Consumer reactions to corporate tax strategies: The role of political ideology

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A B S T R A C T

This study contributes to research on how stakeholders react to corporate tax strategies (CTSs). In two experiments we show that consumers are more likely to react negatively to ‘aggressive’ rather than to reward ‘conservative’ CTSs. The impact of CTSs on consumer reactions is mediated by the perceived ethicality of the firm and moderated by individuals’ political identification. Right-leaning consumers are less likely than left-leaning consumers to punish companies engaging in tax avoidance. This moderation depends on the personal connection customers have with a particular brand: both left-leaning and right-leaning consumers punish firms they feel close to when such firms engage in aggressive CTSs. The study extends our understanding of the benefits and risks associated with different CTSs. It contributes to debates on the morality of CTSs, showing that political ideology shapes individuals’ perceived ethicality of corporations engaged in aggressive tax avoidance.

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1. Introduction

There is increasing attention on the morality of corporate tax strategies (CTSs) that try to minimize as much as possible corporations’ tax liabilities (Dowling, 2014; Scheffer, 2013; Sikka, 2010). Global corporations are accused of exploiting national rules in order to pay low taxes on profits made in jurisdictions where they record high sales (Ting, 2014).

Past research has focused mostly on the macro level (e.g., Scheffer, 2013) examining whether aggressive minimization strategies generate negative reactions from stakeholders that affect corporate performance. Some authors find an overall negative impact of aggressive CTSs on firm value (e.g., Hanlon & Slemrod, 2009) while others find no significant overall impact (e.g., Gallenore, Maydew, & Thornock, 2014). Few studies, however, examine how CTSs can affect psychologically organizational stakeholders (Huang & Watson, 2015). Hardeck and Hertl (2014) provide a first examination of how CTSs impact consumer behavior, showing that individuals are willing to punish companies adopting aggressive CTSs and likely to reward companies that do not plan proactively to minimize their tax burden.

Some scholars argue that tax planning decisions should be considered as part of an organization’s Corporate Social Responsibility (CSR) profile (Dowling, 2014; Sikka, 2010; Scheffer, 2013). Companies with a poor CSR record are in fact more likely to employ aggressive CTSs (Hoi, Wu, & Zhang, 2013; Lanis & Richardson, 2015). To the best of our knowledge, however, no study has examined to what extent stakeholders’ reactions to CTSs are motivated by their inferences of corporate ethicality. Although scholars assume that tax planning leads to ethical judgments (Hardeck & Hertl, 2014), we test this assumption explicitly. Since organizations are increasingly keen to present their CTSs as responsible in the hope that it might engender positive effects (Bhattacharya, Korschun, & Sen, 2009; Hardeck & Hertl, 2014) it is important to probe that such expectation holds empirically.

Tax research has shown that political beliefs do not influence individual tax compliance (Bobek, Hageman, & Kellihker, 2013; Li, Eckel, Grossman, & Brown, 2011). Consequently, both right-leaving and left-leaning individuals condemn tax evasion. On the other hand, while many on the left condemn tax avoidance, it is common for right-wing politicians and commentators to justify the use of avoidance schemes (e.g., Scheiber & Cohen, 2015). This evidence is consistent with Moral Foundations Theory (MFT) (Graham, Haidt, & Nosek, 2009) that suggests the existence of systematic differences in the moral concerns of people with different political beliefs. On the basis of this theory we hypothesize that left-leaving consumers, more than right-leaving consumers, perceive aggressive CTSs as unethical. We also hypothesize that such moderation disappears when consumers evaluate companies
they feel connected to (Escalas, 2004). In these circumstances, aggressive CTSs attract the condemnation of both right-leaning and left-leaning consumers.

We propose a model of moderated-mediation that explains how individuals’ political ideology moderates the influence of different CTSs on consumers’ reactions. A deeper analysis of the psychology of stakeholders’ reactions to CTSs is necessary to enhance our understanding of under what circumstances reports of corporate tax avoidance can generate negative reactions from observers. Evidence that consumers make ethical inferences on the basis of tax information offers a further argument in support of the inclusion of tax planning within a company’s CSR profile (Dowling, 2014). Tax avoidance poses a serious threat to brand relationships. Even though consumers who share right-leaning beliefs in general have less negative reactions to tax avoidance, both right-leaning and left-leaning consumers are critical of aggressive strategies carried out by companies they feel close to. On the other hand, conservative CTSs have only a small beneficial effect for the adopter. From the perspective of aligning strategic decision-making and decisions about taxation (Glaister & Hughes, 2008) the study offers a realistic assessment of the potential benefits and risks associated with different CTSs.

Furthermore, we contribute to the literature on CSR that studies cases of unethical corporate behavior (e.g., Grappi, Romani, & Bagozzi, 2013; Huber, Vollhardt, Mattes, & Vogel, 2010). Firstly, past research focuses on clear cases of irresponsibility (e.g., Grappi et al., 2013), examining a practice which is not universally condemned, we highlight how judgments of ethicality are informed by: 1) the information presented, 2) the values of the observer, and 3) the relationship between the observer and the brand. Secondly, past studies analyzed how an observers’ relationships with the brand influence reactions to potentially questionable behavior (e.g., Trump, 2014). Our findings complement this approach by studying the interplay between (political) beliefs of the observer and his/her relationship with the company. Thus, the findings extend our analysis of how consumers make complex ethical judgments.

2. Research background

2.1. Aggressive and conservative CTSs

We conceptualize CTSs as corporate ‘efforts to minimize tax liabilities’ (Hardeck & Hertl, 2014: 310). CTSs range from illegal tax evasion to legal tax minimization (Cullberg & Bajde, 2014). Our focus rests on legal CTSs with a debatable ethical content. The adjective aggressive is commonly attributed to CTSs that are perceived as leaning towards a literal interpretation of regulation and consider acceptable the exploitation of legal loopholes (Hoi et al., 2013). Conversely, conservative CTSs are perceived as in line with the intention of the legislator regardless of whether a literal interpretation would allow for a more effective (lower) tax liability (Dowling, 2014). We study how stakeholders perceive aggressive/conservative CTSs that are reported by the media (Hardeck & Hertl, 2014).

2.2. CTSs and stakeholders’ responses

Scholars suggest that stakeholders react negatively to aggressive CTSs. Social movements promote a fairer approach to business taxation (see Tax Justice Network Australia, 2014) and critics point to the inconsistency between a ‘corporate citizenship’ discourse and the use of aggressive CTSs (Sikka, 2010).

Investors can also react negatively to aggressive CTSs (Hanlon & Slemrod, 2009). This effect appears dependent on external circumstances; especially the damaging effect that being branded as a tax shirker could have on consumer behavior (Cloyd, Mills, & Weaver, 2003). Contrasting evidence shows that aggressive CTSs do not have any adverse effect on organizational performance (Gallemore et al., 2014). The conceptual argument that underpins much of existing normative research is that consumers will punish aggressive CTSs because they perceive them as unjust (Dowling, 2014; Sikka & Willmott, 2013). Similarly, with conservative CTSs, individuals should reward companies who are perceived as acting fairly (Scheffer, 2013). In other words, CTSs influence consumers’ perception of the morality of an organization. To the best of our knowledge, however, there is no existing evidence that tests explicitly this assumption (Huang & Watson, 2015).

Brunk (2010, 2012) proposes a construct called Consumer Perceived Ethicality (CPE) as an overall assessment of an organization’s ethical conduct. She argues that consumers use a mixture of consequentialist and deontological arguments to assess the morality of a corporation. We hypothesize that aggressive CTSs are likely to skew such judgments in a negative direction, leading to lower perceptions of ethicality. Conservative CTSs should instead lead to a perception of increased ethicality.

H1a. Aggressive CTSs (when compared to a control) have a negative influence on the perceived ethicality of a target organization.

H1b. Conservative CTSs (when compared to a control) have a positive influence on the perceived ethicality of a target organization.

2.3. Consumers’ responses to aggressive versus conservative CTSs

Since tax rules represent codified legal obligations, the extent to which CTSs can be interpreted as examples of positive or negative CSR is debated (Hasseldine & Morris, 2013). Customers are less likely to reward companies’ CSR activities that they consider are caused by strategic or selfish motives (Skarmeas & Leonidou, 2013). Reports about conservative CTSs could be easily discounted by consumers. Taxation is a legal requirement which is enforced through, among others, administrative penalties for irregularities and cost/time-consuming audits. Consequently, companies adopting conservative CTSs might be perceived as merely trying to minimize risks and costs rather than behaving ethically (Hasseldine & Morris, 2013).

Furthermore, because most consumers have a limited ability to understand the legal and moral intricacies of tax decisions, positive outcomes are more likely to be attributed to contextual circumstances, while negative outcomes to the character of the company (Ybarra, 2002). When motivations about the adoption of conservative CTSs are not provided, individuals might attribute these practices to external circumstances (e.g., legal risks) and therefore discount them as a sign of ethicality (Vonk, 1999).

Evidence provided by Hardeck and Hertl (2014), however, contradicts this argument. The authors document a positive, albeit small, effect of conservative CTSs on consumer reactions. Research on CSR supports this argument, showing that organizations can be punished as well as rewarded for their ethical conduct (e.g., Bhattacharya et al., 2009; Trudel & Cotte, 2009). Consequently, we hypothesize a positive (negative) effect of conservative (aggressive) CTSs, although we expect to observe differences on the relative impact of the two strategies (Hardeck & Hertl, 2014).

H2a. Aggressive CTSs (when compared to a control) have a negative influence on attitudes towards the company and purchase intentions (PI), and a positive influence on negative word of mouth (NWOM).

H2b. Conservative CTSs (when compared to a control) have a positive influence on attitudes towards the company and purchase intentions (PI), and a negative influence on negative word of mouth (NWOM).

H3. Perceived ethicality mediates the influence of CTS condition on attitudes towards the company, purchase intentions (PI) and negative word of mouth (NWOM).
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