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The ESG-tax avoidance nexus in SOEs: Do investment, strategy, and political ties matter

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Abstract
Research aims: This study investigates the effects of the investment opportunity set, prospector business strategy, and political connections on tax avoidance, with ESG disclosure playing a potential moderating role.
Design/Methodology/Approach: Using an unbalanced panel of 127 observations from 32 non-financial State-owned enterprises (SOEs), listed and non-listed on the IDX, this research utilizes secondary data from financial and sustainability reports for 2019–2023. Hypothesis testing was conducted via multiple linear regression at a 10% significance level.
Research findings: This study indicates that only the prospector business strategy positively influences tax avoidance, while ESG (Environmental, Social, and Governance) disclosure dampens this relationship. In contrast, the investment opportunity set and political connections do not significantly affect tax avoidance, and ESG disclosure does not strengthen nor weaken these relationships.
Theoretical contribution/ Originality: This study enhances the application of stakeholder theory, highlighting how ESG disclosure aligns with the ethical and transparent behavior expected in corporate tax strategies.
Practitioner/Policy implication: Effective ESG disclosures encourage companies to adopt ethical tax practices, reduce aggressive tax avoidance, and foster transparency.
Research limitation/Implication: Limited data on non-listed SOEs, as only 12 firms provided comprehensive financial and sustainability reports, restricts the sample size for these entities.
Keywords: Tax Avoidance; ESG Disclosure; Investment Opportunity Set (IOS); Prospector Business Strategy; and Political Connection

Introduction

Managers carry out a range of critical strategies and make strategic decisions, including those related to corporate tax planning (Koester et al., 2017). Since taxes represent a significant expense for most businesses (J. H. Kovermann, 2018), managers must leverage their expertise to optimize tax management. This can be achieved through tax planning strategies to minimize the company's tax obligations (Koester et al., 2017).

Tax avoidance is an obstacle in tax collection and reduces state treasury revenues (G20 Indonesia, 2023). The problem is that tax avoidance practices are always interpreted as legal activities, such as minimizing the tax burden without going against tax provisions. According to Lietz (2013), tax avoidance not only makes tax avoidance actions more pronounced but also makes tax avoidance done legally still considered socially unethical. Companies generally have a variety of instruments and options available to reduce their explicit tax burden. Many of these tax measures are straightforward and largely legal, while others are legally dubious and more difficult to defend in an audit or even avoid (Lietz, 2013).

Tax avoidance remains a prominent concern in many countries, including Indonesia. Tax avoidance is evident among global companies such as Amazon, which recorded UK sales of £3.35 billion in 2011 but reported a tax charge of only £1.8 million. Similarly, Google paid just £6 million in taxes to the UK Treasury in 2011, despite a UK turnover of £395 million. Starbucks also exemplified this issue, with UK sales of £400 million in 2012, yet avoided paying corporate taxes by transferring funds to a group company in the Netherlands as royalty payments, purchasing coffee beans from Switzerland, and incurring high interest from internal business loans (Barford & Holt, 2013). Meanwhile, cases in Indonesia that can show tax avoidance practices in state-owned companies include PT RNI, which was identified in 2016 as practicing tax exemptions in various ways, such as reporting financial reports showing that the company suffered considerable losses and saying that the company's turnover remained below 4.8 billion rupiah per year to be able to get a final Income Tax rate facility of 0.5% by utilizing Government Regulation 23/2018 concerning MSME special Income Tax (Suryowati, 2016). In the second case at PT Coca-Cola Indonesia (CCI), PT CCI allegedly cheated on taxes. According to CCI's calculations, the total taxable income was only IDR 492.59 billion, but the Directorate General of Taxes' calculation was IDR 603.48 billion. As a result, the Directorate General of Taxes calculated PT CCI's income tax shortfall of IDR 49.24 billion (Djumena, 2014). What PT CCI has done is increase costs in the form of advertising costs by IDR 566.84 billion from 2002 to 2006. It is done so that taxable income is reduced and tax deposits become small.

According to Rahedi (2019), if tax avoidance is carried out following tax regulations, these activities are allowed and acceptable, but these activities are not desirable for the government because they reduce state revenue. Tax avoidance has reduced national income, affected national welfare policies, prevented the government from providing public services, disrupted social and economic order, and destroyed market resources (Rahedi, 2019). Actually, for companies as taxpayers, this tax avoidance practice can have a negative impact, especially on business in the long run. In the long run, tax avoidance practices can reduce the company's value, which can affect the company's business development. Investors will assess the company for the risk of facing legal problems when it wants to expand, which will require external funding.

Given the previously described context of tax avoidance, this topic warrants deeper investigation and discussion in this study. Numerous cases and underlying factors highlight the importance of understanding how companies engage in tax avoidance, particularly in countries like Indonesia, where taxes are a primary source of government revenue (Tandean & Winnie, 2016). Drawing on findings from prior research and the mapping by Zhang et al. (2022), it is evident that many previous studies have focused on identifying the factors driving corporate tax avoidance on a global scale. The studies that have examined international tax avoidance by linking, among others, business strategy (Higgins et al., 2015; Zhang et al., 2022), institutional ownership (J. Kovermann & Velte, 2019; Moore et al., 2017), corporate governance (Moore et al., 2017), and corporate governance (Moore et al., 2017), corporate governance (Bauer, 2016), tax enforcement (J. Kovermann & Velte, 2019; Kubick & Lockhart, 2017), tax risk (Guedrib & Bougacha, 2024), political connections (Ajili & Khlif, 2020; Khlif & Amara, 2019), investment opportunities (McGuire et al., 2014), and ESG performance (Jiang et al., 2024; Yoon et al., 2021). Meanwhile, tax avoidance research in Indonesia that has been tested includes business strategy (Aryotama & Firmansyah, 2020; Ulfa et al., 2024), institutional ownership (Sari & Indrawan, 2022), set of investment opportunities owned by the company (Firmansyah & Bayuaji, 2019; Lubis et al., 2015), political connections (Iswari et al., 2019; Ulfa et al., 2024) and ESG (Environmental, Social, and Governance) disclosure (Anggraini & Wahyudi, 2022).

Several national and international studies have presented inconsistencies in research results. The research gap from previous research summarizes that the investment opportunity set has a negative effect on tax avoidance practices based on research by McGuire et al. (2014), Firmansyah & Bayuaji (2019), and Dewi & Noviari (2021). Meanwhile, research by Firmansyah et al. (2022) shows that investment opportunity set has a positive effect on tax avoidance, and research by Nisa' & Kurnia (2023) did not find a significant relationship between investment opportunity set and tax avoidance. The study by Ulfa et al. (2024), Hanif et al. (2023), Astuti et al. (2023), and Zhang et al. (2022) found that business strategy can affect tax avoidance practices. Meanwhile, Girindratama & Rudiawarni (2022) and Lopo Martinez & Ferreira (2019) show that business strategy does not affect tax avoidance. The research of Kim & Zhang (2016), Ajili & Khlif (2020), Firmansyah et al. (2022), and Hanif et al. (2023) show that political connections can significantly affect tax avoidance practices. However, research by Widarjo et al. (2021) and Solikin & Slamet (2022) did not find a significant relationship between political connections and tax avoidance.

This study examines the effect of investment opportunity set, business strategy, and political connections on tax avoidance. The investment opportunity set is an independent variable chosen because it shows the company's future investment potential, which can affect management decisions about tax avoidance. Business strategy can affect the company's tax avoidance strategy by influencing the company's priorities in minimizing or managing the tax burden. Political connection is used to investigate how political relationships can facilitate or influence tax avoidance practices because they provide certain access or advantages in the context of taxation.

This research differs from previous research at the international level and in Indonesia because the data used in this study uses listed and non-listed State-owned enterprises (SOEs). The focus of the review on SOEs in a country's economy is because they support government tax revenue. According to (Sasongko, 2020), SOEs function as an agent of development and value creators, whereas as an agent of development, SOEs are expected to help national development, and as an agent of the value of creator, SOEs is expected to contribute value to the state. SOEs are synonymous with political connections, so it is necessary to use listed and non-listed SOEs data to get a comprehensive picture of the political connections of SOEs that have gone public. In addition, this study also includes ESG disclosure as a moderating variable in testing the independent variable on the dependent variable, which has rarely been used in previous studies. Adding moderating variables in the form of ESG disclosure can increase or decrease the direction of the relationship between the independent and dependent variables. ESG is essential in business and investment, as it helps companies manage risk, build reputation, and positively impact the environment and society (IEC, 2023). ESG disclosure can act as an additional monitoring mechanism, thereby reducing agency conflicts related to tax avoidance. This study extends agency theory by adding ESG as a moderating variable influencing the relationship between managers' interests and actions taken, particularly in tax avoidance practices.

This research contributes to knowledge development in one of them by using ESG disclosure as a moderating variable. ESG indicates a company's commitment to responsible business practices. By testing the moderating influence of ESG, this study provides new insights into how sustainable disclosures can strengthen or weaken the impact of various factors on tax avoidance. It is important as ESG is in the global spotlight, where companies are expected to have higher accountability. In addition, the use of ESG disclosure as a moderating variable enriches stakeholder theory. ESG disclosure is a tool to maintain good relations with external stakeholders, such as the government and the wider community. Companies that make high ESG disclosures may have a lower tendency to avoid taxes, as they are more concerned about perceptions and social responsibility. It strengthens the position of stakeholder theory, which emphasizes the importance of corporate social responsibility towards all stakeholders.

Literature Review and Hypotheses Development

Agency Theory

This theory postulates that when both parties seek to maximize utility, the agent will refuse to act following the principal's interests (Amidu et al., 2019). As a result, a conflict of interest arises between managers and shareholders outside the public company. This conflict is known as the agency problem. Agency problems occur due to differences in interests between principals and agents and asymmetric information. Agents have greater access to information related to company operations than principals. According to Onatuyeh & Ukolobi (2020), agency theory can be associated with the behavior of managers (agents) who engage in opportunistic behavior, such as initiating unclear aggressive tax policies at the expense of the interests of shareholders (principals). It is because both parties seek to maximize their profits.

Agency theory occurs in the presence of conflicts that result in differences in viewpoints that cause conflict between the two (Wahyuni et al., 2017). One of the agency conflicts is that this can encourage managers to take more risks in terms of taxation, depending on the incentives and controls provided by the company owner. Two ways that a leader can reduce the opportunistic behavior of agents are by establishing a corporate governance structure and making contracts based on agent performance (Eisenhardt, 1989). One of these ways can reduce opportunistic behavior related to the level of tax avoidance carried out by agents.

Stakeholder Theory

Stakeholder theory serves as a valuable framework for examining sustainability. This theory highlights the importance of addressing the interests of diverse parties involved in a company's operations, including shareholders, employees, customers, suppliers, local communities, and governments. This theory raises awareness of a company's relationships and chain effects and its many stakeholders (Simon, 2022). A company's long-term success is closely tied to effectively managing these stakeholder relationships (Freeman, 2010). Companies will succeed if they do things that make this group happy (Shad et al., 2019). In addition, companies need to consider how their actions impact society and the environment. This will help them maintain a good reputation and do good work (Freeman & David, 1983). One approach to sustainability involves incorporating environmental, social, and governance (ESG) considerations into business operations and investment decisions.

Companies that are transparent in their ESG practices will tend to be more socially responsible by not engaging in aggressive tax avoidance practices. The company tries to maintain good relations with all its stakeholders, including the government, by fulfilling its tax obligations (Hoi et al., 2013). According to Bani-Khalid & Kouhy (2017), companies must pay attention and provide benefits to their stakeholders because the policies they take can affect their business activities. It suggests that ESG disclosure benefits the environment and society and encourages more ethical and sustainable business practices.

Effect of Investment Opportunity Set (IOS) on Tax Avoidance

In agency theory, agents (management) are incentivized to avoid taxes to increase the company's net profit, which can increase manager compensation (Onatuyeh & Ukolobi, 2020). Agency conflicts can occur if managers focus more on personal gain than the company's and shareholders' long-term interests. Risk aversion and horizon problems cause differences in motivation between managers and shareholders. One of the conflicts occurs because managers exhibit opportunistic behavior when conducting tax avoidance. Such behavior, for example, occurs when companies with a high IOS tend to allocate resources to productive and long-term investments, effectively reducing management incentives and tax avoidance activities.

The investment opportunity set represents the portion of a company's value that relies on future expenditures, which are currently viewed as investment options expected to yield higher returns (Gaver & Gaver, 1993). Market participants typically focus on investment opportunities that facilitate long-term company growth through strategic investments. These growth opportunities can be assessed by examining the various components of the investment opportunity set (Prayogo et al., 2022). Thus, the investment opportunity set can be understood as the total value of a company influenced by prospective expenditures that serve as current investment options aimed at generating greater returns. A company's investment policies, guided by the investment opportunity set, can significantly impact its asset composition and financial dynamics, including accounts receivable agreements, executive compensation arrangements, capital structure decisions, dividend policies, and, notably, corporate accounting practices (Goffar & Muhyarsyah, 2022).

A high Investment Opportunity Set (IOS) provides managers ample opportunities to select various investment options that align with shareholders' interests in achieving long-term wealth growth. Companies with diverse investment opportunities are better positioned to choose investments that offer optimal returns while minimizing risk, reducing the likelihood of engaging in tax avoidance practices. It aligns with prior studies by Dewi & Noviari (2021), Firmansyah & Bayuaji (2019), and McGuire et al. (2014), which found that investment opportunities negatively influence tax avoidance. Managers who understand and manage IOS can mitigate reputational risks, enhance market confidence, and support the company's long-term sustainability.

***H_1**: Investment Opportunity Set has a negative effect on tax avoidance.*

Effect of Prospector Business Strategy on Tax Avoidance

Based on agency theory, managers may be able to implement tax avoidance practices as a form of involvement in opportunistic behavior (Onatuyeh & Ukolobi, 2020). Tax avoidance is an effort to minimize tax payments, but it is done legally and safely by taking advantage of loopholes and weaknesses in tax laws and regulations (Gunawan & Darminto, 2021). Managers do this to maximize company profits and meet the owner's wishes. Business strategy affects tax avoidance behavior, depending on how each type of strategy affects the costs and benefits of tax planning (Higgins et al., 2015).

Companies need the right plans and strategies to achieve performance through competitive advantage amid environmental uncertainty. Business strategy is a policy used by companies to survive amid existing competition (Anwar & Hasnu, 2016). Business strategy affects all activities in a company because, in a business process activity, company operations and all transactions carried out result in a business decision, so it must be in line with the business strategy that has been determined (Astuti et al., 2023).

Business strategy includes management planning and decision-making to organize company activities. One of them is using a prospector business strategy, where the main focus is that the company must spend a lot on research and development (R&D) to develop new products and aggressively explore new market opportunities. In addition, companies that use prospectors in their business strategy can better handle operational costs such as employee costs, production costs, sales costs, and other costs.

Implementing a prospector business strategy tends to increase tax avoidance practices in response to a dynamic business environment and the need for flexibility for innovation and growth. Companies that use a prospector business strategy have high flexibility in production, technology, and distribution (Girindratama & Rudiawarni, 2022). High flexibility reflects the organization's ability to adapt, innovate, adapt to new or different environments, and work with various people or groups. It can affect how much tax the company will pay because a high tax burden will affect its production and distribution, making it less effective. As a result, companies may prefer to practice tax avoidance (Ulfa et al., 2024). It is in line with previous research, where research by Hanif et al. (2023), Ulfa et al. (2024), and Zhang et al. (2022) show that prospector business strategy has a positive effect on tax avoidance.

***H₂**: Prospector business strategy has a positive effect on tax avoidance.*

Effect of Political Connection on Tax Avoidance

Agency theory emphasizes that political connections can lead to agency conflicts between shareholders and company management. Management may leverage these connections to obtain specific advantages, such as engaging in tax avoidance. Firmansyah et al. (2022) noted that political connections involve relationships between parties with political interests utilized to achieve mutually beneficial goals. Governments often protect politically connected companies, reducing their likelihood of facing tax audits. Consequently, such companies are more inclined toward tax planning, which can compromise financial transparency.

A company is deemed to have political connections if its shareholders own at least 10% of the total shares or any of its directors/commissioners fulfill one of the following criteria: 1) being a current or former member of parliament; 2) serving as a minister or former cabinet member; 3) being a member or former member of a political party; or 4) holding a current or former position as an official in the central or regional government, including military roles (Firmansyah et al., 2022). Political connections refer to close relationships between companies, government entities, or politicians, which provide companies with preferential treatment and various advantages. These connections are often linked to benefits such as reduced tax burdens through political affiliations to meet business and tax-related objectives (Wicaksono, 2017). Politically connected companies may avoid stringent tax enforcement and better understand tax regulations (C. Kim & Zhang, 2016).

Managers with political connections are incentivized to minimize corporate taxes, as their risk of scrutiny or audits by tax authorities is significantly lower (Hanif et al., 2023). According to Kim & Zhang (2016), politically connected firms tend to adopt more aggressive tax strategies than those without such ties. This aligns with findings from prior research by Ajili & Khlif (2020), Firmansyah et al. (2022), Hanif et al. (2023), and Kim &

Zhang, 2016), which collectively demonstrate a positive relationship between political connections and tax avoidance.

***H*$_3$**: *Political connections have a positive effect on tax avoidance.*

ESG Disclosure Moderates the Effect of Investment Opportunity Set on Tax Avoidance

Stakeholder theory is relevant in explaining the relationship between ESG disclosure and tax avoidance, where ESG disclosure can reduce tax avoidance practices as a form of responsibility to stakeholders, especially the government. According to Jiang et al. (2024), ESG performance is crucial to limit tax avoidance behavior. Companies genuinely committed to ESG practices tend to have strong business ethics and view tax compliance as an integral part of social responsibility (Krisna & Juliarto, 2024). Kim & Li (2021) note that individual and institutional investors now emphasize ESG factors significantly. ESG disclosure refers to companies' transparency about their environmental, social, and governance practices.

In this context, ESG disclosure can moderate the Investment Opportunity Set (IOS) effect on tax avoidance because IOS reflects the investment opportunities available to companies in the future. Companies with high IOS usually have more opportunities to invest their funds in projects that generate high profits. A high IOS allows managers to choose profitable investments with minimal risk, which may reduce the incentive to engage in tax avoidance. Companies may focus more on activities that increase long-term value rather than simply reducing short-term tax liabilities. Good ESG disclosure can strengthen the negative influence of IOS on tax avoidance. When companies transparently report on governance, environmental, and social practices, they tend to be more responsible in corporate tax practices. After all, companies want to maintain a positive reputation in the eyes of the public and stakeholders. It is supported based on research by Yoon et al. (2021), which shows that ESG has a negative effect on tax avoidance practices.

***H*$_4$**: *ESG disclosure strengthens the negative effect of the investment opportunity set on tax avoidance.*

ESG Disclosure Moderates the Effect of Prospector Business Strategy on Tax Avoidance

The importance of ESG information for investors and stakeholders in sustainable development because ESG is a practice of disclosing, measuring, and being responsible for all stakeholders (Almeyda & Darmansya, 2019). The United Nations has also introduced responsible investment principles to encourage investors to integrate ESG considerations into their corporate performance evaluations (Deepmala & Pandey, 2022). In an increasingly dynamic and complex business environment, companies are pressured to achieve financial returns and fulfill responsibilities as a form of sustainability strategy. Transparent and thorough ESG disclosure can increase scrutiny from stakeholders, including regulators and society, although prospector business strategies tend to engage in tax avoidance. Therefore, companies that set a prospector business strategy may be more cautious in avoiding taxes for fear of negative judgment and reputational risk (Grewatsch & Kleindienst, 2015).

Companies with a prospector strategy and good ESG disclosure can limit tax avoidance practices because they are more encouraged to maintain a positive reputation by strictly complying with tax rules. It is supported by the research of Jiang et al. (2024), which shows that ESG has a negative effect on tax avoidance practices.

***H*$_5$*: ESG disclosure weakens the positive effect of prospector business strategy on tax avoidance.*

ESG Disclosure Moderates the Effect of Political Connection on Tax Avoidance

Stakeholder theory provides the basis for Environmental, Social, and Governance (ESG) disclosure as a form of corporate accountability to stakeholders. ESG (Environmental, Social, and Governance) is a critical aspect of a company's investment and business strategy, enabling organizations to manage risks, enhance their reputation, and contribute positively to environmental and social well-being. ESG disclosure represents a modern evolution in voluntary information reporting, building upon earlier frameworks such as CSR, sustainability, and integrated reporting (Prastiwi et al., 2018). Investors increasingly rely on ESG scores as an effective tool for assessing a company's overall sustainability performance. Companies that adopt and disclose ESG practices often achieve higher ESG ratings, which can enhance profitability and ensure long-term sustainability. ESG disclosure is expected to weaken the negative impact of political connections on tax avoidance, where political connections can increase the courage of companies to commit tax avoidance because they feel protected from legal and audit risks. By increasing corporate transparency and accountability, ESG disclosure can force companies to better comply with applicable tax rules and reduce tax avoidance practices.

The discussion above shows that good ESG disclosure can weaken the positive relationship between political connections and tax avoidance. This is supported by Krisna & Juliarto (2024). A company committed to ESG practices will encourage the company to be more responsible in tax matters, as the basic principles of ESG emphasize sustainability, social responsibility, and good governance. Therefore, good ESG disclosure can make companies more responsible in their tax practices, regardless of their political connections.

***H*$_6$*: ESG disclosure weakens the positive influence of political connections on tax avoidance.*

Research Method

The data analysis applied a quantitative method in the form of secondary data sourced from financial reports, annual reports, and sustainability reports of non-financial SOEs listing and non-listing for the 2019-2023 period obtained from each company's website and the Indonesia Stock Exchange website. The population in this study were all non-financial SOEs, while purposive sampling was used with three criteria: Firstly, non-financial companies that publish complete financial and sustainability reports in 2019-2023. The use of non-financial companies was because they have financial reports that are more standardized and easier than those between companies, and non-financial SOEs earn income from main activities such as production, distribution, or services. It is often associated with tax avoidance, such as the choice of production location and transfer pricing arrangements between corporate units. Secondly, non-financial SOEs that did not experience losses in 2019-2023, including loss-making SOEs, may result in distortions in calculating and analyzing tax avoidance variables. For example, the ratios used to measure tax avoidance, such as the effective tax ratio (ETR), cannot provide accurate results due to negative pre-tax profits. Thirdly, the companies have complete data concerning the variables used in this study. It is to facilitate research in calculating the variables used.

The dependent variable in this study was tax avoidance, and the independent variables were investment opportunity set, prospector business strategy, and political connections. This study also added ESG disclosure variables as moderating variables and additional control variables in profitability, leverage, and company size. The proxies used for each variable were as follows. Tax avoidance proxy used Cash Effective Tax Rate (CETR) multiplied by (-1). This proxy can reflect the amount of tax paid by the company in cash during a certain period. In addition, the CETR proxy provides a more accurate picture of the company's real tax liability. Therefore, the value of tax avoidance is opposite to that of CETR, which is tax compliance (Permatasari et al., 2021). The measurement of investment opportunity set refers to the research of McGuire et al. (2014), one of which uses the proxy capital expenditure to book value assets (CAPBVA) in its measurement. Using the CAPBVA proxy can illustrate how much the company allocates funds for additional capital investment to its productive assets. Companies with a large flow of additional capital and the ability to utilize it as a large additional investment have the opportunity to grow more (Sutrisno, 2012).

The measurement of business strategy refers to the research of (Zhang et al., 2022), which uses three proxies, namely Marketing Expense Ratio (MESR), Cost of Good Sold to Sales Ratio (COGSR), and Annual Sales Growth Rate (ASGR). The three proxies were used to assess strategic orientation, and the results were calculated using a composite score. All data were divided among three major groups underlined with different values. For example, companies with the most significant ratio points were given a score of 3. Companies with moderate points scored 2, and companies with the lowest proportion of points were given 1. The summary score was 9, which indicated the maximum score, and 3, the minimum score the company could receive. The measure of business strategy used in this study was business strategy (BSSTRA), which is used as a dummy variable where 1 indicates the prospector nature of the company, and 0 indicates the defender strategy of the company. To set a discrete score ranging from 1 to 9, it is shown that companies with scores between 6 and 9 are considered prospectors, while the others are considered defenders. The measurement of political connections refers to the research of Lin et al. (2018) and Firmansyah et al. (2022), where the measurement is carried out using the natural logarithm of (1 + Politically Connected Board Member). Directors or commissioners who have political ties are those who have served 1) Member or former member of parliament; 2) Minister/cabinet member or former minister/cabinet member; 3)Member or former member of a political party; or 4) Officials or former officials of the central/regional government, which includes military personnel.

The measurement of ESG disclosure refers to Husada & Handayani (2021), who use the GRI index in the ESG disclosure approach. The GRI 300 index for environmental topics has 32 disclosure indicators, the GRI 400 for social topics has 40 disclosure indicators, and the GRI standard 2016 for governance information has 22 disclosure indicators. The calculation of ESG disclosure can be done by comparing the number of indicators successfully reported by a company with the total number of indicators of 94 ESG aspects. This calculation uses a dummy variable that gives 1 for disclosure items and 0 for non-disclosure items. Meanwhile, profitability, leverage, and company size refer to the research of Hossain et al. (2024), where profitability uses the return on asset, leverage uses the debt-to-asset ratio, and firm size uses the natural logarithm of total assets.

Hypothesis testing used multiple linear regression analysis for panel data with a significance level of 10%. Gujarati & Porter (2009) stated that the most appropriate multiple linear regression model must be selected for panel data. Selection testing used the Chow test, comparing common and fixed effect models. The Breusch-Pagan Lagrange multiplier test compares the common effect model and the random effect model, and the Hausman test compares the fixed effect model and the random effect model to determine the most appropriate model. This study used a research model to test the investment opportunity set, prospector business strategy and political connections, and the role of ESG disclosure in moderating the effect of the investment opportunity set, prospector business strategy, and connections on tax avoidance. The equation model was as follows.

$$TAXAVOIDi,t = \beta_0 + \beta_1 IOSi,t + \beta_2 BSSTRAi,t + \beta_3 Polconi,t + \beta_4 ESGi,t + \beta_5 IOS*ESGi,t + \beta_6 BSSTRA*ESG\ i,t + \beta_7 Polcon*ESG\ i,t + \beta_8 ROAi,t + \beta_9 LEVi,t + \beta_{10} Sizei,t + \varepsilon \quad \text{.............(1)}$$

Where IOS is Investment Opportunity Set, BSSTRA is Business Strategy Prospector, Polcon is Political Connection, ESG is Environmental, Social, and Governance Disclosures, ROA is Return on Asset, Lev is Leverage, and Size is Firm Size.

The model explained how tax avoidance is affected by IOS, prospector business strategy, and political connections, while ESG disclosure as moderation acts to strengthen or weaken those impacts based on the firm's sensitivity to compliance, reputation, and stakeholder expectations. In addition, by including ESG disclosure as moderation, ESG disclosure does not directly affect tax avoidance but can alter the relationship between the independent variables and tax avoidance, so this model offers a broader perspective on the relationship issue. This model also included control variables (Profitability, Leverage, and Company Size) to establish correlational or causal relationships between variables by increasing internal validity in regression analysis.

Result and Discussion

Based on the sample selection criteria and to meet the research observation needs, this study uses unbalanced panel data so that 127 observations are obtained from 32 non-financial SOEs listing and non-listing with the period 2019 - 2023. Of 32 SOEs, 14 do not have a 5-year observation period because the period of the year that experienced losses was not included in the research observations. The sample determination method can be seen in Table 1.

Table 1 Sampling Quantity

Purposive Sampling Criteria	Total
Non-financial state-owned companies with the 5 years (2019 to 2023)	235
Companies that do not have a Sustainability Report during the observation period	(70)
Companies that reported losses in their 2019-2023 income statements	(38)
	127

The results of testing the selection of multiple linear regression models using the Chow Test, Hausman Test, and Lagrange Multiplier can conclude that this study's most appropriate regression method is the Common Effect regression model. The results of testing the selection of linear regression models can be seen in Table 2.

Table 2 Conclusion of Unbalance Panel Data Model Selection Test

No	Method	Regression	Results
1	Chow Test	Common Effect vs. Fixed Effect	Fixed Effect (0,0105 < 0,05)
2	Hausman Test	Fixed Effect vs Random Effect	Random Effect (0,6378 > 0,05)
3	Lagrange Multiplier	Random Effect vs Common Effect	Common Effect (0,1076 > 0,05)

The classic assumption test in this study uses heteroscedasticity and multicollinearity, where the test results show that all tests meet the requirements. Table 3 shows the F statistic value of 2.8725, with a significance of 0.0031, which indicates that this research model can be used to explain tax avoidance. Meanwhile, the R-squared value shows 0.1985, which means that the variables in the regression model can explain 19.85% of the variability in tax avoidance. Table 3 below presents the multiple regression results and hypothesis testing.

Table 3 Conclusion of Unbalance Panel Data Model Selection Test

Variable	Sign	Coeff.	t-Stat.	Prob.		Conclusion
C		-0,1256	-0,4802	0,3160		
IOS	(-)	0,9328	0,6541	0,2572		Rejected
BBSTRA	(+)	0,2804	2,4766	0,0074	**	Accepted
Polcon	(+)	0,0717	0,6549	0,2569		Rejected
ESG	(+)	0,3178	0,8053	0,2112		Rejected
IOS_ESG	(+)	-1,2979	-0,3817	0,3517		Rejected
BBSTRA_ESG	(-)	-0,3124	-1,3740	0,0861	**	Accepted
Polcon_ESG	(-)	-0,1083	-0,4300	0,3340		Rejected
ROA	(+)	0,0032	1,2508	0,1068		
LEV	(+)	0,2643	2,6758	0,0043	**	
SIZE	(+)	-0,0292	-2,1965	0,0150	**	
R-squared			0,1985			
Adjusted R-squared			0,1294			
F-statistic			2,8725			
Prob(F-statistic)			0,0031			

Based on Table 3, the IOS coefficient value is 0.9328 with a p-value greater than the significance level (0.2572> 0.1), thus indicating that hypothesis 1 is rejected, which means that IOS does not affect tax avoidance. It illustrates that high IOS tends to choose investments that produce maximum returns with minimal risk, which avoids regulatory risk that can interfere with their investment opportunities. This result is not in line with McGuire et al. (2014) and Firmansyah & Bayuaji (2019) but in line with the findings of Nisa' & Kurnia (2023), which show that companies that have higher investment opportunities tend not to pay attention to tax avoidance practices. The IOS described in this study only describes investment opportunities against the book value of its assets, where companies invest in fixed assets for future growth. Companies focusing more on asset growth and development will be less motivated to avoid taxes (Smith & Watts, 1992). In addition, this study uses SOEs, where SOEs tend to have a strong public mandate and higher transparency in their tax practices. SOEs are government-owned companies, where the government as a shareholder wants tax revenue and dividends to increase national economic growth. It allows SOEs not to engage in tax avoidance even though there are many investment options. It illustrates no agency conflict because the manager (agent) carries out the duties under the principal's interests, namely the government, to provide maximum taxes and dividends. Also, the public nature of SOEs requires adherence to strict governance frameworks, further minimizing the likelihood of aggressive tax planning. Since SOEs often receive government oversight and public scrutiny, engaging in tax avoidance could damage their credibility and legitimacy, leading to potential regulatory intervention. As a result, rather than prioritizing tax-saving strategies, SOEs are more inclined to align their financial policies with national economic objectives, ensuring compliance with tax regulations while maintaining their role as key contributors to state revenue.

The coefficient value of the prospector business strategy is 0.2804 with a p-value smaller than the significance level (0.0074 <0.1), thus indicating that hypothesis 2 is accepted, which means that the prospector business strategy has a positive effect on tax avoidance. Companies that implement certain business strategies, especially those that focus on developing innovation (prospector strategy), tend to practice tax avoidance to minimize the tax burden paid. In this study, there is sufficient evidence that prospector business strategies tend to increase tax avoidance practices in response to a dynamic business environment and the need for flexibility for innovation and growth. This result is in line with the findings of Zhang et al. (2022), Ulfa et al. (2024), and Hanif et al. (2023), which show that the prospector business strategy has a positive effect on tax avoidance. When SOEs prefer a prospector business strategy to increase competitiveness and achieve broader strategic goals, SOEs need high costs for innovation and growth, so managers tend to reduce costs outside of operations by avoiding taxes. The choice of this strategy allows for increased shareholder value. It is a form of opportunistic manager as an agent to increase profits by doing tax avoidance. Therefore, companies often try their best to maximize wealth by using several tax avoidance practices to distribute dividends as they should, and management benefits from tax savings (Martinez & Ferreira, 2019). Companies that implement a prospector strategy have high flexibility in production and distribution technology (Girindratama & Rudiawarni, 2022). It can affect the tax burden that the company will pay because a high tax burden will affect the company's production and distribution less than optimal, so the company practices tax avoidance (Ulfa et al., 2024). As a result, companies may prefer to practice tax avoidance. Additionally, SOEs that adopt a prospector strategy often operate in industries where rapid innovation and market expansion are crucial for sustaining competitive advantage. It necessitates significant financial resources, leading firms to explore tax-saving mechanisms to allocate more funds toward R&D and business development. However, while tax avoidance may provide short-term financial relief, excessive reliance on aggressive tax strategies could expose companies to reputational and regulatory risks, potentially undermining their long-term sustainability.

The coefficient value of political connection is 0.0717 with a p-value greater than the significance level (0.2569 > 0.1), thus indicating that hypothesis 3 is rejected, which means that political connections do not affect tax avoidance. Although companies with political connections may have protection from the government that can affect the risk of tax audits, there is not enough evidence that political connections significantly increase tax avoidance practices in state-owned companies in Indonesia. This result is not in line with Ajili & Khlif (2020), Firmansyah et al. (2022) but in line with the findings of Darmayanti & Merkusiawati (2019) and Solikin & Slamet (2022), which show that political connections do not affect tax avoidance. SOEs are the company identical to their political connections, where the SOEs' directors or commissioners are government people or people appointed by the government. The unrelated relationship between political connections and tax avoidance in companies is because, based on the data obtained, those who have the most political connections are commissioners, where commissioners do not play a direct role in taking tax strategies in the form of tax avoidance but play a role in supervising the company's strategy to comply with government regulations and interests. Effective supervision can reduce management opportunistic behavior and agency problems. The existence of more organized supervision allows managers to follow good corporate management standards and avoid management self-interest (Solikin & Slamet, 2022). Furthermore, the regulatory framework governing SOEs in Indonesia enforces a high level of accountability, which may limit the extent to which political connections influence corporate tax strategies. Since these companies operate under heightened public scrutiny, aggressive tax avoidance could invite reputational risks and government intervention. It suggests that SOEs prioritize regulatory compliance and long-term stability rather than exploiting political ties for tax benefits, reinforcing their role as key contributors to national fiscal policy and economic development.

The coefficient value of IOS moderated by ESG disclosure shows a value of -1.2979 with a p-value greater than the significance level (0.3517 > 0.1), thus indicating that hypothesis 4 is rejected, which means that ESG disclosure does not strengthen the negative effect of IOS on tax avoidance. It is thought to be due to a lack of pressure from stakeholders or low manager awareness of the importance of ESG disclosure as a form of responsibility to stakeholders. Although IOS can influence corporate financial decisions, and ESG disclosure can increase corporate transparency, the influence of IOS on tax avoidance is more dominant and not significantly influenced by ESG disclosure. SOEs often have complex structures and interests, where taxation-related decisions may be more influenced by internal factors such as government policies and managerial strategies that may not be fully affected by ESG disclosure. Therefore, ESG or CSR disclosure is only a tool for SOEs to demonstrate social responsibility and support government policies in achieving sustainable development goals. Information about CSR disclosed in corporate sustainability reports is not always correct and cannot be used to guarantee that socially responsible companies will not avoid tax avoidance (Makhfudloh et al., 2018). Therefore, when SOEs have a high IOS and disclose ESG, the company tends to invest in a way that produces maximum returns with minimal risk to meet government targets and development programs as a responsibility to stakeholders. ESG disclosure in SOEs is often viewed as a compliance-driven requirement rather than a strategic initiative influencing financial decision-making, including tax planning. Since SOEs operate under direct government oversight, their tax policies are primarily shaped by fiscal regulations and national economic objectives rather than voluntary ESG commitments, making ESG disclosure less effective in moderating the relationship between IOS and tax avoidance.

The coefficient value of prospector business strategy moderated by ESG disclosure shows a value of -0.3124 with a p-value smaller than the significance level (0.0861 <0.1), thus indicating hypothesis 5 is accepted, which means that ESG disclosure weakens the positive effect of prospector business strategy on tax avoidance. It shows that when the company conducts a prospector business strategy and discloses ESG disclosure, ESG disclosure will weaken the effect of the prospector business strategy on tax avoidance. Companies with high levels of ESG disclosure tend to reduce tax avoidance practices because they will be more transparent about their tax practices by reducing the possibility of aggressive tax avoidance (Yoon et al., 2021). ESG disclosure can weaken business strategies toward tax avoidance by increasing stakeholder transparency and pressure. Companies prioritizing ESG disclosure tend to comply more with their tax obligations to maintain their reputation and legitimacy in the public eye. Aggressive tax avoidance can damage that reputation, so firms are more cautious about tax avoidance practices (Hanlon & Slemrod, 2009). SOEs pursuing a prospector business strategy for growth opportunities may be more balanced with the need to maintain transparency and accountability in ESG disclosure. SOEs that are more open to environmental, social, and governance issues may tend to be more cautious in their tax practices, given the pressure from the public and regulators to adhere to high standards in corporate governance. SOEs that choose a prospector business strategy also tend to pursue a sustainability strategy by undertaking ESG disclosure and not tax avoidance, as ESG disclosure and tax compliance are a form of responsibility to stakeholders. SOEs operating in highly regulated industries are subject to stricter scrutiny from regulators and policymakers, making ESG disclosure a crucial element in mitigating excessive risk-taking behaviors, including tax avoidance. By aligning their business strategy with ESG principles, SOEs not only enhance their corporate image but also ensure long-term financial stability by fostering trust among investors, government institutions, and the public.

The coefficient value of political connection moderated by ESG disclosure shows a value of -0.1083 with a p-value greater than the significance level (0.3340 > 0.1), thus indicating hypothesis 6 is rejected, which means that ESG disclosure does not weaken the positive effect of political connections on tax avoidance. This shows that companies with political connections may still practice tax avoidance regardless of the level of corporate ESG disclosure. ESG disclosure factors, although important in the context of corporate governance, do not significantly affect tax practices in firms (Abdelmoula et al., 2022). The results reflect that SOEs with strong political influence may remain dominant in taxation decisions despite efforts to improve transparency and accountability through ESG disclosure. In this case, SOEs often operate in a political environment where political interests can influence corporate policies, including taxation practices. Therefore, more effective implementation of ESG disclosures and pressure from stakeholders and regulators may be needed to reduce the negative influence of political connections on tax practices in SOEs. Companies with strong political connections are often less responsive to external pressures to improve transparency and accountability, including ESG disclosure (Chaney et al., 2011). In addition, the unrelatedness of ESG disclosure weakens the positive effect of political connections on tax avoidance because ESG information has no standardization, even though ESG disclosure can help companies adjust to environmental changes and can even be incorporated into the company's competitive strategy (Giannopoulos et al., 2022). Political ties in SOEs may create a perception of regulatory immunity, reducing the effectiveness of ESG disclosure as a tool for curbing tax avoidance behaviors. Without strict enforcement and standardized ESG reporting frameworks, politically connected firms may leverage their influence to maintain favorable tax positions while complying with superficial disclosure requirements.

Conclusion

The findings of this study indicate that a prospector business strategy significantly increases tax avoidance, while ESG disclosure serves as a mitigating factor, reducing the extent of this practice. In contrast, the investment opportunity set and political connections do not significantly impact tax avoidance. Furthermore, ESG disclosure, as a moderating variable, does not enhance the negative effect of the investment opportunity set on tax avoidance nor diminish the positive influence of political connections on such practices.

These results underscore the crucial role of ESG disclosure in fostering more responsible tax planning, particularly for companies adopting an aggressive business strategy. Within the context of state-owned enterprises (SOEs), pursuing innovation and market expansion often leads to greater incentives for tax avoidance. However, transparency through ESG reporting appears to act as a counterbalance, reinforcing ethical corporate behavior. It highlights the function of ESG disclosure not merely as a compliance mechanism and as a strategic tool that aligns corporate tax practices with broader sustainability and governance objectives.

Nevertheless, this study faces several limitations, particularly concerning data availability for non-listed SOEs, as many do not publicly disclose their financial and sustainability reports. Consequently, the sample of non-listed SOEs was limited to only 12 companies, posing constraints on generalizability. Another challenge lies in measuring political connections. Using a logarithmic transformation of the total number of politically connected directors and commissioners did not yield a significant association with tax avoidance, likely due to the method's inability to accurately differentiate the varying degrees of political influence across firms.

Future research could benefit from broadening the dataset by incorporating a more extensive sample of SOEs, particularly those that do not disclose sustainability reports. Collaboration with regulatory authorities or direct engagement with SOEs could provide deeper insights into corporate tax behavior. Furthermore, refining the measurement of political connections may yield more precise results. A ratio-based approach, such as calculating the proportion of politically connected directors or commissioners relative to the total board members, could provide a more nuanced assessment of political influence and its role in shaping corporate tax strategies.

From a policy perspective, these findings carry significant implications for regulatory bodies and policymakers. The Indonesian Financial Services Authority (OJK) may consider reinforcing ESG disclosure regulations by ensuring that corporate tax strategies are explicitly integrated into sustainability reporting. Standardized ESG reporting across both listed and non-listed SOEs could enhance oversight and promote more ethical tax practices. Additionally, embedding ESG considerations into corporate governance assessments could strengthen accountability and encourage greater tax transparency.

Furthermore, the Ministry of SOEs must adopt a more strategic approach to ensure that state-owned companies engage in responsible tax planning while balancing their financial and operational goals. Since prospector business strategies are associated with higher tax avoidance, policymakers should encourage a framework that supports business expansion without compromising tax compliance. Strengthening monitoring mechanisms related to business strategies and tax practices within SOEs would align these companies with national fiscal interests, ensuring they contribute optimally to state revenues.

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Conflicts of Interest

The authors declare no conflict of interest. The funders had no role in the design of the study, in the collection, analyses, or interpretation of data, in the writing of the manuscript, or in the decision to publish the results.