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Financial Performance in Indonesian Companies: The Role of Environmental Performance and Environmental Disclosure

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Abstract: This study takes the aim to acquire empirical evidence which financial performance has been exerted influence by the environmental performance and environmental disclosure. The key differentiation between this study and the earlier ones is the utilization of different variables and measurement methods. The theories of stakeholder and legitimation become the basis to formulate the hypothesis. To collect data, the purposive sampling method was used. The data came from manufacturing companies listed in the Indonesian Stock Exchange and the PROPER 2016-2018 program. Instruments for classic assumptions have been tested. Afterwards, multiple linear regression is used as the method analysis along with the secondary data types with the use of documentation methods. The finding of this study presents that environmental performance and environmental disclosure deliver an essential positive influence towards financial performance.

Keywords: *Financial performance, environmental performance, environmental disclosure.*

1. Introduction

Financial performance is expressed in the perennial financial report of a company. A good financial performance provides an intelligible description of the successes of a company. However, the current economic market does not only demand the conception of financial performance that solely focuses on generating large profits for the company, but also accompanied with an ethical attitude towards financial performance. There is a rise of awareness on sustainable business development as a method to increase long-term financial performance (Gatimbu & Wabwire, 2016). The demand for ethical financial performance has an implication towards the manifestation of industrial activities as a harmonic interaction between shareholders or the business actors themselves. The Ministry of Industry states that the growth of industries in Indonesia in the third quarter of 2017 had reached 5.51%. Although the industrial sector had increased the income of Indonesian citizens, it in turn also left a huge environmental impact. Financial ratio analysis becomes a standard method used to measure the performance of a company financially.

This correlates with the statement made by the World Health Organization (2016) mentioning global health observations have brought up as much as 23% of all considered global deaths are linked to the environment. Furthermore, Stern (2006) states that Indonesia is the third largest contributor for carbon footprint, just behind USA and China. The continuously deteriorating issues of the environment in Indonesia has drawn the attention of the government, citizens, and related industries. Commission VII DPR RI (2011) has stated that the mining industry had become one of the industries often solicited as the main source of environmental damage. Wong (2017) also states that one of the largest contributors to greenhouse gas emission is the paper industry. Environmental performance due to production processes had caused a large shift in manufacturing technology to comprehend environmental concern and environmental awareness as reported by Basuki, (2015). Wisuttisak and Wisuttisak (2016) point out that businesses rely on both natural and human resources, and therefore it is assumed responsibility for their operational consequences and contribute to the local community they control.

The involvement of the government in preserving the environment can be observed from the issuance of regulations such as PP No. 47, 2012 regarding corporate social and environmental responsibility. Companies performing business operations in sectors related to natural resources are required to conduct responsibilities towards social and environmental aspects. Moreover, the BUMN Ministerial Regulation No. PER-05/MBU/2007 regarding partnership programs of state-owned enterprises and small businesses also include natural conservation assistance. Furthermore, the government also offers appreciation towards companies who have environmental awareness and are environmentally friendly. In 2002, the Ministry of Environment had launched a performance rating assessment program for companies regarding environmental management (PROPER) that aims to encourage the increase of company performance in environmental management by disseminating information regarding companies' performance in environmental management.

Companies that fulfill the criteria will be awarded with a Green rating. Organizational activities towards the natural environment is then reported as environmental disclosure. These activities mentioned by Gatimbu and Wabwire (2016) include: carbon and waste management, recycling, emission, pollution, both wetland and wildlife conservation. However, this is not in accordance with a conducted study mentioning environmental performance presents an effect on financial performance (Rockness et al., 1986; Jaggi & Freedman, 1992). Not only environmental performance but also environmental disclosure have influenced the financial performance (Gatimbu & Wabwire, 2016; Nor et al., 2016; Li et al., 2017; Haninun et al., 2018). However, this also contrasts with a study by Rahman et al. (2010) stating that no significant influence towards financial performance is interfered by environmental disclosure. This study pays attention to industrial companies because of their having the highest environmental risk in Indonesia and their having a first-hand impression towards the natural environment. However, although there has been a rise in global and local public environmental awareness in Indonesia with regards to companies' reputations, a contrast relationship between a company's environmental performance and financial performance exist. Considering that matter, analyzing the relationship between environmental performance and environmental disclosure towards the financial performance of companies is the objective of this study.

2. Literature Review

Theory: The stakeholder theory and the legitimation theory are chosen as the two main theories in this study. The stakeholder theory is a theory explaining the connection between stakeholders and received information (Hill & Jones, 1992). The stakeholder theory is a theory regarding management, attitude recommendation, structure and practices, which, the implementation will form a stakeholder management philosophy (Donaldson & Preston, 1995). Meanwhile, Gray (2005) argues that the stakeholder theory assumes that a company requires support from stakeholders to maintain its existence. This theory is considered as one of the implemented strategies applied by companies in order to maintain their relationship with relevant stakeholders by disclosing sustainability reports that encompasses economic, social, and environmental performances. This theory is beneficial in analyzing organizational behavior.

Besides, the legitimation theory is another theory that motivates managers or companies in disclosing sustainability reports (Dowling & Pfeffer, 1975). This is in line with O'Donovan (20020 who states that legitimation is an idea to continue success operating for an organization. Then, the organization should act according to a set of rules that have been widely accepted by the public. The legitimation theory elucidates organizations seeking implemented methods to guarantee that organization operations are appropriate with the scope and norms practiced in the community (Deegan, 2004). Companies will voluntarily disclose their activities if the management regards it as the community's expectation. If the public is aware that both the organization and public convey in line value systems, the organizations or companies have a tendency to continually exist (Gray et al., 1995). In addition to that, legitimation can also provide limitations for an organization or group regarding norms and social values on environmental awareness.

Financial Performance: Financial performance is an analysis done to observe how far a company has implemented and followed financial implementation correctly (Fahmi, 2012). A significant influence between economic performance and environmental performance has been divulged (Al-Tuwaijri, et al., 2004), as well as between environmental disclosure the performance of environmental. Jimenez et al. (2013); Muhammad et al. (2015); Qi et al. (2014), and Kucukbay and Fazlilar (2016) also agree than environmental performance influences financial performance. Ratios are instruments that measure one thing to another, to show the relationship or correlation between financial reports, such as the statement of financial position and the income statement. These ratios are given very close attention to by investors, who wish to see the ability of the company in allocating its funds to generate large profits in the future.

Environmental Performance: Environmental performance deals with the company's conducting acts to preserve the environment and decrease environmental damage due to the company's activities (Lankoski, 2000). In this study, environmental performance is measured using the performance rating assessment program for companies regarding environmental management (PROPER). PROPER is the government's effort, executed by the Ministry of Environment, to motivate companies to better manage the natural environment through a reputation incentive instrument or appreciation for companies that practice good environmental management, and disincentive for companies with bad environmental management.

Environmental Disclosure: Environmental disclosure is reflected as information collection related to past, present, and future environmental management activities (Al-Tuwaijri et al., 2003). It is derived from various methods, such as qualitative statements, assertions or quantitative facts, financial reports, or footnotes. In order to measure the scope of environmental disclosure, previous studies have used checklists based on standard references of environmental disclosure (Leimona & Fauzi, 2008). This study utilizes the Global Reporting Initiative (GRI) in the wide measurement of environmental disclosure. The use of GRI as a benchmark for environmental disclosure measurement correlates to the fact that GRI becomes a mostly applied sustainable reporting framework worldwide as mentioned by Suhardjanto, Tower and Brown, (2007).

The Effect of Environmental Performance on the Financial Performance: Environmental performance is a company system to willingly fuse both environment attention and awareness to the company's operations and interactions with stakeholders that exceeds the organization's legal responsibility (Ikhsan & Muharam, 2016). It is thought to be influential. If there is a good environmental performance of a company, the public will put more trust and satisfaction with the company's manufactured products. Otherwise, the public has the tendency to judge and avoid products made by companies with bad environmental performance, since they are thought to not be environmentally friendly and harms the environment. Therefore, shareholders and stakeholders demand the management to prioritize social and environmental responsibility. Muhammad, et al. (2015) shows that there is a significant influence of environmental performance of companies for the financial performance. Maintaining the environment does not only benefit the public, but also the company, since decreasing environmental damage and waste can enable the company to become more productive in utilizing resources that create products that hold value in the eyes of consumer? Products that hold added value in the eyes of the consumer have better sale value compared to other products, and therefore can increase the number of sales. Studies conducted by Al-Tuwaijri et al. (2004); Jimenez et al. (2013); Muhammad et al. (2015); Qi et al. (2014); and Kucukbay and Fazlilar (2016) point out that environmental performance delivers an essential influence for financial performance. Based on the statement, the proposed hypothesis is as follows: **H1**: Environmental performance influences financial performance.

The Effect of Environmental Disclosure on the Financial Performance: For companies, the environmental performance will be responded to by the public, and consumers will be more inclined to purchase environmentally friendly products, and thus the company's sales will increase. Stanwick and Stanwick (2000) also states that with high levels of responsibilities, a company will also obtain high financial performance. Richardson and Welder (2001) had executed an observation towards social disclosure, focusing on environmental disclosure. Richardson and Welker mention that being measured by the cost of capital, that environmental disclosure presents a positive notable influence towards financial performance. Companies carry out better disclosure whenever their profitability increases (Richardson and Welker, 2001). It is conveyed that a good environmental disclosure will in turn encourage good financial performance (Al-Tuwaijri et al., 2004). Likewise, Gatimbu & Wabwire (2016) also found significant influence from both environmental disclosure and financial performance. It is also mentioned that a notable relationship between environmental disclosure and financial performance exists (Nor et al., 2016). Likewise, an affirmative influence between environmental disclosure and financial performance has been performed (Li et al., 2017; Haninun et al., 2018). Based on these, this following hypothesis is formulated: **H2**: Environmental disclosure influences financial performance.

3. Research Method

The manufacturing companies listed in the Indonesian Stock Exchange for the period 2016-2018 have been the samples of this study. There were 66 companies in total as samples out of a total population of 136 mining companies in the list of the Indonesian Stock Exchange. The samples in this study were taken through the use of the purposive sampling method. Secondary data in this study is derived from the annual and sustainability reports of the companies. These reports were issued on websites of Indonesian Stock Exchange website: www.idx.co.id and each respective company websites. Analysis and hypothesis testing were done using computer software, which are Microsoft Office Excel 2013, and IBM SPSS Statistics 25. In this study, the measurement of financial performance was limited to the measurement of the company's profitability, using the Return on Asset (ROA) ratio analysis. According to Rizkan, et al. (2017), ROA is a ratio that shows the result (return) with respect to the total assets used by the company. A larger ROA portrays better performance, since the return rate is larger (Ang, 1997 in Rizkan, et al., 2017). This measurement method of financial performance is adopted from a study conducted by Haninun, Lindrianasari and Denziana (2018), which used the return on assets (ROA) ratio, with the formula: Earnings after taxes ÷ total assets.

PROPER is implemented for the measurement of the environmental performance of a company. It is an attempt by the Ministry of Environment to support company organizations to conduct environmental management using information instruments. The five colors and their respective scores indicate the ranking system in PROPER. Environmental disclosure was proxied with the use of the environmental disclosure score that is found in the sample companies' annual and sustainability reports. Each item was scored regarding the disclosure of activities related to the environment found in the annual report. The scores taken were based on the Indonesian Environmental Reporting Index (IER) as the result of a study conducted by Suhardjanto et al. (2007). The use of this scoring method was selected because the weight given is in accordance with the disclosed information regarding the environment in Indonesian companies, and thus the results are more accurate.

4. Results and Discussion

From the total number of companies listed in the Indonesian Stock Exchange in 2016-2018, the amount of companies listed for those periods is 66 companies. Out of 136 companies, 114 companies did not have financial reports that matched the criteria. Thus, there are 22 research samples, each for three years, which brings the total number of samples to 66. Measuring the ability of the model to explain the independent variance variable, the coefficient of determination is used.

Table 1: The Result of Coefficient of Determination (R^2)

Model	R	R Square	Adjusted R Square
1	.555	.354	.314

Table 1 presents the result of the R^2 test. Based on this, the adjusted R^2 value is 0.314. It demonstrates 31.4% of the dependent variable variation (financial performance). It can be explained by the variation of the two independent variables namely environmental performance and environmental disclosure. In the meantime, other factors outside of the model explain the remainder (100% - 31.4%=68.6%). Furthermore, to determine the effect of the independent variables on the dependent variable, multiple regression is carried out. The coefficients for each of the independent variables or independent variables become the results of the regression analysis. This coefficient is acquired by predicting the value of the dependent variable or the dependent variable with an equation. The results of multiple regression are as follows:

Table 2: Multiple Regression Result

		Unstandardized Coefficients		Standardized Coefficients
Model		B	Std. Error	Beta
1	(Constant)	13.970	2.436	
	PROPER	3.285	1.281	.446
	IER	.598	.396	.327

Based on Table 2, the equation for regression is as follows: ROA= 13.970 + 3.285 PROPER + 0.598 IER. The equation above shows a constant value of 13,970. This states that environmental performance and environmental disclosure are regarded as constant. Hence, the average value of financial performance is 13,970. The statistical t-test was conducted to find out whether the environmental performance and environmental disclosure perform an essentially positive influence on financial performance.

Table 3: Regression Result and Hypothesis Testing

Model		T	Sig.
1	(Constant)	9,349	,000
	PROPER	3.677	.002
	IER	2,352	,028

The first proposed hypothesis states that environmental performance affects the financial performance of manufacturing companies listed in the Indonesian Stock Exchange. The regression analysis indicates the result of the variable of environmental performance showing a regression coefficient of 3.285 with a significance rate of 0.002. It is lower than 0.05. It is explained that environmental performance gives impact on the financial performance of those manufacturing companies (H1 proves true). The result of this study is accordant with some studies done by Jimenez et al. (2013) and Kucukbay & Fazlilar (2016). They express that environmental performance delivers a notably significant influence towards financial performance. It is also related to the results of studies conducted by Muhammad et al. (2015); Gatimbu & Wabwire, (2016); Manrique & Ballester (2017); and Haninun et al. (2018). They have mentioned that environmental performance influences financial performance. However, the result of this study is not correlated with the studies by Sarumpaet (2005) and Li et al. (2016). Thus, it can be concluded that the PROPER program by the government, specifically by the Ministry of Environment, does have an influence towards the interest of stakeholders, especially investors and the general public.

Based on the above explanations, it can be drawn that it is possible for the environmental performance to become a consideration in viewing a company's financial performance, since the positive reputation of a company can increase their financial performance (in which the company's revenue increases). This increase in financial performance also increases the price and value of its shares, which in turn attracts investors to company investment. The second proposed hypothesis states that environmental disclosure influences the manufacturing company's financial performance which the companies are noted down in the Indonesian Stock Exchange. The regression analysis reveals that the variable of environmental disclosure has a regression coefficient of 0.598 with a significance rate of 0.028, which is less than 0.05. This proves that environmental disclosure influences the financial performance of listed manufacturing companies in the Indonesian Stock Exchange (H2 proves true). The result of this study is consistent with studies conducted by some researchers specifically Gatimbu and Wabwire (2016); Nor et al. (2016); Li et al. (2017); and Haninun et al. (2018). It is conveyed in their studies that environmental disclosure influences financial performance. However, Rahman et al. (2010) affirms that there is not any positive yet essential influence performed by environmental disclosure towards financial performance.

5. Conclusion and Recommendations

The main issue motivating the conducted investigation is providing the understanding regarding the role of environmental performance and environmental disclosure influencing the financial performance companies in Indonesia. This is supported by literature reviews regarding financial performance. Based on the issue, this leads to the formulation of the hypothesis mentioning that the financial performance of companies in Indonesia has been affected by the first factor namely the environmental performance and the second factor namely the environmental disclosure. Based on the data that have been collected and analyzed, this study concludes that environmental performance and environmental disclosure influence the financial performance of the Indonesian Stock Exchange manufacturing companies. This is further supported by the theories of stakeholder and legitimation which focus on the company and the public interaction. It possibly increases the benefits for both parties. Thus, prior explanation mentions that environmental performance becomes a consideration to look over the financial performance of a company. It is because the positive reputation of a company is able to increase the interest of the public to purchase the company's products.

The discussion's result and conclusion of the study uncover a recommendation given to the management to consider environmental factors in regulations regarding the financial performance of the company. Therefore, it is conveyed that the environmental performance of a company has exerted influence towards the financial performance crucially even though there remains to be many other factors that influence it. For investors, it is advised that before investing capital into a company to analyze its financial performance, and consider the positive and negative regulations regarding the environmental performance of the company. Investors should consider the variable of environmental performance and environmental disclosure because their company's financial performance is notably impacted. It leads the investment made to provide maximum profit rates and to minimize investment risks. Studies conducted in the future can extend the period of observation to increase data distribution. The researcher also considers expected variables to impact on the financial performance in order to understand the actual condition of the company to produce more encouraging information.

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