ESG Disclosure and Tax Avoidance: The Mediating Role of Financial Constraints

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ABSTRACT

Tax avoidance has become a critical corporate governance concern because it can diminish government tax revenues while creating ethical questions regarding firms' contributions to economic and social development. In the ESG context, aggressive tax practices are increasingly viewed as inconsistent with corporate sustainability and stakeholder expectations. The total research sample is 611 observations over the period 2017-2024 by excluding financial companies listed on the Indonesia Stock Exchange. The analysis results from Hayes PROCESS Model 4 indicate that higher ESG transparency tends to suppress corporate tax avoidance practices. However, financial constraints do not mediate the effect of ESG disclosure on tax avoidance. Conversely, companies experiencing financial constraints show lower levels of tax avoidance, indicating a tendency to avoid aggressive tax strategies. This study extends the existing literature by examining the mediating role of financial constraints and providing disaggregated evidence on the role of ESG dimensions in explaining corporate tax avoidance.

Keywords: Tax Avoidance; ESG Disclosure; Financial Constraints

Pengungkapan ESG dan Penghindaran Pajak: Peran Mediasi Kendala Keuangan

ABSTRAK

Penghindaran pajak telah menjadi isu penting dalam tata kelola perusahaan karena dapat mengurangi penerimaan negara sekaligus menimbulkan persoalan etis terkait kontribusi perusahaan terhadap pembangunan ekonomi dan sosial. Dalam konteks ESG, praktik pajak yang agresif semakin dipandang tidak sejalan dengan prinsip keberlanjutan perusahaan dan ekspektasi para pemangku kepentingan. Total sampel penelitian adalah 611 observasi selama periode 2017-2024 dengan mengecualikan perusahaan keuangan yang terdaftar di Bursa Efek Indonesia. Hasil analisis Hayes PROCESS Model 4 mengindikasikan bahwa transparansi ESG yang lebih tinggi cenderung menekan praktik penghindaran pajak perusahaan. Namun, kendala keuangan tidak memediasi pengaruh pengungkapan ESG terhadap penghindaran pajak. Sebaliknya, perusahaan yang mengalami kendala keuangan menunjukkan tingkat penghindaran pajak yang lebih rendah, mengindikasikan kecenderungan untuk menghindari strategi pajak yang agresif. Penelitian ini memperluas literatur yang ada dengan meneliti peran mediasi kendala keuangan serta memberikan bukti terdisagregasi mengenai peran dimensi ESG dalam menjelaskan penghindaran pajak perusahaan.

Kata Kunci *Penghindaran Pajak; Pengungkapan ESG; Kendala Keuangan*

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INTRODUCTION

Tax avoidance is a strategic issue in corporate governance because it reduces state revenue and raises ethical dilemmas related to corporate contributions to development. In Indonesia, this practice is still common due to regulatory complexity and the encouragement of tax efficiency. In the past decade, Indonesia's tax ratio has only ranged from 8–10 percent (Kementerian Keuangan, 2025; Rahayu & Ika, 2025). Additionally, this percentage is still well below the 34 percent OECD country average (OECD, 2023). This phenomenon is exacerbated by the still high practice of tax avoidance, where around 25% of companies in Indonesia admit to tax avoidance (World Bank, 2024). Given its significant impact on the economy, tax avoidance is an important concern for academics, regulators, and policymakers (Ali et al., 2024).

From an agency theory standpoint, tax avoidance practices emerge due to conflicts of interest between managers and shareholders, where managers are encouraged to reduce tax burdens to improve short-term performance and compensation (Desai & Dharmapala, 2006; Jensen & Meckling, 1976). However, the development of sustainable business practices through Environmental, Social, Governance (ESG) frameworks fosters enhanced transparency and corporate accountability, encompassing both internal monitoring mechanisms and external disclosure practices, particularly through non-financial reporting such as ESG disclosures (Metwally et al., 2025). ESG disclosures then become an important framework in assessing transparency and influencing company decisions, including tax management (Gillan et al., 2021), and is getting more attention in developing countries such as Indonesia (Yanto et al., 2025). Grounded in stakeholder theory, ESG disclosure represents a firm's commitment to addressing stakeholder interests, including its responsibility toward tax compliance (Amarna et al., 2024).

Taxes are increasingly viewed as an element of the Social (S) and Governance (G) pillars in ESG that reflect the integrity of the company (Morris & Visser, 2022; Sturgis, 2022) and tax payments reflect the company's tangible contribution to development and equity (Amarna et al., 2024). Therefore, ESG disclosures are seen as increasing transparency and reducing information asymmetry, thereby limiting tax avoidance practices and encouraging more responsible tax policies (An et al., 2025; Hu & Xiong, 2025; Yuan et al., 2025). However, prior empirical findings remain inconclusive (Amarna et al., 2024; Chandrasena et al., 2024; Hu & Xiong, 2025; Metwally et al., 2025; Teja, 2024; Widiastutik et al., 2024; Yuan et al., 2025), particularly in developing economies such as Indonesia, where ESG adoption is often more formalistic in nature (Yanto et al., 2025). According to several studies, ESG disclosure can lessen tax avoidance brought on by social, moral, and reputational concerns (Amarna et al., 2024; Hu & Xiong, 2025; Teja, 2024; Yuan et al., 2025). In contrast, other research has found that ESG disclosure can also be leveraged as a greenwashing tool to cover up aggressive tax practices (Chandrasena et al., 2024). This leads to a study gap over how well ESG disclosure works to lower tax avoidance. Based on these gaps, this study examines the effect of ESG disclosure on tax avoidance by considering the role of financial constraints as a mediating mechanism (Jiang et al., 2024).

With the growing challenges and uncertainties facing modern businesses, ESG disclosure is increasingly recognized as a reflection of a company's sustainability and integrity as well as a means of strategic communication (Alessa et al., 2024; Yuan et al., 2025). ESG disclosures serve as quality signals that help investors assess a company's accountability beyond the financial aspects (Aboud et al., 2024; Guo et al., 2024; Kiran et al., 2024; Zhang & Lucey, 2022) thereby promoting transparency and enhancing public confidence, which aligns with the core principles of agency theory. (Hu & Xiong, 2025; Yuan et al., 2025). Corporate tax practices are increasingly recognized as part of firms' broader social responsibilities. Therefore, tax avoidance may conflict with sustainability principles by reducing stakeholder confidence, undermining corporate governance legitimacy, and limiting the financial resources available to support environmental and social development programs (Fallan & Fallan, 2019; Lanis & Richardson, 2012; Mohamad Ariff et al., 2024). Credible ESG disclosures serve as a supervisory mechanism that suppresses opportunistic behavior and increases corporate prudence against reputational risks due to aggressive tax strategies (Amarna et al., 2024; Yuan et al., 2025). Correspondingly, agency theory and stakeholder theory emphasize that ESG transparency can reduce managers' chances of tax avoidance as well as strengthen company legitimacy (Alessa et al., 2024; Jiang et al., 2024; Malik & Kashiramka, 2025; Yuan et al., 2025; Zhang & Lucey, 2022). Therefore, companies with stronger ESG commitments tend to engage in tax avoidance at a lower rate.

ESG disclosures appear to be linked to a decrease in tax avoidance, according to empirical data. ESG disclosures have been shown to reduce temporary tax differences reflecting a reduced accrual-based strategy (Amarna et al., 2024), increasing transparency, and external supervision so as to limit management space in tax avoidance (Yuan et al., 2025). Alomair & Metwally (2025) found that ESG disclosure strengthened the effectiveness of board governance in suppressing tax avoidance. ESG disclosures reflect strong internal controls, including the role of boards and independent audit committees in suppressing aggressive tax practices. These findings are in line with research showing that ESG disclosure signals governance and social responsibility commitments that drive tax compliance and suppress tax avoidance (Hu & Xiong, 2025; Teja, 2024; Widiastutik et al., 2024), it has been independently demonstrated that every ESG pillar has a detrimental impact on tax avoidance (Elgharbawy & Aladwey, 2025). This results in the first hypothesis being put forth:

H_1: ESG disclosures affect tax avoidance.

Grounded in agency theory, market imperfections arising from information asymmetry between corporate insiders (agents) and external capital providers (principals) often cause financial constraints by driving up the costs of external financing relative to internal funding (Fazzari et al., 1988). Due to these information gaps, external investors demand a higher risk premium, which limits the firm's ability to obtain outside funding. Through improved transparency, ESG disclosure operates as an effective corporate governance and supervisory mechanism that alleviates these agency issues (Alessa et al., 2024; Yuan et al., 2025). Consequently, higher sustainability transparency mitigates opportunism, enhances corporate credibility, and strengthens investor and creditor confidence, enabling firms to reduce their financial constraints (Aboud et al., 2024; Guo et al., 2024; Kiran et al., 2024; Luo et al., 2023; Malik & Kashiramka, 2025; Pástor et al., 2021). These arguments lend support to the propositions advanced by agency and stakeholder theories, which emphasize the role of ESG disclosure in strengthening corporate oversight, credibility, and stakeholder trust (An et al., 2025; Hu & Xiong, 2025; Yuan et al., 2025).

ESG disclosures may reduce financial constraints and raise a company's value, according to empirical data (An et al., 2025; Guo et al., 2024). Firms with higher ESG disclosure generally experience lower capital costs and greater access to financing due to improved governance quality and enhanced market credibility (Chen & Xie, 2022; Hu & Xiong, 2025; Jiang et al., 2024; Kiran et al., 2024; Malik & Kashiramka, 2025; Tan & Zhu, 2022). This results in the second hypothesis being put forth:

H_2: ESG disclosures affect financial constraints

Companies with financial constraints tend to manage taxes efficiently and even aggressively to increase cash flow as a source of internal funding, especially due to the high cost of external funding (CChen & Lai, 2012; Koh & Lee, 2015). This aligns with agency theory, which elucidates the inclination of managers to pursue opportunistic strategies, such as tax avoidance, to secure funding for corporate operations and investment projects (Nabila & Rachmawati, 2023). Extant literature suggests that companies burdened by financial constraints exhibit a higher propensity for tax avoidance, utilizing it as a strategic mechanism to bolster their cash flow position (Adela et al., 2023; Edwards et al., 2016). This is reflected in the lower ETR of 3–8 percent compared to companies without constraints (Chen & Lai, 2012).

Similar results were also found in the context of ASEAN-5 that financially constrained companies showed significantly lower ETRs (Syahputri, 2025). Capital generated through tax savings serves as a critical internal funding mechanism, enabling firms to mitigate the impact of existing financial constraints. In addition, the company also strengthens its tax deferral strategy and other practices such as the use of tax havens, especially in low cash conditions (Law & Mills, 2015). This results in the third hypothesis being put forth:

H_3: Financial constraints affect tax avoidance

In addition to its direct effect on tax avoidance, ESG disclosure may also affect tax avoidance indirectly through financial constraints as a mediating variable. ESG disclosure increase transparency, reduce information asymmetry, and improve access to funding thereby reducing financial constraints (An et al., 2025; Guo et al., 2024; Jiang et al., 2024). Empirically, ESG disclosure has been proven to reduce financial constraints and improve corporate funding access (An et al., 2025; Hu & Xiong, 2025; Malik & Kashiramka, 2025). On the other hand, companies with financial constraints tend to avoid taxes as a source of internal funding due to limited access to external funds (Chen & Lai, 2012; Edwards et al., 2016). Through increased transparency and investor trust, ESG disclosure reduces information asymmetry thereby reducing financial constraints. This reduction in constraints ultimately reduces the company's incentive to practice tax avoidance, so ESG is estimated to affect tax avoidance indirectly through financial constraints. This results in the fourth hypothesis being put forth:

H_4: Financial constraints mediate the effect of ESG disclosure on tax avoidance

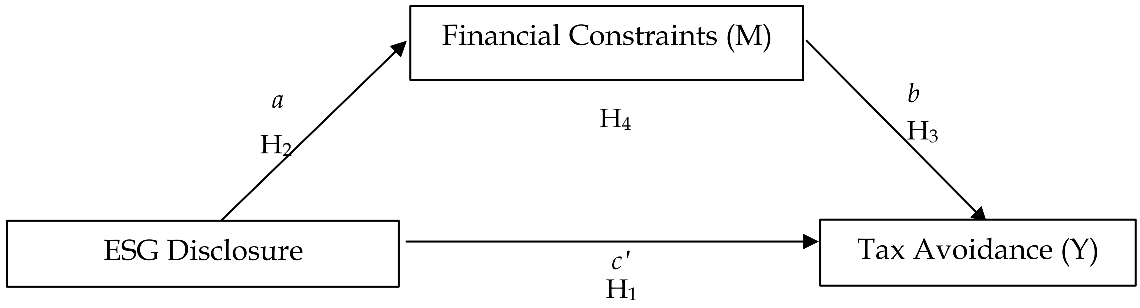

Figure 1. Conceptual Framework

Source: Research Data, 2026

This study employs Hayes PROCESS Model 4 to examine whether financial constraints mediate the effect of ESG disclosure on tax avoidance. In this model, ESG disclosure is specified as the independent variable (X), financial constraints as the mediator (M), and tax avoidance as the dependent variable (Y). Path a shows how ESG disclosure affects financial constraints (H_2), path b shows how financial constraints affect tax avoidance (H_3), and path c' shows how ESG disclosure directly affects tax avoidance after taking the mediator into consideration (H_1). The product of pathways a and b is used to assess the indirect influence (H_4).

RESEARCH METHODS

Financial indicators and non-financial ESG disclosure data from the Bloomberg database are combined in this study's quantitative method using secondary data. Non-financial companies listed between 2017 and 2024 on the Indonesia Stock Exchange (IDX) comprise the sample. The final sample is shown in Table 1 using a purposive sampling technique based on predefined criteria. Furthermore, the Global Industry Classification Standard (GICS) is used for industry classification. Following established practice in the literature, winsorization at the 1st and 99th percentiles was applied to all continuous variables in order to mitigate the impact of outliers.

Validity and reliability tests were not conducted because this study uses secondary archival data and established proxies from prior literature rather than questionnaire-based instruments. Therefore, classical assumption tests and robustness analysis were considered more relevant to ensure model adequacy and reliability.

To capture firms' tax avoidance behavior, this study utilizes the Current Effective Tax Rate (CETR) as the proxy variable. In line with other research, it is calculated as the percentage of current tax liability to the company's earnings before tax (Lanis & Richardson, 2012; Souguir et al., 2024; Yanto et al., 2025).

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Table 1. The Process of Determining Research Samples

No.	Keterangan	Jumlah
1	Non-financial companies that were listed during the observation period on the IDX.	7.344
2	Non-financial companies who failed to submit comprehensive information on the variables under investigation during the observation period.	(6.645)
3	Non-financial companies that suffered losses during the observation year.	(88)
Number of observations during 2017 – 2024 (8 years)		611

Source: Research Data, 2026

This indicator measures the company's ability to lower its existing tax burden and display the amount of taxes it bears in relation to its accounting profit (Lanis & Richardson, 2012; Rego, 2003). The CETR value is in the range of 0–1, but because it is a proxy with a negative direction towards tax avoidance, the value is multiplied by (−1) to facilitate the result's comprehension (Khan & Nuryanah, 2023). The CETR measurement refers to Souguir et al. (2024) as follows:

$$CETR = \frac{Current\ Income\ Tax\ Expense}{Pre-Tax\ Accounting\ Income} \quad (1)$$

The ESG disclosure variables are measured using the ESG disclosure score obtained through the Bloomberg database for the period 2017-2024. This study uses the Kaplan–Zingales (KZ) Index as a proxy for financial constraints because it reflects the company's internal financial condition. The index is considered appropriate for evaluating the extent to which financial constraints affect tax avoidance, especially when it comes to how these actions protect internal cash flow. KZ Index measurement refers to Chen & Lai (2012). The KZ Index formula is described as follows:

$$KZ_{it} = -1.002\left(\frac{CF_{it}}{TA_{it}}\right) - 39.368\left(\frac{DIV_{it}}{TA_{it}}\right) - 1.315\left(\frac{CA_{it}}{TA_{it}}\right) + 3.129LEV_{it} + 0.283Q_{it} \quad (2)$$

Information:

$KZ_{i,t}$ = Kaplan & Zingales Index to measure financial constraints
$\left(\frac{CF_{it}}{TA_{it}}\right)$ = Cash flow over lagged book assets
$\left(\frac{DIV_{it}}{TA_{it}}\right)$ = Cash dividends over lagged book assets
$\left(\frac{CA_{it}}{TA_{it}}\right)$ = Cash balances over lagged book assets
$LEV_{i,t}$ = Total debt over book assets
$Q_{i,t}$ = The ratio of the market-to-book value of the firm's assets

Control variables are employed to ensure the precision of the results, reducing potential biases that could interfere with estimating the effect of ESG disclosure and financial constraints on tax avoidance avoidance. The controlled variables included company size (FSIZE), profitability (ROA), sales growth (GROWTH), and capital intensity (CAPINT), which theoretically and empirically influenced tax avoidance. An extra analysis was carried out using GAAP Effective Tax Rate (GAAP ETR), an alternate proxy for tax avoidance, to guarantee the robustness of the findings. Consistent result across alternative proxies indicate that the findings are robust. Additional analysis was conducted to examine the influence of each ESG dimension, namely environmental (ENV), social (SOC), and governance (GOV), on financial constraints and tax avoidance (Khlifi et al., 2025).

This study uses a simple mediation approach with the help of a macro PROCESS Model 4 developed by Hayes and implemented through SPSS software (Hayes, 2022). This model is used to test the direct effect of ESG disclosure on tax avoidance, as well as the indirect effect through mediation variables, namely financial constraints. The mediation test in this investigation was conducted utilizing the bootstrapping method with a 95% confidence level to obtain an estimate of the confidence interval from indirect effects. The empirical model in this study consists of two regression equations, namely the equation for the mediation variable (financial constraints) and the equation for the dependent variable (tax avoidance).

Model 1: The Effect of Financial Constraints on Tax Avoidance (path *a*)

$$KZ_{it} = \alpha_1 + \beta_1 ESGD_{it} + \beta_2 FSIZE_{it} + \beta_3 ROA_{it} + \beta_4 GROWTH_{it} + \beta_5 CAPINT_{it} + \varepsilon_{it} \quad \ldots\ldots(3)$$

Model 2: The Effect of ESG Disclosure and Financial Constraints on Tax Avoidance (paths *b* and *c'*)

$$CETR_{it} = \alpha_2 + \beta_1 ESGD_{it} + \beta_2 KZ_{it} + \beta_3 FSIZE_{it} + \beta_4 ROA_{it} + \beta_5 GROWTH_{it} + \beta_6 CAPINT_{it} + \varepsilon_{it} \quad \ldots\ldots(4)$$

RESULTS AND DISCUSSION

The descriptive statistics for the research variables are shown in Table 2. Tax avoidance, measure as the negative value of Current Effective Tax Rate (CETR) has a mean of -0.248, indicating a relatively low to moderate level of tax avoidance among the sampled firms. Meanwhile, ESG disclosure (ESGD) records an average score of 45.661, suggesting a moderate extent of ESG reporting accros the sample.

Furthermore, financial constraints, measured by the KZ Index, have a mean value of 2.175 and a relatively high standard deviation, indicating considerable variation in firms' financial constraints across the sample. The control variables, including firm size (FSIZE), profitability (ROA), firm growth (GROWTH), and capital intensity (CAPINT), also exhibit adequate variation. This indicates that the dataset is sufficiently dispersed and appropriate for further regression analysis.

As illustrated by the Pearson correlation analysis in Table 3, a negative association exists between ESG disclosure and tax avoidance. This pattern implies that as firms bolster their ESG reporting standards, their inclination toward tax avoidance strategies notably decreases. In addition, ESG disclosure shows a positive but weak correlation with financial constraints. Meanwhile, financial constraints exhibit a very weak correlation with tax avoidance, suggesting that financial constraints are not a dominant factor directly associated with firms' tax avoidance. Importantly, no high correlations are observed among the independent variables. Accordingly, it can be concluded that the model is suitable for additional hypothesis testing and does not raise any serious multicollinearity issues.

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Table 2 Descriptive Statistics

Variable	N	Mean	Std. dev.	Min	Max
CETR	611	-0.248	0.208	-1.383	-0.004
ESGD	611	45.661	12.525	17.718	73.055
KZ	611	2.175	2.617	-0.200	18.012
FSIZE	611	30.708	1.179	27.205	33.158
ROA	611	0.074	0.072	-0.087	0.396
GROWTH	611	19.615	62.348	-73.645	650.889
CAPINT	611	0.394	0.198	0.002	0.899

Source: Research Data, 2026

Table 3 Pearson Correlation

Variable	CETR	ESGD	KZ	FSIZE	ROA	GROWTH	CAPINT
CETR	1.000	-0.078	0.021	-0.052	0.174	-0.006	-0.005
ESGD	-0.078	1.000	0.153	0.312	0.105	-0.062	0.107
KZ	0.021	0.153	1.000	-0.013	0.693	-0.062	-0.067
FSIZE	-0.052	0.312	-0.013	1.000	-0.142	0.000	0.023
ROA	0.174	0.105	0693	-0.142	1.000	0.033	-0.076
GROWTH	-0.006	-0.062	-0.062	0.000	0.033	1.000	0.026
CAPINT	-0.005	0.107	-0.067	0.023	-0.076	0.026	1.000

Source: Research Data, 2026

Table 4. Multicollinearity Test

Dependent Variable: CETR					
Variable	Coefficient	Std. Error	t-Statistic	Collinearity Tolerance	Statistics VIF
C	-0.324	0.225	-1.440	0.000	0.000
ESGD	-0.002	0.001	-2.169	0.858	1.166
KZ	-0.015	0.004	-3.333	0.502	1.992
FSIZE	0.003	0.008	0.454	0.863	1.159
ROA	0.922	0.163	5.642	0.492	2.031
GROWTH	0.000	0.000	-0.852	0.980	1.021
CAPINT	0.018	0.042	0.435	0.978	1.023

Source: Research Data, 2026

Prior to hypothesis testing using PROCESS Model 4, diagnostic tests were conducted to evaluate the adequacy of the regression model. Formal normality testing was not emphasized in this study due to the relatively large sample size, consisting of 611 firm-year observations. The Central Limit Theorem states that the distribution of the error term asymptotically approaches a normal distribution when the sample size is high enough, guaranteeing the validity of the t-test and F-test (Gujarati & Porter, 2009). In addition, traditional autocorrelation tests such as the Durbin–Watson statistic are less appropriate for unbalanced panel data structures because the chronological sequence may vary across cross-sectional entities (Ekananda, 2016; Nachrowi & Usman, 2020). Therefore, this study focuses primarily on multicollinearity and heteroskedasticity diagnostics. Furthermore, Hayes PROCESS Model 4 utilizes bootstrapping procedures with 5,000 resamples, which reduce sensitivity to non-normality in estimating indirect effects (Hayes, 2022).

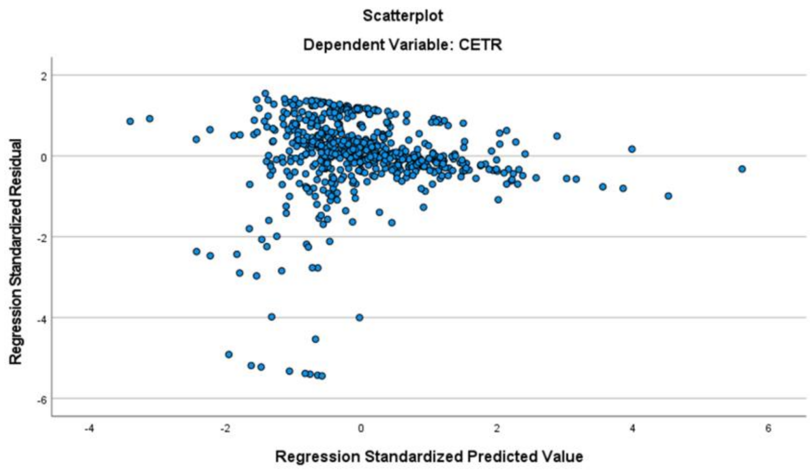

Figure 2. Heteroskedasticity

Source: Research Data, 2026

The mediation analysis results utilizing PROCESS Model 4 are presented in Table 5. Panel A investigates the influence of ESG disclosure on financial constraints (path a), whereas Panel B explores the combined effects of ESG disclosure and financial constraints on tax avoidance (paths b and c'). The coefficient of determination (R^2) for Model A is 0.498, demonstrating that ESG disclosure along with the model's control variables collectively explain 49.8% of the variability in financial constraints. Meanwhile, the remaining 50.2% of the variation is attributed to variables outside the scope of the research model. Furthermore, the R^2 value obtained for Model B is 0.058, implying that the model accounts for only 5.8% of the variability in tax avoidance, with the remaining 94.2% being driven by factors beyond this study's coverage. The relatively modest R^2 value indicates that tax avoidance is a multifaceted phenomenon that is shaped by numerous external factors not captured within the research model, including tax policy, corporate governance, and managerial strategies that fall outside the boundaries of the present study.

The results of the PROCESS Model 4 research show that ESG disclosure significantly and negatively affects tax avoidance, as measured by CETR. According to Table 5 Panel B, the ESG disclosure coefficient on the CETR is -0.002 ($p = 0.030$). H_1 is supported because this results implies that corporations are less likely to participate in tax avoidance activities when they have higher levels of ESG disclosure. These results align with agency theory, which posits that transparency strengthens accountability and stakeholder oversight, thereby reducing managers' opportunities to engage in tax avoidance and other opportunistic behavior (An et al., 2025; Hu & Xiong, 2025; Jiang et al., 2024; Yuan et al., 2025). In this regard, enhanced ESG disclosures contribute to greater transparency and heightened external oversight, which in turn reduces the opportunity for management to pursue tax avoidance activities (Amarna et al., 2024; Yuan et al., 2025).

Table 5 Results of Mediation Analysis (PROCESS Model 4)

Panel A.

Dependent Variable: KZ				N	=	611
				R	=	0.706
				R-square	=	0.498
Variable	Coefficient	Std. Error	t-Statistic	Prob.	LLCI	ULCI
C	-4.850	2.050	-2.365	0.018	-8.876	-0.823
ESGD	0.011	0.006	1.773	0.077	-0.001	0.024
FSIZE	0.156	0.069	2.268	0.024	0.021	0.290
ROA	25.482	1.081	23.571	0.000	23.359	27.605
GROWTH	-0.003	0.001	-2.793	0.005	-0.006	-0.001
CAPINT	-0.261	0.385	-0.676	0.499	-1.017	0.496

Source: Research Data, 2026

Panel B.

Dependent Variable: CETR				N	=	611
				R	=	0.240
				R-square	=	0.058
Variable	Coefficient	Std. Error	t-Statistic	Prob.	LLCI	ULCI
C	-0.324	0.225	-1.440	0.150	-0.765	0.118
ESGD	-0.002	0.001	-2.169	0.030	-0.003	0.000
KZ	-0.015	0.004	-3.333	0.001	-0.024	-0.006
FSIZE	0.003	0.008	0.454	0.650	-0.011	0.018
ROA	0.922	0.163	5.642	0.000	0.601	1.243
GROWTH	0.000	0.000	-0.852	0.395	0.000	0.000
CAPINT	0.018	0.042	0.435	0.664	-0.064	0.101

Source: Research Data, 2026

Furthermore, businesses that disclose a lot about their ESG practices typically have stronger internal control systems and are supported by independent boards and audit committees (Yuan et al., 2025). This condition encourages stricter supervision of corporate tax policies, so that aggressive practices such as profit shifting and the utilization of tax havens can be minimized. Thus, ESG disclosure not only serves as a means of non-financial reporting, but also as a governance mechanism that promotes tax compliance and suppresses tax avoidance practices.

The empirical results displayed in Table 5 Panel A reveal that ESG disclosure lacks statistical significance at the 5% level (coefficient = 0.011, p-value = 0.077). Consequently, the second hypothesis (H_2) is not supported. While these findings deviate from the prevailing literature that identifies a negative link between ESG disclosure and financial constraints (An et al., 2025; Z. Chen & Xie, 2022; Guo et al., 2024; Hu & Xiong, 2025; Jiang et al., 2024), they resonate with Azmi et al. (2021) assertion. This suggests that the effect of ESG disclosures on a firm's financial state is highly contingent on the specific market environment, such as emerging economies.

According to agency theory, greater ESG transparency can strengthen the flow of information to capital providers, fostering creditor confidence and improving the availability of external financing (Goss & Roberts, 2011; Jiang et al., 2024; Reverte, 2012; Yuan et al., 2025; Zhang & Lucey, 2022). Nevertheless, the insignificant results indicate that ESG information has not been considered sufficiently relevant in credit risk assessments. The literature shows that creditors focus more on debt repayment capabilities than non-financial activities, so ESG does not always translate as a signal of reduced risk (Goss & Roberts, 2011). In fact, ESG can be perceived as the use of resources that do not directly increase the financial capacity of a company (Magnanelli & Izzo, 2017).

Stakeholder theory states that ESG disclosure should improve the company's credibility and standing with stakeholders, which will eventually impact how simple it is to secure funding (Alessa et al., 2024; Benlemlih & Cai, 2020; Jiang et al., 2024; Yuan et al., 2025; Zhang & Lucey, 2022). However, in the context of a market with a growing level of ESG sensitivity, such signals have not fully translated into tangible financial gains. The effectiveness of ESG disclosure is highly dependent on the quality of internal governance mechanisms that ensure the credibility and substance of the information conveyed. Without strong governance support, markets tend to doubt the economic value of such disclosures (Elmghaamez et al., 2024).

Furthermore, the findings reinforce earlier empirical studies reporting inconsistent evidence on how ESG disclosure affects a company's financial condition. According to studies, credit markets may not always react favourably to ESG actions that are reported (Goss & Roberts, 2011; Magnanelli & Izzo, 2017). In certain situations, they may even see them as an extra expense that could lower a company's resource efficiency. In addition, the effect of ESG disclosure on financial constraints is also influenced by industry characteristics and the institutional environment, so ESG disclosure is not always the main determinant in consistently reducing financial constraints (Guo et al., 2024).

The study's results also support stakeholder theory, which holds that businesses are answerable to a wider range of stakeholders, such as the government, society, and investors as recipients of financial contributions, in addition to shareholders (Freeman & McVea, 2005). ESG disclosure signals social responsibility and governance credibility while also demonstrating a company's dedication to accountability and transparency (Alessa et al., 2024; Hu & Xiong, 2025; Teja, 2024; Widiastutik et al., 2024). From this perspective, tax avoidance practices are viewed as actions that may harm a firm's reputation and conflict with stakeholder expectations (Du & Li, 2024; Lanis & Richardson, 2012).

Table 5 Panel B shows that financial constraints (KZ) exert a significant negative effect on tax avoidance ($\beta = -0.015$; $p = 0.001$). H_3 is not supported by these results, which demonstrate that the tax avoidance rate decreases with increasing financial constraints. These results contradict the agency's premise that managers tend to carry out tax avoidance as a form of opportunistic action to reduce the tax burden in order to maintain internal funding, support investment, and improve performance that has an impact on the compensation received (Bayar et al., 2018; Chen & Lai, 2012; Edwards et al., 2016; Nabila & Rachmawati, 2023).

These results indicate that companies that face financial constraints typically steer clear of riskier tax tactics. Although tax avoidance provides benefits in the form of tax savings (Arsalan Khan & Tjaraka, 2024), the practice also entails costs such as the risk of sanctions, reputational degradation, and increased scrutiny (Arsalan Khan & Tjaraka, 2024; Fallan & Fallan, 2019; Ferdiawan & Firmansyah, 2017; Kałdoński & Jewartowski, 2020; Redaksi Online Pajak, 2019). Companies who are having financial difficulties usually don't engage in tax avoidance since they don't want to lose value or their reputation among stakeholders. Companies are likely to choose other alternatives to overcome financial constraints, such as increasing reporting transparency to lower funding costs (Biddle & Hilary, 2006; Nasih et al., 2016; Shakespeare, 2020). Therefore, financial constraints in this study actually suppress tax avoidance practices. These findings are in line with several previous studies (Andika & Sukartha, 2023; Aristyatama & Bandiyono, 2021; Bayar et al., 2018). However, they differ from studies reporting a positive effect of financial constraints on tax avoidance (Chen & Lai, 2012; Edwards et al., 2016; Law & Mills, 2015; Nabila & Rachmawati, 2023), implying that different institutional and economic situations may have different effects of financial constraints on tax avoidance.

Table 6. Direct and Indirect Effects (Bootstrapping Results)

Effect Type	Effect	Prob.	BootLLCI	BootULCI	Decision
Direct Effect (ESG → CETR)	-0.002	0.030	0.003	0.000	Significant
Indirect Effect (ESG → KZ → CETR)	0.000		0.000	0.000	Not Significant

Source: Research Data, 2026

According to the statistics in Table 6, the indirect effect value is 0.000, accompanied by a bootstrap confidence interval of [0.000; 0.000], indicating a lack of statistical significance. Consequently, H4 is not supported because the effect of ESG disclosure on tax avoidance does not operate through financial constraints. The failure of the mediation model is primarily attributable to the insignificant effect of ESG disclosure on financial constraints (path a). In the framework of Hayes PROCESS Model 4, mediation only occurs if the indirect pathway is significant, which in this study is not met. Theoretically, these results show that the effect of ESG disclosure on tax avoidance is more direct, namely through increased transparency, accountability, and stakeholder pressure, rather than through the mechanism of the company's financial condition.

To further examine the robustness of the primary findings, an additional test was performed by employing the GAAP ETR as an altenative measure of tax avoidance. Based on the results presented in Table 7 Panel B, ESG disclosure appears to have no statistically significant influence on GAAP ETR at the 5% significance level ($\beta = 0.001$; $p = 0.094$). This finding differs from the main analysis using CETR, where ESG disclosure was found to significantly reduce tax avoidance. The result suggests that the direct effect of ESG disclosure on tax avoidance is sensitive to the measurement of tax avoidance. One reason could be that CETR and GAAP ETR capture different dimensions of corporate tax behavior. While CETR reflects actual cash taxes paid, GAAP ETR is based on accounting tax expenses and may therefore capture different aspects of firms' tax planning activities.

Consistent with the main analysis, ESG disclosure does not significantly affect financial constraints according to Table 7 Panel A ($\beta = 0.011$; $p = 0.077$). Moreover, financial constraints continue to show a statictically significant relationship with GAAP ETR ($\beta = 0.015$; $p = 0.001$). The positive coefficient values suggest that companies experiencing higher degrees of financial constraints tend to demonstate elevated effective tax rates. Given that a higher GAAP ETR represents a greater share of income allocated to tax payments, this results implies that financially constrained firms engage in lower levels of tax avoidance behavior. Therefore, although the coefficient is positive when tax avoidance is proxied by GAAP ETR, the economic interpretation remains consistent with the main analysis using CETR, namely that financial constraints reduce tax avoidance. More importantly, the indirect effect of ESG disclosure on tax avoidance through financial constraints remains insignificant, consistent with the main analysis using CETR.

Table 7 Robustness Analysis
Panel A.

Dependent Variable: KZ				N	=	611
				R	=	0.706
				R-square	=	0.498
Variable	Coefficient	Std. Error	t-Statistic	Prob.	LLCI	ULCI
C	-4.850	2.050	-2.365	0.018	-8.876	-0.823
ESGD	0.011	0.006	1.773	0.077	-0.001	0.024
FSIZE	0.156	0.069	2.268	0.024	0.021	0.290
ROA	25.482	1.081	23.571	0.000	23.359	27.605
GROWTH	-0.003	0.001	-2.793	0.005	-0.006	-0.001
CAPINT	-0.261	0.385	-0.676	0.499	-1.017	0.496

Source: Research Data, 2026

Panel B.

Dependent Variable: GAAP ETR				N	=	611
				R	=	0.220
				R-square	=	0.049
Variable	Coefficient	Std. Error	t-Statistic	Prob.	LLCI	ULCI
C	0.321	0.232	1.383	0.167	-0.135	0.777
ESGD	0.001	0.001	1.678	0.094	0.000	0.003
KZ	0.015	0.005	3.278	0.001	0.006	0.024
FSIZE	-0.003	0.008	-0.443	0.658	-0.019	0.012
ROA	-0.874	0.169	-5.176	0.000	-1.206	-0.543
GROWTH	0.000	0.000	0.029	0.977	0.000	0.000
CAPINT	0.019	0.043	0.428	0.669	-0.067	0.104

Source: Research Data, 2026

Table 8. Direct and Indirect Effects (Bootstrapping Results)

Effect Type	Effect	Prob.	BootLLCI	BootULCI	Decision
Direct Effect (ESG → CETR)	0.001	0.094	0.000	0.003	Not Significant
Indirect Effect (ESG → KZ → CETR)	0.000		0.000	0.000	Not Significant

Source: Research Data, 2026

Overall, the robustness analysis indicates that the evidence regarding the direct effect of ESG disclosure on tax avoidance is not entirely uniform across different tax avoidance proxies. However, the conclusion regarding the mediating role of financial constraints remains unchanged. The insignificant indirect effect across both CETR and GAAP ETR suggests that financial constraints do not function as a mediating mechanism in the effect of ESG disclosure on tax avoidance. Accordingly, the robustness test strengthens the evidence that financial constraints do not serve as a mediating mechanism in the effect of ESG disclosure on tax avoidance, regardless of how tax avoidance is measured.

Additional analysis was conducted to test the effect of each ESG dimension, namely environmental (ENV), social (SOC), and governance (GOV), on financial constraints (KZ) and tax avoidance (CETR) using PROCESS Model 4. In Model 1 (KZ), only the social dimension (SOC) had a positive and significant effect on financial constraints ($\beta = 0.014$; $p = 0.036$), while the ENV and GOV dimensions were insignificant. This indicates that social disclosure is related to an increased need for resources that affects the financial condition of the company. In Model 2 (CETR), only the social dimension (SOC) had a negative and significant effect on tax avoidance ($\beta = -0.002$; $p = 0.016$). Taking into account that CETR has been multiplied (−1), these results show that tax avoidance practices decrease with increasing social disclosure. Meanwhile, the ENV and GOV dimensions did not show a significant influence.

Table 9. Additional Analysis

	KZ Model 1			CETR Model 2		
	ENV	SOC	GOV	ENV	SOC	GOV
Coefficient	0.005	0.014	0.007	-0.001	-0.002	-0.001
Std. Error	0.004	0.007	0.006	0.000	0.001	0.001
t-Statistic	1.348	2.103	1.089	-1.717	-2.410	-1.439
Prob.	0.178	0.036	0.277	0.087	0.016	0.151
LLCI	-0.002	0.001	-0.005	-0.002	-0.003	-0.002
ULCI	0.013	0.027	0.019	0.000	0.000	0.000
R^2	0.497	0.499	0.496	0.055	0.059	0.054
F-Statistic	119,505	120.538	119.255	5.848	6.350	5.694
N = 611						

Source: Research Data, 2026

From a stakeholder theory perspective, these findings show that the social dimension is most directly related to stakeholder interests, thus creating stronger pressure for companies to maintain legitimacy through tax compliance (Amarna et al., 2024; Freeman & McVea, 2005; Lanis & Richardson, 2012; Yuan et al., 2025). Viewed through the lens of agency theory, the social dimension also serves as a more effective external oversight mechanism in limiting managers' opportunistic behavior (Jiang et al., 2024; Khlifi et al., 2025; Malik & Kashiramka, 2025; Yuan et al., 2025).

These results provide a substantial contribution by proving that the effect of ESG on tax avoidance is not aggregate, but is driven dominantly by the social dimension, which has often been treated on an equal footing with other dimensions in the literature. In addition, these results reveal that the significance of ESG in the main model has the potential to be a reflection of the dominant effects of the social dimension, thus confirming the importance of disaggregated analysis in ESG studies.

CONCLUSION

The study focuses on the role of ESG disclosure in shaping corporate tax avoidance while considering financial constraints as a potential mediator. The findings demonstrate that stronger ESG disclosure is linked to a lower tendency to engage in tax avoidance practices, as measured by CETR. This findings also suggesting that greater ESG transparency may encourage higher levels of corporate tax compliance. However, the robustness analysis employing GAAP ETR as an alternative proxy suggests that the direct effect of ESG disclosure on tax avoidance is sensitive to the tax avoidance measure used. The mediation hypothesis is not supported because financial constraints fail to transmit the effect of ESG disclosure to tax avoidance under both the primary and alternative specifications. Furthermore, financial constraints have a negative effect on tax avoidance, indicating that financially constrained firms tend to avoid aggressive tax strategies. Additional analysis also reveals that the influence of ESG disclosure is primarily driven by the social dimension.

Theoritacally, this study extends the integration of agency theory and stakeholder theory by highlighting ESG disclosure as a transparency mechanism that may constrain opportunistic corporate behavior. More importantly, the evidence indicates that financial constraints are not the channel through which ESG disclosure affects corporate tax behavior. Practically, the results provide insights for regulators, investors, and corporate managers regarding the role of ESG transparency in shaping corporate tax behavior and sustainability pratices.

This study has several limitations. First, ESG disclosure scores may not accurately reflect firms' actual commitment to ESG practices because some disclosures may be symbolic rather than substantive. Second, because the analysis focuses exclusively on Indonesian listed non-financial firms, caution should be exercised when generalizing the findings to different regulatory environments or industry settings.

Future investigations could utilize ESG quality measures or external ESG ratings to distinguish genuine sustainability commitment from symbolic disclosure practices. Broader empirical settings involving financial firms, multiple countries, or other emerging markets would help assess the generalizability of the findings. Moreover, incorporating alternative tax avoidance measures and examining governance- and ownership-related contingencies may offer additional insights into the mechanisms through which ESG disclosure shapes corporate tax decisions.

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