CHAPTER I
INTRODUCTION

A. Background

Environmental reporting has become an important dimension of corporate external information system in the twenty-first century. This is because environmental, social and corporate governance issues are now considered to be important and integral aspects of company performance (Trireksani, Terri and Djadjikerta, 2016). Moreover, the increasing pressure on companies to be responsible to the society has influenced them to operate in an environmentally responsible manner because there is a growing concern towards the investors, creditors, government and public.

There has been a growing interest in the issue of corporate governance and its integration within the concept of sustainability in recent years (Cuesta and Valor, 2013; Galbreath, 2013). However, the impact of corporate governance aspect on sustainability disclosures (including environmental disclosures) is relatively small and focused largely on developed countries (Michelon and Parbonetti, 2012; Trireksani et al., 2016). In addition, Peters et al. (2011) state that emerging countries have tendency to show weaker measures on the issue of corporate governance and environmental disclosures.
The sample selection is limited to the mining sector because in this sector the companies are related to the exploitation of natural resources. The exploitation is closely linked to the waste and environmental pollution which have high level of industrial and environmental risks. Those are proven by the fact that nearly 70% of environmental damage in Indonesia is caused by the mining company (Bangkapos.com, 2012). Moreover, in November 2014, Greenpeace Indonesia released the results of their investigation stated that 3,000 km of rivers in South Kalimantan (about 45% of the total river in South Kalimantan) are potentially polluted due to mining activities. In line with these, Gunawan et al. (2009) found that companies in the environmentally sensitive industries, such as mining, tended to disclose more about environmental information compared to companies in the other industries during the period in 2003-2006.

In response to this state, this study is focused on corporate governance and environmental disclosures level in one of emerging countries, Indonesia. Basically, the implementation of corporate governance principle is called as a disclosures. The word disclosures refers to uncover, unveil, or expose. It means, the disclosures in financial statements or annual report should provide sufficient information and explanation about the activities of a business unit (Ghozali and Chariri, 2007).

According to IAI (Ikatan Akuntansi Indonesia, 2007) there are two kinds of disclosures. They are mandatory and voluntary disclosures. Mandatory disclosures is the disclosures required by accounting standards and applicable regulations.
Meanwhile, voluntary disclosures is a disclosures published by management to provide additional information related to the business activities. Environmental disclosures is an example of voluntary disclosures practices.

Moreover, Khan et al. (2013) also states that the information contained in the annual report is published with mandatory disclosures and voluntary disclosures. The role of disclosure is very important for shareholders and users of financial statements because the additional information presented in the annual report might be affected an investment decision. In addition, voluntary disclosures can provide benefits to the company by becoming a differentiator between the companies.

The environmental disclosures is an important part of annual report because it will make the company’s financial statements more transparent and reliable. The company's annual report is an intermediary of communication between companies and its stakeholder which provides information on a company’s activities that legitimize company behavior, educate and inform, and change the perceptions and expectations of the stakeholder (Adams and McNicholas, 2007). Lujun (2010) states that companies with good environmental performance have an incentive to disclose more about environmental information in their financial statements.

The disclosures of environmental information in the annual report in Indonesia is something that is still voluntary, so the presence or absence of this disclosures in the annual report depends on the policies of each company. Because of financial accounting standards in Indonesia do not require companies to disclose
any social and environmental information as mandatory subject, they will lead many companies to not disclose their environmental activities (Miranti, 2009).

Corporate governance mechanism is a pattern of relationships, systems, and processes used by corporate organs to provide value added to shareholders on an ongoing basis over the long term by taking interests of stakeholders, based on laws and regulations and prevailing norms (Daniri, 2005). Implementation of the corporate governance mechanism is one of the significant efforts to escape from the economic crisis happened in Indonesia in 1997, oriented to show the concern and responsibility towards the environment through environmental disclosures. The good implementation of corporate governance mechanism will increase the level of investor’s confidence in investing and will influence corporate information disclosures to users of financial statements in order to reduce information asymmetry.

There are several factors which can describe corporate governance mechanism including external and internal factors. In this study, there are seven factors which are used to describe corporate governance mechanisms. They are the board of commissioner size, gender diversity (female directors), proportions of independent commissioners on the boards, the number of board of commissioners meetings, audit committee size, managerial ownership, and foreign ownership.

Top management of a company consists of board of commissioners and directors. Each company has a different board size depending on the company's needs. Based on agency theory, the board of commissioners is regarded as the
highest internal control mechanism, which is responsible for monitoring management activities. The small size of the board of commissioners can improve the quality of monitoring. It will result in increased environmental disclosures of the company. This is due to the lack of board personnel who minimize the occurrence of differences of opinion in decision making. Lipton and Lorsch (1992) argue that large board sizes cannot function optimally because with the large number of boards will be easily controlled by top managers. Meanwhile, the small size of the board of commissioners will increase the effective and efficient level in decision-making as it can minimize disagreements between shareholders (Raheja, 2003).

Therefore, the companies need an independent board of commissioners which is impartial to the board of directors. In accordance with agency theory, having an independent board of commissioners will result greater power in monitoring management activities to disclose information. Agrawal and Knoeber (1996); Baysinger and Butler (1985) found that with the existence of Independent Board of Commissioners, the performance of management is more effective and efficient in order to produce better quality of environmental disclosures.

Several studies (e.g., Bonn, 2004; Huse and Solberg, 2006; Rao, Tilt and Lester, 2012) have found the effect of women as members of boards of commissioners and directors on an increasingly firm performance. Rovers (2010) and Ararat et al. (2010) also found that companies with women in boards of directors and commissioners perform better than companies without representation
of women in board of commissioners and directors. It has been suggested that
gender-based directors are diligent, committed and involved (e.g., Bonn, 2004; Huse and Solberg, 2006; Rao et al., 2012; Webb, 2004). Robbins and Judge (2008) stated that women generally have more detailed thinking in decision-making analysis. Consequently, the gender diversity (female directors) on the board would be positively associated with the level of environmental disclosures.

A company consists of at least three boards of commissioners who each year always hold meetings to discuss the direction and strategy of the company, the evaluation of policies that have been taken or carried out by the management, and address the issue of conflict of interest. Xie et al. (2003) point out that meetings that are held more frequently can increase the supervisory level of managers in order to increase the disclosures level, especially in terms of environmental disclosures.

An audit committee is a committee assigned to assist the board of commissioners in conducting supervisory mechanisms on management. According to Said et al. (2009), audit committee is regarded as an effective tool for conducting oversight mechanisms, thereby reducing agency costs and improving the quality of corporate information disclosures. Collier (1993) and Ho and Wong (2001) stated that the existence of the audit committee helps the top management to ensure about companies disclosures and the control systems would be better. Thus, it is expected with the size of the audit committee getting bigger, the controlling, monitoring and the quality of additional information disclosures are better.
Managerial ownership is one form of ownership structure that can overcome the problem of the agency led to the creation of GCG concept. Jensen and Meckling (1976) established a theory that management ownership of shares will decrease agency conflicts, because the more shares owned by management then the stronger their motivation to work in improving company value by disclosing any additional information.

Besides managerial ownership structure, there are also foreign ownership structures. According to Machmud and Djakman (2008), the structure of foreign ownership within the company will also affect the company's voluntary disclosures. This is because foreign parties are considered to be more concerned about the disclosures related to corporate social responsibility. Multinational companies in Indonesia, especially those from Europe and the United States, pay more attention to social issues such as human rights violations, education, labor and environmental issues such as greenhouse gases, illegal logging and water pollution.

Anggraini (2006) states that the investor will give a positive response in the form of interest in purchasing and stocking investments in companies that have good performance and good environmental disclosures because they perceive that companies with good financial performance will have better financial prospects in the future. Company values are defined by market value. The higher value of the company, the greater the prosperity that will be accepted by the shareholders. This argument is in line with the research conducted in US by Plumlee et al. (2015)
which resulted that the voluntary environmental disclosures had a positive relation with the company's value.

Previous literature has investigated possible determinants of financial, social and environmental disclosures level, in particular focusing on corporate characteristics (size, industry grouping and financial performance) or general contextual factors (the country of origin, the socio-political and cultural context). Indeed, there is an emerging debate on the possibility that other complex and various internal contextual factors influence disclosures practices level (Gray et al., 1995).

Issues of corporate governance and disclosures have dominated headlines from business presses in recent years. Various studies have been published in countries such as the United States, Britain, continental European countries and West Asian countries (e.g., Arcay and Vazquez, 2005; Chen and Janggi, 2000; Ho & Wong, 2001). Most of the empirical studies in various countries around the world that examine the relationship between corporate governance mechanisms and voluntary environmental disclosures level provide mixed results.

Haniffa and Cooke (2005) stated that the study related to effect of corporate government on financial disclosures is relatively higher than the study about the impact of governance on voluntary disclosures, especially environmental disclosures. This can be inferred from the previous studies that claimed that disclosures policies emanate from the board (Ho and Wong, 2001; Gul and Leung, 2004; Haniffa and Cooke, 2005; Cheng and Courtenay, 2006; Cerbioni and
Parbonetti, 2007; Jo and Harjoto, 2012; Michelon and Parbonetti, 2012; Rao et al., 2012). It is expected that the characteristics of the corporate governance model adopted by the company are fundamental determinants of companies’ disclosures.

This study refers to previous studies by Trireksani et al. (2016), which examined about corporate governance and environmental disclosures in the Indonesian mining industry in 2012. This study has some differences with the previous research, because this study used samples of mining companies listed in Indonesian Stock Exchange in 2015-2016 and the author did not use the board of director's variables. However, it used the board of commissioner's variables that have been adapted to the conditions of companies in Indonesia, whereas companies in Indonesia implement the system called Two Tier Board System. In addition, this study provides more contributions by adding another variables, such as the number of board of commissioners meetings, audit committee size, managerial ownership, foreign ownership, and firm value.

Based on the background above, the researcher is interested in conducting research entitled “Analysis of The Effect of Corporate Governance Mechanisms towards Environmental Disclosures and The Impact on Firm Value” (Empirical Study on Mining Company Listed in Indonesia Stock Exchange during 2015-2016).
B. Scope of the Study

The scope of this study is limited to a mining industry. It is because the mining industry is an industry sector whose operations are directly related to the acquisition of natural resources. The mining industry possesses a risk of damage and contamination levels on the surrounding environment which are higher compared to other industrial sectors (Trireksani et al., 2016). Therefore, this study used mining industry to determine the extent of the business sector in the mining industry to conduct the maintenance and protection of the environment associated with the benefits obtained directly from nature in their business activities. The data taken by the researcher in this research were from 2015 until 2016.

C. Research Questions

Considering the background and the scope of the study, the research questions are formulated as follows:

1. Do the board of commissioner size has a negative significant effects towards environmental disclosures level?
2. Does gender diversity (female directors) has a positive significant effects towards environmental disclosures level?
3. Do the proportion of independent commissioners on boards has a positive significant effects towards environmental disclosures level?
4. Do the number of board of commissioners meetings has a positive significant effects towards environmental disclosures level?

5. Does the audit committee size has a positive significant effects towards environmental disclosures level?

6. Does the managerial ownership has a positive significant effects towards environmental disclosures level?

7. Does foreign ownership has a positive significant effects towards environmental disclosures level?

8. Do environmental disclosures level has a positive significant effects towards firm value?

D. Research Purposes

Based on the formulation of the problem above, the purposes of this research are as follows:

1. To examine the negative relation of size of the board of commissioners towards environmental disclosures level.

2. To examine the positive relation of gender diversity (female directors) towards environmental disclosures level.

3. To examine the positive relation of commissioners independent board proportion towards environmental disclosures level.

4. To examine the positive relation of commissioners board meetings number towards environmental disclosures level.
5. To examine the positive relation of audit committee size towards environmental disclosures level.

6. To examine the positive relation of managerial ownership towards environmental disclosures level.

7. To examine the positive relation of foreign ownership towards environmental disclosures level.

8. To examine that environmental disclosures level positively affects the firm value.

E. Significance of the Study

The study is expected to provide theoretical and practical contributions. They are explained as follows:

1. Theoretical Benefits

This research is expected to provide benefits for the development of economics and accounting, especially on factors that will affect environmental disclosures issues.

2. Practical Benefits:

a. For the Government

This research is expected to be a reference in the framework of evaluation and in making regulations on environmental disclosures issues.
b. For the Company

This study is expected to give an idea to the company about the importance of environmental accounting, so it can encourage the companies to increase their awareness of the environmental issues.