CHAPTER I

INTRODUCTION

1.1 Study Background

Performance of an industry that takes part in preserving the environment is called environmental performance. Environmental performance in the form of ratings is made by environmental institution. Operational activities of an industry that exploits natural resources in an uncontrolled action have a potential to cause harm to the natural environment such as air and water pollution, deforestation, and climate change that eventually will disturb human and animal life. Being aware of the damages, interests in environmental issues have slowly increased which in turn become environmental performance which is a competitive process (Tacconi, França, Silva, & Marques Junior, n.d., p. 1).

These environmental issues may have more seen in industries which produce physical products (e.g. manufacture industries). For hospitality industries, such as hotels and hospitals are considered to not have any impact on environment because their environmental issues are not visible. For example, hotels operational activities for 24 hours to provide not only services but also products such as food and beverages, could give impact for environment (Niwedya & Singgih, 2015). According to Xuchao et al. (2010), hotels are reported as the most energy-consumptive sectors in many countries. Not only impact on energy, but they also impact on other environments, such as greenhouse gas emissions, wastewater discharge and so on (Xuchao et al., 2010). Singh et al. (2014) even suggested that hotels should do recycling more thoroughly not only for helping the environment, but also recognized there are some potential monetary profits.

While the environmental performance is operated, the environmental disclosure is required. One part of environmental disclosures which are majorly non-financial in nature is corporate environmental disclosure. The range of literature on corporate environmental disclosure focuses on the determinants of *voluntary disclosure and on the effect of voluntary disclosures on return-earnings relation (Lundholm and Myers 2002). The environmental disclosure is an important part of financial reporting in an industry for the purpose of giving the information that stakeholders need (Salomone & Gallucio, 2001).*

Financial reporting should provide useful information to investors and other users for process of decision making (FASB, 1980 in SFAC No. 1). Investors would use this information to help them make decisions about whether they will buy, sell, or hold stocks. Investors and other users use general purpose financial reports so frequently, those companies often release them together in a bundle called "annual reports," or "shareholder reports". Not only investors as a major group use financial reports, but also creditors. A creditor would use financial reports to determine the risk of lending money to a particular company.

Environmental disclosure is a part of financial reporting, even though it is largely non-financial in nature. However there are insufficient studies about Corporate Social and Environmental Disclosures (CSEDs) in developed and developing countries. In Indonesia, for example, environmental disclosure is mandatory according to the Law of the Republic of Indonesia Number 40 of 2007, section 74 of the Limited Liability Company and Badan Pengawas Pasar Modal (BAPEPAM-LK Decree No. Kep-134/BL/2006, chapter I). Nonetheless, in the regulation there is no rule concerning extensive environmental disclosure. In general, hotel groups with larger size have more comprehensive guidelines but they also have greater gaps in implementation of environmental performance (Font et al., 2012). Font et al. (2012) continued that on the other hand, hotel group with smaller size only focus on environmental management and distribute what they have promised. While Berthelot et al. (2003) in Nengzih (2014) stated that investors' interest in environmental issues for economic decision making leads the need for environmental disclosure in financial statements become more important, an opposite finding said that corporate social disclosure has a competitive disadvantage for the company because it has to spend extra money to disclose social information (Belkaoui & Karpik, 1989 in Nengzih, 2014).

There is a link between environmental disclosure and financial performance and it can be reviewed by legitimacy theory. Legitimacy theory shows that a company is a part of a huge social environment where it is located. By doing environmental responsibility and conducting environmental disclosure in financial reporting, the company seeks its establishment and maintains validity in community. This eventually will raise the company's value in the long term. Januarti & Apriyanti (2005) stated that environmental disclosure could be used to build a good image for the company, as a marketing tool (in business perspective), to show that the company is accountable and transparent (in right-based perspective), and to ensure its sustainability (in eco-social perspective).

Another theory that can review the relationship between environmental disclosure and financial performance is stakeholder theory. Stakeholder theory describes that companies will have a great benefit and excess funds for investment if they have a good financial performance (Waddock & Graves, 1994 in Setyowati, 2009). The funds could be invested in environmental management to get succeed on good environmental performance and as a form of corporate social responsibility. Another research said that all stakeholders have the right to be treated equally by an organization (Deegan, 2003, p. 268). It means that the management, at least in some measure, sacrifices the shareholders interest to other stakeholders. Thus, this theory indicates that business has environmental responsibility. It also implies that a company with good environmental performance will likely conduct more environmental disclosures.

Another theory that can review the relationship between environmental performance and financial performance is eco-efficiency theory (Hansen & Mowen, 2007). This theory explains that there are reasons for companies to motivate its operations to be more environmentally friendly, which are: (1) improve corporate image, (2) consumers increasingly want products that have added value and friendly environments, (3) reducing the costs to be incurred due to negligence in managing the environment, while improving the company's competitive advantage, (4) reducing capital costs and minimizing the cost of insurance, (5) increasing innovation and opening new opportunities; (6) workers are fond of working in an environmentally friendly company, because good corporate environmental performance can be indicated by increasing employee productivity.

This research will examine the relationship of environmental disclosure and environmental performance on company's financial performance in hospitality industries, specifically in hotels and hospitals. This research uses Program Penilaian Peringkat Kinerja Perusahaan dalam mengelola lingkungan or PROPER, a program of assessing company's performance in environmental management to measure environmental performance. A measurement for environmental disclosure in this research makes use of the Global Reporting Initiative (GRI). Meanwhile, financial performance is measured by profitability ratios of return on equity (ROE).

Previous research has been conducted to test the relationship between financial performance towards environmental performance and environmental disclosure (Utami, 2014). It showed positive results for both relationship between environmental performance and financial performance in manufacturing companies; and relationship between environmental disclosure and financial performance in manufacturing companies. However, there are also issues with harmful impacts on the environment naturally brought by growth of hospitality industries (Padilla, 2012). Even though there is no direct danger to the financial performance of the company, environmental awareness is needed not only to provide enough evidence of social and environmental impact, but it also needs to be clear about their actual determinations to achieve the results that they put in annual report (Hopper, 2010). Thus, this research will reveal the relationship between financial performance towards environmental performance and environmental disclosure on hospitality industries.

1.2 Problem Identification

By considering the different results in previous research, the researcher was motivated to examine more about environmental disclosure, environmental performance, and financial performance in hospitality industries. The researcher wanted to reveal if there is a relationship between those variables. Thus, the researcher would like to examine the relationship between financial performance towards environmental disclosure and environmental performance in hospitality industries.

1.3 Problem Formulation

This research refers to the problem as follows:

1. *Is there any relationship between financial performance and environmental disclosure in hospitality industries?*
2. *Is there any relationship between financial performance and environmental performance in hospitality industries?*

1.4 Problem Limitation

The scope of this research is not too broad that it has problem limitation. The problems discussed in this research deal with environmental disclosure as an information disclosure of environment in corporate financial reporting. Financial reporting is limited to the information provided in company's annual report and related information contained in company's official website.

1.5 Research Objectives

The objective of this research is to test and provide empirical evidence on the relationship between financial performance towards environmental disclosure and environmental performance of hospitality industries listed in Indonesia Stock Exchange in the period 2012-2015.

1.6 Research Contributions

This research provides benefits theoretically and practically. Theoretically it would make a significant contribution to the field of accounting, especially to the study of financial performance *associated with environmental issues. Furthermore, it can be a reference for other researchers to conduct further research.*

Practically, the industries may take advantage of the research findings as they can be a reference in decision making on environmental performance and environmental disclosure in annual reporting. In addition, investors can also benefit from the research findings. When this study can prove the relationship, the investors may measure the variables involved in decision making.

1.7 Thesis Organization

This research report is organized with the following sections.

CHAPTER I: INTRODUCTION

Chapter I is an introduction of the research topic and its study background. It also covers problem identification, problem formulation, research limitation, research objectives, research contribution and thesis organization.

CHAPTER II: LITERATURE REVIEW

Chapter II presents the theories related to the research topic which function as a basis of analysis. A few hypotheses are also presented in this section.

CHAPTER III : RESEARCH METHODOLOGY

Chapter III includes the operational definition of each variable and the measurement, data collection methods, populations and samples used in this study, the sampling technique used, including criteria of selected samples and methods of data analysis.

CHAPTER IV : DATA ANALYSIS AND DISCUSSION

Chapter IV presents the results of the data processing and analysis apart from whether the hypotheses or null hypotheses are proven along with further discussion of statistical analysis results.

CHAPTER V: CONCLUSIONS AND RECOMMENDATIONS

Chapter V presents the final conclusions and recommendations for how this project could be extended in the form of further possible studies in the future.