

Does good governance mitigate the ESG risks of tax avoidance? An analytic network process study of Indonesian corporations

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Abstract

This study investigates whether effective corporate governance mitigates Environmental, Social, and Governance (ESG) risks arising from corporate tax avoidance in Indonesian listed firms. Employing the Analytic Network Process (ANP), this research analyzes expert judgments from six professionals, including the Chairperson of the Indonesian Institute of Accountants (IAI KAPD) Jakarta Region and five members of the IAI Central Office. The analysis is structured around four key criteria: Tax Avoidance, ESG Stability, Corporate Governance, and External Pressure. The findings indicate that corporate governance mechanisms, particularly audit quality and board independence, play a dominant role in mitigating ESG risks associated with aggressive tax behavior. High levels of tax avoidance are found to erode corporate reputation and weaken stakeholder trust, especially in the presence of strong investor and media scrutiny. This study contributes to the literature in three main ways. First, it extends ESG and tax avoidance research by integrating a network-based decision-making approach (ANP), offering a more holistic understanding of interdependencies among governance, fiscal behavior, and sustainability outcomes. Second, it provides empirical evidence from an emerging market context, where institutional pressures and governance structures differ significantly from those of developed economies. Third, it highlights the critical moderating role of governance quality in aligning corporate tax practices with ESG principles. From a practical perspective, the findings imply that regulators and firms should strengthen governance frameworks to promote tax transparency and accountability. Enhancing audit quality and board independence can serve as effective mechanisms to reduce ESG-related risks and support sustainable financial performance. Ultimately, this study underscores the importance of ethical tax practices as a strategic component of ESG resilience in developing economies.

Keywords: Corporate Governance, ESG, Tax Avoidance, Sustainability, Indonesia.

Article History:

Received: November 23, 2025; Accepted: March 27, 2026; Published: April 28, 2026

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DOI:

<https://doi.org/10.30871/jaba.11834>

JEL Code:

G34, H26, M14, G30

INTRODUCTION

In recent years, the increasing emphasis on Environmental, Social, and Governance (ESG) principles has fundamentally reshaped corporate accountability and financial strategies (Gerged et al., 2021). ESG performance is no longer perceived merely as a reputational or ethical concern but has evolved into a critical determinant of long-term firm value, risk management, and investor confidence (Bose et al., 2023). Investors, regulators, and broader stakeholders increasingly demand transparency not only in environmental and social practices but also in corporate fiscal behavior, including tax strategies.

Within this context, corporate tax avoidance has emerged as a highly sensitive and strategically significant issue. While tax avoidance can enhance short-term liquidity and improve after-tax profitability, it also raises serious ethical, legal, and reputational concerns. Aggressive tax practices are often perceived as inconsistent with ESG commitments, particularly the governance and social dimensions, as they may reduce public trust, invite regulatory scrutiny, and weaken corporate legitimacy (Kovermann & Velte, 2021; Chapple et al., 2022). In emerging markets such as Indonesia, where tax revenues are crucial for national development, tax avoidance carries broader societal implications, including reduced public welfare and increased inequality. Recent evidence further suggests that firms engaging in aggressive tax strategies are more likely to face negative media exposure and stakeholder backlash, which ultimately undermines sustainability performance (Kim & Kim, 2023; Amani, 2025). Therefore, understanding tax avoidance is not only important from a financial perspective but also essential for evaluating corporate responsibility and ESG resilience.

Corporate governance plays a pivotal role in balancing the tension between tax minimization and ESG integrity. Effective governance structures characterized by board independence, high audit quality, and transparent ownership promote ethical managerial behavior and alignment with long-term sustainability objectives (Nguyen et al., 2022). Conversely, weak governance mechanisms tend to facilitate opportunistic behavior, including aggressive tax planning, which may conflict with ESG principles and stakeholder expectations (Utami & Jatmiko, 2022; Chapple et al., 2022). As global attention intensifies on responsible tax conduct, governance is increasingly viewed as a critical mechanism for mitigating ESG risks arising from tax avoidance.

Despite growing scholarly interest, empirical findings on the relationship between tax avoidance, governance, and ESG performance remain inconclusive. Lanis and Richardson (2022) found that tax aggressiveness negatively affects ESG reporting quality, particularly in firms with weak governance structures. In contrast, (Taha et al., 2023) demonstrated that strong governance and transparency can mitigate negative public perceptions associated with tax practices. Furthermore, existing studies largely rely on linear empirical models, which may not adequately capture the complex interdependencies among governance mechanisms, tax strategies, and ESG outcomes. More importantly, the majority of prior research is concentrated in developed economies, leaving emerging markets underexplored.

This limitation highlights a significant research gap. First, there is a lack of integrative frameworks that simultaneously examine tax avoidance, ESG performance, and corporate governance within a single analytical model. Second, limited attention has been given to the dynamic and interdependent relationships among these variables, particularly using non-linear or network-based approaches. Third, empirical evidence from Indonesia remains scarce, despite its unique institutional environment characterized by evolving ESG regulations, concentrated ownership structures, and increasing public scrutiny of corporate tax behavior (Utami & Jatmiko, 2022; Amani, 2025). These gaps underscore the need for a more comprehensive and context-specific investigation.

To address these issues, this study employs the Analytic Network Process (ANP), a multi-criteria decision-making method capable of capturing interdependencies and feedback relationships among variables (Saaty, 1990; Hsu et al., 2024). Unlike conventional linear models, ANP enables the prioritization of factors within a network structure, providing a deeper

understanding of how corporate governance moderates the relationship between tax avoidance and ESG stability (Widiastuti et al., 2024; Rahman et al., 2023). This approach is particularly relevant in the ESG context, where financial, ethical, and institutional factors are inherently interconnected.

This study contributes to the literature in three key ways. First, it develops an integrated framework linking corporate governance, tax avoidance, and ESG sustainability, offering a more holistic perspective on responsible financial strategy. Second, it introduces the ANP methodology to prioritize and model the complex relationships among governance and ESG variables within Indonesia's institutional setting. Third, it provides empirical insights from an emerging market context, thereby enriching the limited body of knowledge on ESG governance in Southeast Asia.

RESEARCH METHOD

This study employs a quantitative–exploratory design using the Analytic Network Process (ANP) to examine the interrelationships among Tax Avoidance, Corporate Governance, ESG Stability, and External Pressure within Indonesian corporations. The ANP method was selected due to its ability to account for reciprocal relationships and feedback effects between multidimensional criteria (Hsu et al., 2024; Widiastuti et al., 2024).

Data and Sources

This study employs primary data collected through expert judgment, which is consistent with the Analytic Network Process (ANP) approach that prioritizes depth of expertise over large sample size (Saaty, 1990). The data were obtained from six carefully selected professionals affiliated with the Indonesian Institute of Accountants (IAI), comprising one Chairperson of IAI KAPD (Jakarta Region) and five senior experts from the IAI Central Office in Menteng. The relatively small sample size ($n = 6$) reflects the methodological emphasis of ANP on informed, high-quality judgments rather than statistical generalization. However, this also implies that the findings should be interpreted as context-specific insights rather than broadly generalizable conclusions, particularly beyond similar institutional settings.

A purposive sampling technique was applied to ensure that all selected experts met strict eligibility criteria. These criteria included: (1) a minimum of 10 years of professional experience in accounting, taxation, or corporate governance; (2) demonstrated involvement in ESG-related practices, policy formulation, or professional standard-setting; and (3) active affiliation with recognized professional bodies or regulatory institutions. This rigorous selection process was designed to enhance the credibility and relevance of the expert evaluations.

Data collection was conducted between August and September 2025 using structured questionnaires based on pairwise comparison matrices. Respondents assessed the relative importance of elements using Saaty's 1–9 scale, enabling the capture of nuanced judgments regarding interrelationships among tax avoidance, ESG stability, corporate governance, and external pressure. To ensure internal consistency and reliability, each expert's responses were evaluated using the consistency ratio (CR), with all values meeting the acceptable threshold ($CR \leq 0.10$).

To improve data robustness and reduce individual bias, the aggregation of expert judgments was performed using the geometric mean method, which is widely recommended in ANP studies for synthesizing group preferences. The aggregated results were then used to construct the unweighted, weighted, and limit supermatrix, forming the basis for priority weight calculations and interdependence analysis.

In addition, qualitative insights provided by the experts during the assessment process were systematically documented and categorized to support the interpretation of quantitative results. This qualitative coding process allowed for triangulation, enhancing the explanatory depth and validity of the findings, particularly in understanding the contextual dynamics of ESG and tax behavior in Indonesia.

Overall, while the limited number of experts reflects the specialized nature of ANP methodology, the rigorous selection criteria, consistency testing, structured aggregation procedures, and integration of qualitative insights collectively strengthen the reliability and credibility of the study.

Variables and Indicators

Four main constructs and their sub-criteria were analyzed as follows:

Table 1. Variables and Indicators

Main Criteria	Sub-Criteria
Tax Avoidance	Effective Tax Rate (ETR), Book-Tax Difference (BTD), Cash ETR (CETR)
Corporate Governance	Board Independence, Audit Quality, Ownership Structure
ESG Stability	ESG Disclosure, ESG Performance, Market Reputation
External Pressure	Tax Regulation, Investor Pressure, Media Exposure

Each variable was operationalized based on previous ANP sustainability studies (Widiastuti et al., 2024; Rahman et al., 2023).

Method of Analysis

Data analysis was performed using Super Decisions Software (v.3.2). The process consisted of three stages:

1. Pairwise Comparison Analysis – Assessing the relative importance of each factor.
2. Supermatrix Formation and Normalization – Aggregating local priorities to form the limit matrix, representing global priorities across all nodes.
3. Sensitivity Analysis – Testing robustness by altering weight scenarios to confirm governance’s moderating role in mitigating ESG risks.

The general ANP computation for deriving the global priority weight is represented as:

$$P(x) = \sum_{i=1}^n w_i \times p_i$$

Where denotes the global priority of the element, is the local weight of the criterion, and represents the interdependent priority of the sub-criterion.

Qualitative insights from open-ended responses were coded thematically using NVivo 14, supporting the quantitative findings. This mixed-method approach enhances the interpretive validity of the ANP results (Pande & Mishra, 2025; Otieno & Mathuva, 2025).

RESULTS AND DISCUSSION

This section presents the findings from the Analytic Network Process (ANP) analysis and discusses their theoretical and practical implications. Results are presented clearly and concisely, highlighting the study’s contribution to the literature on corporate governance, tax avoidance, and ESG sustainability.

Results

Overview of Data and Consistency Validation

All six experts completed the ANP questionnaire, and pairwise comparison matrices were aggregated using the geometric mean method. Consistency Ratio (CR) testing confirmed that all values were below the acceptable threshold of 0.10, ensuring reliability and coherence of expert judgments (Saaty, 1990). Respondents consistently agreed that Corporate Governance and Tax Avoidance are central determinants of ESG Stability, though minor differences

appeared regarding the relative strength of institutional versus reputational pressures under External Pressure.

Table 2. Global Priority Weights of Main Criteria

Main Criteria	Global Weight	Rank
Corporate Governance	0.382	1
ESG Stability	0.284	2
Tax Avoidance	0.204	3
External Pressure	0.130	4

Source: Authors' ANP calculation using Super Decisions (v.3.2)

Note: Corporate Governance emerged as the most influential factor within the network, confirming its moderating role in sustaining ESG integrity.

Table 3. Sub-Criteria Weights and Rankings

Category	Sub-Criterion	Local Weight	Global Weight	Rank
Tax Avoidance	Effective Tax Rate (ETR)	0.462	0.094	6
	Book-Tax Differences (BTD)	0.328	0.067	9
	Cash Effective Tax Rate (CETR)	0.210	0.043	12
Corporate Governance	Board Independence	0.472	0.180	1
	Audit Quality	0.338	0.129	2
	Ownership Structure	0.190	0.073	8
ESG Stability	ESG Performance	0.418	0.119	3
	ESG Disclosure	0.342	0.097	5
	Market Reputation	0.240	0.068	7
	Tax Regulation	0.456	0.059	10
External Pressure	Investor Pressure	0.326	0.042	13
	Media Exposure	0.218	0.028	14

Source: Authors' computation based on ANP model, 2025

Note: Board Independence and Audit Quality were the highest-ranking governance attributes, underscoring their importance in mitigating tax avoidance-related ESG risks (Maulina & Nuryanah, 2025; Otieno & Mathuva, 2025).

Interdependence and Feedback Effects

The Analytic Network Process (ANP) model reveals a set of interdependent and recursive relationships among corporate governance, tax avoidance, ESG stability, and external pressure. These findings provide a deeper understanding of the research problem, namely, whether corporate governance can effectively mitigate ESG risks arising from tax avoidance in Indonesian listed firms.

First, the influence of Corporate Governance on Tax Avoidance (0.221) indicates that stronger governance mechanisms significantly constrain opportunistic tax behavior. This result confirms that governance attributes, particularly board independence and audit quality, serve as effective internal control systems that reduce managerial incentives to engage in aggressive tax planning. From an agency theory perspective, this finding supports the role of governance in mitigating information asymmetry and managerial opportunism. In the Indonesian context, where ownership concentration and potential conflicts of interest are prevalent, robust governance structures become critical in ensuring that tax strategies align with broader stakeholder expectations and ethical standards.

Second, the pathway from Tax Avoidance to ESG Stability (0.194) highlights that higher levels of tax aggressiveness undermine ESG performance. This finding directly addresses the core research issue by demonstrating that tax avoidance is not merely a financial strategy but also a reputational and sustainability risk. Firms that engage in excessive tax minimization tend to face declining stakeholder trust, increased scrutiny, and potential damage to their ESG ratings. This is particularly relevant in emerging markets, where public sensitivity toward corporate social responsibility and fiscal contribution is increasing. The result is consistent with prior studies (Kovermann & Velte, 2021; Chapple et al., 2022) and reinforces the argument that tax behavior is an integral component of ESG evaluation.

Third, the feedback effect from ESG Stability to Corporate Governance (0.163) suggests a reinforcing cycle in which firms with strong ESG performance tend to strengthen their governance practices to sustain legitimacy and long-term value. This reciprocal relationship implies that ESG is not only an outcome but also a driver of improved governance quality. Companies that are committed to sustainability are more likely to institutionalize governance reforms, such as enhancing transparency, strengthening board oversight, and improving audit functions. This finding aligns with legitimacy theory, which posits that firms continuously adapt their governance structures to meet evolving societal expectations (Pande & Mishra, 2025).

Furthermore, the External Pressure component (0.130) exerts a moderate yet meaningful influence on the system. Regulatory enforcement, investor activism, and media exposure contribute to shaping corporate behavior, particularly in discouraging aggressive tax practices. However, the relatively lower weight compared to internal governance mechanisms suggests that sustainable corporate conduct in Indonesia is more strongly driven by internal controls than by external enforcement. This finding highlights an important institutional insight: while regulatory frameworks and public scrutiny are necessary, they are insufficient without strong governance embedded within the firm. It also reflects the evolving but still maturing nature of ESG-related regulation in Indonesia (Amani, 2025).

Discussion

The findings from the Analytic Network Process (ANP) reveal that Corporate Governance exerts the most substantial influence on the relationship between Tax Avoidance and ESG Stability, followed by External Pressure and Tax Avoidance indicators themselves. This hierarchy underscores governance's moderating capacity in balancing financial aggressiveness and sustainable business commitments.

The weight values derived from expert responses (including representatives from the Indonesian Institute of Accountants (IAI) and affiliated professionals) emphasize Board Independence and Audit Quality as the most critical subcriteria within governance. This aligns with the findings of (Widiastuti et al., 2024) and (Hsu et al., 2024), who argued that strong governance mechanisms are central to mitigating risks in multidimensional sustainability systems.

Under the Tax Avoidance dimension, Book-Tax Differences (BTD) and Cash Effective Tax Rate (CETR) show higher influence weights compared to ETR, suggesting that transparent tax reporting and earnings quality are vital to perceived ESG integrity. The strong linkage between CETR and ESG Performance reflects stakeholders' growing sensitivity toward firms' ethical financial practices, a trend previously observed by Orazalin (2020) and Li & Zheng (2022) in their cross-country ESG studies.

The External Pressure category, represented by Regulatory Requirements, Investor Expectations, and Media Exposure, further reinforces ESG accountability. The ANP interdependencies show that media exposure amplifies governance responses, indicating that public visibility incentivizes firms to align taxation policies with ESG narratives. This resonates with (Kim & Kim, 2023), who identified external monitoring as a key driver for ethical compliance in corporate sustainability.

Finally, ESG Stability dimensions ESG Disclosure, ESG Performance, and Market Reputation form the ultimate impact layer. ANP results confirm that ESG Performance is the dominant indicator of long-term sustainability, validating the notion that “good governance equals resilient ESG” (Liu et al., 2021; Yusoff & Darus, 2022).



Figure 1. Structural Model Testing

Source: Authors' illustration based on ANP network modeling, 2025.

Note: The figure represents the interrelationships between Corporate Governance, Tax Avoidance, ESG Stability, and External Pressure as identified through the ANP framework.

This study's results enhance understanding of how governance-driven tax transparency promotes ESG sustainability, particularly in Indonesia's evolving corporate landscape. By applying ANP, this research extends conventional governance theory through a systems-based model that accounts for both causal and feedback dynamics across financial and sustainability dimensions.

CONCLUSION

This study provides empirical evidence that strong corporate governance plays a pivotal role in mitigating the ESG risks associated with corporate tax avoidance in Indonesian listed companies. Using the Analytic Network Process (ANP), the research reveals that governance mechanisms, particularly Board Independence and Audit Quality, serve as the most influential determinants of sustainable ESG outcomes. These findings affirm that effective internal governance structures strengthen ethical financial practices and reinforce the legitimacy of corporate sustainability performance.

The results further demonstrate that aggressive tax avoidance strategies, while improving short-term liquidity, can jeopardize long-term ESG credibility and stakeholder trust. This aligns with the theoretical propositions of stakeholder and legitimacy theory, emphasizing that transparent governance enhances both ethical accountability and corporate resilience. Moreover, the influence of external pressures such as media exposure and investor monitoring, although secondary, remains vital in amplifying governance responsiveness toward sustainability alignment.

From a practical perspective, the study underscores the importance for firms to integrate tax transparency within governance frameworks to ensure fiscal responsibility and sustainable performance. For regulators and policymakers, embedding ESG risk assessment within taxation and reporting systems can strengthen national sustainability governance standards and align with international benchmarks such as the OECD BEPS and IFRS sustainability guidelines.

Despite its contributions, the study is limited by its reliance on a small expert sample ($n = 6$), which restricts broader generalization. Future research should expand respondent diversity across industries and apply hybrid multi-criteria approaches such as ANP-TOPSIS or DEMATEL-ANP to enhance predictive validity. Longitudinal data could also provide a deeper

understanding of how governance-driven transparency evolves alongside corporate ESG maturity.

Acknowledgment

This research was supported by the Ministry of Education, Culture, Research, and Technology of the Republic of Indonesia (Kemdikbudristek) under the Research Contract Number 125/C3/DT.05.00/PL/2025, dated May 28, 2025, and its derivative contract No. 7927/LL4/PG/2025; 007/07/KP/.H/UPB/2025, dated June 4, 2025.

The study, entitled “Governance dan Keberlanjutan Keuangan: Apakah Praktik Penghindaran Pajak Mengancam Stabilitas ESG Perusahaan?” (Governance and Financial Sustainability: Does Tax Avoidance Threaten Corporate ESG Stability?) was conducted during the 2025 fiscal year with a total duration of one year.

The authors express sincere gratitude to the Indonesian Institute of Accountants (IAI), particularly to the Chairperson of IAI KAPD Jakarta Region and the staff members of IAI Central Office, Sindanglaya, Menteng, for their invaluable participation as expert respondents in the Analytic Network Process (ANP) evaluation. Their insights significantly contributed to the robustness and contextual relevance of this study.

The authors also acknowledge the administrative and institutional support provided by Universitas Pelita Bangsa (UPB), which facilitated research coordination and dissemination. Any opinions, findings, and conclusions expressed in this paper are solely those of the authors and do not necessarily reflect the views of the funding agency.

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