CHAPTER II
LITERATURE REVIEW

A. THEORETICAL FRAMEWORK

1. Agency Theory

   Specifically, agency theory is a relationship, in which one party (the principal) delegates work to another (the agent), who performs that work. Principal and agent relationships should reflect efficient organization of information and risk-bearing cost. According to Jensen and Meckling (1976), agency theory is concerned in resolving problem that occurs in agency relationship. The most of agency problems arise when the principal and agent have partly differing goals and risk preferences (e.g., in regulation, leadership, whistle blowing system, impression management, compensation, transfer pricing, and vertical integration); and when there is asymmetry information between principal and agent.

   The partial goals and risk preferences cause shareholders as principal to be more eager in order to monitor any decisions made by managers (agent) by delegating authority to directors. Reporting information of all activities to the principal is very important to do, because the existence of the report is expected to be used as the basis evaluation on company's performance and as a form of agent’s responsibility to the principal and society.
In the agency theory, it is explained that there is a relationship between corporate financial performance and environmental disclosures information. The companies which have good financial performance would certainly increase their profit in order to reduce agency costs. The profits owned by the company will make the management motivated in expanding towards corporate environmental information disclosures.

2. Legitimacy Theory

In the legitimacy theory, it is stated that companies should continually ensure that they are operating within the norms upheld by the community and ensure that their activities are acceptable to outsiders (legitimized). Dowling and Pfeffer (1975) state that "legitimacy is important for the organization, the constraints imposed by the norms and social values, because the reaction to these limits encourage the importance of the analysis of organizational behavior with attention to the environment." The postulate of the theory of legitimacy is that organizations should not only be concerned about the rights of investors, but also should pay attention to the rights of the public (Deegan and Rankin, 1996).

Ghozali and Chariri (2007) argue that what underlines the theory of legitimacy is the social contract between the company and the society in which it operates and uses its economic resources. So basically every company has an
implicit contract with the community to do its activities based on the values that are upheld within the community. Higher costs will arise because people refuse to legitimize the existence of companies in their midst.

Therefore, the company seeks to gain legitimacy from the community by implementing programs that meet the expectations of the community (Wartick and Mahon, 1994). Thus as a system that prioritizes the alignment to the society, the operations of the company must be congruent with the expectations of the society. The real implementation is through the implementation of corporate social responsibility (including environmental disclosures) programs. Further, it discloses them both in the annual report and sustainability report as a form of information that investors need to make decisions regarding the company's performance in accordance with the values in the community.

3. **Stakeholder Theory**

Stakeholder is an individual, a group of people, or society either as a whole or partially that has relationships and interests to the company. Individuals, groups, and communities can be said to be stakeholders if they have the power, legitimacy, and interests of the company (Budimanta et al., 2008). In 1963, the Stanford Research Institute (SRI) defines stakeholder as a capable group of supporting the existence of an organization. Without the support of this group, the organization could not exist.
There are two kinds of stakeholder, which are primary stakeholders and secondary stakeholders. The primary stakeholder consists of owners, employees, customers, suppliers, and public stakeholder groups. Meanwhile those that belong to secondary stakeholders are media and stakeholders with broader scope (SRI, 1963).

Stakeholder theory begins with the assumption that the value is explicit and undeniable part of business activities (Freeman, et al., 2002). In stakeholder theory, it is stated that a company is not an entity that only operates for its own sake but must provide benefits to its stakeholders. Thus, the existence of a company is strongly influenced by the support given by stakeholders to the company.

Stakeholder theory states that all stakeholders have the right to obtain information about company activities that may affect their decision-making. Stakeholders may choose not to use such information and may not even play a role directly within a company (Deegan, 1996). This is because stakeholders are considered to influence but can also be influenced by the company. Thus, the existence of a company is strongly influenced by the support given by stakeholders to the company.

The success of a company's business is determined by the company's successful management in fostering relationships between companies and stakeholders. Disclosures in financial reporting can be seen as a kind of dialogue between management and stakeholders. Lujun (2010) argues that over the last
few decades, environmental issues have received more attention from stakeholders.

Companies need to provide information to relevant stakeholders about the positions of their social and environmental responsibilities and achievements through social and environmental disclosures. Thus, companies need to maintain the legitimacy of the stakeholders in the policy framework and decision-making purposes, in order to support the achievement of corporate objectives, namely stability and collateral businesses going concern (Ardianto and Machfudz, 2011).

4. Signaling Theory

Signaling theory is useful in describing behavior when two parties (individuals or organizations) have the access to different information. Typically, one party, the sender, must choose whether and how to communicate (or signal) that information, and the other party, the receiver, must choose how to interpret the signal (Brian et al., 2010).

Basically, signaling theory discusses about how to provide information to the external parties. This becomes important due to the asymmetry information between management and external parties. To reduce the asymmetry information, companies must disclose their own information, both financial and non-financial information. Those information might be published in an annual report or in a sustainability report.
Lujun (2010) states that companies with good environmental performance have tendency to disclose more about environmental information in their annual reports. The absence of environmental disclosures information might indicate a higher level of environmental risk and costs associated with future regulation. Because disclosing environmental information will increase the transparency which makes the report more reliable, resulting in a positive response from investors in the form of investment decision to purchase the company’s shares. Investors will be more interested in companies that conduct performance and environmental disclosures in a sustainable manner. Furthermore, if it continues to be implemented by the companies, it will increase the reputation and value of the companies (Rustiarini, 2010).

5. **Corporate Governance Mechanism**

A Good Corporate Governance (GCG) is a long-term key of successful companies in facing global competition, especially for companies that go public. According to the Forum for Corporate Governance in Indonesia or FCGI (2002), the corporate governance is a set of rules governing relationships between shareholders, managers, creditors, governments, employees, and other internal and external stakeholders related to their rights and obligations.

The company's advantages to implement GCG are to increase the confidence level of investor for investing in the company and to encourage the company to disclose more about any additional information in order to reduce
asymmetry information. Thus, it can be concluded that GCG mechanism is a procedure or process used by company to regulate and control the company.

There are five principles of corporate governance defined by the Decree of the Minister of Stated Owned Enterprises No. Kep-117 / M-MBU / 2002 in implementing good corporate governance practices which are explained as follows:

a. Transparency

Transparency is the transparent mechanism of decision making and disclosures of material and relevant information regarding the company.

b. Independence

Independence is the professional management of the company without conflict of interest and influence from any other parties that are against the laws and regulations and healthy corporate principles.

a. Accountability

Accountability is the clarity of functions, implementation, and responsibility of the organs to enable an effective management of the company.

b. Responsibility

Responsibility is the conformity of business management with the laws and regulations and healthy corporate principles.

c. Fairness

Fairness is the equal treatment in fulfilling rights of all stakeholders based on the healthy corporate principles.
Corporate governance is a concept reference of the corporation in running their daily operation smoothly. The five principles above which are transparency, independence, accountability, responsibility, fairness can be used as guidelines for a corporation in running their business. Therefore, the companies that already follow the guidelines or five principals are likely to have a good condition.

In this study, the factors which describes corporate governance mechanisms are the board of commissioner size, gender diversity, proportions of independent commissioners on the boards, the number of board of commissioners meetings, audit committee size, managerial ownership, and foreign ownership.

a. Board of Commissioners Size

The board of commissioner size refers to the total number of members of commissioners on a company’s board. The board of commissioner size is one factor of the company's success but there are still conflicting opinions regarding the appropriate size for company’s commissioner (Trireksani and Djadjadikerta, 2016). The size of the board of commissioners will increase the knowledge of each board that will assist them in running the company. However, the great size of the board of commissioners can lead to contradiction of thought in making decisions that result in delayed decision making (Said, 2009). Meanwhile the board of
commissioner size is seen to be more efficient and effective in monitoring and supervising corporate performance and decision making because it does not cause contradictions of thought that will hamper the company's operations.

b. Gender Diversity (Female Directors)

Several studies have found the effect of women as members of boards of commissioners and directors on board has increasing firm performance (Rao et al. 2012; Rupley et al. 2012). Carter et al. (2002) found a positive influence between female fractions in the board of commissioners and directors with firm value. Rovers (2010) and Ararat et al. (2010) also found that companies that have women in boards of directors and commissioners perform better than companies without representation of women in board of commissioners and directors.

Kusumastuti et al. (2007) revealed that women have a very high cautionary attitude, tend to avoid risk, and are more thoroughly than men. This side is what makes women are able to carefully make decisions. Therefore, the women in the board of commissioners can help the companies in making decisions more precise and with lower risk. Robbins and Judge (2008) suggest that women generally have more detailed thinking in decision-making analysis. Women tend to analyze problems before making
a decision and make decisions that have been made, resulting in more careful consideration of the problem and alternative solutions.

c. **Proportion of Independent Commissioners on the Boards**

According to the General Guidelines of Good Corporate Governance (2006), the board of commissioners consists of affiliated management and unaffiliated parties or commonly referred to as an independent board of commissioners. The affiliated board of commissioners is the commissioners board member who has business or family relationships with directors and shareholders. An independent board of commissioners is the commissioners board member who is not affiliated with the board of directors, the board of commissioners, controlling shareholders, and is free from any business relationship or other relationship that may affect the ability to act independently or act solely for the benefit of the company (*Undang-Undang Perseroan Terbatas* ayat 12(2) no 40, 2007).

d. **The Number of Board of Commissioners Meetings**

FCGI (2002) explained that the board of commissioners meeting is a communication and coordination medium among management. In the meeting, the board of commissioners will discuss issues regarding the direction and strategy of the company, evaluation of policies that have been taken or carried out by management, and address the issues of conflict or interest.
e. **Audit Committee Size**

An important role of an audit committee is to ensure the quality of financial reporting, reviewing, assessing internal control systems, and monitoring the relationship between management and external auditors (*Otoritas Jasa Keuangan*, 2000). This role will greatly assist the users of financial statements in making decisions. The important characteristic of good corporate governance is the existence of a majority independent audit committee in order to maintain the quality of the auditor's results because the audit committee works objectively and impartially with either the manager, the shareholder or the ruling parties.

f. **Managerial Ownership**

Based on agency theory, the relationship between management with shareholder, prone to agency problems. Agency theory suggests that one mechanism to minimize corporate conflicts is to increase the amount of managerial ownership. Thus, managerial ownership is a condition that indicates that managers have shares in the company or manager as well as shareholders of the company (Rustiarini, 2008). The parties are those who sit on the board of commissioners and the board of directors of the company.

By increasing the amount of managerial ownership, managers will feel a direct impact on every decision they make because they are the owners of the company (Jensen and Meckling, 1976). An increase in managerial
ownership will make management wealth, personally, increasingly tied to corporate wealth. Therefore, the management will find a way to reduce the risk of losing its wealth.

g. **Foreign Ownership**

Foreign ownership is the proportion of the company's common shares owned by individuals, legal entities, government and its overseas sections (Angling, 2010). Foreign ownership in the company is a party that is considered a concern to the disclosures of corporate social responsibility (Machmud and Djakman, 2008). According to Susanto (1992), if the company has a contract with foreign stakeholders both in ownership and trade, then the company will be more supported in disclosing both of financial and non-financial information.

Companies that are mostly owned by foreigners are usually more likely to encounter information asymmetry problems due to geographic and language barriers. Therefore, companies with large foreign ownership will be compelled to report or disclose their information voluntarily and widely (Xiao et al., 2004)

Susanto (1992) found several reasons why firms that have foreign ownership should provide more disclosures than those which do not have foreign shareholdings. The reasons are explained as follows:
1. Foreign companies get better training in the field of accounting from the parent company.

2. The company may have a more efficient information system to meet the internal needs and needs of the parent company.

3. There is a possibility of having greater demand on foreign-based companies from customers, suppliers, and the general public.

   Research conducted by Rustiarini (2008) found that foreign ownership influences corporate disclosures. Meanwhile, the study conducted by Machmud and Djakman (2008) found that share ownership structures including foreign ownership did not affect the extent of social responsibility disclosures made by companies listed on the Indonesian Stock Exchange in 2006.

6. **Environmental Disclosures**

   Disclosures is generally divided into two types namely, mandatory disclosures and voluntary disclosures. According to Darrough (1993), mandatory disclosures is the disclosures of information required by accounting standards and applicable regulations. Meanwhile, voluntary disclosures is the disclosures of various information related to voluntary corporate activities or circumstances. A good company has a tendency to disclose more about any additional information. Therefore, managers of a company will only disclose good information that can give benefit for the company.
According to Berthelot et al. (2003), environmental disclosures is a set of information items that relate to a firm’s past, current and future environmental management activities and performance. This information can be conveyed to stakeholders through several reporting mechanisms. Ghozali and Chariri (2007) argue that the company will disclose all the necessary information in the course of the functioning of the capital market. The proponent of the opinion states that if an information is not disclosed, it can be because the information is irrelevant to the investor or the information is already available elsewhere.

The environmental disclosures is the disclosures of information related to the environment in the company’s annual report. It is generally located in a separate section of the sustainability report or reported in the annual report. In America, the Securities and Exchange Commission (SEC) is responsible for disclosures-level issues, and the disclosures format is the Financial Accounting Standards Board’s (FASB) task. Meanwhile in Indonesia, the institution which has mandatory disclosures authority is Otoritas Jasa Keuangan (OJK).

The environmental disclosures measurement requires a checklist containing disclosures items or indicators contained in the company's annual report. The environmental disclosures measurements in this study use check list for environmental indicators in Global Reporting Initiative's (GRI) G4. Global Reporting Initiative (GRI) is a framework for reporting the economic,
environmental, and social performance of an organization. This framework can be used by different types of organizations, in terms of size, sector, and location (Global Reporting Initiative's, 2015). In GRI G4, there are 34 environmental indicators consist of 12 aspects which are materials, energy, water, biodiversity, emission, effluent and waste, product and services, compliance, transport, overall, supplier environmental assessment, and environmental grievance mechanism.

7. Firm Value

Nurlela and Islahuddin (2008) explain that enterprise value (EV) which is also known as firm value is an important concept for investors, because it is an indicator for the market to assess the company as a whole. Supporting this, Wahyudi (2005) states that the value of the company is a price that is willing to be paid by the third parties if the company is sold.

According to Nurlela and Islahudin (2008), company value is the company's selling value or growth value for shareholders. The value of the company will be reflected from the market price of its shares. Thus, the company value can be defined as market value. The value of the firm can provide maximum shareholder wealth if the company's stock price increases. The higher the stock price, the higher the shareholder's wealth. To achieve the value of the company, generally the financiers give their management to the professionals. Professionals are positioned as managers or commissioners.
B. HYPOTHESIS DEVELOPMENT

1. The Relation of Board of Commissioners Size and Environmental Disclosures

One of the most important elements of corporate governance mechanism in overseeing the conduct of the company business is being properly managed by the board of commissioner’s agents. With regard to the effect of board size on the level of environmental disclosures, past studies have found that board commissioner size effects could increase the communication and coordination problems, and decrease the ability of the board to control management and the spread among a large group of the cost of poor decision making (Lipton and Lorsh, 1992; Eisenberg et al., 1998; Raheja, 2003). Jensen (1993) found that the large size of commissioner boards results in less effective coordination, communication and decision making. It is more likely to be controlled by the CEO. It is predicted that ineffective coordination in communication and decision making will lead to low quality of financial disclosures since the board of commissioner are unable to carry out their roles efficiently.

The result is in line with the research conducted by Lipton and Lorsh (1992) stated that small commissioner boards will mitigate agency conflict between managers and shareholders. Moreover, the argument claims that the small sized boards since they are considered more effective in achieving a collective decision, monitoring management’s actions, and tend to disclose
more about environmental information in their annual report (Lakhal 2005; Cheng 2008). Therefore, with the small commissioner on boards will make the company to disclose more regarding corporate environmental disclosures practices. On the other hand, Rao et al. (2012) found a significant positive relationship between board size and the level of environmental disclosures.

Based on the arguments above, the formulated hypothesis is:

H1. The board of commissioner size has a negative significant effect towards environmental disclosures level.

2. The Relation of Gender Diversity (Female Directors) and Environmental Disclosures

It has been suggested that gender diversity on the board of directors generates a positive effect on companies decision-making process and performance since female directors are diligent, committed and involved (Bonn 2004; Huse and Solberg 2006; Rao et al. 2012; Webb 2004). Companies with female directors tend to have stronger corporate governance mechanism than those with no presence of female directors (Bernardi and Threadgill, 2010). The female directors tend to use more non-financial performance such as innovation and corporate social responsibility to evaluate company performance compared to the male directors. Consequently, it has been suggested that gender diversity on the board would be positively associated with level of environmental disclosures (Rupley et al. 2012).
It can be assumed that the environmental disclosures levels are affected by gender diversity considering the findings in previous research. First, that gender diversity leads to the improvement of firm performance (Siciliano, 1996). Second, that women generally have more detailed thinking in decision-making analysis, resulting in more careful consideration of the problem and alternative solutions including the decision regarding the environmental disclosures practices (Robbins and Judge, 2008). Moreover, Khan (2013) stated that the higher proportion of female directors tends to create a special attendance pattern at board meetings, which lead to be more successful than the homogeneous board of directors. Therefore, the existence of female directors on the board will make the company to disclose more regarding corporate environmental disclosures practices.

Based on Rao et al. (2012) and Rupley et al. (2012) in their studies, there is a significant positive relationship between the proportion of female directors on the board and the level of environmental disclosures. On the other hand, Nalikka (2009), found a significant negative relation between gender diversity and the level of environmental disclosures.

Based on the arguments above, the formulated hypothesis is:

H2. Gender diversity (female directors) has a positive significant effect towards environmental disclosures level.
3. The Relation of Proportion of Independent Commissioners on Boards and Environmental Disclosures

An independent board of commissioners is the commissioner board member who are not affiliated with the board of directors, the board of commissioners, controlling shareholders, and is free from any business relationship or other relationship that may affect the ability to act independently or act solely for the benefit of the company. An independent commissioner is required to increase the independence of commissioner board member against the interests of majority shareholder. Thus, the large size of independent commissioner on board will increase the board's ability to make decisions in order to protect stakeholders and prioritize the company.

Agrawal and Knoeber Research (1996); Baysinger and Butler (1985) found that with the existence of independent board of commissioners, the management of the company is more effective and can improve the performance of the company. If the number of independent commissioners is greater or more dominant, it can reduce the agency problems and increase their power in order to suppress management to improve the quality of corporate environmental disclosures information (Haniffa and Cooke, 2002).

Independent commissioners are required to increase the independence nature of commissioners on board (Muntoro, 2006). Thus, the greater composition of independence board commissioners lead to the greater ability of board commissioners to take decisions in order to protect all
stakeholders and put the company more objectives. Based on the agency theory, having an independent board of commissioners will have greater power in monitoring management to disclose information (Ayu, 2013). Therefore, the existence of independent commissioners on board will make the company to disclose more regarding corporate environmental disclosures practices.

Several empirical studies such as Ayu (2013); Chen and Jaggi (2000); Arcay and Vazquez (2005) found that there is a positive relation between independent board of commissioners and environmental disclosures. On the other hand, Said (2009) found a significant negative relation between independent board of commissioners and environmental disclosures practices.

Based on the argument above, the formulated hypothesis is:

H3. The proportion of independent commissioners has a positive significant effect towards environmental disclosures level.

4. The Relation of Board of Commissioners Meetings Number and Environmental Disclosures

The board of commissioner plays a very important role in the company, especially in the implementation of good corporate governance. The board of commissioner’s task are to ensure the implementation of corporate strategy, controlling and monitoring the management activities, and to ensure the implementation of corporate accountability. To support the effectiveness
implementation of their duties, commissioner on board need to hold a regular meeting.

FCGI (2002) states that the board of commissioners meeting is a communication and coordination medium among management. Thus, the meetings are held to make sure that the agent and the principal has the same goals and risk preferences. From the perspective of agency theory, the frequency of meetings can be viewed as the time proxies used by the board to carry out the tasks and levels of their monitoring activities (Laksamana, 2008).

The meeting will address issues regarding the company's direction and strategy, the policy evaluation that has been taken or carried out by the management, and address the conflict of interest issues. Therefore, the more often the board of commissioners conducting meetings can be expected to increase the level of supervision of managers in order to increase the level of voluntary disclosures information (Ahmad, 2012). Therefore, the larger number of meeting held by commissioner on board will make the company to disclose more regarding corporate environmental disclosures level.

This research has been supported by the results of Xie et al. (2003) and Ahmad (2012) in their studies which revealed a positive influence on the number of board of commissioners meeting on environmental disclosures level. On the other hand, Supianto and Pratiwi (2015) have found a significant negative relation between the boards of commissioners meeting towards environmental disclosures level.
Based on the arguments above, the formulated hypothesis is:

H4. The number of board of commissioners meeting has a positive significant effect towards environmental disclosures level.

5. The Relation of Audit Committee Size and Environmental Disclosures

The audit committee is a committee that assists the board of commissioners in conducting supervisory mechanisms on management. Audit committee is considered as a liaison between shareholders and commissioner on board with the management in handling control issues. FCGI (2002) states that the audit committee should consist of individuals who are independent and not involved with management in performing the operational activities. They also should have experience in performing effective monitoring functions.

Prior researches have proven that audit committee plays an effective role in enhancing the corporate governance standards. Wright (1996) found that audit committee composition is strongly related to financial reporting. Because of their task is related to financial reporting, the existence of the audit committee can be perceived as a high quality control and have significant effect in providing more about additional information to the users through their financial statements and annual report. The existence of the audit committee may affect the disclosures of the company significantly (Ho & Wong, 2001). According to Forker (1992), the audit committee is considered an effective tool
for monitoring mechanisms, thereby reducing agency costs and improving the quality of corporate information disclosures.

Collier (1993) states that the existence of the audit committee helps companies to ensure their corporate disclosures practices. Thus, it is expected that with the bigger size of audit committee, then the supervision will be better and the quality of voluntary information disclosures conducted by the company is increasing. Therefore, the existence of audit committee should be able to reduce the agency cost and improve their internal control that will lead to greater quality of corporate environmental disclosures level.

Several empirical studies have examined the existence of an audit committee. According to Ho and Wong (2001) and Bliss and Balachandran (2003) there are significantly and positively relation between audit committee size and environmental disclosures practices. On the other hand, Said (2009) found a significant negative relation between audit committee size and environmental disclosures level.

Based on the arguments above, the formulated hypothesis is:

H5. Audit committee size has a positive significant effect towards environmental disclosures level.
6. The Relation of Managerial Ownership and Environmental Disclosures

According to the agency theory of Jensen and Meckling (1976), in business processes there are conflicts of interest involving principals and agents. In the implementation of corporate governance mechanism, managerial ownership is used as an effort to reduce agency conflict or conflict of interest between manager and owner (Said et al., 2009). Managerial ownership is the shareholders who have a position on the management of the company and actively participate in decision making process.

As a shareholder, managers have an interest in improving their own wealth. Therefore, the policies adopted by management tend to increase profit-oriented. Environmental disclosures is assumed as a policy that can improve the company's image. Good corporate image will certainly have a positive impact on the interests of managers as shareholders. Moreover, if a company has a higher managerial ownership, then the company tend to take decisions in accordance with the interests of the company. Therefore, environmental disclosures is used as a way of managers to cater their interests as managers and shareholders in order to enhance the company's reputation (Gray et al., 1988). Fama and Jensen (1983) also stated that the higher level of managerial ownership, the higher company's motivation to disclose various activities conducted by the company. Therefore, the larger share owned by managerial
should be able to improve their internal control that will lead to greater quality of corporate environmental disclosures level.

Nasir and Abdullah (2004) revealed a significant positive result in the relation between managerial ownership and environmental disclosures. Consistent with the previous study, Anggraini (2006) and Rosmasita (2007) found that managerial ownership had a positive effect on environmental disclosures practices in Indonesia. On the other hand, Rouf et al., (2014) found a significant negative relation between managerial ownership and environmental disclosures level.

Based on the arguments above, the formulated hypothesis is:

H6. Managerial ownership has a positive significant effect towards environmental disclosures level.

7. The Relation of Foreign Ownership and Environmental Disclosures

Companies with foreign ownership are usually more likely to encounter information asymmetry problems due to geographic and language barriers. Therefore, companies with large foreign ownership will be encouraged to report or disclose their information voluntarily and more widely (Xiao et al., 2004). Moreover, the companies that have contracts with foreign investors are expected to be more concerned about practices and disclosures of social responsibility (including environmental disclosures practices) in order to avoid information asymmetries between the users.
Brown, Earle, and Telegdy (2004) argue that foreign owners have better access to finance, greater knowledge of markets, rich management skills, and new technologies. It will lead to higher productivity effects. Boubakri, Cosset, and Guedhami (2005) state that foreign investors maintain more effective monitoring of management and require higher disclosures standards. Thus, it can be concluded that foreign investors have more knowledge and experience in regional and international markets and they are more likely to demand higher disclosures standards.

Supported by the fact, until 2016 the 60% shares on the IDX are owned by foreign institution and individual. Foreign investors also tend to buy shares with large quantities and long-term investment goals in order to earn considerable returns. As a long-term investors appear sensitive to external investors’ information demands.

Moreover, Ferguson et al. (2002) states that the disclosures behavior of the companies is a showcasing method in order to give a signal to international investment communities that the companies are willing to increase transparency and act as good corporate in the worldwide capital market. Therefore, the larger share owned by foreign corporate and individual should be able to improve the company internal control. If foreign investors have behaved as an effective external monitoring agents, it will lead to greater quality of corporate environmental disclosures level.
There are several studies that have examined the relation between foreign ownership and environmental disclosures level. According to Abdul Samad (2002); Haniffa and Cooke (2005); Barako et al. (2006); Al-Akra et al. (2010); Qu et al. (2013); and Sartawi et al. (2014) found a significant positive result between the influence of foreign share ownership and the disclosures made by the company. On the other hand, Hassan (2013) found a significant negative relation between the foreign ownership and environmental disclosures level.

Based on the arguments above, the formulated hypothesis is:

H7. Foreign ownership has a positive significant effect towards environmental disclosures level.

8. **The Relation of Environmental Disclosures and Firm Value**

Stakeholder theory suggests that the sustainability and the success of the company depends on the organization's ability to meet economic and non-economic aspects, by fulfill the stakeholder interests. Therefore, the voluntary disclosures is used as a way to meet the economic and non-economic aspects by the management. Companies that invest in various voluntary disclosures practices tend to have a lower risk. This is happened because the potential cash flow to be charged in the future is smaller. By disclosing any voluntary information in their annual report tend to enhance the company’s reputation. Having a good reputation in public also increasing the chance in term of sales. Thus, it will enhance the profitability and the company can provide high return
to the investors and shareholders. The positive response from public can raising the stock prices from the investor point of view. If the stock price rises, then the company’s value will also increase.

Earlier studies examining the link between environmental disclosures and firm value frequently focus on the associations between specific environmental issues or events and stock price or stock price changes (Plumlee, 2015). Blacconiere and Patten (1994) and Blacconiere and Northcutt (1997) provide evidence of the benefits of improved environmental disclosures level. Blacconiere and Patten (1994) stated that, while chemical companies experienced negative share price return after a significant chemical leak, the stock price reaction was mitigated for firms with better environmental disclosures. Furthermore, Blacconiere and Northcutt (1997) found that chemical firms with more extensive environmental disclosures included in their annual reports had a weaker negative reaction to environmental regulation than other firms.

The commitment is required by the company to perform corporate environmental disclosures practices in order to increase company's value and company’s concern. The traditional economic theory predicts that increased voluntary information regarding environmental disclosures will be associated with an increase in the firm value through a reduction in information asymmetry or estimation risk (Barry & Brown, 1985; Coles et al., 1995), increased
awareness of a firm’s existence and enlarging the investor base (Merton, 1987), or increased liquidity (Amihud & Mendelson, 1986).

Matsumura et al. (2014) stated that firm value is associated with carbon emissions and whether firms voluntarily disclose environmental information. Therefore, there are some empirical supports for this significant positive result between the influence of foreign share ownership and the disclosures level made by the company (e.g., Richardson & Welker, 2001; Botosan & Plumlee, 2002; Dhaliwal et al., 2011; Matsumura et al., 2014). These findings suggested that investors view environmental disclosures as relevant as firm value.

Based on the arguments above, the formulated hypothesis is:

Hs: Environmental disclosures level has a positive significant effect towards firm value.

C. Research Model

This research was conducted in order to determine the relation of GCG towards environmental disclosures and how environmental disclosures has positive effect towards firm value. There are two dependent variables in this research. They are environmental disclosures and firm value. However, environmental disclosures variable is used as a dependent and an independent variable.
In the first research model, the dependent variable is environmental disclosures and the independent variables used to measure the relation between CGC mechanisms towards environmental disclosures level are board of commissioner size, gender diversity, proportion of independent commissioners on boards, number of board of commissioner meeting, audit committee size, managerial ownership, and foreign ownership.

Meanwhile, in the second research model, the dependent variable is firm value and the independent variable is environmental disclosures. Control variables such as firm size, profitability and leverage are used in order to test the relation of environmental disclosures level towards firm value.
1. Research Model 1

**INDEPENDENT VARIABLE**

- Board of commissioners size (-)
- Gender diversity (+)
- Proportion of independent commissioners on boards (+)
- Number of board of commissioners meetings (+)
- Audit committee size (+)
- Managerial Ownership (+)
- Foreign Ownership (+)

**DEPENDENT VARIABLE**

- Environmental Disclosures

Control Variable:
- Firm Size
- Profitability
- Leverage

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Picture 2.1

Research Model 1, Hypothesis 1 – Hypothesis 7
2. Research Model 2

**INDEPENDENT VARIABLE**

Environmental Disclosures (+)

**DEPENDENT VARIABLE**

Firm Value

Control Variable:
- Firm Size
- Profitability
- Leverage

*Picture 2.2*
Research Model 2, Hypothesis 8