CHAPTER I

INTRODUCTION

1.1 Background of the Problem

Sustainable development is a development concept applied by various countries today. This is in line with the United Nations' call for all countries, both rich and poor, to take action in achieving the 17 sustainable development goals in order to change the world. The Brundtland Commission popularized sustainable development, which has been defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs (Rankin, 2014). Seeing the global issues that continue to be a concern, namely how to reduce or eliminate the creation of emissions to increase activity on a large scale in social and economic aspects, increase natural resource exploration, production, consumption, and human lifestyles Many environmental issues are caused by or relate to the production, transformation, and use of energy (Silva, 2013). This will have a negative impact on environmental sustainability, such as global warming, water pollution, maritime pollution, land use and siting impacts, hazardous air pollutants, and a drastic decrease in the number of natural resources that cannot be renewed.

Various world meetings were held to discuss these issues, including the Conference of the Parties (COP), which discussed various climate changes and various agreements, such as the Kyoto Protocol (1997), which operated the United Nations

Framework Convention on Climate Change by requiring industrial countries and economies in transition to limit and reduce greenhouse gas (GHG) emissions according to individual goals. The Paris Agreement (2017) also resulted in an international agreement on climate change covering mitigation, adaptation, and finance. After COP 26 was held in Glasgow, Scotland, it became a major task for world leaders to phase out the use of coal to achieve zero emissions. Various alternatives and solutions have been made and developed in various countries as an effort to reduce carbon emissions, such as recycling, process change and sectoral modification, acceleration of forestation, application of carbon and/or fuel taxes, material substitution, promoting public transport, changing lifestyles, and increasing public awareness of energy-related environmental problems (Silva, 2013).

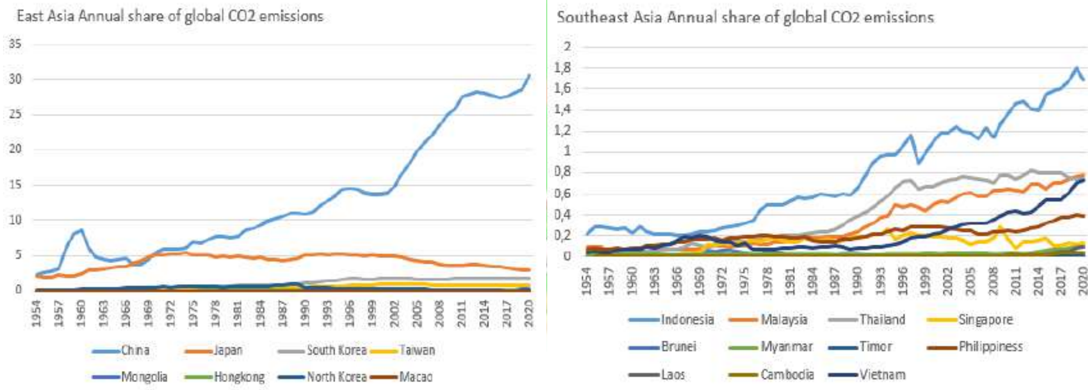

Figure 1.1 East Asia and Southeast Asia Annual Share of Global CO2 Emissions, 1954-2020

(*Resource : ourworldindata.org*)

Based on Figure 1.1, it can be seen that, from 1954–2020, the annual share of global CO2 emissions was highest in East Asian and Southeast Asian countries. China will account for 30.6 percent of carbon emissions in the East Asian region in 2020, with Japan accounting for 2.96% and South Korea accounting for 1.72%. While in Southeast Asia, the countries that contributed the most carbon emissions were Indonesia at 1.69%, Malaysia at 0.78%, and Thailand at 0.74%. East Asia and Southeast Asia are in the Asia-Pacific region. This area became very popular starting in the 1980s as a developing economic area due to increased capital flows, trade, and other forms of economic and political interaction. This Asia-Pacific economic cooperation is certainly one of the causes of the increase in carbon emissions, given the increasing economic activity. As the concept of sustainable development has three main pillars that are mutually sustainable, namely economic growth, social sustainability, and environmental sustainability, These three pillars are of particular concern today for business entities' survival. As stated by Elkington (1997), where businesses are faced with challenges that come from the environment and society, awareness arises from business entities to run businesses that can have a positive impact on social and environmentally friendly activities (Hockerts & Wüstenhagen, 2010).

All over the world, business trends are changing rapidly due to the competitive environment. Traditionally, the focus of corporations was to conduct their activities in a profitable manner, but nowadays, besides making a profit, companies also focus on

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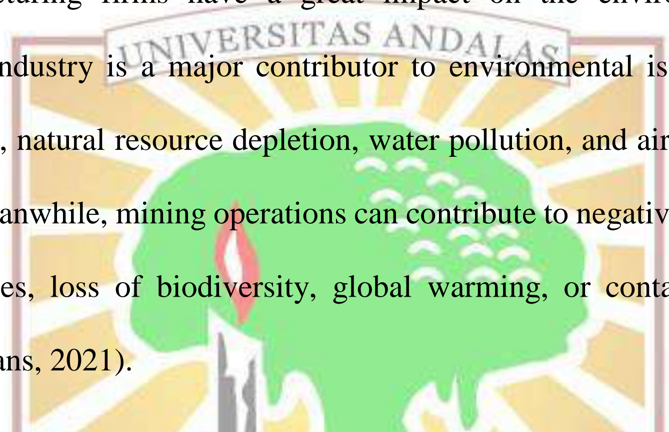
social and environmental issues, strive to obey all applicable laws, and behave in an ethical and responsible way (Kraus et al., 2018). Although this is not enough to gain profit and a competitive advantage, it is also necessary to have a positive impact on the environment. For example, manufacturing, energy, and mining companies that are directly related to natural resources are the biggest contributors to environmental issues. Manufacturing firms have a great impact on the environment, and the manufacturing industry is a major contributor to environmental issues like climate change, wastage, natural resource depletion, water pollution, and air pollution (Kraus et al., 2020). Meanwhile, mining operations can contribute to negative impacts such as erosion, sinkholes, loss of biodiversity, global warming, or contamination of soil (Miklosik & Evans, 2021).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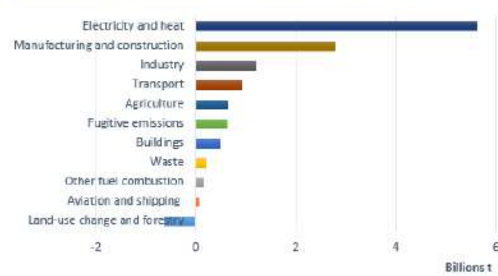

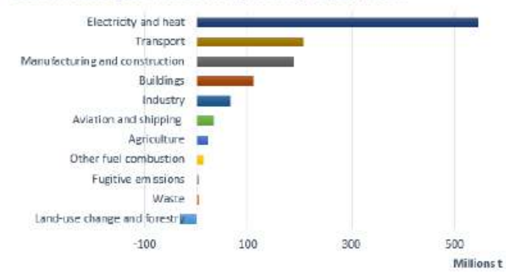

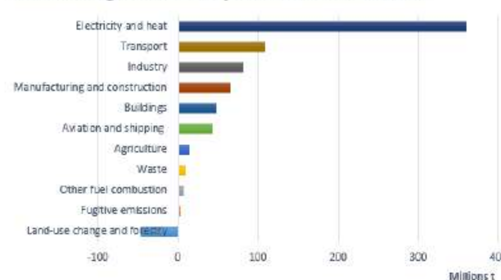

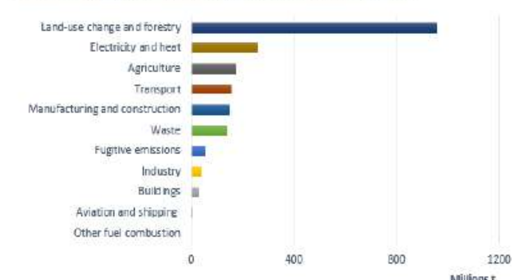

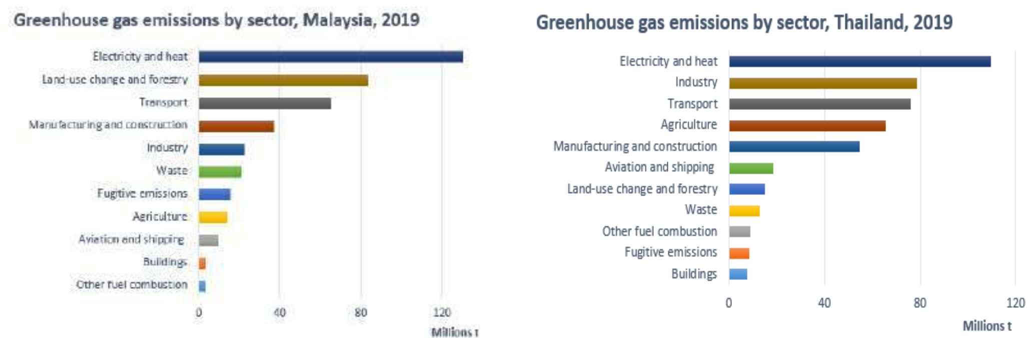

Figure 1.2 China, Japan, South Korea, Indonesia, Malaysia, and Thailand Greenhouse Gas Emissions by Sector 2019

(*Source : ourworldindata.org*)

Figure 1.2 shows that the countries with the highest emissions from East Asia are China, Japan, South Korea, and Southeast Asia, namely Indonesia, Malaysia, and Thailand, by sector. In 2019, the State of China reported that the following sectors contributed the most emissions: electricity and heat (5.62 billion t), manufacturing and construction (2.79 billion t), and industry (1.22 billion t). In Japan, the sectors that contributed the most emissions were electricity and heat (545.21 million t), transport (206.41 million t), and manufacturing and construction (190.12 million t). Next to South Korea, the sectors that contributed the most emissions were electricity and heat (360.26 million t), transport (108.89 million t), and industry (80.78 million t). While in Southeast Asia, the State of Indonesia, land-use change and forestry contribute the most carbon emissions (957.35 million t), electricity and heat (258.23 million t), agriculture (176.94 million t), and transport (154.71 million t). Next to Malaysia, the sectors that contribute the most carbon emissions are electricity and heat (130.03 million t), land-

use change and forestry (83.09 million t), transport (65.31 million t), and manufacturing and construction (37.11 million t). In Thailand, the sectors that contribute the most carbon emissions are electricity and heat (109.44 million t), industry (78.49 million t), and transport (75.93 million t).

In this study, the focus of the concept of sustainable development is environmental sustainability. This is inseparable from the global issues that have been discussed previously. Due to various environmental issues, firms must concentrate on environmental and nature conservation tasks, and promoting environmental performance is an essential prerequisite to responding to global challenges (Kraus et al., 2020). Previous studies that discussed sustainability used indicators that are currently popular in the investment world, known as environmental, social, and governance (ESG) indicators. These studies include linking ESG with economic or financial performance (Alareeni & Hamdan, 2020; Cek & Eyupoglu, 2020; Tarmuji et al., 2016; Velte, 2017); sustainability performance (Ismai et al., 2020; Rajesh & Rajendran, 2020).

ESG is a set of operational standards that refer to these three components in measuring the sustainability and impact of an investment in a company. Companies need to be aware that ESG disclosure is critical to portraying their good reputation and image in meeting the challenges of green issues to their stakeholders (Tarmuji et al., 2016). As stakeholder theory says that the company must be able to satisfy or please all parties involved, it is necessary to adopt various strategies that can make all

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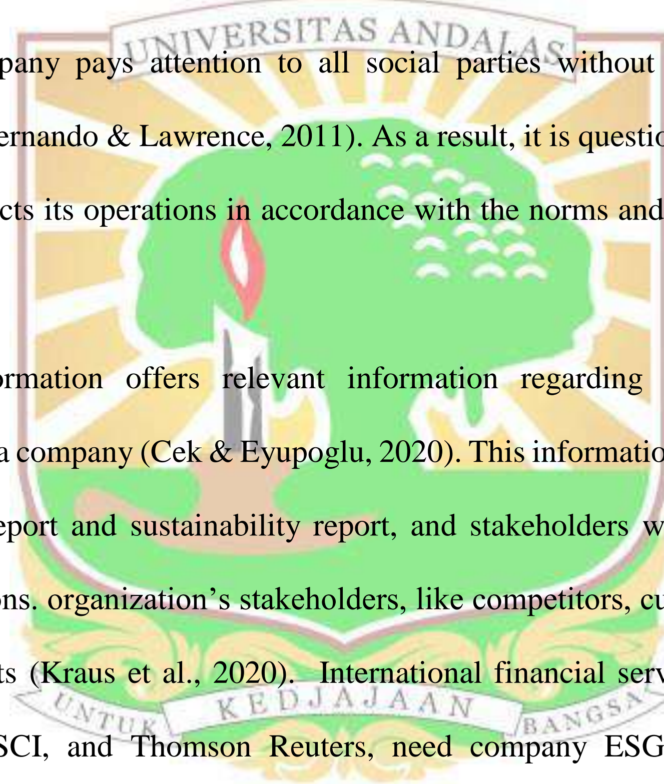
stakeholders interested in the business being carried out. Stakeholders are certain individuals or groups that can have an impact on achieving company goals (S. Fernando & Lawrence, 2011). In addition, green issues cannot be avoided by society. A good relationship between social parties and the company is needed so that the business run by the company gets support from the community. Deegan's (2009) legitimacy theory explains that there is a social contract between business and the social environment. where the company pays attention to all social parties without discriminating or separating (S. Fernando & Lawrence, 2011). As a result, it is questionable whether the company conducts its operations in accordance with the norms and can meet societal expectations.

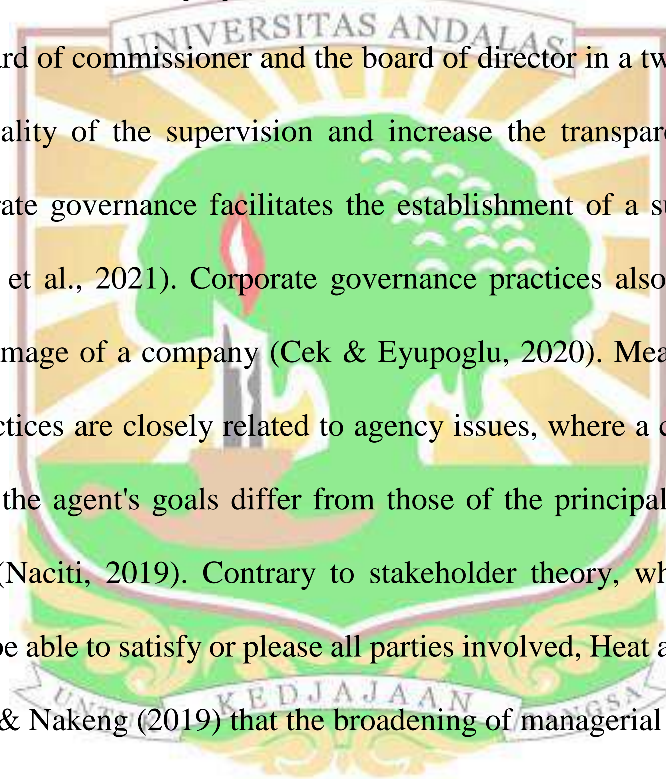


ESG information offers relevant information regarding the non-financial performance of a company (Cek & Eyupoglu, 2020). This information will be available in the annual report and sustainability report, and stakeholders will use it to make business decisions. organization’s stakeholders, like competitors, customers, workers, and governments (Kraus et al., 2020). International financial service agencies, like Bloomberg, MSCI, and Thomson Reuters, need company ESG information and provide an integrated ESG score that indicates companies that score highly on ESG principles are focused on creating long-term shareholder value (Tarmuji et al., 2016). As stated in Statement of Financial Accounting Standards (PSAK) No. 1 of 2011 regarding the presentation of financial statements, companies should be able to add reports on the environment, especially for industries where environmental factors play

an important role and for industries that consider users of this report to have an important role for the sustainability of their business. The ESG score issued by the international financial agencies is used to assess the performance of each ESG component, namely environmental performance, social performance, and corporate governance performance.

The company's environmental performance is inseparable from what the company's management does in managing the company to fulfill every aspect, including company sustainability performance. The implementation of social and environmental responsibility in Indonesia has been regulated by the Limited Liability Company Law since 2007. This law also regulates corporate governance practices (Tjahjadi et al., 2021). Fortunella & Hadiprajitno (2015) and Tjahjadi et al., (2021) state that corporate governance plays a strong role in the provision of environmental information about the company's environmental performance. Many companies are now adopting good corporate governance to run the company in accordance with applicable regulations. Corporate governance refers to action taken by organizations to improve relationships and interactions with various stakeholders, such as investors, workers, the government, consumers, and business partners, as well as engage in community activities and promote good environmental practices. The concept of corporate governance covers a set of rules, procedures, and operational structures that guide the short-term and long-term actions of companies (Fernando et al., 2017).

There are two types of corporate governance systems adopted by countries around the world, namely the one-tier system and the two-tier system. In a one-tier system, the board of directors acts as a supervisor and executor. In Indonesia, which follows a two-tier system, the supervisory role is carried out by the board of commissioners, and the board of directors is the executor (Tjahjadi et al., 2021). Pellegrini et al. (2016), in (Tjahjadi et al., 2021), state that the separation of roles between the board of commissioner and the board of director in a two-tier system will improve the quality of the supervision and increase the transparency of decision-making. Corporate governance facilitates the establishment of a superior disclosure strategy (Novia et al., 2021). Corporate governance practices also contribute to the reputation and image of a company (Cek & Eyupoglu, 2020). Meanwhile, corporate governance practices are closely related to agency issues, where a conflict of interest can arise when the agent's goals differ from those of the principal, as illustrated by agency theory (Naciti, 2019). Contrary to stakeholder theory, which says that the company must be able to satisfy or please all parties involved, Heat and Noman (2004) state in Fakoya & Nakeng (2019) that the broadening of managerial responsibilities to meet the needs of various stakeholder groups has exacerbated the occurrence of agency issues. agency problems like the presence of information asymmetry, opportunistic behavior, and conflict of interest (Naciti, 2019).



There are many studies that try to test corporate governance on environmental sustainability performance, such as (Fakoya & Nakeng, 2019; Fortunella & Hadiprajitno, 2015; Lu & Wang, 2021; Ludwig & Sassen, 2022; Naciti, 2019; Shahab et al., 2022; Shui et al., 2022; Tjahjadi et al., 2021; Xu et al., 2022). Previous studies used various proxy measures to measure the corporate governance of a company. The research of Lu & Wang, (2021) divides governance into two categories and includes proxies used by other studies. The first is internal governance, which includes board of directors characteristics, a board of commissioners, an independent board, separating board chair and CEO positions, CEO non-duality, CEO tenures, ESG committees, gender diversified boards, ownership structure, and executive compensation. The second is external governance, consisting of public pressure, the business environment, takeover markets, regulatory environments, a legal system that protects investors' rights via filling, compliance, and disclosure requirements by capital markets, security laws, and shareholder litigation.

Research by Naciti (2019) finds that firms with more diversity on the board and a separation between chair and CEO roles show higher sustainability performance. Moreover, Naciti's findings reveal that a higher number of independent directors leads to lower sustainability performance. Fakoya & Nakeng (2019) find that the number of female board members has a negative and insignificant influence on corporate energy usage; board independence positively and significantly influences energy usage. Based on their research, not all board characteristics influence companies' environmental

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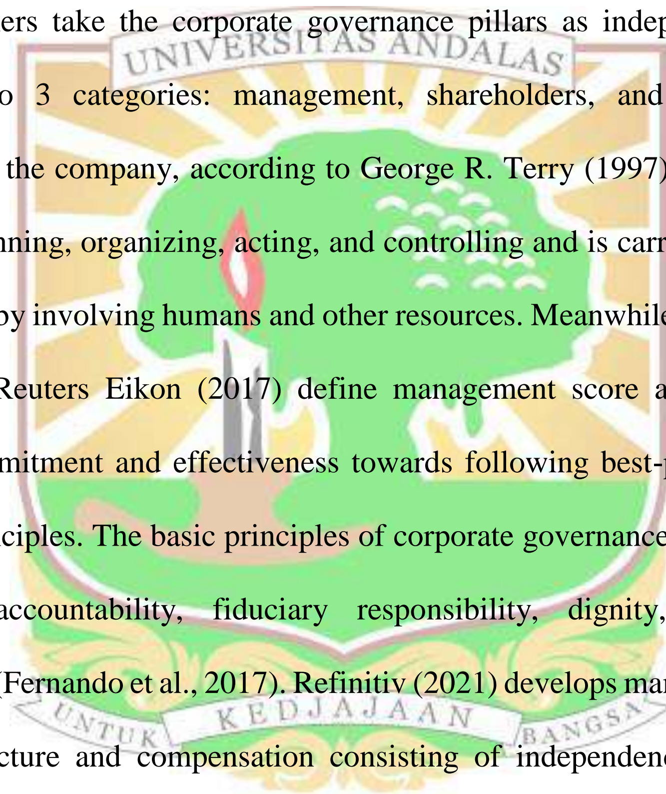
performance. Moreover, Xu et al. (2022) research finds that the CEO's tenure at a listed company will reinforce the positive effect of corporate environmental responsibility on innovation legitimacy at the same time.

In this study, researchers categorize corporate governance based on (Refinitiv, 2021; Thomson Reuters Eikon, 2017), namely, the 10 main indicators on the ESG score. Researchers take the corporate governance pillars as independent variables, which refers to 3 categories: management, shareholders, and CSR strategies. Management in the company, according to George R. Terry (1997), is a process that begins with planning, organizing, acting, and controlling and is carried out to achieve company goals by involving humans and other resources. Meanwhile, Refinitiv (2021) and Thomson Reuters Eikon (2017) define management score as measured by a company's commitment and effectiveness towards following best-practice corporate governance principles. The basic principles of corporate governance, namely fairness, transparency, accountability, fiduciary responsibility, dignity, propriety, and responsiveness (Fernando et al., 2017). Refinitiv (2021) develops management into two categories: structure and compensation consisting of independence, diversity, and commitments. Lu & Wang (2021), research finds that common corporate governance best practices such as CEO non-duality, ESG committees, and gender diversified boards are associated with better environmental performance and more disclosure of CSR-related information.



The shareholders are the owners of the company, and as such, they have certain rights and responsibilities. A good corporate framework is one that provides adequate avenues for the shareholders to make an effective contribution to the governance of the company while insisting on a high standard of corporate behavior without getting involved in the day-to-day functioning of the company (Fernando et al., 2017). By not involving the shareholders as the owners of the company, this can trigger agency problems if the agent, as a representative of the company, has conflicting interests. Fernando et al. (2017) mention that the shareholders delegate many of their responsibilities as the owners of the company to the directors, who then become responsible for corporate strategy and operations. So, this relationship brings the accountability of the boards and management to the shareholders of the company. Fortunella & Hadiprajitno (2015) research found that institutional ownership has no significant effect on environmental disclosure. The term "institutional ownership" refers to the fact that the company's shares held by institutions are unaffected by the company's actions in terms of environmental disclosure, which will be used to determine environmental performance. Garel and Petit-Romec (2020) show that firms with high environmental responsibility are rewarded by outside investors (Lu & Wang, 2021).

The next category is CSR strategy, which is closely related to environmental performance. Social and environmental responsibility are external factors that the company considers in running the business to support the company's sustainability.

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Ezzi and Jarboui (2016) mention that companies can modify existing strategies to improve sustainability performance from both environmental and social perspectives (Fakoya & Nakeng, 2019). The implementation of corporate social responsibility has been regulated in Law No. 40 of 2007, concerning limited liability companies, in which Article 74, Paragraph 1, states, "Companies that carry out their business activities in the field of and/or related to natural resources are obliged to carry out social and environmental responsibilities." The World Business Council for Sustainable Development in its publication "Making Good Business Sense" by Lord Holme and Richard Watts used the following definition: "Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large" (Fernando et al., 2017).

Today's companies generally have a division that carries out and oversees the implementation of CSR, called the CSR or ESG committee. According to Baraibar-Diez & Odriozola, (2019), aside from corporate boards' conviction and commitment to sustainability, one of the first steps that most international standards and guidelines will advise is the implementation of a CSR policy. Lu & Wang, (2021) found that ESG commitments are associated with better environmental performance and more disclosure of CSR-related information. This will have a positive impact on the company by legitimizing society. Legitimacy theory states that disclosure is used by firms to demonstrate that they are operating within the bounds of society. This is

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particularly used strategically by firms with poor environmental performance to cover or smooth negative news and to show that their activities are perceived as legitimate (Lu & Wang, 2021).

Therefore, based on the explanation above, the author intends to examine "**The Effect of the Components of Corporate Governance Pillars Consisting of Management, Shareholders, and CSR Strategy on Environmental Performance."** in energy and mining sector companies in China, Japan, South Korea, Indonesia, Malaysia, and Thailand for the period 2012–2021. To ensure the research variable remains constant, the researcher uses a set of control variables consisting of firm risk or leverage as measured by the ratio of total debts divided by total assets (Naciti, 2019), profitability as measured by return on asset (Akram et al., 2019; García Martín & Herrero, 2020), firm size as measured by the logarithm of the total assets, and firm age (Tjahjadi et al., 2021).

1.2 Research Question

Based on the background that the author explained earlier, the research question from this research is as follow :

1. How does the effect of Management on Environmental Performance?
2. How does the effect of Shareholders on Environmental Performance?
3. How does the effect of CSR Strategy on Environmental Performance?

1.3 Research Objective

Based on the research question above, the objectives of this study are as follows:

1. To exam the effect of Management on Environmental Performance.
2. To exam the effect of Shareholders on Environmental Performance.
3. To exam the effect of CSR Strategy on Environmental Performance.

1.4 Contributions of the Research

Based on the research objectives above, the contributions of this research are :

1. For Practical

   This research is expected to be used as a reference for further research on the influence of corporate governance pillars (management, shareholders, and CSR strategy) on environmental performance.

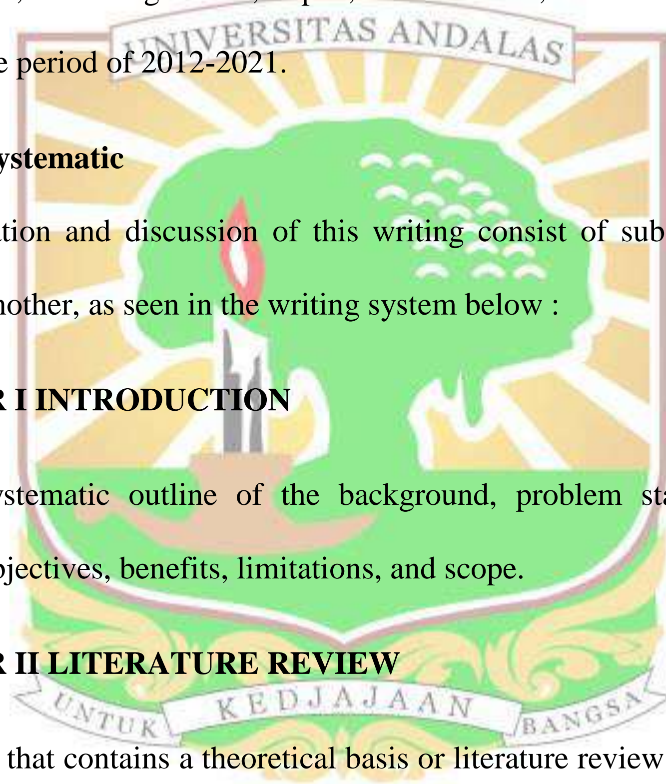
2. For Theoretical

   This research is expected to provide additional knowledge regarding corporate governance pillars and their influence on environmental performance. This research is also expected to contribute to the development of research methodologies.

1.5 Research Scope

For more focused problems that will be discussed, the writer will give limitations for this research so that the goals and objectives of this study can be achieved. There

are several variables that will be discussed by the writers, namely corporate governance. Pillars will consist of management (X1), shareholders (X2), and CSR strategy (X3). Firm characteristics as variables under control will be measured by firm size, leverage, firm age, probability, and environmental performance (Y) as a dependent variable. This study uses energy and mining sector companies in six Asia-Pacific countries, including China, Japan, South Korea, Indonesia, Malaysia, and Thailand, for the period of 2012-2021.



1.6 Research Systematic

The preparation and discussion of this writing consist of sub-chapters that are related to one another, as seen in the writing system below :

CHAPTER I INTRODUCTION

Write a systematic outline of the background, problem statement, research problem, objectives, benefits, limitations, and scope.

CHAPTER II LITERATURE REVIEW

is a chapter that contains a theoretical basis or literature review that is relevant to the problem identified. Theories include agency theory, stakeholder theory, legitimacy theory, corporate governance, an environmental, social, and governance (ESG) score, and environmental performance. Further, this chapter included such topics as previous research, a conceptual framework, and the development of hypotheses.

CHAPTER III RESEARCH METHODOLOGY

This chapter describes the research method, which consists of the method used, population and sample determination, data collection sources and techniques, operationalization and measurement of variables, and data technique analysis.

CHAPTER IV RESULTS AND DISCUSSION

This chapter contains the results of research, which includes an overview of the participants, descriptive analysis, hypotheses testing, and justifications.

CHAPTER V FINAL PART

This chapter is a closing chapter that contains useful conclusions, research implications, recommendations, and limitations contained in this study.