effect is tempered in those companies which show a higher consideration of principles of corporate social responsibility ('CSR') and corporate governance. Although CEO effects, such as tax knowledge attributed to the CEO, can influence corporate tax avoidance directly, it is argued that the tempering effect observed by CSR is evidence that CEO effects are also mediated by corporate culture; this is insofar as a company's consideration of CSR principles can be described as a dimension of corporate culture. This evidence relates to Upper-echelon theory, which predicts the significant influence of top leadership-characteristics on corporate behaviour. Here, the term 'top leadership' comprises the CEO and the other top managers. If Upper-echelon theory were the only factor relating to corporate behaviour, then tax avoidance at those companies with particular CEO effects would not have been changed by the fact that some of those companies perform well in the area of corporate social responsibility. This evidence show that the behaviour attributed to the upper-echelon effect is conditional and is influenced by some other elements of corporate culture, *ex ante*. This would mean that some CEO effects, such as tax knowledge as a CEO effect, may influence corporate culture to become more aligned with the

principles of shareholder value maximisation theory; this may be tempered by some corporate culture elements that may be more encouraging of stakeholder-orientation. The direct impact of the CEO and the CEO characteristics on corporate tax avoidance are described by some interviewees in Chapter 6, which reports on the results of interviews with corporate tax advisors. Some interviewees cannot recall any particularly memorable experience of a CEO's direct influence on tax matters and tax avoidance; this suggests that the CEO effect is not overly important in those cases where an ethical corporate culture prevents 'unethical' CEO effects from influencing 'ethical' tax behaviour, as corporate tax avoidance is sometimes described.

*F. To conduct interviews with corporate tax advisors to understand the severity of corporate tax avoidance in large, listed South African companies; understanding the influence of corporate culture on tax avoidance, as well as to obtain their impressions about the CEO's influence on both corporate tax avoidance and corporate culture.*

Chapter 6 of this study reports on the experiences of corporate tax advisors regarding the issues stated in this research objective. Most interviewees are moderately dismissive of the notion that corporate tax avoidance is pursued aggressively at the large companies in South Africa; they attribute this to three factors. The first factor concerns reports that banks no longer market and sell 'tax structures' as they used to until the early 2000's because of punitive measures taken by SARS to stop these schemes. The second factor concerns continuous tax audits by SARS and its intensive, unabated scrutiny of large corporates' tax affairs to enable the fiscus to collect all the revenue that it possibly can in view of a shrinking tax base, exacerbated by South Africa's growing budget deficit and other growing economic problems such as widespread unemployment, crime and government corruption. The third factor concerns effective corporate governance mechanisms in South African companies, such as the King IV requirements which require responsible corporate tax behaviour.

Interviewees reported that, according to their experience, corporate culture is indicative of corporate tax avoidance; for example, they perceived that 'profit-only' focused companies are generally more tax aggressive while those having a more stakeholder-sensitive approach are less tax aggressive. Generally, the interviewees experience congruence between the corporate culture as they perceive it and corporate behaviour, including tax affairs.

Some interviewees experienced the direct influence of the CEO on corporate tax avoidance and tax behaviour. For instance, some interviewees report that CEOs communicate or signal targeted effective tax rates, while other CEOs sometime dictate terms to the tax department regarding tax decisions. Other interviewees do not experience such behaviour, saying that the CEO's attention to more strategic matters and corporate governance mechanisms, limit the CEO's direct influence on tax matters and tax avoidance. Interviewees acknowledge the influence of CEOs on corporate culture, generally, but felt that the influence is mostly 'positive,' because none of them could vividly recall instances where a CEO with 'unethical' tendencies had an unethical influence on corporate culture.

The results of interviews indicate that large companies are developing an increasingly negative disposition towards their responsibility and obligation to pay tax, although the interviewees do not necessarily foresee any dramatic increase in corporate tax avoidance. The reasons for the negative attitude towards taxes include factors such as government's widespread mismanagement of taxpayers' money, government corruption, and the regulator's incessant requests for more information; they also report that information and correspondence is ignored by SARS after legitimate tax deductions are claimed. This can be interpreted as evidence that deteriorating political and governmental factors will not necessarily push corporate behaviour to become more oriented towards shareholder value maximisation. The regulator's reported tendency to ignore careful consideration of well-documented responses to SARS's queries and the inordinate costs involved in satisfying the regulators' inquisitions are also contributing to a low tax morale, although interviewees argue that this will not necessarily lead to more corporate tax avoidance.

*G. To obtain an understanding of the mechanisms that South African CEOs of large corporations may use to effect corporate tax avoidance.*

Interviews with the corporate tax advisors indicate interesting mechanisms that CEOs use to encourage and effect corporate tax avoidance. Some interviewees note the use of targeted effective tax rates which are communicated or signalled tacitly or more overtly by the CEO to those people in the company best positioned to achieve them. Other interviewees report that some CEOs would put pressure on tax departments to play their part in company-wide initiatives to save costs and to conserve cash. Other interviewees recall examples where a CEO would dictate terms to the tax department regarding important tax decisions that could have implications for corporate tax avoidance. Some interviewees report that some CEOs are more inclined than others to make 'grey' issues in tax a subject for board-level discussion; those interviewees argue that initiating board-level discussion indicates a CEO's commitment to transparency and risk-aversion pertaining to tax avoidance. Interviewees report that some CEOs encourage the use of CSR initiatives to reduce a company's tax burden. According to the interviewees, this indicates that CEOs are increasingly prepared and willing to channel corporate profits to those communities on which companies depend, as part of their CSR initiatives; this movement represents an attempt to bypass the South African government which is perceived to be an inefficient and corrupt distributor of social benefits. This suggests a new view of the use of CSR to effect tax avoidance, for the intended good of society, not for legitimacy purposes or shareholder value creation, nor for agents' rent-extraction as reported in the literature. This type of tax avoidance will however not manifest in changes in effective tax rates, because the CSR expenditure is tax deductible and deducted as an expense for accounting purposes. The levers used by the CEO to avoid corporate tax can be described as levers used to achieve certain outcomes; this is in line with Upper-echelon theory that posits the significant influence that top leadership has on corporate behaviour.

### 8.3 Evaluating the thesis statement

The thesis statement examined in this study was formulated as follows in Chapter 1, the introduction to this study:

*“Corporate culture exerts a long-term influence on corporate tax avoidance that is not merely a reflection of the CEO’s characteristics.”*

This section evaluates the extent to which the evidence collected in the preceding chapters of this study support the thesis statement. For this purpose, the thesis statement is first broken down into its constituent parts and is then considered as a whole; at that point a conclusion is reached.

The thesis statement presupposes that corporate culture is a recognizable construct with consequences for corporate behaviour. The literature review in Chapter 2 grounded this construct in academic literature and showed that it is values-based, and with consequences for corporate behaviour and for corporate outcomes; these extend to corporate tax behaviour and therefore corporate tax avoidance. The interviews conducted with corporate tax advisors confirm their experience of the existence of corporate culture, as well as its variability across their client-companies. They also refer to the influence of corporate culture on all aspects of corporate behaviour, including tax behaviour.

The sub-phrase of the research thesis states that corporate culture influences corporate tax avoidance; the validity of this sub-phrase is supported by quantitative and qualitative evidence. Thus, Chapter 4 examines, quantitatively, the relationship between long-termism as a type of corporate culture, and corporate tax avoidance; that chapter provides evidence that companies with a long-term orientation do pay more tax, on average. This indicates the influence of corporate culture on corporate tax avoidance. Chapter 5 provides quantitative evidence that tax knowledge attributed to the CEO (as a CEO effect), is positively associated with corporate tax avoidance. This means that CEO effects, as described, can make a company more shareholder-oriented as opposed to stakeholder orientated; this is posited in the theory of shareholder value maximization and the stakeholder theory, respectively. The CEO effect can be direct or indirect: the direct effect means that tax avoidance can be influenced directly, for example, by the CEO propagating target effective tax rates. In contrast the indirect effect could occur by influencing corporate culture; for example to emphasize the importance of certain values which can influence behaviour. However, the interviews with corporate tax advisors together with the data obtained in this study indicate corporate culture’s influence on corporate tax avoidance. The evidence includes experience recalled by interviewees of differences between corporate cultures at client companies; the interviewees report that these differences in culture coincide with differences in tax behaviour, including corporate tax avoidance.

Evidence shows that the influence of corporate culture on corporate tax avoidance is not merely related to CEO characteristics (CEO effects) alone; this is an important tenet in the thesis statement as formulated. This is based on

two arguments. The first of these is based on quantitative evidence derived from Chapter 5 which finds that the type of corporate culture can temper the CEO effects that are associated with corporate tax avoidance. This shows that CEO effects can be subject to other firm-level characteristics including factors related to corporate culture, such as a company's sensitivity to wider stakeholder interests. The second argument involves qualitative evidence from the interviewees. Generally, they experienced the important effect of corporate culture on corporate behaviour, including tax behaviour and corporate tax avoidance. However, not all interviewees reported experiencing the direct effect of CEO characteristics on corporate tax avoidance. It is argued that these latter instances indicate examples where a company's corporate culture is less permeable to CEO influences (CEO effects), supporting the notion that corporate culture, while influenced by a CEO, also has a part in it that is less amenable to change in response of upper-echelon pressure, which could be part of the reason why a CEO's direct effect on corporate tax avoidance is not always consistently perceived by the interviewees.

The last section of this discussion relates to the reference in the thesis statement to '*a long-term influence*' on corporate tax avoidance. On a cross-sectional basis between companies, the effect of long-termism on corporate tax avoidance is weaker than the 'within-company' effect which is stronger, signifying that the effect of corporate culture changes over time. Therefore, this part of the thesis statement is not supported by the evidence. That statement is therefore slightly amended in line with the evidence available, to postulate only that:

*"Corporate culture exerts an influence on corporate tax avoidance that is not merely a reflection of the CEO's characteristics."*

This study has examined, from a theoretical perspective, how three different theories explain corporate tax avoidance in the South African context. Thus, the study shows that the theory of shareholder value maximization, stakeholder theory, and Upper-echelon theory all help towards an explanation of corporate tax avoidance. However, this study provides empirical evidence that the applicability of Upper-echelon theory to corporate tax avoidance is conditional; thus, it depends upon the extent to which a corporate culture (such as long-termism) can suppress or encourage the effects related to Upper-echelon theory, as far as the CEO's influence on especially unethical corporate behaviour is concerned.

This section argues for the acceptance of the overall research statement, as amended above. However, that acceptance is subject to some limitations which are discussed later in section 8.5.. These limitations also present research opportunities which are also considered.

#### **8.4 Towards a new theoretical perspective**

On a high level, this study examines and indicates empirical support for the influence of three theories that explain or predict corporate tax avoidance. These theories are: the Upper-echelon theory ('UET'), stakeholder theory ('ST') and shareholder value maximisation ('SMV') theory. Their definitions and contextual place in this study have been

explained in the literature review. In accordance with the findings in the literature, this study also finds evidence that tax knowledge, as a CEO effect, influences corporate tax avoidance; this stems from the relevance of UET to explain corporate behaviour. There are many other CEO attributes or CEO characteristics that can also influence the likelihood of the CEO influencing corporate tax avoidance, and these surfaced from the interviews. The interviews revealed and theorised that short-tenured CEOs tend to be conservative, and are inclined to act on the conservative or 'safe side' of judgement; this is probably because short-tenured CEOs are still new to, and unaccustomed to, the role and therefore subject to much scrutiny. In contrast, CEOs who have been longer in the role tend to be less conservative, with a higher risk appetite and more tolerance for uncertainty that accompanies a more aggressive approach to tax and to uncertain tax positions. The previous experience of a CEO in a banking environment is a predictor of a more aggressive attitude towards tax, predicting more tax avoidance. Therefore, the qualitative evidence indicate the influence of CEO attributes or CEO effects in determining corporate tax avoidance.

Moreover, this study finds evidence that long-termism (as a dimension of corporate culture which is closely related to the ideas contained in stakeholder theory) influences corporate behaviour; in this instance, corporate tax behaviour. UET posits that CEO characteristics influence corporate culture, and this is supported by the literature review. Conversely, this study argues that short-termism, as the opposite of long-termism, is closely related to the ideas contained in SVM theory; this posits that top-management behaviour is incentivised to prioritise the creation of shareholder value, sometimes to the exclusion or neglect of the interests of other stakeholders, depending on circumstances.

It is argued that these three theories, that explain corporate behaviour and relationships between stakeholders, will always be relevant and applicable, to a greater or lesser extent, in explaining corporate tax avoidance in the general case. What is less obvious, however, is the nature of the interaction between CEO effects and types of corporate culture (corporate culture effects); this is because the effects' intensity may be conditional on the factors described next.

Some corporate cultures are more long-term oriented, while others are more short-term oriented, as described before. Empirical evidence indicates that organisations with long-term orientated corporate cultures pay more tax on average than those with short-term oriented corporate cultures. Generally, this study argues that long-termism is the apex of a corporate ethical disposition. Corporate culture is a function of a company's entire growth trajectory, the founder's values, and founder's ideals, and even shareholder attributes. Then one can add factors such as the culmination of the accretive effects of all of the past CEOs, and the legacies of all the employees who have been employed at the company through its entire history, to mention but a few of an almost infinite number of factors. Some interview participants indicated that corporate governance has become institutionalised in the larger South African companies and this also influences corporate culture. In order to reconcile the findings of this study within the current theories available to explain corporate tax avoidance, then one could posit that corporate culture is constituted of two different parts. Thus, there is a more stable part, and a less stable but more dynamic part which is

more subject to dynamic change. It is theorised that the nature of the stable part of corporate culture explains the extent to which corporate behaviour, including tax avoidance, is influenced by the CEO; this applies especially if critical CEO values are not aligned to the values presented by the stable part of corporate culture. For example, it is theorised that a long-term oriented corporate culture, which is arguably related to the more stable part of corporate culture, will be less likely merely to accept the influence of a CEO who encourages corporate tax avoidance, or tries to effect aggressive tax avoidance directly through other channels. Conversely, in organisations where the stable part of corporate culture is more short-term oriented, one would expect that the CEO's influence in encouraging or favouring tax avoidance, to create shareholder value, will be more successful in achieving such an objective. Arguably, the CEO effect on corporate tax avoidance will be stronger in such organisations, where the corporate values and CEO values are aligned to reinforce each other.

However, it is argued that some provisos to this general rule exist. After all, some CEO attributes could be expected to nullify any general rules that predict the intensity or likelihood of success of the CEO's influence on corporate tax avoidance. The first proviso concerns the CEO's personality: as far as one can predict, the general rule will not hold in the case of a narcissistic CEO. The ideas and goals of the narcissistic CEO will eradicate the influence of the stable part of corporate culture when CEO values and corporate values are not aligned. Also, if the CEO is hired from outside the organisation, then one can expect that the relationship between the permeability of corporate culture and the influences of the CEO to be changed; however, two opposing theories can be developed from this assumption. Thus, it is expected that the stable part of corporate culture will either yield or not yield to the influence of the CEO, which is an empirical question, with arguments supporting both options. Firstly, it is possible that a new CEO will be sensitive to the existing stable part of corporate culture and will attempt to fit in, adapt and obtain the support and guiding coalition of the people in a company in order to achieve that CEO's goals. Alternatively, the fact that an externally-hired CEO has few pre-existing relationships and networks within the company that need to be honoured, provides more room for an externally-hired CEO act to swiftly, and with determination and with less sensitivity to try and disrupt the stable part of corporate culture. A new CEO's behaviour and leadership style also have no precedents which should be honoured, which makes it easier for the CEO to ignore the stable part of corporate culture to execute their plans.

## **8.5 Limitations to this study**

The conclusion to the thesis statement, above, is subject to some limitations, which are discussed in this section. Some of these limitations relate to the data and methodology used while others concern the extent to which findings can be generalised to other countries.

### **8.5.1 Methodological limitations in quantitative methods**

The general nature of quantitative statistical research in social research is highlighted as an overall limitation for most quantitative findings. Regression analysis is based on observational data which means that randomised assignment of

data into control- and intervention-groups cannot be done. While techniques such as 'natural experiments,' regression-discontinuity, or instrumental variables are sometime used to control for endogeneity and lack of random assignment, the use of these requires specific contexts which are not available in this study; for example, an instrumental variable needs to be available or a discontinuity should be present. Endogeneity is therefore not entirely controlled for, although it is addressed to some extent using fixed-effect regression.

### **8.5.2 South African data**

South African data is used in this study for specific reasons. The most important reason is that South African data allows the researcher to operationalise tax knowledge as a CEO effect, because a significant percentage of the CEOs of large companies are chartered accountants. This argument is explained in Chapter 5. However, there are some limitations regarding the use of South African data. For example, South Africa has fewer large listed companies than other countries such as the US and the UK, which results in smaller sample sizes in South African studies. Also, the large international providers and aggregators of financial databases, such as Bloomberg or Reuters, only rate the larger companies for their performance related to corporate social responsibility and corporate governance; for example in the form of Bloomberg's ESG-rating. The unavailability of these ratings for all company observations results in smaller samples and issues related with missing variables for the application of quantitative analysis.

South African corporate tax advisors were interviewed during the qualitative research stream. For reasons explained elsewhere in this thesis, it was felt that those interviewees were best-qualified to provide valid comments on their experiences in the South African context, which is the focus in this study. Although the qualitative findings could be relevant to other contexts as well, it is possible that the nationality of interviewees could influence people's perceptions and interpretation. For example, Hofstede, Neuijen, Ohayv and Sanders (1990:300) note the importance of national culture as a determinant of interpretation; this means that interviews with American tax advisors, for example, might have rendered different opinions.

### **8.5.3 Proxy variables and construct validity**

Proxy variables are used to operationalise constructs which are used as explanatory variables in regression specifications; these include, for example, long-termism as a dimension of corporate culture and tax knowledge of a CEO as a CEO effect. Moreover, the literature review indicates that the nature of corporate culture has characteristics of irreducible complexity. Some level of measurement error when measuring these constructs is possible, which may impact the validity of the findings. As far as can be assessed, this academic research is the first to use the guidelines published by McKinsey to calculate a long-term orientation score. In this thesis, it is highlighted that some degree of measurement error can be present in the calculation of the MCHI score; this is largely attributable to missing data on some of the indicators used in this instrument. For example, not all companies in South Africa are actively followed by investment analysts and this shortcoming gave rise to the need to calculate the MCHI score also without this indicator, as described in Chapter 4.

#### **8.5.4 Limitations related to qualitative data collection processes**

The qualitative findings are based on the data obtained from interviews with corporate tax advisors. This suggests the possibility of bias in capturing the data as well as in the analysis of data based on themes; this stems from the inherent subjective nature of interviews as a narrative social process that relies on subjective interpretation. The steps taken by the author to reduce the impact of bias are described in Chapter 6 but the author concedes that some level of bias may remain. In this regard, the author acknowledges that self-selection bias or interviewee bias can be present. For example, the dismissiveness of some interviewees regarding the extent of tax avoidance may be a form of bias as they may be sensitive to the fact that they may have played a part in corporate tax avoidance processes. Admittedly, the interviewees may have differing amounts of experience of tax avoidance practises and this could explain why some of are more prejudiced than others toward some of those issues. Also, they could be more prejudiced because they remember specific experiences better than others, which could affect the qualitative findings. For example, a tax advisor who advises clients intensively on transfer pricing could be less aware of other forms of tax avoidance pursued at the same company if other tax advisors are used for other tax issues. If a company follows a conservative tax strategy with regard to transfer pricing, but is more aggressive in other domains in which the particular advisor is not consulted, then it follows that this tax advisor would not describe the same company as being engaged in overly aggressive tax avoidance behaviour.

Also, the author's identity, personal preferences and interests, as well as his gender, race, and educational background could have resulted in more bias, leading the author to ask certain questions, to encourage more elaborate discussion of certain topics. For example, the author has a keen interest in history and may therefore have a tendency to interpret current developments in tax avoidance as being a case of history repeating itself.

As indicated in the literature review, tax advisors have been instrumental in helping companies pay less tax. As noted in Chapter 8, some interview participants were sometimes neutral or even dismissive regarding the existence of corporate tax avoidance. It may be argued that tax advisors who have helped companies to avoid tax, in the past or present, might be inclined to be desensitised to identifying or discussing practical considerations, because their views of the severity of that tax avoidance may be biased.

The interviews were conducted at the time of the Covid pandemic, which necessitated the use of Teams meetings and other online forms of media to conduct the interviews. This method has some disadvantages; for example, the interviewees' face-expressions, tone of voice and even body-language have not always been easily observable.

#### **8.6 Recommendations for future research**

The limitations discussed in the previous section offer opportunities to researchers who may be able to overcome those limitations to advance understanding of corporate tax avoidance.

### **8.6.1 Examining the relationship of other CEO characteristics, corporate tax avoidance and corporate culture**

The interviews with corporate tax advisors indicated that CEO characteristics such as the CEO's age or gender, or whether a CEO was promoted into the role or recruited from outside the company, can all influence the nature and extent of the CEO's influence on corporate tax avoidance and corporate culture. The influence of these CEO characteristics could be examined empirically by researchers with access to such data for use in regression analysis. For example, these characteristics could be operationalised using dummy-variables and included the specifications of regressions.

The theoretical discussion in section 8.4 posits that the direct influence of the CEO on corporate behaviour is subject to the nature of the stable part of corporate culture; this would apply to matters such as corporate tax avoidance, which could be argued as being unethical. In that theoretical development discussion, it is argued that the stable part of corporate culture is less permeable by dynamic CEO effects. This theory can be empirically tested. For example, the stable part of corporate culture could be operationalised using a dummy variable for being either long-term or short term oriented; having done this, the researcher could then examine the influence of the CEO effects, discussed above, on other corporate behaviour as the nature of the stable part of corporate culture varies between different states. Furthermore, the theory advanced in the theoretical discussion posits that the theory is conditional on some CEO characteristics. For example, it is posited that a CEO who shows signs of narcissism will supersede the influence of the stable part of corporate culture when there is a lack of congruence between the values of the CEO and the corporate values at the heart of the stable part of corporate culture. Narcissistic tendencies in CEOs can be operationalised, for example, by using analytics on signatures of CEOs; this approach was followed in a study by Ham, Seybert and Wang (2018).

### **8.6.2 Use of broader data sets**

US data and the MCHI could be used to calculate long-termism scores for a sample larger than the one used in this thesis; the outcome may vindicate this study's findings with more statistical power on tests. Fewer missing data points, for example ESG-data, could provide more clarification on the relationship between long-termism, CSR and CEO-characteristics.

### **8.6.3 Identification and use of other proxies for corporate culture**

The MCHI is used in this thesis as a proxy for a corporate culture, which is found to be negatively associated with corporate tax avoidance. Nevertheless, the complexity inherent in corporate culture encourages the consideration of other proxies. For example, one could consider the use of Glassdoor<sup>39</sup> data which measures employee happiness in

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<sup>39</sup>Glassdoor is a social media recruitment company that *"offers insights into the employee experience powered by millions of company ratings and reviews, CEO approval ratings, salary reports, interview reviews and questions, benefits reviews, office photos and more, combined with the latest jobs. Unlike other career sites, all of this information is shared by those who know a*

companies through a self-reporting platform and social media. The Glassdoor platform is widely used in the US, which makes US data useful for conducting similar studies in this regard. The author of this study considered using Glassdoor data to measure corporate culture, but very few South African companies have a social media presence on Glassdoor which ruled out the use of this source.

#### **8.6.4 Using value-index instruments to measure corporate culture**

Corporate culture has been operationalised in this thesis using the MCHI, because it incorporates financial indicators which are available to the researcher. The literature review indicates that industrial psychologists also use corporate values surveys, which are administered to employees of companies to measure corporate culture with a focus on specific values. It may be possible to use previously-compiled data on corporate culture, collected in such a way, to perform quantitative studies similar to this one, to understand the relationship between corporate culture and corporate financial behaviour, including tax behaviour. Those researchers with more resources at their disposal could use this route to measure corporate culture afresh, to study the relationship between corporate culture and corporate tax avoidance.

#### **8.7 Developing or identifying another proxy for tax knowledge attributed to a CEO**

A CEO attributed with tax knowledge is operationalised in this study with reference to whether that CEO is a South African chartered accountant or not. Other qualifications may also involve tax knowledge. Another proxy for tax knowledge could be developed or identified which should be more universally applicable than the one used in this study.

##### **8.7.1 Qualitative investigation on outlier companies in the sample**

A quantile cross-sectional regression was performed in Chapter 5 and indicated significant effects at the lowest effective tax rates in the sample of companies. More qualitative research on these outlier companies' tax behaviour may yield interesting insights into the practices of corporate tax avoidance. The use of quantile regression is suggested to investigate the effects of many of the variables frequently investigated as possible determinants of tax avoidance, especially in those areas where mixed effects are reported at the conditional mean.

##### **8.7.2 Interviews with retired CEOs of large companies**

This study's qualitative research stream is based on data obtained from interviews with corporate tax advisors. They are arguably more independent in voicing their opinions when compared to CEOs *who are currently in that position*. However, corporate tax advisors are still not fully independent from the process of corporate tax avoidance. With this in mind, interviews with retired CEOs may be useful in gleaning a fresh perspective on the CEO's influence on

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*company best — the employees*" (Glassdoor, 2021). It is the fact that companies' internal cultures are rated by their own employees which may be used as a proxy for corporate culture and corporate values in quantitative studies.

corporate tax avoidance. Retired CEOs may be willing to take part in anonymous interviews about their experience with corporate tax avoidance, since they are less dependent on the financial performance of their former employers, and no longer accountable, which should limit bias.

## **8.8 Contribution**

The contribution of this thesis involves better understanding of the relationship between corporate culture and tax avoidance, but also the relationship between tax knowledge attributed to a CEO (a CEO-characteristic) and corporate tax avoidance. Quantitative data is used from large listed South African companies, which is followed up with interviews with tax corporate tax advisors. Investigating tax avoidance from the perspective of corporate culture, responds to calls in the literature to move tax avoidance literature forward from research dominantly informed by principal-agent theory and shareholder value maximisation theory, as far as long-termism (a type of corporate culture), is argued to be indicative of consummate stakeholder-orientation. Using corporate culture - also described as the sum of past and present patterns of corporate behaviour – also informs a process-oriented analyses of the practice, actors, and the roles they play relating to corporate tax avoidance. This process-oriented analysis is further complemented and enriched with qualitative research when interviews are subsequently conducted with corporate tax advisors to obtain their views on the role of corporate culture and CEO-characteristics on corporate tax avoidance. This approach responds directly to calls in the literature for more qualitative research to uncover hidden tax avoidance mechanisms and activities which are not visible in financial statements, making it difficult to understand the black-box qualities inherent to the problem. The use of the McKinsey Corporate Horizon Index to measure long-termism, as a type of corporate culture, is novel in the academic environment and suggests a foundation for future studies using the same approach for research informed by what is argued to be an all-inclusive way to understand stakeholder-theory. Last, this study responds for more research to understand the influence of CEO-skills (as a CEO-effect) on corporate tax avoidance, when it exploits homogeneity in the qualifications of a significant percentage of South African CEOs, who are chartered accountants, a feature used to operationalise tax knowledge of a CEO. Furthermore, the evidence indicates the plausibility that CEO-effects and corporate culture cross-influence each other, the extent of which is hypothesised to be conditional on aspects such as whether the CEO is internally appointed or externally recruited. Other contributions from an empirical, theoretical and literature perspective are discussed in more detail in the sections that follow. The results also indicate evidence of tax-avoidance pursued through CSR, but not for the benefit of shareholders or agents as reported in the literature, but rather for the benefit of societies who suffer if governments are corrupt distributors of tax-funded social benefits.

### **8.8.1 Empirical contribution**

This study makes its empirical contribution from two perspectives. It is argued that the use of quantitative and qualitative data to inform findings about the same research problem is a contribution because the researcher cannot identify any similar use of mixed methodology in the field of research on corporate tax avoidance. This provides a more subjective perspective about the workings of corporate tax avoidance, which is in accordance with the

subjective nature of the human beings who are the decision makers in companies, even when the corporate veil is often assumed to absolve the human element. This study contributes to the body of knowledge as it includes the human interpretation of corporate tax avoidance in a topic which, according to the literature review, is mostly investigated using quantitative research methodology.

The use of the MCHI to measure a latent construct such as corporate culture may encourage other researchers to consider the use of that particular instrument for other observational research as well.

The production of a data base of CEOs who are chartered accountants in South Africa was a tedious hand-collection process. However, this data base will now be available in the public domain and as such, may be useful to others who study other aspects of corporate behaviour. For example, it may be used to assess whether the qualification has any bearing on company profitability, corporate social responsibility or corporate governance.

### **8.8.2 Theoretical contribution**

The empirical analysis in this study indicates stronger evidence of a longitudinal effect of a long-term corporate culture over time ('within-companies') as opposed to a cross-sectional effect ('between companies'). It is theorised that a company's temporal orientation (meaning being short or long-term oriented) alternates between periods in which a long-term orientation is evident and periods in which short-term behaviour is exhibited. Altogether, it indicates that the temporal orientation of a company may be a less stable dimension of corporate culture. The study also examines the extent to which a combination of stakeholder theory, shareholder theory, and Upper-echelon theory explain corporate tax avoidance in those large South African listed companies studied. This study provides evidence regarding the influence of all three of these theories, based on the data used to test them. However, the evidence suggests that the effect of behaviour construed from the perspective of Upper-echelon theory can be mediated by the effects of other elements of corporate culture in a company; these include, for example, a company's level of long-termism as a corporate culture. Theoretically, this means that a CEO's characteristics influence corporate behaviour, but the extent of that influence can be altered by the corporate culture which can emphasise the importance of other theories, such as stakeholder theory.

### **8.8.3 Literature review contribution**

The literature review presented in Chapter 2 refers to the dominant theories in the fields of finance and accounting, and shows how ethical and corporate cultural considerations, argued to be stakeholder-oriented drivers, have been neglected as determinants of corporate tax avoidance. Here, the literature review provides a form of heat-map regarding the use of popular theories applied in research into tax avoidance, while at the same time, it shows which theories have not been explored extensively. Furthermore, the literature review shows that many papers dealing with corporate tax avoidance do not conceptualise quantitative research from a solid theoretical expectation. This study provides a classification system for the extant literature on corporate tax avoidance and this may be used in future literature reviews. It points out that agency theory and shareholder value maximisation are used extensively in

research on corporate tax avoidance, possibly to the exclusion or neglect of those determinants grounded in more ethical theories.

## **8.9 Recommendations**

### **8.9.1 Tax authorities (Fiscus)**

Corporate tax avoidance is a problem with harmful consequences for society. The findings of this research can help regulators to draw up better profiles of potential corporate tax avoiders. More effective identification of tax avoiders may result in more effective use of funds allocated by SARS to perform tax audits.

The qualitative findings of this study indicate that the targeting of large companies by SARS is causing tax morale to decline, which may make it harder for the fiscus to collect taxes. The fiscus may benefit by taking note of this trend and then taking steps to rectify and restore tenuous relationships with the largest corporate taxpayers.

### **8.9.2 Professional regulatory bodies (i.e. SAICA)**

This study provides empirical evidence that those companies whose CEOs are chartered accountants (registered and affiliated with SAICA) pay less tax, on average, than those companies where the CEOs are not chartered accountants. SAICA suggested a similar idea in a previous advertisement but perhaps SAICA could note that the message in the advertisement is now supported by the evidence in this study. However, one could argue that is not in the interests of either the regulator or the chartered accounting profession if that profession is generally associated with tax avoidance. The CA (SA) qualification has always been associated with values such as unblemished integrity, and holders of that qualification have been regarded as a body guarding societal interests. Association with aggressive tax avoidance may tarnish this reputation and erode trust. As an intervention, the regulator could, for example, place more emphasis on the importance of ethics, which should manifest in the CA(SA) curriculum as well as in assessments in its qualifying exams.

### **8.9.3 Other regulatory bodies**

This study has highlighted the potential consequences of the temporal orientation of companies and creates further awareness of this orientation being measurable. A better ability to measure constructs can lead to a better monitoring of the effectiveness of many governmental policy interventions; this can be difficult to measure when the underlying intervention aspires to induce ethical behaviour.

## **8.10 Reflection on a journey**

The author records the following account of his experiences and some key learning points that surfaced while completing this project. The account is written from the personal perspective, using the first person and without reference to academic literature. The author aims to provide a reconciling account between the person that he was before starting with the PhD and the person that he is today after completing it. The author also reflects on changes in his views regarding research. In particular, the author reflects on the changes in his views concerning qualitative

and quantitative research as contrasting research methodologies. Completing the process took more than 5 years, which indicates a reasonably long time, in which the author could see some visible changes in his views.

The most important skills and qualities that I have developed during this journey are resilience, and to become more self-trusting and independent in respect of so many decisions that I had to take during this project which often seemed insurmountable. In addition to the normal factors one has to contend with doing a PhD, I personally had to acknowledge and become more comfortable with two important issues. First, I had to come to terms, and become more at ease with the idea that research could never be “absolute” and that successful or valuable research is driven by asking valid questions and by using available data and following it to its logical conclusion. Perhaps this has been the first major project of such a scale that I’ve undertaken personally, and many of the initial plans or ideas to execute some of the components did not work out as originally intended. This required frequent ‘*going-back-to-the drawing board*’ or tweaking of initial plans, to make sure of reaching the underlying research objectives. Arguably most students want to have maximum control and certainty of the development of the research process, because a considerable investment in time and money is involved. However, after I completed the project, I recognised that although a lot can, and should, be planned beforehand, the research process also has a rhythm of its own which guides the flow and results in unanticipated outcomes. In this regard the process can be iterative: for example, I learned how to be more strategic when I conducted the later interviews; this was only after I had already interviewed a few respondents, which gave me the opportunity to reflect on my method and identify better ways to guide the subsequent interviews.

The second issue that I had to become more comfortable with was the need to follow a plan through to its conclusion, especially when faced with difficulties which seem to suggest the need for a comprehensive overhaul of the whole research idea. I frequently found myself tempted to redesign the whole PhD, or to identify or pursue a ‘better’ topic related to the underlying problem of corporate tax avoidance. Here, I had to exercise patience, and I also had to become more comfortable with the idea that there is no such thing as absolutely ideal data, and the same generally applies to the ideal research setting. In this ‘large’ project I came to understand first-hand that the nature of large projects often does not allow for a complete overhaul or total redesign to provide better findings; however, worthwhile research is still possible if the available data is used systematically and if conclusions are formulated in line with what analysis of the data indicates. Further to this, I had to become more open to accepting the results of statistical analysis, while resisting the temptation to increase sample sizes, or to exclude more outlier observations to obtain ‘expected’ results.

Coming to terms with the incremental nature of research was also a learning milestone for me. I now appreciate that research is almost like a block-chain in which each academic adds a small amount of knowledge to a chain that may culminate in the truth. Looking back at the person that I was when I started this study 5 years ago shows how ignorant I have sometimes been: both in terms of my assessment of my own study’s originality, and the scope, or goals with the project. I believe that those immature qualities have been tempered during the process. I have

attained a much more realistic perception and assessment of myself and my own contribution, as well as more respect for other academic researchers, as I try to position my own work into the existing constellation of knowledge.

I think most researchers' personalities and other personal characteristics make them inherently more inclined to use either the qualitative or the quantitative methodology as their preferred research paradigms. My natural predilection was towards the narrative and the subjective, which are inherent to qualitative methodology. The conceptual, the narrative perspective towards problems and knowledge was my research methodology of choice. Having been unfamiliar with quantitative methodology and quantitative techniques such as regression, I believed that some theories are inherently so good and logical that they dispose of the need for empirical testing. Having had the opportunity to use both qualitative and quantitative methodology in this study allowed me to appreciate the benefits and limits of both of these, to such an extent that I can now see how knowledge can only advance with the application of both of them, in order to advance the search for what is true. I have always been attracted by the interesting story, the unique and the outlier observation which perhaps explains why I used to avoid quantitative research; thus I felt bored because it focuses on the average behaviour. However, I now appreciate that measurement of the average is needed to define the outlier, which makes a focus on the average worthwhile and therefore interesting.

Ironically, but not surprisingly, I became more sceptical and realistic about the nature and the limitations inherent in qualitative methodology, which had always been my preferred research approach. This experience provided me yet again with tangible evidence regarding the notion that unfamiliarity with a specific research methodology can make one biased when selecting the most appropriate ones to advance knowledge about a research problem. Thus, my unfamiliarity with quantitative methodology made me biased to use the qualitative research paradigm. I think that the knowledge and understanding that I gleaned from using quantitative methodology in combination with qualitative methodology makes me a more full-rounded, or balanced researcher, who is now more comfortable with the benefits and disadvantages inherent to both research paradigms. For example, nowadays, whenever I consider the research proposals of students or colleagues developed with a qualitative research methodology in mind, I find myself looking more intuitively for opportunities to reduce qualitatively entangled problems to their constituent components and to identify operational constructs and proxies to subject the investigation to quantitative empirical scrutiny.

A better understanding of the nature of quantitative methodology and regression analysis, as a frequently-used method to do quantitative research, has made me more appreciative of, and sensitive to, its limitations. After having experienced consideration of endogeneity and aspects of claims regarding causation in my own research, I now have a better understanding and empathy for the dilemma with which research in general, and social research in particular, must contend. It is only now that I truly understand the fortunate situation of researchers in the natural sciences, who can devise controlled experiments where all factors can be controlled for. In this regard I find myself

constantly looking for opportunities to apply designs such as regression-discontinuity or the use of instrumental variables, or to identify appropriate the setting for a natural experiment.

Reflecting on this project, I am strongly reminded of two quotes regarding the use of statistics that speak directly to the personal learning points that surfaced for me from this PhD. Ernest Rutherford (New Zealand physicist and Nobel prize winner for Nuclear Physics), said: *"if your experiment needs statistics, you ought to have done a better experiment."* It is only now that I understand the dichotomous nature of this quote: On the one hand it is true but only if one has perfect and complete data. On the other hand, the quote is devoid of understanding and appreciation of the conditions under which much social research is carried out, especially as far as observational data is concerned. Nevertheless, the quote serves as a reminder to be critical of regression specifications, and the use of statistics, for purposes for which they are not intended. My approach in this research in measuring and operationalising corporate culture, and tax knowledge attributed to a CEO, makes me much more understanding of the importance of good measurement in quantitative research and what Alan Ryan really means when he says that: *"Counting only counts when we have learnt how to count what really counts"*.

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