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Consistent Environmental Performance: Does It Matter for Achieving Good Financial Performance? Abstract This study examines

> **the impact of environmental performance on financial performance** in Indonesia. **To** improve **the** prior **results,** this **study** — **12**

focuses on companies that consistently achieve good environmental performance and those who do not consistently obtain good performance.

> **The environmental performance measured by environmental ratings** that published **through a** PROPER **Program, while the financial performance is measured by return on assets,** — **1**

> **earning per share,** and **Tobin's q.** — **57**

Some control

> **variables included in this study** such as **firm** age, firm **size,** leverage, **and** — **4**

market share.

> **The study** finds **that environmental performance is** positive **significantly associated with** financial **performance** — **4**

for the companies that consistently record a good environmental performance. The more consistent the company’s performance in environmental, the higher the association with the

> **financial performance. Keywords: environmental performance, financial performance, PROPER** — **44**

1. Introduction Prior studies

> **on the impact of environmental performance on financial performance** — **1**

that showed various results (Qi

> **et al., 2014;** Sarumpaet **et al.,** 2017). Can **environmental performance** — **56**

increase financial performance? Is going green cost worth with the return that the company gets in the future? Some studies argue that doing environmental performance cost more than the return that they got, but some researcher assumed that market appreciates green companies. Finally, environmental performance will increase financial performance indirectly (Sarumpaet, 2005). The studies

on the impact of environmental performance and financial performance 1

are still inconclusive. Some of the studies found that there are

significant and positive association of environmental performance and 11

firm performance (Al-Tuwaijri, et al, 2004; Suratno, et al, 2006; Arafat et al, 2012; Alvarez et al, 2015; 8

Vafeas & Nikolaou, 2015; Misani & Pogutz, 2015; Li,

et al, 2017; Manrique, et al, 2017; Sarumpaet, et al, 2017), but the 26

others showed insignificant results (Rockness et al., 1986; Sarumpaet, 2005; Almilia & Wijayanto, 2007; Earnhart & Lizal, 2007; Iwata & Okada, 2011; Liang & Liu, 2016). Several studies even find the negative impact of

environmental performance and financial performance (Rahmawati & Ahmad, 2012; Vastola et al., 2016). 37

Most of the previous

studies are conducted in some developed countries such as the USA 27

and Japan, where people lived in a high awareness of environmental issues. Studies on environmental issues in developing countries become interesting since the awareness of people in developing countries on this issue tends to become increasing. In Indonesia as one of developing countries, the Government has a big concern about this issue. Through the Environment Ministry, the Government of Indonesia conducted a national extensive environmental performance valuation that called PROPER (Sarumpaet, 2005). The Indonesian Government released PROPER ratings published

by the Indonesian Ministry of Environment. This rating is believed to 7

have a reliable indicator since it is published annually so that it can reduce information asymmetry. PROPER ratings are

used to describe each company' s environmental performance from best to worst, i.e., gold, green, blue, red and black 1

(Sarumpaet et al., 2017). The concern of companies to the environmental issues should be paid by the high firm performance, as the argumentation of Stakeholders Theory. According to this theory, if the company fulfill the needs of stakeholder both economic and non-economic, they will get support from the stakeholder. Performance in environmental responsibility will improve the company's image & reputation, get more loyal customer and increase share price (Heinkel

et al., 2001; Prisch et al., 2007; Guenster et al., 2011). The contradictive of 32

the previous results open the venue for the current study; therefore, the

purpose of this study is to add the evidence on the impact of environmental performance on financial performance from the developing country. To improve the 6

results, this study split the sample

into two groups, the first group is the companies that 51

consistently achieve good performance and the second group is the companies with consistent poor environmental performance. Consistency in environmental performance will enable the company to continue it is operating and keep the trust from the stakeholders (Misani and Pogutz, 2015; Vafeas & Nikolaou, 2015). Companies that have high

environmental performance will also have high financial performance 3

while companies with low

environmental performance will also have low financial performance. 3

PROPER is used to measure the environmental performance and return on asset, earning per share and

Tobin's q is used to measure the financial performance. 33

2. Literature Review

Environmental performance is the performance of the company in protecting and preserving a suitable environment (Suratno et al. 2006). 10

Ikhsan (2008) argues that environmental performance is an activity carried out by the companies that related to the surrounding natural environment. In Indonesia, the rules regarding environmental performance are regulated in the regulations of the environment minister number 6 in 2003 which says “The program for rating the performance of companies in environmental management referred to as PROPER, is a research program on the efforts of those responsible for businesses and activities in controlling pollution and environmental damage or

management of hazardous and toxic materials. The purpose of 7

this program is to make companies to be more concerned with the needs of stakeholders and to encourage companies to be better manage their

environmental performance and their responsibility. Environmental 11

responsibility **is a** form **of**

organizational obligation that not only provides goods and services for the community but also participates in maintaining environmental quality and contributing positively to the community (Januarti and Apriyanti, 2006). Companies that have environmental responsibility can avoid claims from the public and the government so that it will improve product quality which will ultimately increase economic benefits (Porter and Linde, 1995). According to stakeholders theory, there is a

relationship between a company which concerns **environmental performance and** financial **performance.** 40

According to Sari (2012), companies are not only responsible to stakeholders but shifting to be broader namely to arrive at the social (stakeholder) domain by taking into account factors social dimension.

The relationship between environmental performance and financial performance in the 24

theory of stakeholders, stating that the company must take direct action into stakeholders (shareholders, customers, investors) and indirect stakeholders (community, society). Financial performance is the result obtained by the company due to carrying out various activities in using the resources they have. Financial performance can be seen through financial statement analysis and financial ratio analysis (Husnan, 2005). Susanto and Tarigan (2013) argue that financial performance is a result of decisions obtained based on an assessment of the ability of a company, both regarding profitability, liquidity, activity, and solvency. Horngren & Harisson (1993) argue that financial performance is useful for measuring company performance and management of a business where financial performance is a tool for management that is useful in controlling a company.

Previous studies on environmental performance or reporting have used different measures of financial or economic performance. For example, Bragdon and Marlin (1972) used accounting-based measures that are **earning per share and return on equity; while Spicer (1978) used both accounting-based and market-based measures,** i.e., **profitability and the price-** earnings **ratio). This study** 1

uses Earning Per Share (EPS),

Return on Assets (ROA) and **Tobin's Q as the financial performance** 16

measurement. EPS is net income that is ready to be shared with shareholders

divided by the **number of shares of the company** 5

(Tandelilin, 2010). The following formula calculates EPS: = hh (1)

Return on Assets ratio that shows the **company's ability to** 34

use the number of assets it has to generate profits in a period (Almilia et al., 2009). According to

Rachmithasari (2015), return on assets

can be measured by using the formula for net income 52

after tax divided by total assets. = (2) Tobin's Q measures the company's financial performance concerning potential market value, and Tobin's Q is more directed at investment growth potential. Mathematically

Tobin's Q can be calculated by formulating the 54

formula as follows Lindenberg & Ross (1981): ′ = + (3) 2.1 Hypothesis Development Companies do not just have to focus on shareholders but also must focus on the stakeholder (Ferner & Quintanilla, 1998). Besides that, the success and sustainability of a company are in the hands of stakeholders, by maintaining the support from stakeholders. The commitment of companies to protecting and preserving the environment is one of the ways to get support from the stakeholders (Prisch

et al., 2007; Li et al., 2017). Muhammad et al., (2015) 28

showed

that there was a significant influence impact of the company's environmental performance on the company's financial performance. Coopers and 13

Lybrand (1993) argue that company with excellent environmental performance can get trust from society and make the company have a better financial performance. The company should be concerned with not only short-term profit but also the long-term profit by attracting the stakeholder interest (Li et al. 2017). The company with excellent environmental performance does not only disclose the company concern for the environment but also about product quality, product safety, corporate social responsibility towards the surrounding community, and the company concern for the safety and employee prosperity (Rakhiemah and Agustia, 2009). Verrecchia (1983) argues that a company with good environment reveal good news for the stakeholder to invest in that company better than other competitors. Suratno, et al., (2006) argue that good news is essential to company and stakeholder for the future company operating to improve financial performance and have more valuable company than others.

Based on the above explanation, the hypothesis is as follow. H1: 42

Environmental Performance has a significant positive effect on Financial Performance 30

Some of the previous studies indicate that environmental performance has insignificant or

even negative effect on financial performance. However, some 58

researchers have successfully found the consistent results on the

on the association between environmental performance and financial 1

performance,

Vafeas & Nikolaou (2015), Sarumpaet,

et al., (2017) and **Misani and Pogutz (2015).** Sarumpaet **et al.,** 29

(2017)

found a positive **relationship between** PROPER **and** the **stock price** when dividing **the** 50

sample into the ratings of "Good" and "Poor", but found no influence when using all sample data without dividing it. Misani and Pogutz (2015) argue that companies that have high

environmental performance will also **have** high **financial performance** 3

while companies with low

environmental performance will also **have** low **financial performance.** 3

Consistency in environmental performance will enable the company to continue it is operating and keep the trust from the stakeholders. Following Vafeas & Nikolaou (2015) that prove the consistent results this study divide sample into two groups. The first groups are the companies that consistently get an excellent PROPER ranking (Gold, Green, and Blue) and the second group is the companies that consistently records the poor rating (Red and Black). When the company consistently contribute to environmental performance, it will contribute to the significant positive effect on financial performance. H2: Companies that consistently receive good environmental performance have positive

financial performance compared to those who **do not have** 46

consistent environmental performance

3. Research Method 3.1 Sample This study is 39

applied to listed firms in

Indonesia Stock Exchange (IDX) **and participated in** the **PROPER** Program for **the** 47

period of 2010 to 2017. Companies that have information that

needed for this study will directly exclude **from the sample. After** strong selection **for the** completeness of the **data, the sample of** 2

this study are 48 companies that come from 8, and that will make total observation around 384 firm-year observation. In table 3.1 explained in the sample selection to 48 companies and made the data of this study

to be 384. Data are collected from Bloomberg; meanwhile, for the company's annual environmental performance are gathered

from the website of the Indonesia Ministry of Environment 2

Table 3.1 Sample selection output Sample Requirement The amount of observation The company that listed in BEI Incomplete data Companies that do not enter in PROPER Program from 2010 to 2017 Total company Total Observations 626 (182) (396) 48 384 3.2 Variables Operationalization Financial

performance is measured by **return on assets (ROA), earning per share (EPS),** 21

and Tobin's Q.

Return on asset **is measured by** earning **after tax** divided **by** 53

total asset (Rachmistasari, 2015). Return on asset is a critical component to show how well a company deals with the asset to generate profit in a period (Almilia et al., 2009).

Earnings per share are **measured by** earning after **interest and** tax **divided by** total **outstanding** 2

share (Tandelilin, 2010). Earnings per share are as an indicator of company sustainability in the future, the stable value of earning per share as a positive signal to companies sustainability (Young, 2002; Kasmir, 2008).

Tobin's Q is measured by Total Debt plus **market value of** 5

all outstanding stock (MVS) are divided by the total asset. MVS is closing price multiplied with the outstanding share (Lindenberg & Ross, 1981). Tobin's Q is an investor perception towards company about their share price. The high price of the share will also

increase the value of the company (Brealey **et al.,** 45

2007). PROPER ratings measure environmental performance. This rating is divided into five color ranks which are

gold for the best, and **then green, blue, red, and black for the worst** 9
(Indonesia Ministry **of**

Environment, 2015). Gold was given to the company that consistently show the excellence of environment in the production process or service process. Green was given to the company that does the environmental management better than the applicable law. Blue was given to the company that does the environmental management following applicable law. Red was given to the company that does environmental management, but their effort is below the standard of the applicable law; meanwhile, Black was given to the company that intentionally break the law that was given that can make serious effect that will harm the environment, black was also given to the company that violates the rule and ignore the administration fine

that given to them. To increase focus on our study,

> **we use** some **control variables** which are **firm size, firm** age, **leverage, and** **38**

market share.

> **Firm Size** is **measured by the logarithm of** the **total** asset **of the company** **23**

(Johnson and Greening, 1999; Ball and Foster, 1982; Dechow and Dichev, 2002). Firm age

> **is measured by the logarithm of the total** years of **the** **36**

companies since listed in IDX (Chun et al., 2008).

> **Leverage is** measured **by the ratio of total debt** divided by **total equity** (Weston **and** **20**

Copeland, 2012). Debt to equity ratio (DER) informs a company equity structure to help investors to assess the company's risk (Husnan and Pudjiastuti, 2002). Market share

> **is measured by** a **ratio of total** company **sales** divided by **total** **43**

industry sales (O' Regan, 2002). 3.3 The Model of Analysis The study uses multiple ordinary least squares to test the hypothesis. The following is the model of analysis FP, = + 1PROPER

> **,−1** + 2PROPCONS **,−1** + 3LEV **,−** 1 + 4FSIZE **,−1** + 5FAGE **,−** 1 + 6 **,−1** **25**

+ Ɛ (4) Where: Q,t: FPi,t: PROPER,t: PROPCONS,t: LEV,t: FSIZEi,t: FAGEi,t: MSHAREi,t: Tobin's Q of

> **company i at year t** Firm **performance of company i at year t-** **2**

1, measured by ROA, EPS and

> **Tobin's Q** PROPER rank **of company i** at **year t-1** **35**

Dummy variable for the consistency of the PROPER rank

> **of company i at year t-** **15**

1 Leverage

> **of company i** at **year t-** 1 Firm **size of company i** at **year t-** **22**

1 Firm age

of company i at year t- 15

1 Market

Share of company i at year t- 1 4. Result **and** 2

Discussion Table 4.1

shows the descriptive statistic **for the full sample.** Companies **that** 48

accomplish good PROPER rating consistently show different characteristics from companies that get good PROPER rating inconsistently. The market share, firm size, and firm age inconsistent group, on average is smaller than the other one, except leverage. The financial performance of companies that achieve good PROPER rating consistently is better than inconsistently get a good PROPER rating. The PROPER inconsistent group is higher than the inconsistent group, this is indicated by the mean of the PROPER inconsistent group is 3.29, and the inconsistent group is 2.95. Table 4.1. Descriptive Statistic for the Full Sample Variable All Sample Inconsistent PROPER Consistent PROPER ROA Mean 0.0677 0.0538 0.0817 std dev 0.106 0.0870 0.122 EPS Mean 265 224 305 std dev 655 657 652 Tobin's Q Mean 1.96 1.5 2.42 std dev 2.59 1.13 3.42 PROPER Mean 3.12 2.95 3.29 std dev 0.438 0.379 0.426 MSHARE Mean 2.06 2.16 1.96 std dev 1.9 2.23 1.49 FSIZE Mean 12.9 13 12.9 std dev 0.574 0.622 0.521 AGE Mean 1.2 1.27 1.14 std dev 0.264 0.18 0.315 LEV Mean 0.408 0.26 0.556 std dev 2.89 3.9 1.2 Observation 384 192 192 Table 4.2 shows that PROPER do not have significant effect to return on asset (p-value= 0.3412) and Tobin's q (p-value= 0.2843), but have significant negative effect to earning per share (p-value= 0.0196). It seems that the increase in PROPER can cause a decrease in earning per share. However, after dividing the sample into two groups, we find that PROPCONS has positive significant effect to return on asset (p-value= 0.0235), earning per share (p-value= 0.0278), and Tobin's q (p-value= 0.0007). These findings show that consistent good environmental performance has

a significant impact on firm performance. This result **is in line with** 14
stakeholder theory **and**

previous research (Sarumpaet et al., 2017). The company that has consistent good environmental performance will have a competitive advantage, that can be translated into better

financial performance (Al-Tuwaijri et al., 2004; Sarumpaet **et al.,** 31

2017). Good environmental performance leads to a positive market response, building good relations with stakeholder especially primary stakeholder, that finally create a competitive advantage (Hillman & Klein, 2001). Table 4.2 The Results of Hypothesis Testing Variables Return on Asset Earnings per Share Coefficients p-value Coefficients p-value Tobin's Q Coefficients p-value Const 0.2462.85 0.1322 −4872.53 <0.0001*** PROPER 0.0130.289 0.3412 −195.503 0.0196** PROPCONS 0.0269.166 0.0235** 159.423 0.0278** MSHARE 0.0152.797 0.0001*** −37.3272 0.1180 FSIZE −0.0208.091 0.1126 466.218 <0.0001*** FAGE 0.0352.151 0.0852* −66.4276 0.5939 LEV −0.0003.1642.7 0.8611 0.931235 0.9327 IDSector −0.0115.410 0.0001*** −63.6745 0.0006*** 6.4689.2 0.3389.40 0.9313.10 0.4500.07 −0.5547.58 1.2543.0 −0.0111.858 −0.3983.80 0.0874* 0.2843 0.0007*** <0.0001*** 0.0675* 0.0082*** 0.7891 <0.0001***

Notes: *, * * and * * * denote statistical significance at the 10%, 5% or 19

1% level.

Good environmental performance will lead to being better environmental reputation, improve company's image, increase loyal customer, and reduce unnecessary costs like workers or society demonstrate on (Heinkel et al., 2001; Cai & He, 2014). Environmental performance is an investment, where the benefit cannot be expected in the short- term but long-term (Wong et al., 2016). The

result is in line with stakeholder **theory which** states **that** 49

if a company fulfill the needs of stakeholder both economic and non-economic needs, the company will get support from stakeholder like a more loyal customer, improve brand image, increase the share price, and financial performance (Crisóstomo, Freire, & Vasconcellos, 2011). The results explain the inconsistent results of the previous research in

environmental performance and financial performance. The firm determination **to** maintain good **environmental** 41

performance will have

a positive impact on financial performance information. **The** findings **of** this **study** support that **the** concern **of** 17

the Government of Indonesia

to encourage companies **to be responsible for their environmental** 55

impact produce good results. The restricted regulation on the environmental impact matter since it can save the stakeholders' interest and prevent a potential violation of the environmental responsibility. The company that disobeyed the rule must be punished based on the regulation. Stakeholders appreciate to the company that consistently have a good ranking of environmental performance. Their role is essential in motivating companies to keep good performance in the environmental aspect. Therefore, there is a payoff for the consistently good performance and vice versa. Some control variables show as the determinant of the firm performance, MSHARE has positive significant effect to both return on asset (p-value= 0.0001) and Tobin's Q (p-value= 0.0001), FSIZE has significant effect to both earning per share that has p-value= 0.0001; coef= 466.22 and Tobin's Q that has p-value= 0.0001; coef= -0.54. AGE has positive significant effect to return on asset (p-value= 0.0852) and Tobin's Q (p-value= 0.0082), however, LEV has no significant impact on financial performance. A company that has high market share, it means that the company can fulfill market demands and most of the consumers like that company's products. Because of that, the company will get more profit and increase financial performance. Companies that have a high market share also indicate that the company has a good image in the perspective of a stakeholder. Financial performance is also explained by firm size. Big companies usually have more stable in operations, have a competitive advantage that small companies and have a good reputation in stakeholder's perspective. The big companies are trusted by the stakeholder that it has a better future. Company's age shows the experience of the company in running their business. Age of company is one of the components of company success. This makes more experienced companies more trusted by the market. Leverage should be a positive impact towards financial performance because the higher debt that owned by the company can maximize the profit and operations. However, hypothesis testing shows the opposite result. 5. Conclusion This study examines whether environmental performance will be followed by good financial performance, especially for the consistent good performer. The results support that the consistency of the companies to keep good environmental performance resulting in good financial performance. We find that the group of firms that consistently have a

inconsistent results of prior studies. It confirms that environmental information is needed to inform stakeholder that the companies made a better contribution to the environmental issues. There are some limitations to this study. First, we fail to include all the companies participate in the PROPER Program since many companies are not listed in Indonesia Stock Exchange so that data are not available. Second, our results should be carefully generalized, since it is only applicable to the listed companies. Future research is still needed to convince the companies the benefit of involving in PROPER and environmental issues, as well. References Almilia, L. S., & Wijayanto, D. (2007). PENGARUH ENVIRONMENTAL PERFORMANCE DAN ENVIRONMENTAL DISCLOSURE TERHADAP ECONOMIC PERFORMANCE. Proceedings The 1st Accounting Conference. Depok. Almilia, L. S., Shonhadji, N., & Angraini. (2009). 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