Proceedings of CONF-BPS 2026 Symposium: GenAI, Labour Markets, and the Economics of Human and Financial Capital
DOI: 10.54254/2754-1169/2026.LD31021

Social Trust, ESG Disclosure and Corporate Leverage Manipulation

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Abstract. This study examines how social trust affects corporate leverage manipulation and how ESG disclosure shapes this relationship. Using data on Chinese A-share listed firms from 2006 to 2023, the results show that higher social trust is linked to more manipulation. This suggests that strong trust in the local environment may weaken outside oversight and create room for opportunistic financial behavior. The study also shows that ESG disclosure reduces this risk. When firms provide clearer information, investors and other stakeholders can monitor them more effectively, which limits the influence of trust-based leniency. After addressing endogeneity and testing alternative measures, the results remain stable. Overall, the findings reveal the double-sided nature of informal institutions and show that ESG disclosure can serve as an important tool for restraining opportunistic actions.

Keywords: social trust, ESG disclosure, leverage manipulation.

1. Introduction

In recent years, China's macro leverage ratio has grown at a high pace. To control the risks caused by heavy debt, the country has moved into a stage of enforced deleveraging. Under these policies, and in order to ease the pressure linked to high leverage, some firms have turned to leverage manipulation through off-balance-sheet debt and other accounting practices [1-3]. Leverage manipulation refers to the use of such methods to hide a firm's real leverage risk [4]. These actions may reduce short-term financing pressure, but they also mask the firm's real financial problems [5]. This lack of transparency increases the likelihood of corporate collapse [6], thereby harming investor interests and threatening the stability of the financial system [7]. Leverage manipulation poses significant risks, but the current literature does not provide a comprehensive understanding of it. Research from the perspective of the general public is a gap.

The establishment and spread of social trust are closely related to the normal operation of the economy [8]. The interaction between the public and enterprises is closely related to social trust. Trust affects individuals' willingness to participate in stock markets [9], promotes international trade [10] and enables firms to expand their markets within target customer groups [11]. Many studies have examined how social trust relates to economic outcomes, but its influence on corporate leverage manipulation is still unclear. At the same time, Environmental, Social, and Governance (ESG) disclosure has become an important part of corporate governance. ESG practices can bring indirect benefits, such as a better reputation, more loyal customers, and stronger ability to attract

DOI: 10.54254/2754-1169/2026.LD31021

skilled employees, which help create long-term value [12,13]. Clear ESG disclosure also gives the market more information, limits opportunistic behavior from managers, and may change how social trust affects leverage manipulation.

Using panel data from Chinese A-share listed firms between 2006 and 2023, this study examines whether social trust influences leverage manipulation and whether ESG disclosure moderates that effect. The paper makes three main contributions: (1) It expands the literature on informal institutions by showing that social trust may unintentionally drive leverage manipulation. (2) It highlights the governance value of ESG disclosure, demonstrating that transparent ESG reporting reduces opportunistic financial behavior linked to high trust. (3) It brings informal cultural factors and formal governance tools together, offering a coherent framework to explain how trust and ESG shape firms' financial decisions in emerging markets.

2. Literature review and research hypotheses

Leverage manipulation distorts firms' true financial conditions and can trigger serious consequences [7]. Poor leverage disclosure increases information asymmetry and threatens operational stability [14]. Unlike genuine deleveraging, manipulation does not improve long-term solvency; its short-term effects fail to reflect future returns and instead damage reporting quality, elevate default risk, and impair managerial judgment, ultimately hindering high-quality development [4,15]. Misleading information can also complicate government macroeconomic forecasting and decision-making, reducing the effectiveness of policies [16,17].

Recent studies have explored the factors influencing leverage manipulation. Local government debt expansion can crowd out financing resources, intensifying competition and prompting firms to manipulate leverage for financing advantages [18]. Firm leverage [4], insufficient institutional investor monitoring [19], and climate risk [5] further aggravate manipulation. By contrast, corporate digitalization helps curb manipulation by easing financial constraints and enhancing transparency [7]. Corporate financialization [1], state capital injections [2], market integration [20], and financial technology application [17] may also suppress manipulation. However, most research emphasizes internal characteristics or macro policies, with limited attention to informal institutional environments.

Within such environments, social trust is a core cultural factor [21] and part of the informal institutional framework [22]. Yet high trust may also induce negative governance outcomes. When major shareholders fail to effectively monitor, stakeholders may rely excessively on trust-based interactions, leading to regulatory relaxation and opportunistic corporate behavior [23]. Evidence shows that social trust can increase greenwashing [24], raise risk-taking in insurance firms [25], and heighten risk-taking for individuals and companies [26].

Based on this evidence, high social trust may weaken firms' self-discipline and foster leverage manipulation. Thus, I propose the following hypothesis:

H1: Social trust increases corporate leverage manipulation.

Over the past decades, shareholders and stakeholders have increasingly called for firms to incorporate corporate social responsibility into their business practices and to pursue sustainable development strategies. As interest in sustainable investing continues to grow, both professional and non-professional investors have shown rising demand for various types of governance- and CSR-related information [27,28]. One important reason is that high-quality information disclosure helps investors integrate sustainability into decision-making and alleviate information asymmetry [29], which in turn benefits the broad stakeholder community [30].

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Correspondingly, firms seeking improved access to financing increasingly rely on ESG disclosure as a tool to meet investors' information needs [31], and such transparency can also suppress financial misconduct [32]. Based on this logic, I propose the second hypothesis:

H2: ESG disclosure moderates the positive relationship between social trust and corporate leverage manipulation.

3. Research design

3.1. Sample and data

This study uses A-share listed companies in China from 2006 to 2023 as the research sample. The social trust data come from the China Entrepreneur Survey System, and the ESG disclosure data come from Bloomberg. All other variables are taken from the CSMAR database. Following common practice, I remove ST and *ST firms, financial firms, and observations with missing values. The final sample includes 11,114 firm-year observations.

3.2. Variables and empirical model

3.2.1. Dependent variable: corporate leverage manipulation

Based on previous studies [4,33], this study uses the extended XLT-LEVM method (indirect approach). The calculation formula is shown in equation (1):

$$LevM_{i,t} = \frac{Debt\_Total_{i,t}+Debt\_OB_{i,t}+Debt\_NSRD_{i,t}}{Asset\_Total_{i,t}+Debt\_OB_{i,t}-DA_{i,t}} - LevB_{i,t} \quad (1)$$

In equation (1), $LevM_{i,t}$ represents the level of corporate leverage manipulation. $Asset\_Total_{i,t}$ refers to total on-balance-sheet assets; $Debt\_Total_{i,t}$ is the total on-balance-sheet liabilities; $Debt\_OB_{i,t}$ represents off-balance-sheet liabilities; $Debt\_NSRD_{i,t}$ captures abnormal debt; $DA_{i,t}$ is the estimated value of discretionary accruals, and $LevB_{i,t}$ denotes the book leverage ratio.

3.2.2. Independent variable: social trust

Data on social trust comes from a survey commissioned by Zhang and Ke [34] from the China Entrepreneurs Survey System. The survey asked managers to rank the five regions they considered most trustworthy, and then calculated the trust index for each province by counting the number of times a region was considered the most trustworthy, the number of times it was ranked, and the percentage of all respondents.

3.2.3. Moderator variable: ESG disclosure

I obtain ESG disclosure data from Bloomberg. Bloomberg rates ESG disclosures on a scale of 0 to 100. This rating reflects the quantity of data disclosed by a company across the three pillars of ESG, but does not judge the quality of the disclosure [30].

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3.2.4. Control variables

Following previous researches [35-36], I control firm characteristics, including firm size (Size), debt-to-asset ratio (Lev), return on assets (Roa), asset turnover ratio (Ato), cash flow ratio (Cash), fixed asset ratio(Fixed), Tobin's Q (TobinQ) and firm age (Age) in the model.

3.2.5. Empirical model

$$LevM_{i,t} = \alpha_0 + \alpha_1 Trust_{i,t} + \alpha_2 X_{i,t} + Year + Industry + \varepsilon_{i,t} \quad (2)$$

$$LevM_{i,t} = \beta_0 + \beta_1 Trust_{i,t} + \beta_2 ESG_{i,t} + \beta_3 (Trust_{i,t} \times ESG_{i,t}) + \beta_4 X_{i,t} + Year + Industry + \varepsilon_{i,t} \quad (3)$$

In equation (2) and (3) , $LevM_{i,t}$ denotes the leverage manipulation of firm i in year t, $Trust_{i,t}$ is the level of social trust in the region where the firm is located. $ESG_{i,t}$ shows the ESG disclosure level of the firm. The interaction term $Trust_{i,t} \times ESG_{i,t}$ is used to capture how ESG disclosure changes the effect of social trust on leverage manipulation. $X_{i,t}$ is the set of control variables, $Year$ and $Industry$ represent year and industry fixed effects. $\varepsilon_{i,t}$ is the error term.

3.3. Descriptive statistics

Table 1. Descriptive statistics

Variables	N	Mean	SD	Min	Max	P25	P50	P75
LevM	11,114	0.117	0.119	-0.0566	0.533	0.0181	0.0882	0.191
ESG	11,114	30.13	10.33	6.198	78.41	22.94	28.76	34.71
Trust	11,114	0.895	0.694	0.0410	2.189	0.159	0.962	1.187
Size	11,114	23.28	1.291	19.43	26.45	22.36	23.19	24.10
Lev	11,114	0.493	0.191	0.0298	0.927	0.350	0.504	0.638
Roa	11,114	0.0460	0.0609	-0.375	0.255	0.0161	0.0398	0.0745
Ato	11,114	0.686	0.470	0.0537	3.106	0.365	0.577	0.866
Cash	11,114	0.0579	0.0675	-0.226	0.279	0.0177	0.0553	0.0967
Fixed	11,114	0.226	0.171	0.0121	0.601	0.0847	0.185	0.334
TobinQ	11,114	1.900	1.330	0.789	16.65	1.104	1.455	2.136
Age	11,114	2.932	0.358	1.099	3.638	2.708	2.996	3.178

Table 1 presents the descriptive statistics for the main variables. The mean of LevM is 0.117 with a standard deviation of 0.119, showing a moderate level and clear variation across firms. The average ESG disclosure score is 30.13, with values ranging from 6.20 to 78.41, which shows wide differences in disclosure practices. The mean of Trust is 0.895 with a standard deviation of 0.694, pointing to strong regional variation in social trust. The patterns of the other variables are in line with findings in previous studies.

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4. Empirical results

4.1. Baseline regression

Table 2 presents the baseline regression results. Column (1) includes only Trust and the year and industry fixed effects. Column (2) adds the control variables. The coefficients on social trust are 0.0047 in Column (1) and 0.0050 in Column (2). Both are significant at the 1% level, showing that higher social trust is linked to more leverage manipulation. This supports H1.

Column (3) adds ESG disclosure and the interaction term between trust and ESG (Trust#ESG). The interaction term is negative and significant (–0.0003, $p<0.01$), which indicates a clear moderating effect. Figure 1 shows that ESG disclosure reduces the positive link between social trust and leverage manipulation, supporting H2.

Table 2. Baseline regression and moderating effect analysis

	(1)	(2)	(3)
	LevM	LevM	LevM
Trust	0.0047***	0.0050***	0.0153***
	(2.7495)	(3.9203)	(4.0903)
ESG			0.0006***
			(3.3589)
Trust#ESG			-0.0003***
			(-3.1258)
Size		-0.0112***	-0.0118***
		(-12.3424)	(-11.9195)
Roa		0.2398***	0.2374***
		(11.2979)	(11.1795)
Lev		-0.0351***	-0.0338***
		(-4.7418)	(-4.5689)
Cash		-0.2795***	-0.2809***
		(-15.8236)	(-15.9051)
Age		0.0193***	0.0190***
		(6.9018)	(6.7993)
Fixed		0.0997***	0.0992***
		(14.8374)	(14.7982)
Ato		0.1927***	0.1923***
		(72.6956)	(72.3350)
TobinQ		-0.0043***	-0.0043***
		(-4.7628)	(-4.7550)
_cons	0.0787***	0.1433***	0.1440***
	(4.7703)	(6.3528)	(6.1071)
Year FE	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
N	11114	11114	11114
r2	0.0155	0.4531	0.4536

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

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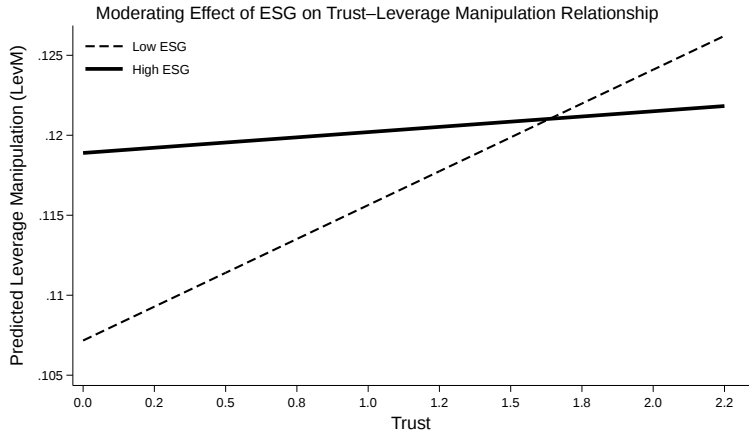

Figure 1. Moderating effect

4.2. Heterogeneity analysis

4.2.1. Pollution attributes

Heavily polluting firms are typically major carbon emitters and are more directly affected by ESG-related policies and environmental regulations, which may constrain their flexibility and capacity to manipulate leverage. Following previous study [37], firms are classified into heavily and non-heavily polluting groups.

4.2.2. Industry attributes

To test whether the effect of social trust on leverage manipulation differs across firms, I group the sample by industry features [38], The firms are classified into technology-intensive, asset-intensive, and labor-intensive groups based on their main production factors.

Table 3. Heterogeneity analysis

	(1) Low-polluting	(2) Heavy- polluting	(3) Technology-intensive	(4) Asset-intensive	(5) Labor-intensive
	LevM	LevM	LevM	LevM	LevM
Trust	0.0053***	0.0056	-0.0015	0.0021	0.0127***
	(3.8356)	(1.3473)	(-0.8290)	(0.7604)	(5.6636)
Size	-0.0104***	-0.0149***	-0.0098***	-0.0100***	-0.0134***
	(-10.7283)	(-5.7859)	(-7.2668)	(-5.6541)	(-8.2602)
Roa	0.2643***	0.1499**	0.1850***	0.1130**	0.3041***
	(11.6640)	(2.2959)	(5.5381)	(2.1551)	(9.0510)
Lev	-0.0264***	-0.0874***	-0.0128	-0.0622***	-0.0344**
	(-3.3874)	(-3.8772)	(-1.1519)	(-4.4195)	(-2.5046)
Cash	-0.2816***	-0.2336***	-0.2687***	-0.1392***	-0.3564***
	(-14.7352)	(-4.9654)	(-10.0863)	(-3.0967)	(-13.5987)
Age	0.0208***	-0.0057	0.0150***	0.0218***	0.0059
	(7.0912)	(-0.6095)	(3.8052)	(3.5965)	(1.1293)
Ato	0.1888***	0.1905***	0.2201***	0.2298***	0.1624***
	(62.5874)	(30.9098)	(41.7307)	(35.3864)	(45.9751)

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Table 3. (continued)

TobinQ	-0.0043***	-0.0026	-0.0025**	-0.0060**	-0.0019
	(-4.6344)	(-0.7664)	(-2.1080)	(-2.3268)	(-1.1744)
Fixed	0.0947***	0.0866***	0.0999***	0.0529***	0.1149***
	(12.7142)	(4.5322)	(7.5664)	(3.9233)	(9.1535)
_cons	0.1182***	0.3254***	0.0613**	0.0789*	0.2422***
	(4.8678)	(5.6366)	(1.9761)	(1.7524)	(5.9760)
Year FE	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
N	9451	1663	4269	2408	4347
r2	0.4302	0.5709	0.4840	0.5073	0.4319

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 3 shows that social trust significantly promotes leverage manipulation in non-heavily polluting firms (coef.=0.0053, p<0.01) and labor-intensive firms (coef.=0.0127, p<0.01). For pollution attributes, the results suggest that strict ESG regulation constrain firms' flexibility in leverage adjustment. For industry attributes, technology-intensive firms rely on innovation reputation and asset-intensive firms on tangible collateral, both of which limit room for opportunistic manipulation. In contrast, labor-intensive firms face tighter financing constraints, making them more dependent on relational financing and trust networks, thereby increasing their incentives to engage in leverage manipulation.

4.3. Robustness tests

4.3.1. Instrumental Variable (IV) method

To reduce concerns about endogeneity between social trust and leverage manipulation, I use an instrumental variable approach. The instrument is the average years of education per capita (Edu) [39]. Education reflects the cultural environment of a region and shapes social trust, yet it does not directly affect a firm's financial decisions [40-41]. The first-stage regression shows a clear and positive link between education and trust (coef.=0.4507, p<0.01). In the second stage, social trust still has a strong positive effect on leverage manipulation (coef.=0.0064, p<0.01). The Kleibergen–Paap LM statistic (3851.02, p<0.01) and the Cragg–Donald F-statistic (14652.92 > 16.38) indicate that the instrument is both valid and strong.

4.3.2. An alternative measure of social trust

I employ China Urban Commercial Credit Environment Index (Trust2) as an alternative proxy for social trust. This index evaluates the level of credit transaction risk and the potential for credit-based economic development from a city-level perspective. I exclude firms located in cities with missing data. As shown in Table 4 Column (3), the result remains positive and statistically significant.

4.3.3. An alternative measure of corporate leverage manipulation

Replacing the extended XLT-LEVM method (indirect approach) with the direct approach (LevM2) [4]. After changing the measurement method, as shown in Table 4 Column (4), the regression results remain consistent with the previous ones.

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4.3.4. Adding province and firm fixed effects

After adding province and firm fixed effects into the model, the regression conclusions remain consistent with the previous analysis, as shown in Tables 4 Column (5).

Table 4. Robustness tests

	(1) 2SLS Stage 1	(2) 2SLS Stage 2	(3)	(4)	(5)
	Trust	LevM	LevM	LevM2	LevM
Trust		0.0064***		0.0050***	0.0781**
		(3.6235)		(3.8581)	(2.3976)
Trust2			0.0005***		
			(2.9065)		
Edu	0.4507***				
	(134.0639)				
Size	0.0102**	-0.0113***	-0.0110***	-0.0122***	-0.0096***
	(2.2728)	(-12.4346)	(-11.6255)	(-13.2737)	(-3.7414)
Roa	0.1186	0.2406***	0.2277***	-0.2041***	0.3211***
	(1.2903)	(11.3565)	(10.3658)	(-8.2980)	(13.9788)
Lev	-0.2141***	-0.0342***	-0.0300***	-0.0224***	-0.0814***
	(-6.7418)	(-4.6101)	(-3.9552)	(-2.9606)	(-7.3102)
Cash	0.2853***	-0.2797***	-0.2636***	0.1737***	-0.2839***
	(3.7684)	(-15.8792)	(-14.2557)	(9.7152)	(-16.1508)
Age	0.0499***	0.0194***	0.0180***	0.0170***	0.0434***
	(3.4257)	(6.9468)	(6.1131)	(6.0501)	(3.8632)
Fixed	-0.2704***	0.1003***	0.0976***	0.0610***	0.1503***
	(-8.0510)	(14.9547)	(14.1891)	(8.9758)	(10.9117)
Ato	0.0470***	0.1926***	0.1956***	0.1914***	0.1704***
	(4.3036)	(72.9049)	(70.1212)	(71.6356)	(37.7070)
TobinQ	-0.0024	-0.0043***	-0.0043***	-0.0024***	-0.0011
	(-0.6068)	(-4.7999)	(-4.6760)	(-2.6932)	(-1.1183)
_cons	-3.6259***	0.1450***	0.1107***	0.1584***	-0.0143
	(-31.9402)	(6.4314)	(4.4778)	(6.9966)	(-0.1878)
Year FE	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Province FE	No	No	No	No	Yes
Firm FE	No	No	No	No	Yes
N	11114	11114	10327	11114	11114
r2	0.6161	0.4530	0.4558	0.4445	0.6637

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

5. Conclusion

This study finds that social trust significantly increases corporate leverage manipulation, indicating that trust may weaken external monitoring and create space for opportunistic financial behavior. However, high-quality ESG disclosure mitigates this positive effect by enhancing transparency and

DOI: 10.54254/2754-1169/2026.LD31021

stakeholder oversight, and the result remains robust across multiple tests. Overall, the study highlights the dual nature of social trust and emphasizes the importance of strengthening ESG disclosure and regulatory supervision to curb leverage manipulation.

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