

CHAPTER 2

LITERATURE REVIEW

2.1 Agency Theory

Schroeder & Clark (1995) defined an agency as relationship by consent between two parties, whereby one party (agent) agrees to act on behalf of the other party (principal). Inherent in this theory is the assumption that there is a conflict of interest between the owners of a corporation (shareholders) and the managers (Schroeder & Clark, 1995). Agent is responsible to optimize the benefits of the shareholders, but in the other side the agent also has their own interest to maximize their own welfare. Thus, there is a possibility that agent is not always acted for the shareholders (Jensen & Meckling, 1976). Agency theory has three human characters assumption, such as (1) most of people prioritize their selves (self-interest); (2) human has limited way of perception thinking about the future (bounded rationality); and (3) human always avoid the risks (Eisenhardt in Ujiyantho, 2007).

The theory explained that agent is worked for shareholders and one of their duty is to give the information related to business (Jensen & Meckling, 1976). The conflict can be happened if both part act individually to maximize its interest. This conflict happen because of information asymmetry. Information asymmetry happen because of manager has more information than shareholders. Brammer & Pavelin (2006) state that information asymmetry problem is reduced between the corporation and the shareholders through the efforts made by the corporations to disclose as much information reflecting good environmental performance.

Environmental disclosure can be associated with agency theory, which means that the disclosure of social responsibility in part of environmental aspects particularly can improve the positive relationship between the agent and shareholders. Dewati (2014) states that good environmental disclosure for managers is proof to investors that the corporation's resources have been managed effectively and efficiently. Thus, environmental disclosure will reduce the agency conflict.

2.2 Legitimacy Theory

Legitimacy is a systems-oriented view of organization and society permits us to focus on the role of information and disclosure in the relationship between organizations, the state, individuals and group (Gray *et al.*, 1995). This definition shows that legitimacy is a corporation management system that oriented to the society, government and communities. Legitimacy theory takes the society as a whole and explains its effect on the corporation's disclosure intensity (Cho & Patten, 2007). Based on Ghozali & Chairi (2007), legitimacy theory is a condition that exist when a value of corporation is in line with the social value that become a part of it. Legitimacy theory focuses on the social contract that should exist between corporations and society. In the legitimacy theory, the corporations will try to convince that they have done the activity as the norm and regulation in the society which linking the value of both parties. If the corporation could not satisfy the society then the contract is considered broken and thus corporation are negatively impacted then enhance their environmental disclosure process (Milne & Paten, 2002), (Deegan, 2002) and (Paten, 1992). In the legitimacy theory, corporation will

voluntary report their activity if the management assume this is what community hope for (Deegan, 2002).

According to Hadi (2014), the theory of legitimacy can used as a vehicle for the construction of the corporation's strategy, especially related to efforts to position themselves in the middle of society. Therefore, disclosure of the environment is important and related to legitimacy theory due to the disclosure of environmental management can assure that the activities in accordance with the limits of norms that exist in society as well as the rules and regulations.

2.3 Stakeholder Theory

Stakeholder theory considered a broader view of agency theory states that there is an agency relationship between the principal (shareholders) and the agent (management) and that the agent should work for the interest of the principal to avoid any conflict of interest who leads to the agency problem (Jensen & Meckling, 1976).

Freeman & Reed (1983) stated that stakeholder is any identifiable group or individual who can affect the achievement of an organization's objectives or affected by the achievement of an organization's objectives. Wheelen & Hunger in Wibisono (2007) explained that stakeholder as individual or groups who have interest to the existence or activity of corporation because they are affecting and affected by corporations. It also supported by Ghozali & Chariri (2007) who stated that stakeholder theory assumes that the existence of corporation determined by the stakeholders. Stakeholder theory stronger the paradigm that corporation is

responsible not just to the shareholders but also the stakeholders (Maulida & Adam, 2012).

Stakeholder theory in Hadi (2011) stated that corporation is not just an entity that operate for their own interest otherwise giving benefit to its stakeholders. Corporations try to seek the justification from stakeholders in running the business. The stronger stakeholder position, the greater tendency of the corporation to adapt the wishes of stakeholders. According to Langtry (1994), stakeholders in accounting literature refers to individuals or groups who have a stake in or a legitimate claim on the corporation. Freeman (1984) stated that any group or individual that can affect or affected by the achievement of an organisation's objectives called as stakeholder.

From the definitions above, it can understood that the philosophical framework of the stakeholder theory based on trying to pay attention to all parties that are associated with corporations. Stakeholder theory is one of the most prominent strategic issues for corporations relating on how to manage their relationship with stakeholders.

In this regard, Gray *et al.*, (1995) argue that to continue the existence of corporations, corporations require the support of the stakeholders then their approval must be sought and the activities of the corporation adjusted to gain that approval. The more powerful stakeholders, the more the corporations must adapt. Thus, corporate social responsibility disclosure in environmental aspects seen as part of the dialogue between corporation and its stakeholders.

In line with the stakeholder theory, corporate social responsibility disclosure considered as an effective mechanism to use by corporations for managing and developing relationships with its stakeholders, in order to gain their support and approval, or to distract their opposition (Gray *et al.*, 1996). Similarly, Roberts (1992) asserts that the corporate social responsibility disclosure is one of the most successful means in the interpretation and negotiation of the relationships between the internal and external parties. Moreover, Guthrie & Parker (1990) argue that the corporate social responsibility disclosure is an important way to reflect public social priorities, respond to government pressure, accommodate environmental pressures and sectional interests and protect corporate prerogatives.

2.4 Environmental Disclosure

2.4.1 Definition of Disclosure

Ariani (2005) states that the information provided by the corporation is so general and it cannot fully meet the needs of the parties requiring information. Suwardjono (2005) argues that disclosure is related to the way of disclosure or explanation of informative matters that considered important and useful to the user other than what can be stated through the main financial statement. In general, the purpose of disclosure is to provide information that is deemed necessary to achieve the objectives of financial reporting and serve various parties who have different interests. According to Hendriksen & Breda (1992), there are three concepts of disclosure: (1) Adequate, is minimal disclosure that must be done so there will be no misleading corporation information; (2) Fair, is normal disclosure so will give

same treatment for the user of corporation's information; (3) Full, is complete disclosure that show all of relevant information.

On the other hand, there are two characteristics of disclosure, those are (1) mandatory disclosure, regulated on *Keputusan Ketua BAPEPAM* No. Kep-134/BL/2006 that public corporations have obligation to deliver annual report that loads of important financial information, commissioners board report, director report, profile, director responsibility to the report & audited financial statement; and (2) voluntary disclosure, every kind of report that does not regulated in regulation or law. Corporations are willing to make voluntary disclosures, even they should add cost to meet the public's wishes or improve the corporation's image. According to Na'im & Rakhman (2000), the benefits of voluntary disclosure to be gain by corporations include enhancing corporate credibility, helping investors understand business management strategies, attracting analysts to improve market accuracy, reducing market information asymmetries and reducing market shocks. In addition to the benefits, the corporation will consider the costs incurred for voluntary disclosure. Suripto (1998) states that there are two costs to which voluntary disclosure is considered:

- 1) Direct costs that include data collection costs, information process cost, auditing cost and information dissemination costs.
- 2) Indirect costs that include litigation costs, competitive loss costs, and political costs.

In general, corporations are reluctant to disclose beyond specified regulations. Hendriksen & Breda (2001) mention several reasons that cause corporation are reluctant to make voluntary disclosure:

- 1) Voluntary disclosure will assist competitors and harming shareholders.
- 2) Complete disclosure will benefit unions in wage bargaining.
- 3) The presumption that investors cannot understand the policies and procedures adopted by the corporations so that full disclosure will only be misleading.
- 4) The existence of information other than the financial statements that can access from sources with a cheaper cost.
- 5) Lack of knowledge about the needs of investors.

Global Reporting Initiatives (2006) recommends several aspects of the environment that have to be disclosed in the annual report. There are 35 items recommended by GRI and consist of 9 aspects. The nine aspects are material, energy, water, biodiversity, emissions and waste, products and services, obedience to the rules, transportation and overall costs incurred to preserve the environment.

2.4.2 Definition of Environmental Disclosure

Environmental disclosure is a set of information related to the activity of environmental management by corporation in the past, current and future (Barthelot *et al.*, 2003). Another explanation about environmental disclosure stated by Zeghal & Ahmed (1990) identified that environmental disclosure consist of pollution control, prevention or repair of environment, nature conservation and other

disclosure related to the environment. Environmental disclosure is the disclosure of information related to the environment in the corporation's annual report (Suratno *et al.*, 2006). The disclosure of the corporation's environmental information aims to communicate reality to economic, social and political decision-making. Environmental accountability is also a response to the information needs of interest groups such as trade unions, environmentalist, religious and other groups (Guthrie & Parker, 1990).

Environmental disclosure is also a form of corporate social responsibility and non-financial nature (Makori & Jagongo, 2013). It is a process of delivering the environmental impact caused by the corporation activities and the settlement of these problems (Yulianti *et al.*, 2016) and it is still voluntary (Rouf, 2011) & (Aulia & Agustina, 2015). Through the environmental disclosure of the annual report, the public can monitor the activities undertaken by the corporations in order to fulfill its social responsibilities. By this way, the corporations will gain the attention, trust and support of the community so that the corporation can still exist (Brown & Deegan, 1998). Environmental disclosure shows the corporation commitment towards the environment (Stray, 2008).

Patten (2000) identified the coverage of eight items of environmental disclosure. While Zeghal & Ahmed (1990) identify environmental reporting that includes controlling for pollution, prevention or repair of environmental damage, natural concentration, and other disclosures related to the environment. Suhardjanto *et al.*, (2007) in their research created an environmental disclosure index consisting

of 35 items of environmental disclosure that many corporations revealed based on environmental issues written by the media.

2.5 Type of Industry

Type of industry described a corporation based on operation scope, risk and ability to face the business challenge. Generally, society is more sensitive to the type of industry because of corporation negligence in maintaining the production process and the result of the production that give big impact to society (Indrawati, 2009).

Type of industry that has by corporation related to the business, risk, employees and as potential factor that influence the information disclosure (Adawiyah, 2013). The type of industry is divided into two, they are (1) High Profile Industry and (2) Low Profile Industry. Robert (1992) defines high profile industry as those with consumer visibility, a high level of political risk, or concentrate intense competition. Society see corporations that in the high profile industry is like the corporation that in doing their activity take much modification of the environment and has negative effect in the society (Suttipun & Stanton, 2012), thus society will ask the high profile corporation to do more environmental responsibility and disclose it into annual report than low profile industry.

2.6 Size

Size is the determination of magnitude, dimension or capacity of a corporation (Suryani, 2007). Size shows how much the wealth of the corporation that measured by natural logarithm of total assets. Bigger corporation will have

bigger expenditure in realizing corporation legitimacy. This is happened because of the corporation tend to disclose information wider. Legitimation is need to create the conformity of the social value from the activity based on the norm that exist in society (Widianto, 2011). On the other hand, bigger corporation is easy to supervised by its stakeholder, so it will give pressure to corporations to do more complete and faster in reporting practice.

2.7 Age

Age is show how much the experience of a corporation (Arifianata & Wahyudin, 2017), how long a corporation run their business and give the impact to the society. Age has been considered as another important characteristics that can influence the corporations environmental disclosure (Akbas, 2014), it suggested that age of corporation can serve as an indicator of perceived stability of the corporation (Liu & Anbumozhi, 2009). Age can measured by seeing from the date of establishment or date of listing in stock exchange. Generally, older corporation tend to have more responsible to disclose not just financial information but non-financial information to the society. Welbeck *et al.* (2017) explained that older corporations are more likely to engage in environmental performance to influence perception about their business and to legitimize their existence. Age shows the ability in solving the corporation's problems and barrier in running their business (Pradana & Suzan, 2016).

2.8 Profitability

Profitability is the ability of a corporation to make a profit in a certain period. Profitability is one of an important aspect that can be as reference by investor or the

shareholders of corporations to evaluate the management performance in doing the business. Profitability as a factor that make the management to be free and flexible to disclose the social responsibility to the stakeholders. Thus, bigger profitability means bigger information to be disclosed (Bowman & Haire, 1976).

Profitability is an important thing in running the long run business because profitability shows whether corporation will have a good prospect in the future or not. Corporation that has high profitability will have a strong encouragement to spread the information of corporation. Corporation in a bad performance avoid the disclosure more than what it is should be disclose to conceal the bad news of the corporation. Profitability can be shown by several models like return on equity, return on assets, gross profit to sales, operating income to sales and net income to sales.

2.9 Annual Report

Annual report is the main media to communicate the financial and non-financial information from managers to the outside parties and usually used by corporations to disclose corporate social responsibility (Wiseman, 1982). For the outside parties, financial information is the information that allow to see the condition of corporations. Annual report become the main tool for managers to show the effectivity of performance and implementation of responsibility functions. Naim & Rakhman (2000) stated that the main purpose of the annual report is to give relevant information for the stakeholders.

Annual report has some advantages than other information sources (Astuti in Suhardjanto & Miranti (2009)), they are:

- a. Provide information about a corporation specifically.
- b. Contains financial report that generally audited by an independent auditor. Information from other sources does not checked by an independent party so the information has a lower level of reliability.
- c. The report can used by all parties because of the go public corporations have tendency to publish and give the annual report extensively.
- d. Indonesia Capital Markets Supervisory Board (*Badan Pengawas Pasar Modal/BAPEPAM*) has regulations about the maximum date of corporations to issue annual report, while other sources do not have definite rules.

Another advantage is that the annual report has high credibility (Zeghal & Ahmed, 1990) so it will widely be used by stakeholders in decision-making. Other things mention that the annual report is an absolute information source for stakeholders (Deegan & Rankin, 1997), offering management descriptions at a certain period (Neimark, 1992) and more accessible for research purposes.

2.10 Previous Research

Even though the environmental disclosure still being voluntary disclosure, there are many corporations interested to make this disclosure. In a row of the increasing of environmental disclosure, researchers interested to research about that. Here is the previous research related environmental disclosure.

Table 2.1
Previous Research

Title	Writer(s)	Variable	Result
The Impact of Corporate Characteristics on Environmental Information Disclosure: An Empirical Study on the Listed Firms in Egypt	Yousra N. Elshabasy (2017)	<i>Dependent</i> Environmental Information Disclosure <i>Independent(s)</i> Size, Age, Leverage & Profitability	<i>Significant Relationship</i> Age and Profitability <i>Not Significant Relationship</i> Size and Leverage
<i>Pengaruh Karakteristik Perusahaan terhadap Environmental Disclosure</i>	Bunga Widia Paramitha & Abdul Rohman (2014)	<i>Dependent</i> Environmental Disclosure <i>Independent(s)</i> Size, Profitability, Leverage & Age <i>Control(s)</i> Commissioners Board Composition	<i>Positive Relationship</i> Size and Leverage <i>No Positive Relationship</i> Profitability and Age
Effect of Corporate Characteristics on Environmental Disclosure	Heni Nurani Hartikayanti, M. Ryan Trisyandi & ER. Budhi Saptono (2016)	<i>Dependent</i> Environmental Disclosure <i>Independent(s)</i> Size, Profitability, Type of Environmental Disclosure & Foreign Ownership	<i>Significant Influence</i> Type of Environmental <i>Not Significant Influence</i> Profitability, Size and Foreign Ownership
<i>Karakteristik Perusahaan terhadap Environmental Disclosure dengan Good Corporate</i>	Ahmad Faris Arifianata & Agus Wahyudin (2016)	<i>Dependent</i> Environmental Disclosure <i>Independent(s)</i>	<i>Positively Affect</i> Size & Type of Industry <i>No Positively Affect</i> Age

Governance <i>sebagai</i> <i>Pemoderasi</i>		Size, Type of Industry & Age Moderation Good Corporate Governance	Moderation Size & Age Non Moderation Type of Industry
<i>Pengaruh Karakteristik Perusahaan, Kinerja Lingkungan dan Liputan Media terhadap Environmental Disclosure</i>	Febri Zaini Aulia & Linda Agustina (2015)	Dependent Environmental Disclosure Independent(s) Size, Profitability, Leverage. Environmental Performance & Media Environment	Affect Size, Profitability, Environmental Performance and Media Environment Do not Affect Leverage
Company Characteristics and Environmental Disclosure: An Empirical Investigation on Companies Listed on Bursa Istanbul 100 Index	Halil Emre Akbas (2014)	Dependent Extent of Environmental Disclosure Independent(s) Size, Leverage, Profitability, Industry Membership, Age	Positive Relationship Size and Industry Membership No Positive Relationship Profitability, Leverage & Age
<i>Pengaruh Karakteristik Perusahaan terhadap Praktek Pengungkapan Lingkungan</i>	Maya Indriastuti (2012)	Dependent Environmental Disclosure Practice Independent(s) Size, Type of Industry & Profitability	Affect Type of Industry & Profitability Do not Affect Size
<i>Pengaruh Ukuran Perusahaan, Profitabilitas, Tipe Industri dan Kinerja</i>	Ida Ayu Putu Oki Yacintya Dewi & Gerianta Wirawan Yasa (2017)	Dependent Environmental Disclosure Independent(s)	Positive Relationship Size, Type of Industry & Environmental Performance

<i>Lingkungan terhadap Environmental Disclosure</i>		Size, Type of Industry, Profitability & Environmental Performance	No Positive Relationship Profitability
Indonesian Environmental Reporting Index <i>dan Karakteristik Perusahaan</i>	Djoko Suhardjanto & Laras Miranti (2009)	Dependent Environmental Disclosure Independent(s) Size, Leverage, Profitability & Corporations Operational Coverage Control(s) Type of Industry & Independent Commissioner Board	Positive Relationship Profitability, Type of Industry No Positive Relationship Leverage, Size, Corporations Operational Coverage, Independent Commissioner Board
Environmental Disclosure Determinants in Dutch Listed Companies	Dion van de Burgwal & Rui Jose Oliveira Vieira (2014)	Dependent Environmental Disclosure Independent(s) Type of Industry, Size & Profitability	Positive Relationship Type of Industry and Size No Positive Relationship Profitability
Determinants of Environmental Disclosures of Listed Firms in Ghana	Emerald Edem Welbeck, Godfred Matthew Yaw Owusu, Rita Amoah Beku & John Amoah Kusi (2017)	Dependent Environmental Disclosure Independent(s) Size, Profitability, Industry Type, Auditor Type, Foreign Association & Age	Affect Industry Sensitivity, Size & Age Do not Affect Profitability, Ownership Type & Auditor Type
Factors Affecting Disclosure Levels of Environmental	La Soa Nguyen, Manh Dung Tran, Thi Xuan Hong	Dependent Environmental Disclosure	Positive Relationship Size, Age, Profitability & Independent Audit

Accounting Information: The Case of Vietnam	Nguyen & Quoc Hoi Le (2017)	Independent(s) Size, Profitability, Leverage, Age & Independent Audit	Positive Relationship Leverage
Determinant of the Corporate Environmental Disclosure: Study on Jakarta Islamic Index	Yulianti, Leis Suzanawaty, Zuwesty Eka Putri & Ismawati Haribowo (2016)	Dependent Environmental Disclosure Independent(s) Size, Age, Leverage, Independent Commissioner Board and Corporate Secretary	Affect Size & Age Do not Affect Leverage, Corporate Secretary & Independent Commissioner Board

Source: Processed Data 2018

2.11 Hypothesis Development

2.11.1 Type of Industry

Dierkes & Preston (1977) in Hackston and Milne (1996) argued economic activity that affect the environment like high profile industry will tend to disclose the information of environment compared to low profile industry. The industry that oriented to the customer (low profile industry) will give more attention to show their social responsibility because of the image of the corporation affect the sales (Cowen *et al.*,1987). Commonly, corporations in high profile industry tend to disclose some information related to environment because of they have used and exploited the environment in running the business and these things made the stakeholders attracted to see and control what the corporation have done. Disclosing the environmental information is because of they want to be seen by society and external parties that have in line with the norm value that exist in a society.

Corporation is sensitive to the environment will be considered by the community, government or other parties. Moreover, the existence of corporation determined by its stakeholders. When the stakeholders know that certain corporations used and exploited the environment, the stakeholders will asked that corporation to disclose more about their responsibility regarding the environment. It can conclude that stakeholders have important role in corporation management decision. Environmental disclosure is needed as a corporation tool to responsible their environment activity to the society.

Based on the previous research conducted by Hartikayanti, Trisyardi & Saptono (2016), Arifianata & Wahyudin (2016), Akbas (2014), Indriastuti (2012), Dewi & Yasa (2017), Suhardjanto & Miranti (2009) and Burgwal & Vieira (2014) proved that type of industry is significant affect the environmental disclosure and resulting positive relationship when the level of environmental disclosure higher in high profile industry. Thus, this is shows that high profile industry do more disclosure than low profile industry. Based on the explanation and the result of the previous studies this research will have hypothesis:

H₁: There is a positive significant relationship between type of industry and environmental disclosure.

2.11.2 Size

Size is a variable estimator that is widely used to explain variations of disclosure. The reasons underlying size to be variable that affect the environmental disclosure are (1) larger corporation engage in more activities resulting in greater

impact on the environment, stakeholders are concerned about the environmental programs run by the corporation (Hackston and Milne, 1996); (2) Agency theory and legitimacy theory support this relationship (Ahmad & Sulaiman, 2004). Larger corporation means bigger activities, from those activities the corporation resulted the information. Information should be considered by corporation to be disclosed to decrease the agency conflict. Larger corporation also has more agency cost because of the high public demand for corporation. Based on legitimacy theory, larger corporations will have more activity than smaller so the demands and pressures from society will be bigger to maintain that the corporation value still in line with the value in the society. Environmental disclosure process is costly and the larger corporations are more likely to be able, in contrast to medium and small sized corporations to spend resources, to prepare and to disclose environmental information (Monteiro & Aibar-Guzmán, 2010).

The majority of the research showed significant relationship between size and environmental disclosure, such as the research conducted by Paramitha & Rohman (2014), Arifianata & Wahyudin (2016), Aulia & Agustina (2015), Akbas (2014), Dewi & Yasa (2017), Burgwal & Vieira (2014) and Nguyen *et al.* (2017). The main reason behind this positive relation is the idea of how visible the corporation is to the society, so the larger the corporation is, the more visible it becomes and therefore it is obligated to disclose more information (Patten, 2002) and (Cormier & Gordon, 2001). Other reason stated by Despina *et al.* (2011), is that larger corporations care about their reputation, so they try to increase their financial performance through disclosing more environmental information to gain the public

trust. Moreover, the activity that conducted by corporation gave the impact to the environment. Larger corporation has larger impact resulted by the activity. The impact of the corporation make some parties pay attention on it such as mass media, public opinion and also government that push the corporation to disclose more about the environmental (Galani *et al.*, 2011). Larger corporation also be seen as a corporations that has much fund so the society will see that corporation is able to do environmental disclosure and disclose it into annual report. Under those explanations, the second hypothesis is:

H₂: There is a positive significant relationship between size and environmental disclosure.

2.11.3 Age

Age could actually help corporation become more efficient (Elshabasy , 2017). Over time, corporation discover what they are good at and learn how to do things better (Arrow, 1962) (Jovanovic & Hart, 1982) (Ericson & Pakes, 1995). They specialize and find ways to standardize, coordinate and speed up their production processes, as well as to reduce costs and improve quality. A positive relation is suggested by prior literature explaining that if the corporation has been established since a long time ago this shows that the corporation is satisfying its stakeholders as it meets its financial and social/environmental obligations (Liu & Anbumozhi, 2009) & (Choi, 1999). A motive to meet these obligations could be to protect its reputation by being involved in the environmental disclosure process (Roberts, 1992). Nguyen *et al.*, (2017) explained that according to the legitimacy theory, the longer corporation listed in the capital market, the easier they will be to

comply with the disclosure requirements because they already know that the society willing for and understand what are the things that need to be disclosed. Older corporation be seen can survive so there will be many corporations who disclose environmental information as responsibility to society.

Age represent how many experience of the corporation. These experiences made the corporation understand what do stakeholders willing for (Saputro, 2013). Age shows the ability of corporations to solve the problem that risk the corporation (Untari, 2010). Therefore, older corporation is able to increase the trust of stakeholder and professional to disclose the activity of corporation especially environmental disclosure. It also supported by the previous research that conducted by Elshabasy (2017), Welbeck *et al.*, (2017), Nguyen *et al.*, (2017) and Yulianti *et al.*, (2016) who proved that age is significant affect the environmental disclosure. Thus, the third hypothesis is:

H₃: There is a positive significant relationship between age and environmental disclosure.

2.11.4 Profitability

Profitability is a performance indicator by management in managing corporation's wealth (Juhmani, 2014). On the other hand, profitability also known as the ability of the corporation to gain the profit from its operation. Higher profitability shows the successful of management performance. This is because of the high profit increase the corporation value and make managers be motivated to disclose more information especially in environmental. Based on the agency theory,

profitability considered as an indicator for satisfying the stakeholder needs when management shows profit in their annual report. Hertikayanti *et al.* (2016) explained that the performance assessment agency in fulfilling its responsibilities to the principal can be measured by profitability.

Based on stakeholder theory, higher profitability means higher satisfaction because corporations have managed well. The more profitable corporations are, the more ambitious they are to meet and satisfy the information needs of stakeholders, especially the stakeholders are in control of the important resources of the corporations (Nguyen *et al.*, 2017). In legitimacy theory, the society gives pressures to the profitable corporation for more caring to the environmental problem, corporation with high profitability is easier to solve those pressures because have extra resource that can be used to do environmental disclosure. Disclosure of environmental responsibility is believed to be a management approach to reducing social pressures and responding to social needs (Hackston & Milne, 1996). Another reason is that corporation will disclose more information when the ability to generate profits is above the industry average for investors and creditors to believe that the corporation is in a position of strong competition and the corporation's operations run efficiently (Suhardjanto & Miranti, 2009). Empirical studies of the relationship between profitability and environmental disclosure provide mixed results. Research Elshabasy (2017), Aulia & Agustina (2015), Indriastuti (2012), Suhardjanto & Miranti (2009) and Nguyen *et al* (2017) provide results that proved the relationship between environmental disclosure and profitability. A positive relation between profitability and the environmental disclosure can be expected

based on the argument that more profitable corporation may have sufficient funds for compensating costs of environmental disclosures (Brammer & Pavelin, 2008).

By the explanation above, the fourth hypothesis is:

H₄: There is a positive significant relationship between profitability and environmental disclosure.

2.12 Research Model

Picture 2.1
Research Model

