CHAPTER II

LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 Disclosure

Theoretically, disclosure is a fundamental part of financial reporting. Technically, disclosure is the last step in accounting process namely a presentation of information in the form of a full set of financial statements. Evans (2003) in Suwardjono (2012) defined disclosure as:

> *"Supplying information in the financial statements themselves, the notes to the statements, and the supplementary disclosure associated with the statements. It does not extend to public or private statements by made management or information provided outside the financial statement."*

Evans (2003) in Suwardjono (2012) also stated that in disclosure definition, management statement in newspaper or other mass media and information beyond the scope of financial reporting are not included. On the contrary, disclosure is often interpreted as providing information more than what can be delivered in the form of formal financial statements.

In Suwardjono's book "Teori Akuntansi Perekayasaan Pelaporan Keuangan" (2012), it is stated that generally, the purpose of disclosure is to present information that is deemed necessary to achieve the objectives of financial reporting and to serve various parties with different interests. In operation, investors and creditors vary in terms of sophistication. This is because the stock market is the primary of fulfillment of public funds, so disclosure may be required to: (1) protect, the purpose is to protect management treatments that may be unfair, thus, the rate and volume of disclosure will be high; (2) inform, the purpose is to provide information that can assist the user's decision-making *effectiveness so users are clear with certain level of sophistication; and (3) serve special needs (differential), the purpose is limited to what should be disclosed to the public and what is deemed useful for the intended users, and to submit the information to the regulatory body that requires disclosure in detail accordance with regulation form.*

Alternatively, in book of Accounting Theory (Belkaoui, 2006), disclosure serves to provide information that will help investors and creditors assess risks and the potential of things that are recognized and not recognized. It is also explained to help investors assess the return on their investment.

In relation to the issue of how much information should be disclosed referring to the disclosure levels, Evans (2003) in Suwardjono (2012) identified three corporate disclosures:

a) *Adequate Disclosure*

   Adequate Disclosure is a concept that is often used, which is the minimum disclosures required by the applicable regulations, so that the numbers presented can be interpreted correctly by investors.

b) *Fair Disclosure*

   Fair Disclosure is implicit in the ethical goal to give equal treatment to all report users by providing adequate information to potential readers.

c) *Full Disclosure*

   Full Disclosure is the completeness of the presentation of relevant information disclosed. Suwardjono (2012) showed two benefits of full disclosure that can be achieved *simultaneously, there is a possibility that investors make better investment decisions and increase the ability of capital markets to the most productive direct investment.*

The nature of disclosure which is done by companies is divided into two, namely voluntary disclosure and discretionary disclosure. Voluntary disclosure is the disclosure of the company other than what is required by the accounting standards or regulatory body. Meanwhile, discretionary disclosure is a disclosure made by company on what is required by the accounting standards or regulatory body. Suwardjono (2012) revealed that management always tries to expose private information which is considered in great demand by investors and shareholders, especially if the information is good news. Management is also interested in delivering information to improve the credibility and the success of the company even though the information is not required.

At the same time, the disclosures made by the firms can be categorized into two, achievements and intents (Jacobs et al., 2010 in Hora & Subramanian, 2013). Disclosures as achievements mean the companies pertained to their accomplishment of prior environmental performance, while disclosures as intents mean the companies make disclosure to undertake planned environmental performance. There are two reasons why disclosure as achievements has a strong positive impact with environmental performance (Jacobs et al., 2010 in Hora & Subramanian, 2013). First, based on the perspective of legitimacy theory, there is a greater possibility that companies may seek to influence stakeholder perceptions without promising the environmental performance. Ramus & Montiel (2005) in Hora & Subramanian (2013) stated that there is a difference between actually implementing environmental performance and intending to implement it. Second, since intents contain commitments and pledges, those may take time to happen. On the other hand, achievements of environmental performance in the disclosure should be already realized by the company.

2.1.2 Environmental Disclosure

Environmental disclosure is a public disclosure about company's environmental performance. In this research, the context for environmental disclosure is to disclose specific pollution measures and existences (e.g. water waste, air pollution, environment damage, etc.) so the investors can estimate the future cash flows (Al-Tuwaijri et al., 2003). Al-Tuwaijri et al. (2003) also stated that environmental disclosure measurement technique is categorized into two general groups, the technique that measures the level of environmental disclosure in annual report and the technique that uses a disclosure-scoring measure resulted from content analysis.

Hora & Subramanian (2013) described that environmental disclosure can be categorized as either: (1) discretionary, it includes disclosures in corporate reports (e.g. annual reports, environmental policy statements, and sustainability reports) and announcements in the press, or (2) mandated, it includes environmental disclosures in the Securities and Exchange Commission's (SEC) Form 10-K and per the Financial Accounting Standards Boards (FASB). The latter is negative or report on compliance activity by their nature, while the former could include both positive and negative information (Hora & Subramanian, 2013).

Al Tuwaijri et al. (2003) cited from Bethelot (2002) defined environmental disclosure as a collection of information related to environmental activities by the company in the past, present, and future. This information can be obtained in many ways, such as qualitative statements, assertions or quantitative facts, the form of financial statements or footnotes.

To measure environmental disclosure, previous studies used two methods, first includes measures that calculate the level of environmental disclosure in annual report. Each of these measures has its limitations. The second measurement technique uses a disclosure-scoring measure derived from content analysis. Therefore, this study measures the environmental disclosure with a disclosure-scoring from content analysis method by using Global Reporting Initiative (GRI). The selection of GRI as a *broad benchmark of environmental disclosure measurement is on the ground that GRI is a framework of sustainable report which is the most widely used around the world (Leimona & Fauzi, 2008). Alternatively, some companies in Indonesia also adopt GRI as a standard in environmental disclosure.*

The Global Reporting Initiative (GRI) is a network-based organization that has initiated the development of sustainability reporting framework. It is widely used in the world and committed to its continuous improvement and application throughout the world (www.globalreporting.org). Categories contained in GRI and also used in this study are:

1. *Economic category*
2. *Environmental category*
3. *Social Category*
    - *Labor practices and decent work*
    - *Human rights*
    - *Society*
    - *Product responsibility*

This study focuses on the measurement of environmental disclosure, so the category that will be used is Environmental category. Environmental category according to GRI can be seen in the following table:

Table 2.1

List of Environmental Performance Indicator according to GRI

NO.	**Environmental Category Indicators**	
1	**Aspect: Materials**	
	G4-EN1	*Materials used by weight or volume.*

	G4-EN2	*Percentage of materials used that are recycled input materials*
2	**Aspect: Energy**	
	G4-EN3	*Energy consumption within the organization*
	G4-EN4	*Energy consumption outside of the organization*
	G4-EN5	*Energy intensity*
	G4-EN6	*Reduction of energy consumption*
	G4-EN7	*Reductions in energy requirements of products and services*
3	**Aspect: Water**	
	G4-EN8	*Total water withdrawal by source*
	G4-EN9	*Water sources significantly affected by withdrawal of water*
	G4-EN10	*Percentage and total volume of water recycled and reused*
4	**Aspect: Biodiversity**	
	G4-EN11	*Operational sites owned, lease, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas*
	G4-EN12	*Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas*

	G4-EN13	*Habitats protected or restored*
	G4-EN14	*Total number of IUCN Red List Species and national conservation list species with habitats in areas affected by operations, by level of extinction risk*
5	**Aspect: Emissions**	
	G4-EN15	*Direct greenhouse gas (GHG) emissions*
	G4-EN16	*Energy indirect greenhouse gas (GHG) emissions*
	G4-EN17	*Other indirect greenhouse gas (GHG) emissions*
	G4-EN18	*Greenhouse gas (GHG) emissions intensity*
	G4-EN19	*Reduction of greenhouse gas (GHG) emission*
	G4-EN20	*Emissions of ozone-depleting substances (ODS)*
	G4-EN21	*Nox, Sox, and other significant air emissions*
6	**Aspect: Effluent and Waste**	
	G4-EN22	*Total water discharge by quality and destination*
	G4-EN23	*Total weight of waste by type and disposal method*
	G4-EN24	*Total number and volume of significant spills*

	G4-EN25	*Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I, II, III, and VIII, and percentage of transported waste shipped internationally*
	G4-EN26	*Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the organization's discharges of water and runoff*
7	**Aspect: Product and Services**	
	G4-EN27	*Extent of impacts mitigation of environmental impacts of products and services*
	G4-EN28	*Percentage of products sold and their packaging materials that are reclaimed by category*
8	**Aspect: Compliance**	
	G4-EN29	*Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations*
9	**Aspect: Transport**	
	G4-EN30	*Significant environmental impacts of transporting products and other goods and materials for the organization's operations, and transporting members of the workforce*
10	**Aspect: Overall**	

	G4-EN31	*Total environmental protection expenditures and investments by type*
11	**Aspect: Supplier Environmental Assessment**	
	G4-EN32	*Percentage of new suppliers that were screened using environmental criteria*
	G4-EN33	*Significant actual and potential negative environmental impacts in the supply chain and actions taken*
12	**Aspect: Environmental Grievance Mechanisms**	
	G4-EN34	*Number of grievances about environmental impacts filed, addresed, and resolved through formal grievance mechanisms*

Source: GRI (Gobal Reporting Initiatives) G4 Guideliness

2.1.3 Environmental Performance

Environmental Practitioner @ Work (http://www.epaw.co.uk) stated that environmental performance is the relationship between environment and the company that includes the environmental impacts on consumed resources, the products, etc. According to the International Standards Organization, there are two definitions of environmental performance (http://www.epaw.co.uk), measurable results of the environmental management system that is linked to the company's control on its environmental aspect (ISO 14001: 1996 definition 3.8); and results of the company's management on its environmental impacts (ISO 14031: 1999 definition 3.7).

The concept of environmental performance refers to the level of environmental damage caused by activities undertaken by the company (Lanskoki, 2000). The lesser the damage level the better the environmental performance of the company and vice versa, the higher the damage of the environment then the worse the company's environmental performance.

Environmental performance in this research is measured using PROPER, which was initiated in 1995 in Indonesia. Performance Rating PROPER known as a government effort is undertaken by the Ministry of Environment through its Bapedal (Badan Pengendalian Dampak Lingkungan). The purpose is to inspire companies to manage the environment in a better way through instrument of incentive reputation or image for companies that have good environmental management performance and disincentives reputation or corporate image with bad performance (Lemonia & Fauzi, 2008).

A research by Sarumpaet (2005) proved that the PROPER rating provided by Indonesian government, is quite dependable as a measure of the company's environmental performance, due to a compliance with international certification in environment aspect, ISO 14001.

2.1.4 PROPER as an Environmental Performance Measurement

The Ministry of Environment makes a Program assessing company's performance in environmental management called PROPER. PROPER is embodied in the Decree of the Minister of Environment No. 127 of 2002, with the purpose of assessing corporate responsibility in controlling pollution or environmental damage.

Since 2002, PROPER undertaken by Minister of Environment has already adopted an instrument arrangement in various countries such as India, the Philippines, China and Ghana, along with the subject of the research in various universities and research institutes. Performance evaluation in companies that join in PROPER should meet various specified requirements in applicable legislation *and in implementation of various activities related to environmental management activities which have not been beyond compliance (PROPER reports, 2009).*

Currently, PROPER has seven aspects in management organizational assessment that is environmentally friendly. There are four aspects of risk management and compliance obligations: (1) adherence to controlling water pollution regulations, (2) adherence to air pollution regulations, (3) adherence to the B3 waste management regulations, and (4) adherence to the AMDAL regulations. On the other hand, there are three aspects of compliance: (1) assessment of the efforts that have been done by the company in implementation of environmental management system (Sistem Manajemen Lingkungan-SML), (2) conservation and resource utilization, and (3) Corporate Social Responsibility (CSR) activities included in Community Development activities.

2.1.5. PROPER Rating Criteria

PROPER ranking considers the results of PROPER assessment that will be published openly to public and other stakeholders which is expected to be easier to understand the structuring performance of each company. Corporate structuring performance ranking criteria are grouped into color rank. According to Regulation of the Minister of Environment No.7 of 2011, PROPER is divided into 5 colors Gold, Green, Blue, Red and Black. The compliance criteria are blue, red and black ranking, while the aspects assessment criteria over the criteria required (beyond compliance) are green and gold. PROPER criteria according to Regulation of the Minister of Environment No.7 of 2011 can be seen in the table 2.2:

Table 2.2

PROPER Rating Criteria

NO.	RANKING	DESCRIPTION
1.	**Gold**	*Given to the company that has consistently demonstrated the environmental excellency in the production process and/or services, implementing ethical business and responsible to society. The company has undertaken Environmental management more than required and implemented 4R (Reduce, Reuse, Recycle, Recovery), sustainable environmental management systems, as well as made efforts which will be useful for public interest in the long-term.*
2.	**Green**	*Has conducted Environmental management more than required, in regulation (beyond compliance) through the implementation of environmental management systems, made environmental management systems, has a good relationship with the society, including 4R (Reduce, Reuse, Recycle, Recovery).*
3.	**Blue**	*Has conducted Environmental management required in accordance with the provisions or specific regulations.*
4.	**Red**	*Has conducted Environmental management but only some efforts yield results in accordance with the requirements and regulations.*
5.	**Black**	*Has not made significant attempts to manage the environment, do not have environmental*

		management as required deliberately, and also have a potential to pollute the environment.

Source: Kementerian Lingkungan Hidup (KLH)

In the period 2012-2015 PROPER performed an evaluation and monitoring through PROPER mechanism towards 2,137 companies. In 2012, there were 1,310 companies and it was included only 78 hotels and 70 hospitals. Then, in 2015 there was an increase hotels and hospitals by 197 and 113, respectively. Compared when hotels and hospitals were ranked more in Black color in 2012, in 2015 they improved their awareness by decreased on Black rank.

PROPER is expected to support the implementation of environmental management in existing instruments, such as environmental law enforcement, and economic instruments. Hora & Subramanian (2013) found that firms in some industries were perceived to be more likely to commit to disclosures but not likely to implement them. Furthermore, PROPER application can respond the needs of information access, transparency and public participation in environmental management (Article 65 paragraph (2) of Law no. 32, 2009 about the Protection and Management of the Environment). Meanwhile firms make discretionary disclosures for external validity and endorsement, they also acknowledge the normative pressures by stakeholders such as investors, activists, and consumers that monitor such disclosures (Delmas & Toffel, 2004 in Hora & Subramanian, 2013). Lyon & Maxwell (2011) in Hora & Subramanian (2013) also stated that in recent years, activist pressure has been increasing on companies to observe the environmental impacts from their operations.

Indicators of PROPER positively can be seen if it is qualified as follows:

1. *Decreasing pollution load issued by companies to environment.*
2. *Decreasing the level of pollution and environmental damage, increasing the environment quality, increasing the number of companies that comply with environmental regulations.*

2.1.6 Financial Performance

Financial performance is a subjective measure on how well the business is run in the company. This also could be an overall measure for financial health in a company for a period of time. Financial performance can be explained as an accomplishment that have been realized through the work that has been done and reflected in financial statements, and can serve as standards to assess the success of a company within a certain period (Suratno et al., 2006).

Financial performance can be measured with capital-market based measurement and accounting based measurement. An accounting-based measure uses financial ratio analysis as a financial measurement, while market-based capital can be measured using stock returns. On the contrary, according to Fauzi (2009) many measures can be used to represent financial performance. The measures can be divided into three categories: ROA and ROE (cited from Waddock & Graves 1997; Mahoney & Roberts, 2007; and Tsoutsoura, 2004); profitability in absolute term (cited from Stanwick & Stanwick, 1998); and multiple accounting based measure with the overall index using the score of 0 – 10 (cited from Moore, 2001).

This research uses accounting-based measures because of its limited access to use market-based financial performance measurement for the data that consist of listed and unlisted companies. Measurement by this method is more comprehensive with the standards used to measure financial performance, Return on Equity (ROE), which is included in profitability ratios. This research uses the profitability ratios to measure the financial performance of companies. These ratios are strongly taken into account by investors because they want to see company's ability to distribute funds for generating huge profits in the future. A standard used in the profitability ratio is return on equity (ROE). In Walsh's book "Key Management Ratios: The 100+ Ratios Every Manager Needs to Know" (2008) stated that ROE is a measurement of best performance, followed by return on assets (ROA) as a *measurement of the second best performance.*

Return on equity (ROE) is used to measure company's ability to generate profits with their own capital (Soediyono, 1991). The bigger value of ROE, the more total amount of income available to capital owner. ROE is very close to investors because ROE connects directly to earnings, growth and dividends of companies.

ROE ratio is arguably the most comprehensive ratio to assess the policies and activities of a company. High ROE ratio reveals the success of top leadership or management in the mission of the owner, to benefit from capital invested (Soediyono, 1991). The ROE figures will enable the company to grow and create the appropriate market conditions, which in turn provide greater profits. It will also bring success for the company so that it can easily attract new funds. All these things will create high value and sustainable growth over the wealth of the owner.

2.1.7 Stakeholder Theory

Stakeholder theory recognizes that managers should manage the organization in order to benefit all stakeholders. Based on a normative viewpoint, stakeholder theory states that all stakeholders have the right to be treated fairly by an organization (Hanas, 1998 in Deegan, 2003). This theory also considers that a company is not a mechanism to increase the return of shareholders, but as a means of coordinating the interests of investors, and considers that management has a legal or ethical relationship of trust between two or more parties, not only to shareholders but also to all stakeholders. In addition, in stakeholder theory, management should be fair in considering the interests of all stakeholders; and when there is a conflict of interest, management should manage the business in order to attain an optimal balance between them (Deegan, 2003). This theory explains that companies with high financial performance will have a great advantage and excess funds for investment (Waddock & Graves, 1994 in Setyowati, 2009). These funds can be invested in environmental management to *achieve good environmental performance and as a form of corporate social responsibility. This theory shows the influence of financial performance towards corporate's environmental performance.*

Environmental disclosure can become a tool for companies to provide information about their environmental performance so it can be used as a basis for management decisions. Deegan (2003) also revealed that all stakeholders have the right to obtain information of how organizations affect them, even if they choose not to use the information and even if they do not directly affect the organization sustainability.

Based on Lang and Lundholm (1993) in Clarkson et al (2006), companies with good financial performance tend to have broader disclosure to give good news to market and all stakeholders.

2.1.8 Legitimacy Theory

Suchman (1995, p. 574) stated that:

> *"Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions."*

Legitimacy theory explains the ways of organizations in implementing and developing voluntary social and environmental disclosure of information in order to fulfill their social contract that enables the recognition of their objectives and the survival in an unsettled environment.

Public will judge a company based on how the company creates its own image. Based on legitimacy theory, the only way for a company to be able to survive is when society considers that the activities of the company are already in harmony with the environment. Therefore, a company should attempt to establish and maintain its legitimacy in community by doing environmental responsibility and disclosure to public in financial reporting (Dowling and Pfeffer, 1975; Lindblom, 1994, in Deegan, *2003).*

Gray et al. (1995) in Deegan (2003) also revealed that the company's environmental disclosure would enhance the company's image and concern in doing environmental responsibility. This will have an impact on public's assessment of the company. Good corporate image will reap the appreciation from community which in turn give an impact on the value of the company. After that, the value of the company will affect financial performance.

There are three perspectives from legitimacy theory that are relevant when companies make positive discretionary disclosure about their environmental performance (Grey et al., 1995 and Lindblom, 1994 in Hora & Subramanian, 2013). First, companies actually change or intend to change their operating activities in line with the disclosures. Second, in making such disclosures, companies may seek to influence stakeholder perceptions without sincerely undertaking the disclosed efforts. Third, companies make positive disclosures to divert attention away from other companies' activities that may be of environmental concern (Hora & Subramanian, 2013).

2.1.9 Eco-efficiency Theory

Based on Hansen and Mowen's book Managerial Accounting (2007), eco-efficiency theory is a theory that supports company's efforts to drives its operations to be more environmentally friendly. This concept attempts to describe the company's efforts in producing goods and services to have added value and also reduce the negative impact on environment sustainability through resources efficiency. Those efforts will simultaneously reduce the company's costs. This concept may explain the relationship between environmental performance and financial performance. There are reasons suggested by Hansen and Mowen (2007) in their theory:

1. *Consumers are fond of products which are value-added and environmentally friendly.*

2. *These days, labors have a tendency to choose to work in companies with positive image related to environment. A good corporate environmental performance is also indicated by an increase in employee productivity.*
3. *Reducing costs due to negligence in managing the environment, while enhancing company's competitive advantage.*
4. *Reducing capital costs due to lack of agency costs that must be paid by the company, and minimizing the insurance cost that must be borne by the company.*
5. *Improving the company's ability to make innovations and opening up new opportunities.*
6. *Eco-efficiency provides other benefits significantly to company in order to enhance corporate image.*

2.2 Previous Studies

Previous studies on the relationship of environmental performance and financial performance shows various results. Al-Tuwaijri et al. (2003) had findings with the conclusion that good environmental performance has a positive relationship with firm financial performance. Meanwhile, a study conducted by Fitriyani (2012) and Sarumpaet (2005) found negative relationship between environmental performances towards financial performance. Wijayanto (2007), and Sudaryanto (2011) found an absence of relationship between environmental performance and financial performance. Fitriani (2013) showed that there is a relationship between environmental performance and financial performance. Good environmental performance will be positive responded by investors which in turn increase stock price.

This research also refers to previous research conducted by Utami (2014) that investigated the relationship between financial performance towards environmental performance and environmental disclosure. The research found that there is a positive relationship between financial performance and environmental performance (Utami, 2014). It also revealed the positive relationship between financial *performance and environmental disclosure. Utami (2014) used manufacturing companies as a subject, while this research attempts to find if there is a positive relationship in hospitality industries. Thus, the subject for this research is hospitality industries in 2012 – 2015.*

2.3 Theoretical Framework

Stakeholder theory can explain both the effect of financial performance on environmental disclosure and financial performance on environmental performance. Stakeholder theory reveals that both shareholders and stakeholders have the right to be treated equally by their organization. This suggests that the management at least partly sacrifice for the interests of shareholders to other stakeholders. Therefore, in a normative point of view, the stakeholders theory implies that business has environmental responsibilities.

This theory argues that firms with high financial performance will have a great advantage and the excess funds for investment (Waddock & Graves in Setyowati, 2009). The fund can be invested in environmental management to attain good environmental performance and serves as a form of corporate social responsibility. This theory shows the influence of the financial performance on environmental performance of a company. Companies with good environmental performance will tend to perform more environmental disclosure. This is in line with a research by Lang and Lundholm (1993) in Clarkson et al. (2006) which revealed that companies with good financial performance tend to have a broader disclosure to give good news to the market and all stakeholders. The stakeholder theory can also explain the effect of the financial performance on environmental disclosure.

Legitimacy theory reveals that a company is part of a larger social environment where it is located. It explains the influence of environmental disclosure on financial performance. A company attempts to establish and maintain its legitimacy in society by doing environmental disclosure in financial reporting. Disclosure of corporate environment can form the good image of the company, marketing tool, serves as a means of fulfilling accountability and transparency, and also ensure the sustainability of the *company (Januarti & Apriyanti, 2005). This eventually will improve the financial performance of the company and increase the company's value in the long term.*

Hansen and Mowen (2007) showed a theory that supports the company's efforts to drive its operations to be more sustainable called eco-efficiency. Theoretical elaboration on the effect of environmental performance on financial performance can be evaluated through eco-efficiency theory. This concept explains the reasons of companies in conducting environmental responsibility. (1) Consumers get some products with added value and environmentally friendly. (2) Reduce the costs that must be paid caused by the omission in managing the environment, and also improve the company's competitive advantage. (3) Workers are fond of working in companies with a positive image related to the environment. Corporate environmental performance that is getting better is also indicated by an increase in employee productivity. (4) Reducing the cost of capital due to lack of agency costs that must be paid by the company, and minimizing insurance costs that must be borne by the company. (5) Increase innovation and new opportunities. (6) Increase corporate image. The theory gives an opportunity that environmental performance influences company's financial performance. By doing environmental performance, a company is expected to improve its profitability as a benchmark of the company's financial performance.

2.4 Hypothesis Development

Based on theories above and referring to previous studies with various conclusions, the researcher proposes the following hypotheses:

2.4.1 Relationship Between Financial Performance and Environmental Disclosure

Wibisono (2007) revealed that there is no significant relationship between environmental performance and financial performance. This is because companies do not fully disclose information related to the environment as defined by BAPEPAM. In addition, there is no significant influence of environmental disclosure due to the economic performance of the company that tend to reveal only good things and resist the environmental information which adversely affect the company's image.

A research by Fitriyani (2012) found that environmental disclosure is positively and significantly related with financial performance. It is expected that investors will consider environmental disclosures information in company's annual report, so in investor's decision-making are not solely based on income information. Revealing financial information relating to the environment will be more attractive to financial statement users. It would also increase economic performance of the company. An increase in economic performance of a company will be good news for the company, so stakeholders and financial statement users would be more interested and the company will be positively responded by the market fluctuations in stock prices which in turn boost industrial companies' returns. Therefore, the first hypothesis is:

Ha_1 *: There is a relationship between financial performance and environmental disclosure.*

2.4.2 Relationship Between Financial Performance and Environmental Performance

Singh & Jackson research (2015) (cited from Allouche & Laroche, 2005; Jackson & Hua, 2009; Wu, (2006); Turban & Greening, 1997; Preston & O'Bannon, 1997; Waddock & Greaves, 1997) stated that there was a significant effect of environmental performance on financial performance. This shows that the environmental performance of companies occurs due to the companies' financial performance as reflected in their annual rate of return compared to the return of the industry. Conversely, Sudaryanto (2011) showed that environmental performance is not significantly associated with financial performance.

Iwata and Okada (2010) analyzed that nowadays, many stakeholders of firms such as governments, non-governmental organizations, local communities, consumers, trading partners, employees, investors, financial agencies and stockholders are conscious of corporate environmental management, especially in developed countries. This directly or indirectly influences the financial performance of firms. For example, if a firm violates an environmental regulation or causes an environmental accident, the firm not only has to pay fines and penalties, but may suffer from a loss of *trust and reputation or a boycott of goods. Such risks have negative effects on evaluation of the firm's future profits. On the other hand, a firm that actively addresses environmental issues might gain positive reputation among some stakeholders and may influence them to expect that the firm will succeed in reducing environmental risks and production costs in the long term. Therefore, firms have an incentive to address various environmental issues against the backdrop of various stakeholders' interests. Therefore, the second hypothesis is:*

Ha_2 *: There is a relationship between financial performance and environmental performance.*