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The Relationship between Corporate Governance, Tax Aggressiveness, and Economic Value Added (EVA)

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Abstract

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This study aims to examine the relationship between corporate governance, tax aggressiveness, and Economic Value Added using a literature review approach. Sound corporate governance is widely believed to mitigate aggressive tax practices, which in turn affects the company's ability to generate added economic value. By reviewing international scholarly articles published in last five years, the study finds that the relationship among these three variables is complex and contextual, influenced by various mediating and moderating factors, such as corporate social responsibility and board size. These contextual elements affect how tax strategies are designed and implemented under governance structures, which ultimately shape the firm's financial performance measured by Economic Value Added. The study offers in-depth insights into how strategic tax management and effective governance interact to influence firm value. The findings contribute theoretically and practically by informing decision-makers, investors, and regulators about the importance of integrating ethical governance and tax efficiency to achieve long-term sustainable value creation.

1. Introduction

In an increasingly competitive and uncertain era of globalization, coupled with the growing complexity of modern business dynamics, companies are no longer merely required to achieve maximum short-term profit. More than that, companies are demanded to be able to create sustainable economic value-added in the long run. This becomes increasingly important in order to maintain business continuity and provide optimal benefits for all stakeholders. One financial performance measure that has been widely used to measure the creation of economic value by companies is Economic Value Added (EVA). EVA is a financial indicator calculated by subtracting the cost of capital from net income after tax (Hammer & Siegfried, 2022).

Thus, EVA provides an overview of the extent to which the net income generated by a company exceeds the capital cost burden incurred. EVA was developed as a primary metric to assess the effectiveness of management in creating value for shareholders above the market's required rate of return (Ali, 2020). In relation to the creation of economic value, corporate governance plays an important role as an internal control system and mechanism aimed at ensuring that companies are managed ethically, transparently, responsibly, and accountably. Good corporate governance is believed to reduce the level of information asymmetry between management and capital owners, prevent opportunistic behavior by management, and increase efficiency in the company's strategic decision-making process. One strategic aspect that often receives attention in the context of governance is tax management, including policies related to tax management (Miloud, 2022).

One common practice in tax management is tax aggressiveness, which is a form of tax avoidance strategy undertaken by companies, either legally or semi-legally. This practice aims to minimize the tax burden that must be paid, thereby increasing net income after tax, improving company cash flow, and increasing returns for shareholders. However, overly extreme tax aggressiveness practices can lead to several risks, such as company reputation loss, potential legal sanctions, and conflicts of interest between management, regulators, and shareholders (Jananto & Firmansyah, 2019). Several previous studies show that good corporate governance has a negative correlation with the level of tax aggressiveness. This is due to the strong oversight function against managerial actions that are inconsistent with sound governance principles.

In a weak governance system, companies tend to be freer to exploit tax regulatory loopholes to aggressively reduce their tax burden (Ruwanti et al., 2019). However, it is important to note that tax savings through aggressive strategies do not always substantially increase economic value. In fact, in some cases, such strategies can undermine long-term value creation, which should be the company's primary focus. The complexity of the problem increases when companies are under pressure to demonstrate high financial performance in a short period. In such conditions, EVA is often used as a primary benchmark for managerial success.

Consequently, companies may be encouraged to engage in aggressive practices, including in taxation, to improve their EVA scores (Badiana & Kusuma, 2022). However, the economic value-added indicated by EVA may not necessarily reflect real, sustainable value oriented towards the interests of all stakeholders. Thus, this research aims to comprehensively examine the relationship between corporate governance, tax aggressiveness, and EVA through a literature study approach. This study is expected to answer important questions: to what extent does governance influence tax aggressiveness, how does tax aggressiveness affect EVA, and is EVA truly neutral to managerial strategies such as tax aggressiveness and governance? The findings of this research are expected to provide theoretical and practical contributions for management, investors, and regulators in designing policies oriented towards sustainable long-term value creation.

2. Literature Review

2.1. Corporate Governance and Tax Aggressiveness

Corporate governance is generally defined as a comprehensive system designed to direct, manage, and control the operation of a company to remain within the framework of social and economic responsibility towards stakeholders. This system includes a set of rules, practices, and processes used to ensure that the interests of shareholders, the board of directors, management, and other external parties remain aligned within an ethical and legal compliance framework. According to Miloud (2022), the existence of an independent board of directors that has autonomy in carrying out its oversight function, as well as an effective and active audit committee in evaluating financial reports and internal controls, plays a significant role in suppressing opportunistic managerial behavior.

In this context, one of the behaviors supervised is the practice of tax aggressiveness, which is a systematic effort to reduce tax liabilities through strategies that often fall into a gray area between legal and ethical. Conversely, research by Apriyanti and Arifin (2021) shows that a weak governance system, characterized by a lack of independence and oversight effectiveness, actually opens loopholes for management to manipulate taxes for specific interests. This is in line with the findings of Wenwu et al. (2023), who affirm that strong and well-structured internal oversight can be a major barrier to the tendency of companies to engage in risky and detrimental tax avoidance actions in the long run.

2.2. Tax Aggressiveness and Economic Value Added (EVA)

Tax aggressiveness is a strategy implemented by companies with the aim of minimizing tax burdens, either through entirely legal means or through approaches that are on the border of legality or semi-legal. This practice directly impacts the increase in net income, because the taxes paid are lower than they should be. Logically, this increase in net income will then have a positive impact on Economic Value Added (EVA), which is the difference between net income and the cost of capital. Therefore, in the short term, tax aggressiveness is often seen as a strategic step to improve the company's financial performance from the EVA perspective. However, the findings from Wang's (2021) research provide a more comprehensive perspective. The study shows that tax aggressiveness does not always have a positive impact on EVA.

This is due to the emergence of legal uncertainty resulting from overly aggressive tax avoidance practices, as well as an increased company reputation risk in the eyes of the public and regulators. Such uncertainty can lead companies to face intensive audits, fines, or litigation, which ultimately negatively impact the company's finances (Dharmasiri et al., 2022). Furthermore, in the long term, tax aggressiveness can damage investor trust, which is an important element in determining the company's stock value. If investors consider the company's tax strategy unsustainable or risky, this could trigger a decline in the company's market value.

2.3. The Role of Governance in Increasing EVA through Tax Management

According to Jananto and Firmansyah (2019), companies that implement a good and effective governance system tend to have a wiser and more strategic approach to managing their tax obligations. They do not need to rely on tax aggressiveness strategies to achieve financial efficiency. Instead, strong governance allows companies to balance tax efficiency goals with compliance with applicable regulations, thus avoiding legal and reputational risks. By utilizing strategic and compliant tax management, companies can maintain good relationships with tax authorities while meeting shareholder expectations. Strong governance also encourages management to be more cautious in making decisions that impact business sustainability. A well-functioning internal oversight system, transparency in reporting, and accountability for strategic decisions contribute significantly to sustainable Economic Value-Added (EVA) creation.

The research conducted by Badiana and Kusuma (2022) reinforces this view by highlighting that gender diversity in the board of directors' structure, especially the presence of women in decision-making positions, contributes positively to the enhancement of managerial ethics. These ethical values influence management's attitude in conducting more responsible business practices, including in tax management and other financial strategies, thereby positively impacting the achievement of higher quality and long-term oriented EVA.

3. Method

This research uses a literature study (library research) approach as the primary method for exploring and analyzing the relationship between three important variables in the context of modern company management: corporate governance, tax aggressiveness, and Economic Value Added (EVA). This study specifically examines scientific articles published in reputable and indexed international journals, available online through the Google Scholar academic database. The publication period for the articles reviewed is limited to the last five years, with the aim of ensuring that the information and findings analyzed remain relevant to the latest dynamics in corporate governance and tax strategies.

The selection of articles in this study was based on several systematically established inclusion criteria. First, articles must be published in reputable and indexed international journals, ensuring their credibility and methodological quality. Second, selected articles must explicitly contain one or more of the variables that are the main focus of the study, namely corporate governance, tax aggressiveness, or EVA. Third, the research approach used in these articles must employ quantitative methods or mixed methods, particularly those applying statistical analysis techniques such as linear regression or panel data analysis, to provide comparable empirical information. Fourth, selected articles must also have high topical relevance to the study of the relationship between the three variables, both from the perspective of their theoretical framework and empirical findings.

Several articles that met all these criteria were selected for in-depth analysis. This research uses content analysis as the primary tool for analyzing secondary data. Each article was systematically reviewed to identify patterns of relationships between variables, the direction and strength of influence, and to explore potential mediating and moderating factors that might affect the relationship between corporate governance, tax aggressiveness, and EVA. In this process, researchers examined not only the main results of each study but also the economic and legal context underlying each research, given that tax policies and governance practices can vary significantly across countries and industries.

Furthermore, a narrative synthesis approach was used to integrate diverse findings obtained from various sources, and then developed into a conceptual framework that represents the integrative relationship between the three variables. The validity and reliability of the findings were strengthened by comparing results across countries and sectors, to capture a broader spectrum of variations in findings and avoid inappropriate generalizations. This methodological approach was chosen because it can provide more comprehensive insights without relying on the limitations of primary data, thus allowing a thorough exploration of the complex relationship between corporate governance, tax management strategies, and economic value creation through the EVA indicator.

4. Results

This literature study aims to comprehensively collect, review, and analyze international scientific articles that specifically discuss the relationship between three crucial variables in corporate financial and strategic management dynamics: corporate governance, tax aggressiveness, and Economic Value Added (EVA). This study found that the relationship among these three variables is not linear and simple, but rather shows a complex and interactive pattern, which varies significantly depending on various contextual factors such as industry type, the country where the company operates, and the applicable tax regulatory framework in each jurisdiction. Most of the literature reviewed in this study shows a consistent view that corporate governance plays an important and significant role in controlling the level of tax aggressiveness implemented by company management. Miloud (2022), for example, in his research on French-based companies, stated that companies with a strong governance structure, especially those supported by a high proportion of independent board members, show a lower tendency to engage in aggressive tax avoidance practices.

The presence of an active and well-functioning audit committee is also mentioned as a key factor in limiting management's room for excessive tax avoidance strategies. This reflects the importance of the internal oversight function in creating accountability and transparency in company financial practices, including tax policies. Meanwhile, Wang's (2021) research conducted in the manufacturing sector in China provides a more dynamic view of the direct influence of tax aggressiveness on EVA. In the short term, Wang found that tax aggressiveness can have a positive impact on company EVA, as lower tax burdens automatically increase the company's net income. However, this effect is not sustainable. In the medium to long term, companies that are too aggressive in their tax strategies actually experience a decline in EVA. This decline is due to increased company exposure to legal and regulatory risks, including the possibility of litigation, tax penalties, and detrimental reputational damage. These findings emphasize the importance of long-term considerations in evaluating the effectiveness of tax strategies on value creation.

Research by Apriyanti and Arifin (2021) highlights the crucial role of integrity and independence of the board of directors in the effectiveness of corporate governance. In their study on companies in Tunisia, it was found that when there is a conflict of interest within the board of directors, the oversight function over tax practices weakens. This ineffectiveness then opens room for management to implement more aggressive tax avoidance strategies, which ultimately negatively impacts the company's long-term value creation. In other words, internal integrity in governance is the primary foundation for maintaining a balance between fiscal efficiency and regulatory compliance. These findings are reinforced by Jananto and Firmansyah (2019) who stated that companies with good governance tend to be more strategic and legalistic in managing their tax obligations.

Companies do not aggressively avoid taxes but rather choose to utilize fiscal incentives, relief, and legitimate regulatory loopholes within the applicable tax system. This approach is not only legally safe but also allows companies to maintain their credibility in the eyes of regulators and investors, thereby encouraging sustainable company value creation, reflected in stable EVA growth. The research conducted by Badiana and Kusuma (2022) brings an additional dimension to the governance discussion, by including the aspect of gender diversity in the board of directors' structure. They found that this diversity significantly contributes to strengthening corporate governance mechanisms, especially in the context of moderating the relationship between tax aggressiveness and EVA. The presence of board members from different gender backgrounds improves the quality of decision-making by bringing diverse perspectives, higher ethical values, and a culture of caution in implementing financial and tax strategies. This culture impacts the creation of more stable long-term economic value and avoids reputational and legal risks that can weaken EVA.

Within the Southeast Asian regional scope, Husnaini and Basuki (2020) conducted research on companies operating in the region and concluded that tax aggressiveness can contribute to an increase in EVA, provided that the strategy is well-planned and implemented within a framework of good corporate governance. However, when tax aggressiveness is carried out without adequate governance oversight, the effect is counterproductive and negatively impacts the company's economic value. These findings indicate that the synergy between governance and tax strategies is crucial for the company's success in managing its economic value-added sustainably. Furthermore, a study by Wenwu et al. (2023) emphasizes the role of internal audit and financial reporting transparency as important elements in controlling tax aggressiveness. The research proved that companies with transparent reporting systems and strong internal audit systems are able to suppress managerial intent to engage in aggressive tax avoidance practices.

Emphasis is placed on the importance of integrating governance with financial reporting systems, thereby creating an environment of accountability. When this is achieved, investors tend to respond positively, as the reported EVA is considered valid and trustworthy. Another study by Francis et al. (2022) raised the aspect of market perception of tax aggressiveness. They argued that although a company's EVA may increase due to tax avoidance from an accounting perspective, the market or investors do not necessarily respond positively to this. If information about a company's aggressive tax strategy becomes public, investors tend to give a negative evaluation of the company, as it is considered unethical and has a high level of risk. Thus, the economic value-added apparent from the EVA side is illusory and does not reflect the real sustainability of the company's value in the view of the capital market.

Support for these findings is also provided by Tania (2020) who researched public companies in Indonesia. They found that the relationship between tax aggressiveness and EVA is non-linear, meaning it does not always increase with the level of aggressiveness. Low to moderate levels of tax aggressiveness are still considered reasonable and efficient by investors, as they can optimize the tax burden without violating regulations. However, when tax aggressiveness exceeds what is considered ethical or legal, EVA no longer reflects its true economic value because it is accompanied by the risk of oversight from tax authorities and potential legal sanctions. Research by Martínez-Ferrero et al. (2021) also supports the important role of corporate governance in reducing the negative impact of tax avoidance strategies on company value. They stated that corporate governance can function as a risk mitigator against aggressive tax strategies.

With strong internal oversight and compliance structures, companies can maintain the stability of EVA, even when the tax strategy applied is moderately aggressive. This shows that governance is not merely aimed at eliminating risk, but also at strategically managing tax risk. Meanwhile, Boussaidi and Hamed-Sidhom (2021) examined the influence of board size on the relationship between tax aggressiveness and EVA. Their study results showed that an overly large board actually has a negative impact on EVA. This is due to inefficiencies in coordination and a high potential for internal conflict in strategic decision-making, including decisions related to tax policy. An overly large board can also hinder the speed of response to external environmental dynamics, thereby negatively impacting value creation. As for Guo et al. (2020), they offer a more contextual approach by introducing mediating variables in the form of managerial ethics and concern for sustainability. They found that the influence of governance on tax aggressiveness greatly depends on the extent to which ethical values and commitment to sustainability are internalized by the company.

Companies committed to ESG tend to avoid overly aggressive tax practices, even if there is potential to increase EVA in the short term. They prioritize long-term value and sustainability over momentary efficiency. The results of this literature synthesis show that the relationship between corporate governance and EVA tends to be positive and significant, but this influence is mediated by the tax aggressiveness variable, whose nature is highly dependent on the intensity and strategic intent of its implementation. In conditions where corporate governance is well implemented, companies are able to balance fiscal efficiency and legal compliance, thereby creating sustainable economic value-added. Therefore, strengthening the governance system becomes very important, not only as a risk control mechanism but also as a strategic tool to improve the overall quality of company value.

5. Discussion

The discussion of the results from this literature study indicates that the relationship between corporate governance, tax aggressiveness, and Economic Value Added (EVA) is multidimensional, complex, and highly contextual. This relationship is not merely linear but is influenced by many internal and external variables that interact within the company's management system. Strong governance plays a central role as a mechanism for controlling managerial behavior, especially in strategic decision-making in fiscal and taxation matters. Governance mechanisms such as the independence of the board of directors, the effectiveness of the audit committee function, and the level of transparency in financial reporting are key pillars in shaping ethical, accountable, and fiscally efficient tax policies (Luo & Tang, 2021). On the other hand, the practice of tax aggressiveness, when designed and implemented moderately and with clear strategic intent, can contribute positively to increasing the company's EVA. This occurs because a reduction in the tax burden can increase net income after tax.

However, if tax aggressiveness strategies are implemented excessively, the financial benefits generated are often only temporary and illusory, without reflecting sustainable value creation. In the long term, such strategies can lead to reputational risks, investor distrust, and even potential legal litigation, all of which will negatively impact the company's overall value. Furthermore, the effectiveness of governance in controlling tax aggressiveness is also heavily influenced by contextual factors, such as the prevailing tax regulatory system in the country where the company operates, the level of market pressure, and the ethical standards that are norms in the relevant industry (Lenz, 2020). This explains why in various cross-country and cross-sector studies, empirical results regarding the relationship between governance, tax, and EVA show significant variations. For example, in countries with loose tax oversight, tax aggressiveness practices tend to be more common and do not always receive a negative reaction from market players.

This research also indicates that EVA is not a completely neutral measure of managerial strategy, especially regarding tax management. EVA values can be distorted by aggressive tax saving strategies, thus requiring critical scrutiny by investors and other stakeholders. Therefore, the use of EVA as an indicator of value creation must be accompanied by an evaluation of earnings quality, as well as an assessment of the financial and fiscal strategies used to achieve it. The role of governance in improving the quality and credibility of EVA is a key highlight in this study. Governance implemented with high ethical values not only functions as an oversight tool but also directs company policies to always favor long-term sustainability (Lu et al., 2019).

Companies with strong governance systems tend to produce more stable, accurate, and truly reflective of the company's real performance EVA. Thus, this study emphatically emphasizes the importance of strategic integration between corporate governance, fiscal policy, and long-term value creation objectives. Stakeholders such as investors, auditors, and regulators must be more responsive to non-financial indicators, including governance and managerial ethics, which significantly influence the interpretation and evaluation of the validity and sustainability of the EVA generated by the company.

6. Conclusion

This research confirms that the relationship between corporate governance, tax aggressiveness, and Economic Value Added (EVA) is dynamic and interdependent. Strong corporate governance, through an independent board of directors, an effective audit committee, and transparent reporting systems, functions as a control mechanism against excessive tax aggressiveness. Meanwhile, tax aggressiveness strategies can have a positive impact on EVA in the short term but come with reputational and legal risks. It is important to note that EVA as a measure of company value can be distorted if not accompanied by good governance practices. Therefore, the use of EVA as a success indicator must consider the quality of the underlying managerial strategies. Good governance not only improves financial performance but also ensures the sustainability of value creation in the long term. Recommendations from this study include the necessity for companies to balance tax efficiency with ethical compliance by strengthening internal governance. Regulators also need to increase transparency and oversight of taxation practices.

Meanwhile, investors need to be more critical in assessing EVA by considering governance indicators and fiscal risks.

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