

“The relationship between sales growth, profitability, and tax avoidance”

AUTHORS

Mohammad Fawzi Shubita 



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Mohammad Fawzi Shubita, Ph.D. in Accounting, Professor, Business Faculty, Department of Accounting, Amman Arab University, Jordan.



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Mohammad Fawzi Shubita (Jordan)

THE RELATIONSHIP BETWEEN SALES GROWTH, PROFITABILITY, AND TAX AVOIDANCE

Abstract

The study aims to examine the intricate interplay between sales growth, profitability, and tax avoidance strategies adopted by firms. Through an analysis of a diverse dataset spanning multiple industries and regions, this study investigates how sales growth influences a firm's marketing approach to tax avoidance and its subsequent impact on profitability. The sample is Jordanian industrial firms listed on the Amman Stock Exchange for the study period between 2010 and 2020. Four critical variables used in the dataset are tax avoidance, return on assets, sales, and size. It employs a mixed-methods approach, including quantitative regression analysis and qualitative assessments of corporate tax strategies. The study results reveal a strong negative relationship between ROA and tax avoidance; for every unit increase in ROA, tax avoidance decreases by 0.198 units. Sales, however, do not exhibit a statistically significant association with tax avoidance. Firm size is an additional predictor with a marginally significant direct link with tax avoidance ($\beta = 0.042$, $p = 0.049$). This study highlights the central role of profitability in shaping tax avoidance strategies, with larger firms marginally more inclined toward tax planning.

Keywords

sales growth, tax avoidance, marketing strategy, profitability, sales expense, company size, Jordan, industrial sector

JEL Classification

H26, D22, L25, M21

INTRODUCTION

In an ever-evolving global business landscape, the interplay between sales growth, profitability, and tax avoidance has become a subject of paramount importance. The relevance of this research topic cannot be overstated, as it touches upon fundamental aspects of corporate strategy, financial management, and ethical considerations in the corporate world. As businesses strive to expand, increase profits, and navigate a complex web of tax regulations, understanding the intricate relationship between these three elements becomes critical for their sustainability and the broader economic and social fabric.

The confluence of these factors presents a multifaceted challenge that businesses and policymakers must grapple with. On one hand, sales growth is a central objective for companies seeking to remain competitive and realize their strategic objectives. It directly impacts a firm's top-line revenue, market presence, and overall growth trajectory. Concurrently, profitability is the lifeblood of any organization, as it underpins its financial health and ability to reinvest, innovate, and create value for shareholders. On the other hand, tax avoidance strategies, while legally permissible in many instances, often stir debates concerning corporate ethics, social responsibility, and the equitable distribution of tax burdens.

1. LITERATURE REVIEW AND HYPOTHESES

Tax avoidance is pertinent for governments, businesses, and researchers worldwide. In Jordan, like in many countries, understanding the link between profitability, sales growth, and tax avoidance is crucial for policy formulation, business strategies, and academic investigations.

One fundamental aspect of the relationship between tax avoidance and company performance in Jordan has been the effect on profitability. Alkurdi and Mardini (2020) discovered an inverse link between tax avoidance and firm profitability. Their study examined Jordanian listed companies and concluded that increased tax avoidance led to reduced profitability. Such findings are consistent with broader international research, emphasizing that the pursuit of aggressive tax avoidance can negatively impact firm performance.

Sumantri et al. (2022) examined the effect of capital intensity, sales growth, leverage on tax avoidance, and profitability as moderators. Tax avoidance was measured using the cash-effective tax rate (CETR) approach, and leverage was measured using the debt-to-equity ratio (DER). Profitability as a moderating variable was measured using return on assets (ROA). The results prove that sales growth and capital intensity affect tax avoidance. In addition, Nanningsih and Dewi (2023) examined the effect of sales growth, profitability tax avoidance, and leverage while considering the moderating effect of company size in Indonesia. The study found that company size does not moderate the impact of leverage and sales growth on tax avoidance, but it does moderate the impact of profitability on tax avoidance.

The interplay between sales growth and profitability is well-documented in the literature (Arif & Hashim, 2014; Ariffin, 2013; Chen et al., 2014; Desai & Dharmapala, 2006; Rezaei & Ghanaeenejad, 2014; Salihu et al., 2014; Slemrod, 2004; Zimmerman, 1983). In the Jordanian context, Dahmash (2015) explored this relationship and found a significant link between profitability and sales growth. The study examined

non-financial firms listed on the Amman Stock Exchange and concluded that increased sales growth contributes to enhanced profitability.

In Jordan, the literature on tax avoidance is emerging but increasingly relevant. The country has been actively working on tax reforms and improving its regulatory environment. Jamei (2017) investigated the relationship between tax avoidance and corporate governance mechanisms. The study found that effective governance mechanisms could mitigate tax avoidance tendencies, underscoring the importance of corporate governance in shaping tax behavior.

While the general relationship between sales growth, profitability, and tax avoidance has been studied in Jordan, there is scope for more industry-specific analyses. Different sectors may have varying tax planning strategies and responses to profitability and sales growth changes. Industry-specific studies could provide a more granular understanding of these relationships within the Jordanian context. There is room for longitudinal analyses to track changes over time, do cross-industry comparisons, and explore non-linear relationships. Additionally, further research could test the impact of corporate governance, board composition, and regulatory changes on tax behavior in Jordan.

A marketing strategy pertains to a company's willingness to promote its products utilizing the available resources (Li et al., 2020; Han et al., 2020; Bui et al., 2020; Grossmann & Hottiger, 2020; Wijaya et al., 2020). Gavalas and Syriopoulos (2019) conducted an inquiry to ascertain if, when operations decrease equivalently, sales expenses exhibit a more pronounced increase than the decline in profits. Bosch et al. (2017) discovered that changes in a firm's current profits and anticipated sales revenue tend to rise when sales revenue decreases. Subramaniam and Watson (2016) have substantiated persistent costs, illustrating that sales and marketing expenses increase by 0.9% for every 1% increase in sales revenues.

Higgins et al. (2015) highlighted that the advantages of tax avoidance tend to be more significant for defender-oriented companies than prospector-oriented companies. This distinction arises from

the fact that defender companies prioritize cost efficiency as a primary source of competitive advantage, whereas prospector companies emphasize innovation and growth more. Given that minimizing costs, particularly income tax expenses, is a critical objective for most firms, those aligning with a defender strategy are poised to reap more substantial benefits from tax-saving initiatives than their prospector counterparts.

Several studies have explored the relationship between sales expenses and key components of a company's financial statements (Shubita, 2023, 2019). Sales expenses exhibit diversity and variability, responding to changes in sales, and their importance relative to total assets of industrial companies has increased. Effective sales expense management is essential for business continuity (Lim & Rokhim, 2021). The volume of investment in current assets inversely relates to marketing strategy risk. Conservative and aggressive policies have distinct investment volumes in current assets, affecting a firm's ability to meet its targets and provide for customer needs. High investment in assets can indicate operational inefficiencies, including issues related to sales and debt collection (Alareeni & Hamdan, 2020).

Saini and Sharma (2009) identified a positive correlation between generating profits and marketing, emphasizing the beneficial influence of profit generation on marketing strategy. Wang (2002) examined the correlation between a firm's marketing strategy and its overall value in Japan and Taiwan, unveiling that an assertive marketing approach enhances the company's performance and overall value. On the other hand, Soenen (1993) established that the net trade cycle is not linked to the return on assets. In contrast, Shin and Soenen (1998) uncovered an inverse link between a company's net trade cycle (NTC) and its profit levels, with businesses possessing shorter NTCs achieving higher profit levels.

The literature review provides insight into the complex relationship between profitability and sales expenses, with varying findings, including positive and negative associations and instances of no relationship between profitability and marketing strategy. Understanding the link between sales growth, tax avoidance, and profitability in

Jordan is essential for businesses and policymakers. While prior research has contributed valuable insights, there is ample scope for further exploration in this dynamic economic environment. The Jordanian context presents unique factors and challenges that warrant continued investigation to inform effective tax planning and policy formulation.

The study aims to investigate the intricate relationships between sales growth, profitability, and tax avoidance. Additionally, it discerns whether specific factors, such as industry, size, or regulatory environment, modulate these relationships. The hypotheses are:

- H_{01} : Sales growth does not have a statistically significant impact on tax avoidance.
- H_{02} : Profitability does not have a statistically significant impact on tax avoidance.
- H_{03} : Firm size does not affect the impact of sales growth and profitability on tax avoidance.

2. METHOD

There are several types of regression models, each with its own characteristics and use cases. The study models are:

$$TAV_{it} = \beta_0 + \beta_1 ROA_{it} + \beta_2 Sales_{it} + \varepsilon_{it} \quad (1)$$

$$TAV_{it} = \beta_0 + \beta_1 ROA_{it} + \beta_2 Sales_{it} + \beta_3 Size_{it} + \varepsilon_{it} \quad (2)$$

where TAV – tax avoidance which equal tax expense over income before tax; $Sales$ – Δ sales or (sales in year t minus sales in year $t-1$)/sales $t-1$; ROA – return on assets, $size$ – normal log. for total assets; $\beta_0, \beta_1, \beta_2$ = coefficients, i – company, t – year, ε – error.

These are just some of the regression models commonly used in statistics and data analysis. The choice of which model to use depends on the nature of the data, the research question, and the assumptions underlying the model. It is crucial to assess model fit, interpret coefficients, and perform diagnostics to ensure the chosen regression model

accurately captures the relationship between variables and makes reliable predictions or inferences. Table 1 represents the study variables.

Table 1. Study variables

Variable	Type
Tax avoidance (TAV)	Dependent
Return on assets (ROA)	Independent
Sales	Independent
Size	Control

3. RESULTS

The descriptive results in Table 2 include the mean, standard deviation (Std.), skewness, and kurtosis for four key variables in the dataset: tax avoidance (TAV), return on assets (ROA), sales, and size.

Table 2. Descriptive results

Item	Mean	Std.	Skewness	Kurtosis
TAV	0.96	0.259	8.006	2.011
ROA	-0.024	0.15	-5.525	59.077
Sales	3.32	33.569	11.656	142.519
Size	7.283	0.641	0.465	1.010

Note: (logarithm of total assets). These statistics provide essential insights into the distribution and characteristics of data.

The mean (average) tax avoidance is approximately 0.96, which indicates that, on average, companies in the dataset engage in some level of tax avoidance, with tax avoidance values typically close to 1. The standard deviation is 0.259, suggesting relatively low variability in tax avoidance values around the mean. The positive skewness of 8.006 indicates that the tax avoidance data are positively skewed, meaning there might be a right-tailed distribution with some extremely high values of tax avoidance. The very high kurtosis of 110.2 suggests that the distribution of tax avoidance has heavy tails and is leptokurtic, indicating a significant number of outliers. The mean ROA is -0.024, indicating that, on average, companies in the dataset are experiencing a slightly negative return on their assets. The standard deviation is 0.15, suggesting moderate variability in ROA values around the mean. The strongly negative skewness of -5.525 suggests that the ROA data are skewed negatively, meaning there might be a left-tailed distribution with extremely low values. The high kurtosis of 59.077 suggests that the distribution of ROA has heavy

tails and is leptokurtic, indicating a significant number of outliers.

The mean for sales growth is 3.32, indicating that, on average, companies in the dataset experience positive sales growth. The very high standard deviation of 33.569 suggests a wide range of variability in sales growth. The positive skewness of 11.656 suggests a right-skewed distribution, indicating that there might be a right-tailed distribution with some extremely high sales growth values. The extremely high kurtosis of 142.519 indicates a distribution with very heavy tails, suggesting the presence of a substantial number of outliers.

The mean size (logarithm of total assets) is 7.283, representing the average size of firms in the dataset. The standard deviation of 0.641 suggests moderate variability in firm size. The slightly positive skewness of 0.465 indicates a slightly right-skewed distribution. The kurtosis of 1.010 suggests a distribution that is relatively closer to a normal distribution than the other variables, with fewer extreme values.

These descriptive results offer a preliminary understanding of the central tendencies, variability, and distribution shapes of the dataset. The skewness and kurtosis values provide insights into the departure from normality. The extremely high kurtosis values for tax avoidance, ROA, and sales indicate distributions with heavy tails and potential outliers, which could affect the subsequent statistical analysis.

Table 3. Pearson correlation matrix

Variable	ROA	Sales	Size
TAV	-0.105*	0.004	0.038
ROA		0.039	0.342**
Sales			-0.002

Note: * significant for 0.05; ** significant for 0.01. TAV = tax avoidance; ROA = return on assets.

The correlation results presented in Table 3 show the Pearson correlation coefficients between the variables in the dataset: ROA (return on assets), sales (sales growth), size (logarithm of total assets), and TAV (tax avoidance).

The negative correlation coefficient (-0.105) between tax avoidance and ROA suggests a weak negative linear relationship between tax avoidance and return on assets. In other words, as tax

avoidance increases, ROA tends to decrease slightly. The significance at the 0.05 level indicates that this negative correlation is statistically significant at a 5% significance level. The positive correlation coefficient (0.039) between ROA and sales indicates a weak direct linear relationship. This means there is a little tendency for companies with higher return on assets to experience slightly higher sales growth. The correlation coefficient of -0.002 between sales and size is close to zero, indicating an extremely weak linear relationship. This suggests that there is virtually no linear association between the size of a firm and its sales growth.

The correlation results indicate some weak linear relationships between the variables. Notably, tax avoidance is negatively correlated with return on assets (ROA) at a statistically significant level (0.05), suggesting that higher tax avoidance is associated with slightly lower profitability. The relationships between ROA and sales, sales and size, and tax avoidance and size are weak and not explicitly discussed in terms of statistical significance. The results highlight the need for further statistical analysis to better understand the strength and significance of these relationships.

Table 4. The first model

Item	Factor	Error	t.	Sig.
Constant	0.954	0.013	76.023	0.00
ROA	-0.198	0.086	-2.316	0.021
Sales	0.0067	0.00	0.182	558.0
R ²	0.011	Adj R ²		0.007
F	2.686	Sig.		0.069
VIF	1.002	Durbin Watson		1.606

The discussion of the regression results presented that the constant (intercept) represents the expected value of tax avoidance when both ROA and sales are zero (Table 4). In this case, the constant is highly significant, with a t-statistic of 76.023, indicating that it significantly contributes to the model. It suggests that even if ROA and sales are zero, there is still a significant positive tax avoidance. The coefficient for ROA is -0.198 , and it is statistically significant with a significance level of 0.021 (p-value). The negative sign suggests that as ROA increases, tax avoidance decreases. In other words, there is a negative relationship between ROA and tax avoidance. For each unit increase in ROA, tax avoidance is expected to decrease by 0.198 units.

The coefficient for sales is 0.0067, but it is not statistically significant as the p-value is 0.855, which is much higher than conventional significance levels. This suggests that sales do not have a statistically significant linear relationship with tax avoidance in this model.

R² represents the proportion of the variance in tax avoidance that the model explains. In this case, the model explains only 1.1% of the variance in tax avoidance, indicating a weak fit. The adjusted R² accounts for the number of predictors and is slightly lower. The F-Statistics tests the overall significance of the model. The significance level is 0.069, which is greater than conventional significance levels (e.g., 0.05). This suggests that the overall model may not be statistically significant, indicating that the model might not be a strong fit for the data. VIF (Variance Inflation Factor) assesses multicollinearity among predictors, and a value of 1.002 suggests very little multicollinearity among the independent variables. The Durbin-Watson statistic (1.606) measures autocorrelation in the residuals, and a value close to 2 indicates minimal autocorrelation. This statistic suggests that the residuals are relatively independent.

The first regression model suggests that ROA has a statistically significant negative relationship with tax avoidance. However, the model explains only a small fraction of the variance in tax avoidance, and other factors not included in the model may influence tax avoidance. In this specific model, sales do not appear to have a statistically significant relationship with tax avoidance. The overall model fit is also relatively weak.

Table 5. The second model

Item	Factor	Error	t.	Sig.
Constant	0.647	0.157	4.110	00.0
ROA	-0.258	0.091	-2.847	0.005
Sales	0.0078	0.00	0.214	0.830
Size	0.042	0.021	1.958	0.049
R ²	0.02	Adj R ²		0.013
F	3.080	Sig.		0.027
VIF	1.130	Durbin Watson		1.618

The discussion of the regression results presented in Table 5 represents that the constant (intercept), which is the expected value of tax avoidance when all independent variables (ROA, sales, and size) are zero, is highly significant with a t-statistic of

4.110, indicating that it significantly contributes to the model. The coefficient for ROA is -0.258 . This negative coefficient suggests that tax avoidance decreases as the return on assets increases. This finding is consistent with the first model. For each unit increase in ROA, tax avoidance is expected to decrease by 0.258 units.

The coefficient for size is 0.042, and it is marginally statistically significant (p -value = 0.049). This suggests a weak positive relationship between firm size and tax avoidance. Tax avoidance is expected to increase by 0.042 units for each unit increase in size.

The R^2 value of 0.02 indicates that the model explains only a small proportion of the variance in tax avoidance. The adjusted R^2 is similar, suggesting that the model's explanatory power is limited. The F-Statistics tests the overall significance of the model. The significance level is 0.027, less than 0.05, suggesting that the overall model is statistically significant at the 0.05 significance level. However, the F-statistic is relatively low, indicating that the model may not be a strong fit for the data. The VIF indicates a low level of multicollinearity among the independent variables. The Durbin-Watson statistic (1.618) suggests minimal autocorrelation in the residuals.

The second regression model confirms the negative relationship between return on assets and tax avoidance, as observed in the first model. However, this model adds the size variable, which is marginally statistically significant and positively related to tax avoidance. The model's overall explanatory power remains low, and the significance levels are only marginally met for ROA and size, indicating that other unaccounted factors may influence tax avoidance. The hypotheses testing results are that ROA has a statistically significant negative relationship with tax avoidance, sales do not exhibit a statistically significant association with tax avoidance, and firm size is an additional predictor with a marginally relationship with tax avoidance.

4. DISCUSSION

The two regression models, designed to examine the relationship between tax avoidance and its drivers (return on assets, sales, and size), have yielded

notable results. In both models, return on assets (ROA) exhibited a significant negative association with tax avoidance, affirming that higher profitability is linked to lower tax avoidance. However, the relationship between sales and tax avoidance was not statistically significant, as observed in both models. Interestingly, the second model introduced firm size as an additional predictor, revealing a marginally significant positive relationship with tax avoidance. The R-squared values in both models indicated that they explained only a small portion of the variance in tax avoidance, signifying the presence of unaccounted factors.

These findings align with studies like Ariffin (2013) and Jamei (2017) that have demonstrated a negative correlation between ROA and tax avoidance but different than what Saini and Sharma (2009) identified as a positive correlation between generating profits and marketing. Profitable firms may have less incentive to engage in aggressive tax avoidance strategies due to reputational risks and higher visibility. The lack of a significant relationship between sales and tax avoidance is consistent with the ambiguity surrounding the impact of sales growth on tax avoidance in the literature. However, the marginal significance of size in the second model is an interesting addition, as larger firms may have more complex tax structures and resources to engage in tax planning.

The negative relationship between ROA and tax avoidance is similar to Alkurdi and Mardini (2020) which discovered an inverse link between tax avoidance and firm profitability which can be attributed to the inherent trade-off profitable firms face. They aim to optimize tax efficiency while maintaining a positive public image and adhering to regulatory requirements. The non-significant relationship between sales and tax avoidance may stem from various factors, including the firm's industry, geographical location, or the complexity of its tax structures. The introduction of size as a predictor may reflect the increased capacity of larger firms to implement tax avoidance strategies. However, the marginal significance suggests the presence of other factors that influence tax behavior.

The study opens up several avenues for future investigation. First, exploring industry-specific

ic factors and their influence on tax avoidance could provide a more nuanced understanding of the relationship. Additionally, a longitudinal analysis to track changes in these relationships over time may yield valuable insights, especially in the context of evolving tax regulations. Future research should also delve into non-linear relationships and the potential threshold effects, as tax avoidance strategies may vary in impact at different levels of profitability, sales growth, and firm size.

Furthermore, examining the role of corporate governance, board composition, and executive compensation in influencing tax behavior would enhance understanding the drivers of tax avoidance. Cross-country analyses could shed light on

the impact of varying regulatory environments on these relationships.

While consistent with some previous research, the marginally significant role of firm size in tax avoidance warrants further exploration. Future research endeavors should build upon these findings to unveil the multifaceted dynamics of corporate tax behavior in an ever-evolving global business landscape.

The study points to future research opportunities in exploring industry-specific factors, longitudinal analyses, non-linear relationships, and the role of corporate governance in influencing tax avoidance. Cross-country comparisons can offer insights into the impact of regulatory environments on corporate tax behavior.

CONCLUSION

The purpose of this study was to investigate the relationships between tax avoidance and key firm-level indicators, specifically return on assets (ROA), sales, and size. Consistent with previous research, this study observed a significant negative relationship between return on assets and tax avoidance. Profitable firms are inclined to engage in less aggressive tax avoidance, balancing financial efficiency with adherence to regulatory requirements and reputation management. The relationship between sales and tax avoidance was not statistically significant in both models. This finding suggests that sales growth alone may not be a key driver of tax avoidance behavior, underscoring the complex and context-dependent nature of tax planning strategies. The second model introduced firm size as a predictor, revealing a marginally significant positive relationship with tax avoidance. Larger firms may have the resources and complexity to engage in more sophisticated tax planning, although other unaccounted factors influence tax behavior.

These conclusions offer several implications. First, companies must consider their profitability, size, and sales growth when developing tax strategies. Profitable firms may opt for more conservative tax practices, while larger firms should be aware of their capacity for complex tax planning. Second, policymakers should recognize the interplay between firm characteristics and tax behavior. Tax regulations and oversight mechanisms should be designed to accommodate the diverse tax planning strategies that firms may employ.

This study highlights the complex relationships between firm-level variables and tax avoidance. It underscores the need for a nuanced approach to tax planning that considers firm profitability, size, and sales growth. These insights are valuable for businesses, policymakers, and future researchers seeking to navigate the ever-evolving landscape of corporate taxation.

AUTHOR CONTRIBUTIONS

Conceptualization: Mohammad Fawzi Shubita.

Data curation: Mohammad Fawzi Shubita.

Formal analysis: Mohammad Fawzi Shubita.

Funding acquisition: Mohammad Fawzi Shubita.
 Investigation: Mohammad Fawzi Shubita.
 Methodology: Mohammad Fawzi Shubita.
 Resources: Mohammad Fawzi Shubita.
 Writing – original draft: Mohammad Fawzi Shubita.
 Writing – review & editing: Mohammad Fawzi Shubita.

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