Tax Avoidance and Environmental Performance: The Moderating Role of Analyst Coverage in Mitigating Agency Conflicts

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Abstract

This study investigates the relationship between corporate tax avoidance and environmental performance, with a focus on the moderating role of analyst coverage. Results indicate that higher tax avoidance is significantly associated with lower environmental performance, indicating that resources diverted towards tax strategies may detract from environmental initiatives. However, this negative relationship is attenuated in firms with greater analyst coverage, suggesting that external scrutiny can mitigate the adverse effects of tax avoidance on environmental outcomes. Additionally, enhanced environmental performance is associated with reduced information asymmetry, as evidenced by narrower bid-ask spreads, underlining capital market benefits. This research contributes to the literature by integrating agency and stakeholder theories to explain the interplay between financial strategies and sustainability efforts, and highlights the important role of analyst coverage in promoting corporate transparency and accountability. This study offers valuable insights for policymakers, investors, and stakeholders aiming to foster sustainable corporate practices and enhance tax reporting transparency.

Keywords: Tax avoidance, environmental performance, ESG, analyst coverage, agency theory, stakeholder theory

1. Introduction

In recent years, corporate sustainability has garnered heightened attention from regulators, investors, and the public, leading to increased scrutiny of firms' environmental performance and tax practices. Tax avoidance, while legally permissible, often reflects aggressive financial

strategies that may undermine broader stakeholder interests, including environmental stewardship (Hanlon & Heitzman, 2010; Hoi et al., 2013). This study explores the relationship between tax avoidance and environmental performance, proposing that managerial opportunism inherent in tax avoidance can lead to underinvestment in environmental initiatives.

Analyst coverage, defined as the number of financial analysts providing earnings forecasts for a firm, serves as a potential governance mechanism to mitigate agency conflicts (Healy & Palepu, 2001; Yu, 2008). Increased analyst coverage may enhance transparency and hold managers accountable, thereby reducing the negative impact of tax avoidance on environmental performance. Despite the growing body of literature on tax avoidance and environmental performance, the moderating role of analyst coverage remains underexplored.

This research aims to bridge this gap by integrating tax avoidance, environmental performance, and analyst coverage into a comprehensive framework. By doing so, it seeks to provide a deeper understanding of how external monitoring influences corporate behavior concerning tax strategies and sustainability efforts. The study draws on agency theory, which addresses conflicts between principals (shareholders) and agents (managers), and stakeholder theory, which emphasizes firms' responsibilities beyond shareholders to various stakeholders, including the environment (Freeman, 2010; Jensen & Meckling, 1976).

Results indicate a significant negative relationship between tax avoidance and environmental performance. The results also indicate that analyst coverage significantly weakens the negative association between tax avoidance and environmental performance. Additionally, the results suggest that better environmental performance is associated with reduced information asymmetry, as evidenced by narrower bid-ask spreads. Robustness checks, including alternative

measures of analyst coverage and the inclusion of lead-lag research design and three-stage least squares (3SLS) regression, ensure the reliability and consistency of these findings. Overall, the findings highlight the detrimental impact of tax avoidance on environmental performance and the crucial role of analyst coverage in promoting sustainability.

This study makes several substantive contributions to the existing literature. It empirically demonstrates the negative relationship between tax avoidance and environmental performance, providing evidence of how financial strategies can undermine sustainability efforts. This research advances the understanding of external monitoring by highlighting analyst coverage as a mitigating factor that can alleviate the adverse effects of tax avoidance on environmental outcomes. By integrating agency theory and stakeholder theory, this study offers a unified framework that explains how information asymmetry inherent in tax avoidance can hinder environmental performance, and how analyst monitoring restores alignment with stakeholder expectations. The identification of analyst coverage as a mechanism to enhance corporate transparency and accountability provides actionable recommendations for regulators and investors focused on promoting sustainable economic development. The study is among the first to empirically demonstrate how analyst monitoring affects the impact of tax avoidance on environmental performance in an (export-oriented) emerging market.

These insights are valuable for policymakers aiming to enhance corporate transparency and accountability through regulatory measures that encourage analyst engagement. For investors and stakeholders, the findings highlight the importance of considering tax avoidance and analyst coverage in ESG assessments and investment decisions. Ultimately, this research contributes to promoting sustainable business practices, enhancing tax reporting transparency, and fostering long-term economic development by aligning managerial actions and shareholders' interest with

broader environmental goals.

2. Literature Review

2.1 Tax Avoidance and Environmental Performance

Tax avoidance involves strategic planning to minimize tax liabilities within legal frameworks (Hanlon & Heitzman, 2010). While it serves as a tool for optimizing financial performance, it may also signal managerial self-interest and resource misallocation (Desai & Dharmapala, 2006). Previous studies present mixed findings regarding the relationship between tax avoidance and corporate social responsibility (CSR), including environmental performance. Desai and Dharmapala (2009) argue that tax avoidance can provide additional resources that firms might invest in sustainability initiatives. Conversely, Lanis and Richardson (2012) and Hoi et al. (2013) argue that tax avoidance reflects managerial opportunism, leading to reduced transparency and neglect of environmental responsibilities.

The opacity associated with aggressive tax strategies can exacerbate information asymmetry, hindering stakeholders' ability to monitor environmental practices (Chen et al., 2010). Firms engaged in tax avoidance may prioritize financial strategies over environmental commitments, resulting in underinvestment in green technologies and sustainability programs (Lanis & Richardson, 2012). Additionally, tax avoidance can divert resources away from productive investments, including those aimed at enhancing environmental performance (Hoi et al., 2013).

2.2 The Moderating Role of Analyst Coverage

Financial analysts play a pivotal role in reducing information asymmetry by scrutinizing corporate activities and disseminating information to the market (Healy & Palepu, 2001).

Analyst coverage has been associated with improved corporate governance and reduced managerial opportunism (Yu, 2008). Analysts can influence firms to adopt more transparent and responsible practices, including those related to environmental performance (Luo et al., 2015).

Despite the recognized importance of analyst coverage in corporate governance, its role in moderating the relationship between tax avoidance and environmental performance remains unclear. Enhanced analyst scrutiny is posited to mitigate the adverse effects of tax avoidance by increasing managerial accountability and promoting transparency (Healy & Palepu, 2001; Yu, 2008). By closely monitoring firms' tax practices and environmental disclosures, analysts can pressure managers to align their actions with broader stakeholder interests, thereby fostering better environmental outcomes (Luo et al., 2015).

3. Theoretical Framework and Hypotheses Development

3.1 Agency Theory and Tax Avoidance

Agency theory posits that conflicts arise between principals (shareholders) and agents (managers) due to divergent interests and information asymmetry (Jensen & Meckling, 1976). Tax avoidance can exacerbate these agency conflicts by providing managers with opportunities for rent-seeking behaviors and self-serving actions that do not align with shareholders' interests (Desai & Dharmapala, 2006). Managers may engage in tax avoidance to enhance short-term financial performance, potentially at the expense of long-term investments in environmental sustainability.

3.2 Stakeholder Theory and Environmental Performance

Stakeholder theory extends the firm's responsibilities beyond shareholders to include various stakeholders, such as employees, customers, suppliers, and the environment (Freeman, 2010). Environmental performance is a key indicator of a firm's commitment to stakeholder interests

and long-term sustainability (Clarkson et al., 2011). Firms that prioritize environmental performance are perceived as more transparent and ethical, which can enhance their reputation and stakeholder trust (Clarkson et al., 2011).

3.3 Analyst Coverage as a Moderating Mechanism

Analyst coverage serves as an external governance mechanism that can influence managerial behavior by enhancing transparency and accountability (Healy & Palepu, 2001). Increased analyst scrutiny is expected to reduce managerial opportunism by monitoring tax avoidance practices and promoting responsible environmental performance (Yu, 2008; Luo et al., 2015). Analysts disseminate private information, reducing information asymmetry and disciplining managers (Healy & Palepu, 2001). Analysts can act as intermediaries between firms and stakeholders, ensuring that managerial actions align with broader organizational and societal goals. Firms engaging in tax avoidance may divert resources towards opportunistic financial strategies, reducing investments in environmental initiatives and transparency, thereby negatively impacting environmental performance. Greater analyst scrutiny is expected to curb managerial opportunism associated with tax avoidance by enhancing transparency and accountability, thereby improving environmental performance. Enhanced environmental performance signals greater transparency and ethical practices, reducing information asymmetry between managers and stakeholders. Based on the theoretical framework, the following hypotheses are proposed:

H1: Tax avoidance is negatively associated with environmental performance.

H2: Analyst coverage mitigates the negative association between tax avoidance and environmental performance.

H3: Environmental performance is negatively associated with information asymmetry.

4. Methodology

Sample

The study uses data from firms listed in the *Taiwan Economic Journal* (TEJ) database, covering the period from 2016 to 2019. The sample includes publicly traded firms with available data on tax avoidance, environmental performance, analyst coverage, and relevant control variables.

Research Design

Regression analysis is used to test the relationship between tax avoidance and environmental performance and the moderating effect of analyst coverage.

$$\begin{aligned} \textit{Environmental Performance (E)}_{i,t+1} = {} & \beta_0 + \beta_1 TAX\ AVOID_{i,t} + \beta_2 TAX\ AVOID_{i,t}\ x\ ANALYST \\ & COVERAGE_{i,t} + \beta_3 ANALYST\ COVERAGE_{i,t} + \beta_4 FAM_{i,t} + \beta_5 LnMV_{i,t} + \beta_6 BM_{i,t} + \\ & \beta_7 SALESG_{i,t} + \beta_8 ROA_{i,t} + \beta_9 FLEV_{i,t} + \beta_{10} FAGE_{i,t} + \beta_{11} BIND_{i,t} + \sum INDUSTRY_{i,t} + \\ & \sum YEAR_{i,t} + \varepsilon_{i,t} \quad (1) \end{aligned}$$

All variables are defined in the Appendix. Following the related literature, several control variables—such as family firm status, firm size, book-to-market ratio, sales growth, profitability, debt ratio, firm age, board independence, and industry effects—are included in the model. This equation captures how analyst coverage influences the relationship between tax avoidance and environmental performance by including both the main effect of analyst coverage and its interaction with tax avoidance. The interaction term between tax avoidance and analyst coverage

is the key variable of interest, and its coefficient is expected to be positive, indicating that analyst coverage weakens the negative association between tax avoidance and environmental performance.

5. Empirical Results

Table 1 presents the descriptive statistics for all variables used in the analysis, providing insights into the central tendencies and dispersions within the sample, with all variables defined in the Appendix. The mean analyst coverage is 5.726 analysts per firm-year. Table 2 displays the Pearson correlation coefficients among the main variables, indicating the strength and direction of their relationships.[1] The regression results in Table 3 indicate that tax avoidance is negatively associated with environmental performance ($p < 0.01$), supporting H1. The results are consistent with the view that firms engaging in tax avoidance may divert resources away from investments in environmental initiatives, leading to lower environmental performance. The interaction term between tax avoidance and analyst coverage is significantly positive ($p < 0.1$), supporting H2. These results suggest that greater public scrutiny through higher analyst coverage mitigates the negative impact of tax avoidance on environmental performance. Table 4 reveals that environmental performance is negatively associated with information asymmetry ($p < 0.01$), validating H3.[2] The results are consistent with the view that superior environmental performance is associated with lower information asymmetry and higher tax reporting transparency. Table 5 presents the three-stage least squares (3SLS) regression, using the industry average of tax avoidance as an instrument for firm-level tax avoidance. Lee and Bose (2021) suggest that an industry-level tax avoidance unlikely affects a firm's tax avoidance as an industry includes many

[1] Untabulated results indicate that the average Variance Inflation Factor (VIF) is 1.14, with a minimum of 1.01 and a maximum of 1.45, indicating that multicollinearity is not a concern (Greene, 2008).

[2] Several robustness checks were performed. Using the decile ranking of the number of analysts yield consistent results. Including variables such as institutional ownership and earnings volatility does not alter the main results.

firms. The rationale is that the industry average of tax avoidance is largely exogenous from an individual firm's perspective (Lee & Bose, 2021). The results indicate that tax avoidance is negatively associated with environmental performance ($p < 0.1$), further addressing endogeneity concerns.

6. Conclusions

This study provides robust evidence that tax avoidance negatively impacts environmental performance, highlighting the role of managerial opportunism in diverting resources away from sustainability initiatives. Importantly, the findings demonstrate that increased analyst coverage serves as an effective external governance mechanism, mitigating the adverse effects of tax avoidance by enhancing transparency and accountability.

The integration of agency and stakeholder theories offers a comprehensive understanding of how financial strategies intersect with environmental outcomes. By emphasizing the moderating role of analyst coverage, this research highlights the importance of external monitoring in aligning managerial actions with broader stakeholder interests and promoting sustainable corporate practices.

The findings of this study have significant implications for policymakers, investors, and stakeholders. Policymakers should consider implementing policies that promote transparency in tax reporting and environmental disclosures. Policymakers aiming to curb aggressive tax practices may promote environmental stewardship by enhancing public availability of tax and ESG disclosures, thereby empowering analysts monitors. Facilitating analyst access to information can strengthen external monitoring and governance mechanisms. Investors can

incorporate tax avoidance and analyst coverage into ESG investment decisions. Investors should advocate for greater corporate transparency and environmental responsibility to enhance long-term value. Asset managers can refine ESG scoring models by penalizing high tax avoidance unaccompanied by robust analyst coverage, indicating a higher level of environmental risk.

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Data available on request from the authors.

Appendix

Description of Variables

Notation	Variable name	Description
TAX AVOID	Tax Avoidance	Effective tax rate calculated as (Tax Expense / Earnings Before Tax). Lower effective tax rates indicate higher tax avoidance. Tax avoidance equals -1 times effective tax rate.
TAX AVOID_INDU	Industry Average of Tax Avoidance	Industry average of tax avoidance
Env	Environmental Performance	Environmental metric from Taiwan Economic Journal (TEJ) at year y.
Fut. Env	Future Environmental Performance	Environmental metric from Taiwan Economic Journal (TEJ) at year y+1.
Analyst Coverage (Log)	Main Measure of Analyst Coverage	The natural logarithm of the number of analysts following a firm.
Analyst Coverage (Sqrt)	Alternative Measure of Analyst Coverage	The squared root of the number of analysts following a firm.
BASpread	Bid-Ask Spread	Average bid-ask spread percentage over a year.
Fam	Family Firm Status	An indicator variable coded as 1 if the firm is classified as a family firm by the TEJ, and 0 otherwise.
LnMV	Market Capitalization	The natural logarithm of the market value of equity.
BM	Book-to-Market Ratio	The ratio of the book value of equity to the market value of equity.
SALESG	Sales Growth	Sales divided by last year's same quarter sales.

ROA	Return on Assets	Net income divided by total assets.
FLEV	Leverage	Long-term debt divided by total assets.
FAGE	Firm Age	The firm's age since its establishment.
BIND	Board Independence	The percentage of independent board members.

Table 1: Descriptive Statistics

Summary statistics

	Mean	Std. Dev.	p25	Median	p75	N
Env	54.564	10.351	45.940	52.960	61.380	6,688
TAX AVOID	-0.196	0.137	-0.241	-0.187	-0.125	6,688
Analyst Coverage (Log)	1.370	0.919	0.693	1.386	2.197	3,355
Analyst Coverage (Sqrt)	2.194	0.956	1.414	2.000	3.000	3,355
BASpread	0.856	1.180	0.306	0.451	0.778	6,241
FAM	0.611	0.487	0.000	1.000	1.000	6,688
LnMV	8.130	1.440	7.145	7.951	8.965	6,688
BM	0.490	0.248	0.314	0.450	0.615	6,688
SALESG	0.915	48.474	-0.078	0.019	0.126	6,688
ROA	0.047	0.096	0.015	0.045	0.085	6,688
FLEV	0.078	0.127	0.000	0.019	0.118	6,688
FAGE	29.285	13.589	19.000	28.000	39.000	6,688
BIND	0.304	0.137	0.273	0.333	0.400	6,688

Table 2: Correlation Analysis

Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)
(1) Env	1.00					
(2) TAX AVOID	-0.08*	1.00				
(3) Analyst Coverage (Log)	0.22*	0.00	1.00			
(4) Analyst Coverage (Sqrt)	0.23*	0.00	0.98*	1.00		
(5) BASpread	-0.24*	0.11*	-0.32*	-0.31*	1.00	
(6) FAM	-0.05*	-0.03*	-0.09*	-0.09*	0.03*	1.00

* indicates significance at the 0.05 level. Pearson correlations are presented below the diagonal; based on a sample of 6,688 firm-quarter observations from 2016 to 2019; the variables are defined in the Appendix.

Table 3: OLS Regression Results for Association between Tax Avoidance and Environmental Performance and the Moderating Effect of Analyst Coverage

VARIABLES	(1) Fut. Env	(2) Fut. Env	(3) Fut. Env
TAX AVOID	-4.500***	-8.470***	-12.885***
	(-5.585)	(-3.552)	(-3.351)
Analyst Coverage (Log)		1.298***	
		(2.833)	
TAX AVOID x Analyst Coverage (Log)		3.434*	
		(1.808)	
Analyst Coverage (Sqrt)			1.329***
			(2.806)
TAX AVOID x Analyst Coverage (Sqrt)			4.243**
			(2.155)
FAM	-0.981***	-1.583***	-1.589***
	(-4.012)	(-4.156)	(-4.167)
LnMV	2.728***	2.333***	2.362***
	(25.968)	(12.134)	(11.927)
BM	-0.775	-1.951*	-2.007*
	(-1.582)	(-1.864)	(-1.919)
SALESG	-0.000	0.016	0.013
	(-0.417)	(0.120)	(0.093)
ROA	-1.161	-2.325	-2.288
	(-1.111)	(-0.907)	(-0.888)
FLEV	-1.869	-1.800	-1.764
	(-1.552)	(-0.983)	(-0.964)
FAGE	0.036***	0.027*	0.027*
	(3.553)	(1.741)	(1.736)
BIND	-1.530*	-2.338	-2.235
	(-1.710)	(-1.556)	(-1.486)
Constant	33.859***	39.046***	37.654***
	(30.795)	(19.543)	(18.314)
Observations	6,688	3,355	3,355
R-squared	0.169	0.129	0.129
Year FE	YES	YES	YES

Industry FE	YES	YES	YES
Adjusted R-squared	0.168	0.125	0.125

This table presents the OLS regression results for the association between tax avoidance and environmental performance, and the moderating effect of analyst coverage. Models 1-3 present different specifications. Numbers in parentheses are z-statistics based on firm-level and year-level clustered standard errors. Superscripts ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.

Table 4: OLS Regression Results for Association between Environmental Performance and Bis-Ask Spread, and the Moderating Effect of Analyst Coverage

VARIABLES	(1) BASpread	(2) BASpread	(3) BASpread
Env	-0.007***	-0.005***	-0.007***
	(-6.071)	(-4.146)	(-4.501)
Analyst Coverage (Log)		-0.181***	
		(-4.501)	
Env x Analyst Coverage (Log)		0.003***	
		(4.012)	
Analyst Coverage (Sqrt)			-0.158***
			(-4.618)
Env x Analyst Coverage (Sqrt)			0.002***
			(4.363)
FAM	0.043	0.044***	0.046***
	(1.389)	(4.049)	(4.152)
LnMV	-0.364***	-0.083***	-0.087***
	(-21.853)	(-14.798)	(-14.542)
BM	-0.803***	-0.115***	-0.109***
	(-9.101)	(-3.959)	(-3.750)
SALESG	0.017	-0.002	-0.002
	(0.699)	(-1.139)	(-1.083)
ROA	-1.915***	0.016	0.007
	(-5.476)	(0.194)	(0.086)
FLEV	-0.113	0.065**	0.065*
	(-1.068)	(1.965)	(1.938)
FAGE	-0.002**	-0.001***	-0.001***
	(-2.147)	(-3.831)	(-3.691)
BIND	-0.089	0.063*	0.057
	(-0.797)	(1.747)	(1.576)
Constant	4.673***	1.415***	1.550***
	(23.090)	(14.302)	(13.144)
Observations	5,012	2,651	2,651
R-squared	0.280	0.238	0.234
Year FE	YES	YES	YES

Industry FE	YES	YES	YES
Adjusted R-squared	0.279	0.234	0.230

This table presents the OLS regression results for the association between environmental performance and bid-ask spreads, and the moderating effect of analyst coverage. Models 1-3 present different specifications. Numbers in parentheses are z-statistics based on firm-level and year-level clustered standard errors. Superscripts ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.

Table 5 OLS Regression Results for Association between Tax Avoidance and Environmental Performance: Three-stage least squares (3SLS) regression

VARIABLES	(1) Model 1 – TAX AVOID	(2) Model 2 – Fut. Env
TAX AVOID		-8.701*
		(-1.674)
TAX AVOID_INDU	0.910***	
	(11.386)	
FAM	-0.004	-0.997***
	(-1.257)	(-4.050)
LnMV	-0.004***	2.713***
	(-2.841)	(25.125)
BM	-0.038***	-0.928*
	(-4.551)	(-1.763)
SALESG	0.000***	0.000
	(3.907)	(0.142)
ROA	-0.148***	-1.831
	(-8.552)	(-1.375)
FLEV	-0.031**	-2.014
	(-2.451)	(-1.639)
FAGE	-0.001***	0.033***
	(-3.906)	(3.169)
BIND	-0.026**	-1.665*
	(-1.978)	(-1.821)
Constant	0.065***	33.423***
	(3.046)	(28.210)
Observations	6,688	6,688
R-squared	0.055	0.166
Year FE	YES	YES
Industry FE	YES	YES
Adjusted R-squared	0.0525	0.164

This table presents the three-stage least squares (3SLS) regression results for the association between environmental performance and tax avoidance. Model (1) estimates tax avoidance, while Model (2) examines how the expected level of tax avoidance influences the relationship between tax avoidance and future environmental performance. Numbers in parentheses

are z-statistics based on firm-level and year-level clustered standard errors. Superscripts ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively.