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MODERATING IMPACT OF FINANCIAL PERFORMANCE ON CAPITAL INTENSITY STRATEGY OF TAX AVOIDANCE AND CORPORATE LIQUIDITY

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Abstract: There is a general misconception of interpreting the implicit inverse relationship between capital allowance size and tax liability to misjudge capital intensity strategy of tax avoidance as panacea for corporate liquidity. This paper investigated the influence of capital intensity strategy of tax avoidance, and the moderating impact of profitability on corporate liquidity of quoted consumer-goods manufacturing firms in Nigeria. The population of the study consisted of twenty-one (21) listed Consumer goods manufacturing firms in Nigeria. Data for the study were generated from the companies' annual reports and statements of account for an eight –year period: 2013-2020. The stated hypotheses were statistically tested using fixed-effect regression technique. Capital intensity was measured by the ratio of non-current assets to total assets while corporate liquidity was operationalized by acid test ratio. Our findings revealed that Capital intensity was significantly and negatively related with corporate liquidity. Result also showed that profitability significantly moderates the relationship between capital intensity and liquidity. It was therefore concluded that capital intensity is only viable for loss sustaining firms, but not attractive for firms operating in profitable bandwidth. Accordingly, we recommended that firms in profit region should seek alternative tax avoidance strategy different from capital intensity while loss sustaining firms should adopt capital intensity option.

Keywords: Corporate Tax Avoidance, Corporate Liquidity, Capital Intensity, Profitability, Nigeria

1. INTRODUCTION

Taxes paid by companies' impact firm's cash flow and overall liquidity. As a result of this, organizations take reasonable steps to mitigate tax costs (Nwaobia & Jayeoba, 2017). They do this by employing all legitimate opportunities offered by the tax laws to increase their after-tax earnings and improve liquidity position. One of the most important responsibilities for corporate tax manager is to strategize on minimizing a company's overall tax liability. The major challenge of corporate entities, and in particular consumer goods manufacturing firms, come in a midst of high corporate tax rates and multiples of other taxes that lead to high effective tax rates far above the statutory company income tax rate. With the introduction of the Information Technology tax, there are about forty different taxes levied on companies and individuals (Bammeke, 2012). Many of these taxes from the different levels of government overlap and are forcefully extracted from corporate organizations. The effect of these extractions of course is high cost structure for firms (Nwaobia, 2014). One will not fail to agree with Nnadi and Akpomi (2008) that a tax policy defines the cost structure of firms as it is factored into pricing. Therefore, minimizing tax will enhance corporate liquidity. Tax liability is a manageable cost that can be decreased, like any operational costs (Garbarino, 2011). Theoretically, firm's tax liability is proportionally related to its cash flow; attaining firm's wealth maximization objective through diverse means of increasing cash flow pose more challenge on firm's ability to reduce its tax liability.

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Over the years, experience has shown that the tax authorities can dip the largest possible shovel into the resources of an organization if left vulnerable. Fortunately, the law supports a tax payer if he arranges his affairs in such a way that the tax chargeable is minimized or even avoided. In the case between IRC V. Duke of Westminster (1936) 19 TC 490 by Lord Temlin when he averred that:

"*Every man is entitled if he can, to order his affairs so that the tax attracting 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 cannot be compelled to pay an increased tax.*"

Effective tax planning is defined by (Scholes, Wolfson, Erickson, Maydew, & Shevlin, 2009) as strategies that maximize the firm's expected discounted after-tax cash flows. The minimization of tax burden can be achieved through tax planning. Hanlon and Heitzman (2010); and Mappadang (2019) stated that the purpose of tax planning is to minimize taxable income. There are many definition of tax planning. It is defined as "the taxpayer's capacity to arrange his financial activities in such a manner as to suffer a minimum expenditure for taxes" (Hoffman, 1961). Jeff Pniowsky (2010) defined tax planning generally as being "the process of structuring one's affairs in order to defer, reduce or even eliminate the amount of taxes payable to the government". Kiabel (2019) opined that corporate tax planning has to do with the planning and operation of business activities within the context of existing legislation in such a way that the business realizes the optimal or best tax position while achieving its set goals. The implication of this explanation or understanding is that plans which contravene existing legislations are not acceptable and that is the essence of ensuring that tax plans do not run afoul of the law. In corporate tax planning, therefore, it is imperative to distinguish between tax avoidance and tax evasion.

In as much as cash flow is the main purpose of business enterprises, without liquidity, it will be difficult to continue business operations on daily basis. Organizations are constantly faced with pressures on their liquidity and corporate taxation tends to add to this pressure. A major problem facing the development of consumer goods industries that is hindering their development is that of the problem of excessive taxation in the form of high tax rate, double and multiple taxation and these may affect negatively the liquidity of consumer goods firms in Nigeria.

Great deal of research works (Nwaobia et al 2016; Ohaka and Agundu 2012; Yinka and Uchenna, 2018) have been conducted in the area of capital intensity particularly in developing nations of the world, but only a few of those studies related capital intensity to corporate liquidity. More so there seem to be inadequate empirical literature in Nigeria on variables under study particularly in listed Consumer goods manufacturing firms. Consequently, it is difficult to shed light on the mystery surrounding the general misconception of interpreting the implicit inverse relationship between capital allowance size and tax liability to misjudge capital intensity strategy of tax avoidance as panacea for corporate liquidity. It is in a bid to close this existing gap that this study aimed to investigate the relationship between capital intensity strategy of tax planning and corporate liquidity of listed consumer goods manufacturing firms in Nigeria, using profitability as a moderating variable.

The rest of this paper will be organized as follows: section two reviews literature on capital intensity and corporate liquidity. The third section focuses on the research methodology, section four presents the results and section five provides the conclusion and recommendations.

2. LITERATURE REVIEW

2.1 Theoretical Background

2.1.1 Trade-off Theory

While the motivation behind the trade-off theory by Modigliani and Miller (1958) is to explain the capital

structure of firms, the theory's underlying principle also extends to working capital structure of firms (Saluja & Kumar, 2012; Puneet & Parmil, 2012; and Garcia & Martinez, 2007). The theory postulates that firms optimize their debt levels by balancing the tax benefits of debt against the potential costs of bankruptcy. This balancing act manifests in the form of risk-return trade-off, hence the name "trade-off". The more liquid assets a business has, the less risky the business is. If a business wishes to increase profit by lowering the cost of liquidity management, it must also increase risk. If it wishes to reduce risk, it must also reduce profitability. As a result, a trade-off between risk and reward is necessary..

Saluja and Kumar (2012), Puneet and Parmil (2012), and Garcia and Martinez (2007) viewed liquidity and profitability as complementary economic expressions at the tail ends of a thread, where movement in one direction inevitably implies a drive away from the other. In other words, the two are in a position of mutual benefit. According to the liquidity trade-off hypothesis, firms seek an optimal level of liquidity in order to balance the costs and benefits of cash management (Orshi, 2016). The costs of managing cash include the low rate of return on current assets as a result of the liquidity premium and possible tax consequences; however, the benefits of cash management include the fact that firms avoid exchange costs when raising reserves and do not have to settle resources to meet commitments; and firms can use liquid resources to fund their ventures when other sources of finance are unavailable. Thus, obtaining alternative sources of finance becomes arduous for such corporations (Saluja & Kumar, 2012; Puneet & Parmil, 2012; Garcia & Martinez, 2007; Lamberg & Valming, 2009; and Dash & Hanuman, 2008). Thus, firms must strike a balance between liquidity and profitability in order to maintain an optimal level of liquid assets (Samiloglu & Demirgunes, 2008; Raheman & Nasr, 2007; Akella, 2006; and Lazaridiss & Tryfonidis, 2005). Hence in the context of the current study, the takeaway from this theory is the mutual exclusivity between profitability and liquidity. Tax planning is usually focused on increasing appropriable profits for shareholders. Since profitability is mutually exclusive with liquidity objective, a negative relationship is expected between capital intensity and liquidity.

2.1.2 Hoffman's Tax Planning Theory

Hoffman (1961) asserts that tax planning aims to divert cash that would normally flow to tax authorities to corporate entities. Tax planning activities are beneficial to the extent that they minimize taxable income without jeopardizing accounting income. The theory is predicated on the fact that a business's tax liability is determined by its taxable income, not its accounting income. Thus, the objective is to increase activity that reduces taxable income which has no indirect effect on accounting profit. After all, tax liability is determined by capital allowances and capital expenditure. For a business to minimize its tax liability (and therefore maximize its liquidity), it is required to increase capital expenditure which should attract higher capital allowance. Thus in line with the tenet of the theory, a positive relationship should exist between firm capital intensity and corporate liquidity. Invariably therefore, a negative relationship is expected between tax planning and liquidity if the tenets of trade-off theory applies since profitability is negatively related with liquidity.

2.2 Conceptual Review

The thrust of the current study is embodied by three main variables, namely capital intensity being the criterion variable, corporate liquidity being the response variable. Corporate profitability is adopted as the contextual factor. Following in the footsteps of Yinka and Uchenna's (2018) definition, this study conceptualizes capital intensity as the amount of money invested in order to get one Naira output. It is the weight of a firm's tangible noncurrent assets in relation to other factors of production, operationally represented as asset tangibility.

Corporate liquidity on the other hand refers to the ease with which a company pays off its short-term liabilities such as accounts payable that come due in less than a year.

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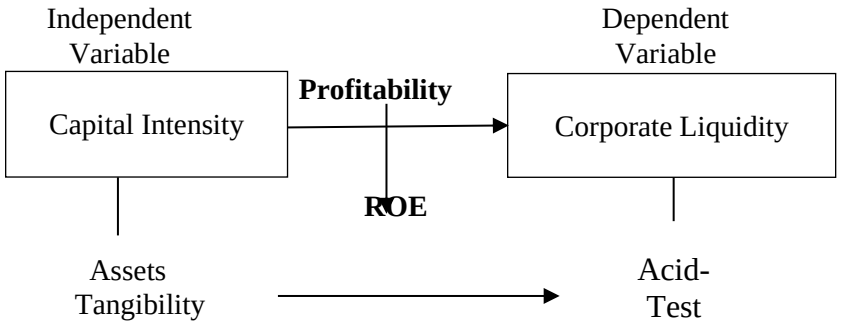
Operationally, liquidity is represented in terms of acid-test ratio, which measures the ability of a company to use its near cash or quick assets to extinguish or retire its current liabilities immediately.



Profitability is adopted as the moderator variable, since different firms are exposed to different levels of profitability which affects thei *Figure-1: Conceptual Framework of Capital Intensity and Corporate Liquidity*

2.3 Hypothesis Development

(i) Capital Intensity and Liquidity

On the question of capital intensity strategy of tax planning and corporate liquidity nexus, there is still no definite theoretical postulation that conclusively rationalize their connection. There are two contending frontline theories commonly found in literature: on one hand there is the Hoffman's (1961) theory that suggests a positive relationship while on the other hand, the trade-off theory by Modigliani-Miller (1958) tend to suggest a negative relationship. A positive relationship between capital intensity and liquidity indicates a justification for capital intensity as a veritable tax planning strategy. On the other hand, a negative relationship indicates a refutation of Hoffman's (1961) tax planning theory thus suggesting non-neutrality of tax planning activity on profitability.

Yinka and Uchenna (2018) argued that capital intensity is the amount of money invested in order to get one Naira output; and the more the capital applied to produce that same unit, the more capital intensive the firm is said to be. In line with Yinka and Uchenna's (2018) conceptual and Hoffman's (1961) Tax Planning Theoretical perspectives, it is arguable to postulate a positive correlation between capital intensity and corporate liquidity since firms with high capital intensity or high proportion of tangible fixed assets to total assets tend to reduce their tax burden through an allowable basic depreciation deduction. These allowances tend to have positive impact on liquidity and operating capacity.

Although a negative relationship (i.e. non-neutrality of tax planning activity on profitability) is not completely ruled out, few existing empirical literatures on the link between capital intensity and liquidity tend to corroborate the Hoffman's (1961) proposition. For instance, Santini and Indrayani (2020) determined the effect of profitability, liquidity, leverage, capital intensity and firm size on tax aggressiveness with market performance as an intervening variable in Indonesia. The sample used was 43 banks registered on the Indonesia Stock Exchange. The study used secondary data from banking financial statements. The result indicated that profitability, leverage, firm size affect market performance while capital intensity does not affect market performance. On the other hand, Onyeka and Chimeruo (2021) investigated the effect of tax planning strategies on liquidity of manufacturing firms in Nigeria. The study sampled 52 manufacturing companies quoted on

the Nigerian Stock Exchange. The study used descriptive and inferential statistics in data analysis. The result revealed that there is no significant effect of tax planning (capital intensity) on the current ratio of manufacturing companies quoted in Nigeria. Therefore since the Hoffman's (1961) tax planning theory appears to have more supporting empirical evidence, the following hypothesis is suggested for testing:

H_{o_1}: **Capital intensity has no significant relationship with corporate liquidity of listed consumer goods manufacturing firms in Nigeria.**

(ii) Capital Intensity and Corporate Liquidity: Moderating Impact of Profitability

Profitability is the mediating variable between capital intensity and liquidity because other than through profitability, there is no basis of connection between the two variables. Saluja and Kumar (2012), Puneet and Parmil (2012), and Garcia and Martinez (2007) viewed liquidity and profitability as complementary economic expressions at the tail ends of a thread, where movement in one direction inevitably implies a drive away from the other. In other words, the two are in a position of mutual benefit. According to the liquidity trade-off hypothesis, firms seek an optimal level of liquidity in order to balance the costs and benefits of cash management (Orshi, 2016). The opportunity costs of high liquidity is low rate of return on current assets as a result of the liquidity premium and possible tax consequences; however, the benefits of liquidity include the fact that firms avoid exchange costs when raising reserves and do not have to settle resources to meet commitments; and firms can use liquid resources to fund their ventures when other sources of finance are unavailable. Thus, obtaining alternative sources of finance becomes arduous for such corporations (Saluja & Kumar, 2012; Puneet & Parmil, 2012; Garcia & Martinez, 2007; Lamberg & Valming, 2009; and Dash & Hanuman, 2008). Thus, firms must strike a balance between liquidity and profitability in order to maintain an optimal level of liquid assets (Samiloglu & Demirgunes, 2008; Raheman & Nasr, 2007; Akella, 2006; and Lazaridiss & Tryfonidis, 2005). This conjecture has been confirmed in empirical literature by Nangih and Onuora (2020) who investigated the influence of capital intensity on profitability of listed oil and gas firms in Nigeria. The study sampled 9 listed oil and gas companies in Nigeria. The random effect regression model was used to analyze their data. It was therefore concluded that firms with higher capital intensity were bound to perform financially better than those with lowers ones. Accordingly, the following hypothesis is suggested for testing:

H_{02}: Profitability significantly moderates the relationship between capital intensity and corporate liquidity of listed consumer goods manufacturing firms in Nigeria.

3.0 METHODOLOGY

The approach used in this study is a quantitative approach because this study aims to find out the causal relationship between two or more variables. This research explains the influence of capital intensity as a tax planning strategy and corporate liquidity. The population of the study consist all listed consumer goods manufacturing firms operating on Nigerian Stock Exchange (NSE) as at December, 2020. In order to generate the necessary data for the study, secondary data were collected from the companies' annual reports and accounts for the year 2013-2020. Capital intensity was measured in line with Yinka and Uchenna's (2018) conceptual definition as being the amount of money invested in order to get one Naira output. Operationally, this was represented as the ratio of tangible total asset per naira book value of total asset. Corporate liquidity on the other hand was operationalized as acid-test ratio (i.e. current assets minus inventory divided by current liability). Profitability as the moderator variable was operationalized as absolute value of return on equity. The model for the study is thus specified as follows:

LIQ = *f*(CAP, PROF)

Where, LIQ = Corporate Liquidity; CAP = Capital Intensity; PROF = Profitability. The objective is to prove

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that at 5% level of significance, $\frac{\partial LIQ}{\partial CAP} > 0$ (thus confirming Hoffman's (1961) tax planning theory) or $\frac{\partial LIQ}{\partial CAP} < 0$ (thus confirming the trade-off theory).

4.0 RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Table-1 presents the descriptive results of the study. The average acid test ratio is 0.7378, indicating that an average firm from among the sampled firms, is liquid enough to offset 73.78 kobo for every ₦1 current liability. The maximum acid test ratio is 2.1387 and the minimum is 0.0517 approximately. Although the descriptive statistics tends to suggest a poor state of liquidity among the sampled firms, this poor state of liquidity is not evenly prevalent across the cross-section of the sampled firms as it is skewed to the right of the data. Furthermore, the acid test ratio is less virulent in fluctuation, as shown by the low standard deviation relative to the mean ratio.

Table-1: Descriptive Result

	LIQ	CAP	ROE
Mean	0.737783	0.513720	0.071109
Median	0.637489	0.490358	0.051055
Maximum	2.138699	0.889205	0.264935
Minimum	0.051653	0.171308	0.000728
Std. Dev.	0.417941	0.199183	0.063186
Skewness	1.420797	0.131430	1.363244
Kurtosis	5.285049	1.864214	4.093864
Jarque-Bera	57.61644	5.889457	37.39786
Probability	0.000000	0.052616	0.000000
Sum	76.72947	53.42684	7.395321
Sum Sq. Dev.	17.99147	4.086425	0.411227
Observations	104	104	104

Capital intensity across the sampled firms for the periods under consideration indicates an average of 0.5137, translating to 51.37 kobo for every ₦1 of total assets. The maximum and minimum are 0.8892 and 0.1713 respectively. These statistics indicate a significant degree of capital intensity across the sampled firms in the periods under consideration. The degree to which capital intensity manifested during the period of the study is fairly distributed symmetrically, meaning it fairly permeates across the industry apart from few outliers. This observation is supported by the Jarque-Bera statistic (5.889) and the probability value of 0.0526, affirming prevalence of normal distribution of the data.

Hypothesis-1: H_{01}

The data analysis technique used in this study is Multiple Regression Analysis (MRA) or multiple linear regression analysis using e-views program. This technique is used to look at the influence of capital intensity on corporate liquidity of consumer-goods manufacturing companies registered in the Nigerian Stock Exchange, period 2013-2020. Since the data collected is a panel data, a preliminary test (Hausman Test) was conducted to ascertain which econometric model, between fixed and random effect to use. The results of the test favoured a fixed-effect model, as presented in Table-2:

Table-2: Correlated Random Effects - Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	8.156215	2	0.0169

The result of the fixed-effect Multiple Regression Analysis is presented in table-3:

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Table-3 Regression Result of LIQ

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CAP	-2.161422	0.390510	-5.534866	0.0000
ROE	1.914185	0.667749	2.866624	0.0052
C	1.712033	0.206885	8.275295	0.0000

Effects Specification			
Cross-section fixed (dummy variables)			
R-squared	0.508617	Mean dependent var	0.737783
Adjusted R-squared	0.431321	S.D. dependent var	0.417941
S.E. of regression	0.315173	Akaike info criterion	0.661314
Sum squared resid	8.840703	Schwarz criterion	1.042717
Log likelihood	-19.38833	Hannan-Quinn criter.	0.815831
F-statistic	6.580103	Durbin-Watson stat	1.354200
Prob(F-statistic)	0.000000		

Based on the results from table-3, the structural equation model for corporate liquidity of listed consumer-goods manufacturing companies in Nigeria, can be stated as follows:

LIQ = 1.712 - 2.161*CAP + 1.914*PROF + e

The regression equation shows the direction of the influence of capital intensity on corporate liquidity. The regression coefficient of capital intensity marked negatively means it has an adverse effect on corporate liquidity, while the regression coefficient of positively marked profitability means it has the direct effect on corporate liquidity described as follows:

The constant term (1.712) means that if capital intensity and profitability were considered zero, then average corporate liquidity (in terms of acid-test ratio) for the sampled firms will be approximately 1.712. The regression coefficient (CAP) of -2.161 implies the rate at which corporate liquidity (i.e. acid-test ratio) responds to 1 unit increase in capital intensity. On the other hand, every unit increase in profitability (i.e. absolute value of ROE), liquidity will increase by 1.914 units. Each of these regression coefficients is significant at 1% level since their probability values are respectively lower than the 5% significance threshold.

The F-significance aims to see if all independent variables included in the model have a co-effect on the dependent variable. Based on table-3, it can be seen that this equation model has a sig value of 0.000 which is smaller than the α significance level of 0.05 which means that independent variables simultaneously or together affect dependent variables so that it can be concluded this model is worth using or fit. The adjusted-R^2 aims to measure how far the model's capabilities explain variations in independent variables. The higher the coefficient of determination is, the higher the ability of independent variables to explain the dependent variable. In our case, capital intensity and profitability can explain 43.13% of the changing behaviour of corporate liquidity. Hence, regarding hypothesis the hypothesis (H_{01}), there is sufficient statistical reason to reject it.

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Hypothesis-2: H_{02}

To evaluate the moderating impact of a moderator variable in the relationship between a dependent and independent variable, focus is on the significance of the coefficients of the interaction terms. In our case, as reported in table-4, the interaction term is significant at 5% level. Therefore, based on the results from table-4, the moderated structural equation model for corporate liquidity of listed consumer-goods manufacturing companies in Nigeria, can be stated as follows:

$$LIQ = 1.362 – (1.523 + 7.105*PROF)*CAP + 5.947*PROF + U$$

In addition to the direction of influence of capital intensity and profitability on liquidity, the regression equation also demonstrates the moderating role of profitability on the relationship between corporate liquidity and capital intensity.

Table-4: Result of Moderated Regression on LIQ

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CAP	-1.523262	0.460486	-3.307948	0.0014
ROE	5.947264	1.767912	3.364004	0.0011
CAP*ROE	-7.105498	2.896773	-2.452902	0.0161
C	1.362933	0.246521	5.528660	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.540064	Mean dependent var	0.737783
Adjusted R-squared	0.461665	S.D. dependent var	0.417941
S.E. of regression	0.306648	Akaike info criterion	0.614409
Sum squared resid	8.274930	Schwarz criterion	1.021238
Log likelihood	-15.94927	Hannan-Quinn criter.	0.779227
F-statistic	6.888723	Durbin-Watson stat	1.400853
Prob(F-statistic)	0.000000		

According to the result obtained, if the effect of profitability on liquidity were to be held constant, liquidity is not likely to increase beyond 1.523 units for every unit increase in capital intensity. Also, above profitability (i.e. ROE) rate of -21.4%, capital intensity as a tax avoidance strategy is not a viable option for firms in the consumer-goods manufacturing business in Nigeria. In other words, capital intensity strategy of tax avoidance is only ideal for loss sustaining firms. Therefore, regarding hypothesis-2, there is sufficient statistical evidence against the acceptance of the hypothesis, hence H_{02} is rejected.

The results of this study fail to corroborate previous research conducted by Onyeka and Chimeruo (2021) which found that capital intensity does not have significant effect on corporate liquidity. However, with regards to the moderating impact of profitability, the result is in line with that of Nangih and Onuora (2020) who investigated the influence of capital intensity on profitability of listed oil and gas firms in Nigeria.

5. CONCLUSION AND RECOMMENDATION

5.1 Conclusion

The study concludes that when a firm seeks to improve its liquidity through tax planning, the strategy chosen is critical. It serves as a guide for tax planning strategies that any organization can implement to reduce its tax liability and strengthen its liquidity position. Additionally, it implies that liquidity improvement does not always reside in capital intensity strategy of tax avoidance. A loss sustaining firm stands to benefit from capital intensity strategy whereas firms with high profit prospects do not stand any chance to benefit from capital intensity strategy of tax avoidance.

5.2 Recommendation

It is therefore the recommendation of this study that firms in profit region should seek alternative tax avoidance strategy different from capital intensity, while loss

sustaining firms should adopt capital intensity option in order to achieve liquidity buoyance.

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