Chapter I

Introduction

1.1 Background

The main topic of the spotlight in recent years is about the environment began to change. The significant change that tend to be negative and have an impact on environmental degradation. Clearly this is illustrated by the increase of global warming in issue that will greatly threaten our lives. The quickness of awareness and sense of responsibility as individuals and also as the part of society is needed to face of this environmental damage.

The increase in globally environmental awareness redirects the attention of companies to environmental sensitivity. Climate change and global warming become a top concern for performance of a company. This encourages companies to pay more attention to the environment surrounding them. High profit will no longer be the most important variable in business success. It means that selling products or delivering services should be followed by addressing the challenge of environmental change such as global warming, health care, poverty, and energy saving. In addition, many multinational business leaders are already demonstrating that tomorrow's most successful companies will be those that are willing to devote time and effort to incorporate social responsibility into their business models . Hence, many multinational companies began to take sustainability reporting seriously. The term of sustainability report is recently used to cover the disclosure of a company's commitment on sustainable development. Many companies worldwide that have recently release sustainability report have a commitment to sustainable development. Responsibility towards environmental and social aspects which businesses have on the community is said to be related to the sustainable development.

Beside the increasing of global environmental awareness and the campaign of sustainable development, the increasing trend of sustainability reporting is also supported by the increasing number of guidelines provided by various government organizations and industry bodies (Basamalah et al, 2005). Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the sustainability reporting framework. Many organizations follow the framework and standard of disclosing sustainability report according to GRI.

Businessman that include investors who are familiar with the public also started to feel concerned with what happening in the environment around them. Investors started to realize the importance of protecting the environment or not they who will receive the result of the destruction of the environment. It's encourage the company to create a sustainability report that contains the company's activities in conducting activities that impact both on the environment , social and economic.

Indonesia government has law for Limited Liability Company (PT) to create an accountability report under Enactment No.40 Year 2007 state that "Social and environmental responsibility is the company's commitment to participate in sustainable economic development to improve the quality of life and the environment that is beneficial, both for the Company itself, the local community, and society in general". The Financial Services Authority (OJK) also gave off similar legislation in OJK No. Kep-431/BL/2012 stated that "The annual report must include corporate social responsibility. The report on corporate social responsibility disclosed in the annual report or separate reports submitted in conjunction with the annual report to the FSA, such as reports on sustainability or corporate social responsibility report ". With the existence of this rule, indicating the seriousness of the government in taking into social and environmental responsibility in the business world. Also expected this rule is starting to be implemented by other companies which have not been entirely revealed sustainability report.

Recently, companies have been called upon to fulfill the needs of wide range of stakeholders who pay attention to company's value. They are interested in understanding the approach and performance of a company in managing the sustainability such as economic, environmental, and social aspects, including the potential for value created from managing sustainability. Besides providing financial information for shareholders, a company needs to publish non- financial information as well. Social responsibility reporting is the communication about a company's responsibility for social and environmental aspects surrounding the business. This reflects that companies owe stakeholders an annual accounting of their social and environmental performance as the financial information they provide to share- holders.

The perspective of sustainability provides a framework to create value which refers to both achieving sufficient profits and to satisfying the request of a diverse group of stakeholder (Lopez et al, 2007). There is a growing recognition among investment analyst that numerous business drivers upstream of a company's profit and loss statement, including environmental, social, and governance, contribute to long-term financial performance and investment returns (KPMG, 2008). There is also a perception that organizations are producing sustainability reports primarily as a public relations exercise to give impression of concern over social and environmental issues (Hubbard, 2008). By disclosing sustainability reports, organizations will have generalized positive repercussions, where the aim is to fulfill the needs of different stakeholder, while also be benefited from the perspective of operations, finance, and reputation (Blyth, 2005, p.29 in Lopez et al, 2007). Investors are increasingly seeking to invest in socially responsible investments (SRI) in the companies that follow good social and environmental practices. Specific indexes have been created in developed country such as US-based kinder and Dow Jones Sustainability index to assist investors who are willing to invest in socially responsible companies. This development shows that the pressure for sustainability reporting will continue to increase. Firms and investors recognize that investing in accordance with sustainability principle has the capacity to create long term value (Bebbington, 2001). These principles constitute a differentiating elements in establishing investments portfolio, as stakeholder believe accredited practices of corporate social responsibility lead to good economic-financial performance (Lopez et al, 2007).

The number of investor claims against the company in sustainability reporting it impact to make guidance for companies that want to create a sustainability report. Sustainability report eventually became a trend and the need for companies to inform about the performance of economic, social and environmental well as to all stakeholders of the company.

Furthermore, corporations need to realize that the purpose of the company is not limited to seeking maximum profits for shareholders. However, the corporation or company has a broader agenda, which aims to serve the affairs of the world (global). Create value as the heritage of future generations to be responsible for the overall stakeholders, including environmental sustainability and creating social justice (Fajar, 2013: 9) By implementing a sustainability report, the company is already considered a commitment to social issues and the environment as a form of transparency in realizing a sustainable global economy .Based on some of the facts that occurred regarding the company's activities that led to the environmental damage that firms are required to maintain a balance between profit (economic performance), planet (environmental performance), and people (social performance) to create a sustainability report. Sustainability reports is a report that provides an overview of the activities and the impact of economic activity, the environment, and social enterprise to stakeholders as a form of transparency in sustainable development (WBCSD, 2002).

Based on several facts that occur regarding company activities that trigger environmental damage, the company is required to maintain a balance among profit (economic performance), planet (environmental performance), and people (social performance) by making a sustainability report. Sustainability reports or commonly called sustainability reports are reports that provide an overview of the activities and impacts of the company's economic, environmental and social activities to stakeholders as a form of transparency in achieving sustainable development

A survey conducted by KPMG shows that the growth of the number of companies issuing environmental, social report or sustainability reports, in addition to annual financial reports, is significant. Nearly, more than half of the world's 250 largest companies issue sustainability reports (White, 2005). Reporting rates are high in developed countries such as France, Germany, Japan, the United Kingdom, and the United States. Reporting rates are highest in certain industries, e.g. chemicals and synthetics, pharmaceuticals, electronics, and computers, automotive, and oil and gas since the activities of those companies are sensitive to the environment (Choi, 2008, p. 162).

Publication of Ernest and Young (2013), found that the disclosure of sustainability reporting has an important role as the use of information that can be seen from a survey conducted 39% for the benefit of consumers, 29% of workers, 25% for the leadership of the company, and 24% for the benefit of investors. Also, this survey also indicates that the presence of a sustainability report 59% can add value and 57% to reduce the risk mitigation activities undertaken by the company which will have a positive impact on the sustainability of the company. Thus, the disclosure of sustainability reports provide benefits to the company as an investor attractiveness for investments and to improve financial performance as it helps build consumer confidence will affect the company's increased revenue.

The company guidelines for disclosing sustainability reports are regulated by the Global Reporting Initiative (GRI). GRI is a world organization that has special attention to sustainability development systems that have the aim of providing guidance globally and extensively in sustainability reporting so that there is uniformity in disclosure. In 2013, GRI published the latest version of the GRI G-4 with a more transparent disclosure system and high materiality level. In Indonesia itself, the development of a sustainability report supported by the National Center for Sustainability Report (NCSR) is an independent organization with the aim of assisting the development, measurement and reporting of the implementation of Corporate Sustainability actively promoting years of sustainability reporting. In 2005, the first time the NCSR held the Indonesia Sustainability Report Award (ISRA), which was a place of appreciation for companies that carried out the disclosure of sustainability reports as a form of attention to the sustainability system in Indonesia.

With the disclosure of sustainability reports, it is expected to provide concrete evidence that the production process carried out by the company is not only profit oriented, but also takes into account social and environmental issues. Companies that do disclosure of sustainability reports will not only get benefits in terms of gaining public trust in the company but also become a signal for investors to invest, so that it will improve the company's financial performance. Soelistyoningrum and

Prastiwi (2011) stated that sustainability reports have a significant positive effect on the company's financial performance which is proxied by ROA, which means that companies that disclose sustainability reports will increase the company's profitability. This is in accordance with the results of Ammer and Othman (2012) which states that the disclosure of sustainability reports can provide a significant increase in sales growth, Return on Assets, and company cash flows, supported by research by Burhan and Rahmanti (2012) and Weber et all (2008).

The practice of disclosing sustainability reports is supported by stakeholder theory. According to Freeman (1984) stakeholder theory explains to which parties the company must take responsibility, in this case the company's responsibility does not only focus on shareholders but the company also has responsibility to the community and the environment. Assets owned by corporations or companies are not only private property, but must be used to provide public benefits (Fajar, 2013: 13). Companies must maintain relationships with those who have power in the availability of resources that support the company's operational activities so that they gain stakeholder trust. So this theory assumes that the existence of a company is determined by stakeholders, therefore the practice of disclosing sustainability reports plays an important role because the company is a unit with the environment and society so that its activities have social and environmental impacts.

Furthermore, corporations need to be aware that the company's goals are not limited to seeking maximum profits for shareholders. However, corporations or companies have a broader agenda, which is aimed at serving global affairs. Creating values as a legacy of future generations by being responsible for all stakeholders, including natural sustainability and creating social justice (Fajar, 2013: 9) By implementing a sustainability report, the company is considered to have a commitment to social and environmental issues as a form of transparency in realizing a sustainable global economy.

Many articles state that sustainability has a capacity for long-term financial performance, investment return, and also value creation which refers to achieving sufficient profits. Companies that are apathetic to their environmental responsibility might experience eventual crashes on their stock price if their investors are rational in considering the future value of the firm based on its present state of environmental responsibility. Also, companies that pollute their environment might experience gradual depletion in earnings which could make their future solvency eroded. Thus, social responsibility behavior or sustainability practices may contribute to financial performance of a company.

Reporting sustainability activities in the sustainability report is proven to be positively correlated to the company's financial performance (Weber et al, 2005). This was specifically stated by Tarigan and Samuel (2014) by stating that disclosure of sustainability reports can improve financial performance in terms of profitability and company liquidity. Sustainability reports as measurement practices, disclosures and accountability efforts of sustainability activities are used by companies to achieve sustainable growth, long-term success, and sustain life (KPMG, 2008). The company's ability to effectively communicate activities and performance through sustainability reports is assessed as a form of accountability, responsibility, and transparency of the company to its stakeholders that are believed to increase the value of the company. Investors prefer to invest in transparent companies because of the high trust in management for the accuracy of forecasting analysis and lower information asymmetry (Ernst & Young, 2013). Sustainability reporting is also believed to increase reputation and trust for consumers. The company's high reputation and trust in the eyes of consumers has an impact on loyalty which will ultimately increase company revenue (Ernst & Young, 2013).

The function of the Sustainability Report is to inform how the company's economic, social and environmental performance. Sustainability Report is intended as a form of evidence of corporate responsibility to stakeholders and evidence that the company is within the limits of existing regulations. Companies need to make a Sustainability Report disclosure to gain stakeholder confidence, because stakeholder confidence is needed for the company's business continuity. The stakeholders' trust can be in the form of investment or cooperation that has the potential to increase company productivity and sales. This can affect the level of the company's net profit, where increasing the company's net profit will increase the profitability of company . Increased profitability can be interpreted that the company's performance increases.

Based on the description that has been stated before and the few facts that occurred in the field of the activities of companies that are less partial to the environment and public disclosure of sustainability reports an interesting topic for research. Previous studies have been conducted regarding the disclosure of sustainability reporting . Tarigan and Samuel (2014) conducted a study on the sustainability report and the financial performance of the conclusion that the disclosure of economic performance in the sustainability report has no effect on the financial performance while disclosure of social and environmental performance affects the financial performance. However, The study results contrary with Simbolon (2016) found that the only economic disclosures in that affect the sustainability of financial performance. While the disclosure of social and environmental performance does not affect to financial performance. Then, Sejati (2014) concludes that the disclosure of economic performance, environmental and social sustainability report does not affect the performance of the company.

After a review of several studies that have been there, the inconsistent results, this must be examined in more depth and more about the disclosure of sustainability reporting on the performance of the company. Companies are strongly associated with the environment is a public non-financial company, and therefore the study will be done by taking a data sample of non-financial companies that have published a sustainability report that is listed on the Indonesia Stock Exchange.

1.2 Problem Formulation

Sustainability reporting promotes transparency as a form of social responsibility that also enhances the company's image and stakeholder trust in the company so that stakeholders, including investors, maintain good relations with the company. This illustrates that the existence of sustainable report disclosure provides a positive value for the company such as conducting natural protection activities, maintaining social relations, the welfare of the community and good relations with employees. With this, the company might improve the performance of the company.

This study seeks to examine whether there is an influence between disclosure of sustainability reports where there are economic, social and environmental dimensions to the financial performance of a company. Therefore, the formulation of the problems examined in this study are as follows:

1. Does economic disclosure influence financial performance?

2. Does social disclosure influence financial performance ?

3. Does environmental disclosure influence financial performance?

1.3 Research Objectives

Current regulation obligate a company to prepare sustainability report. In accordance with the formulation of the problem whether the practice of sustainability reporting disclosure influence corporate financial performance . So the purpose of this study is as follows:

1. To examine the influence of sustainability disclosure for economic aspect on financial performance

2. To examine the influence of sustainability disclosure for environmental aspect on financial performance

3. To examine the influence of sustainability disclosure for sosial aspect on financial performance

1.4 Research Contribution

The results is expected contribute to the academic and practical aspects. The following is an explanation of the contribution of the results of the study later. For the theorical aspect , this study it is expected to enrich previous study by using research data that is longer than previous study. In practical terms , expected to be used as a reference that can be used as information relating to sustainability disclosure and also its relation to financial performance in non-financial companies. It is expected to provide insight to non-financial company about the sustainability report has affect financial performance