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Stakeholders Power, Environmental Performance and Financial Performance Juniarti 1*, Lianny Alandi2, Jessica Mianto3 and Veny Yuana4 1,2,3,4Petra Christian University, yunie@petra.ac.id,

Jl. Siwalankerto 121-131, 60236, Surabaya, Indonesia ABSTRACT 38

Unlike prior study that have concerned more to the ex post effect of good

environmental performance to the financial performance, this paper 6

address **the** role **of**

stakeholders power in driving managers to achieve a good environmental performance. We use 266 listed companies from the period 2010-2017 that consistently enrolled in the PROPER Program, whereas PROPER program is initiated by the government of Indonesia to encourage the involvement of companies on the environmental issues. We find that the power of stakeholders represented by shareholders and government power have a significantly effect to the environmental performance, but creditor power does not. In addition, we also prove

that companies with good environmental performance have a **26**

good financial performance as prior results. Type of Paper: Empirical Keywords: stakeholders power, environmental, financial, performance

1. Introduction In Indonesia, the concern of government related to the issue of global warming, has been shown by the issuing of The Acts of Government of Indonesia Number 17 in 2004. The Acts stipulate a decrease the amount of GHG (Greenhouse Gases) emission due to human activities so as to stabilize the concentration of GHG in the atmosphere and does not endanger the earth's climate. Following this Act, The Ministry of Environment published PROPER to raise company awareness toward the importance of environmental responsibility. Companies in Indonesia that joined PROPER had been aware that environmental responsibility is a matter. Corporate Environmental Responsibility (CER) provides investors with the relevant information value. Therefore, this leads to more efficient capital market (Hussainey & Salama, 2010). Many shareholders necessitate disclosure of several environmental information including an overview of risks and effects on the environment, 1 Corresponding author: Juniarti ; E-mail: yunie@petra.ac.id. environmental policy, measurable environmental targets, performance toward target and environmental cost (Villiers & Staden, 2012). The study that focus on how the power of stakeholders such as shareholders, government and creditor pressure the management to concern with their environmental impact, is still very rare. Among others are Elijido (2007) that found that the stakeholder power, proxied by government power has the significant impact on environmental performance, while stakeholder power, measured by creditor power had not. In addition,

Garcés-Ayerbe, et al (2012) confirmed that **the** level **of** proactive **environmental** strategies **is** **24**

determined by pressures from stakeholders' in companies, whether it be a company with moderate pollution or a high-pollution company. A number of

prior studies have still **focused on the** ex post effect **of the** **30**

environmental responsibility companies on their performance, both financial and non-financial. The studies found that well-managed companies can obtain financial profit through means of environmental strategies,

investor appreciation, and finally, they experience an abnormal return (Cai and He, 2014; Christmann, 2000). Companies responsible towards their environment will create better image, motivate employees, save cost, better reputation, gain favor suppliers and loyal customers (Heikkurinen, 2010). Some other benefits for the companies

> **that choose to improve their environmental performance over time** are likely **to experience** an improvement **in their financial resources and** their **management capabilities** **4**

(Clarkson, et. Al., 2011), better reputation and good economic performance (Zhongfu, et. al., 2011; Li, et al. 2017; Kim and Statman, 2012). Further, companies that

> **proactive in supporting social** responsibilities **and environmental** conservation **(SRES corporations)** is featured **by higher** scale of **profit** **8**

compared to their industrial sector (Akron, 2015). Studies on the benefit of good environmental performance are very important, many previous studies have done this. However, the role of stakeholders as the driver factors that push the management to concern with their environmental problem become an interesting research question, for some reasons. First, stakeholder power is viewed as the function to measure as to what extent does stakeholder control resources needed by the corporation (Ullmann, 1985). A company must maintain relationship with its stakeholders by accommodating demands and needs, especially those who have power over resources availability needed for company operational activities, e.g. human resources, company product market, etc (Chariri dan Ghozali, 2007). This correspond to stakeholder theory according to

> **Dobbs and Staden (2016)** which **indicated that** corporate **management** will identify **the** **37**

necessities of stakeholder and disclose any information to maintain their support. Second, companies that building better relationships with primary stakeholders help corporate develop valuable tangible assets which could

> **become a source of competitive advantage** (Hillman **and** Keim, 2001). Third, **in** **27**

Indonesia, the concern of the government in reducing environmental impact by encouraging companies to improve their environment quality through PROPER Program need to be further investigated, which of the stakeholder power effectively push them to enter in the PROPER Program. Prior studies in Indonesia, i.e Sarumpaet et al (2017), Amilia and Wijayanto (2007) and Sarumpaet (2005) just search the impact of the PROPER ranking with the financial performance. Therefore, it will be valuable for current study to explore

the power behind the loyalty of management to achieve their best performance in environmental responsibility, in addition to measure the benefit of having good environmental performance. Therefore,

using Ullmann's three-dimensional framework	**1**

(1985) that measures

stakeholder power by **shareholder power, creditor power and government power,**	**22**

this study aims to seek the **empirical evidence on the**	**10**

role of the stakeholders power in contributing the good environmental performance achieved by companies.

2. Literature Review 2.1 Corporate Environmental Responsibility	**29**

Corporate environmental responsibility (CER) is as **a** component **of corporate social responsibility (CSR)** which **is**	**16**

a company’s commitments and practices to act responsibly

to protect and improve natural environment (Holtbrügge and Dogl, 2012).	**11**

Demands for implementation of manufacturing activities which are environmentally friendly, environmental audit, environmental accounting management, and environmental report are increasing day by day (Hossain, 2010).

In developing countries, the concept of environmental responsibility is	**25**

starting to be accepted by society and stakeholders has become aware of their environmental rights (Sindhi & Kumar, 2012). Organizations are starting to accentuate themselves as environmentally responsible organizations and display their ambition to improve their environmental performance (Ruepert, et. al., 2017). In Indonesia, weak observations and enforcements of official regulations, and moderate budget, whereas manufacturing companies grow more than 10% each year, have pressured the government to recognize the growing risk of severe damage due to pollution. To overcome the risk, the Ministry of Environment decided

to make

a large-scale public disclosure program so as **to** reduce **pollution** **32**

and develop a formal regulatory system (Afsah, et. al., 2004). Faced with the difference between a strong industrial and development sector and shortage of own resources, The Environmental Impact Management Agency of Indonesia (BAPEDAL) decided to create an information disclosure program which is PROPER (Lopez, et. al., 2004). The fundamental principle of the PROPER implementation is to encourage companies environmental management through means of incentive instruments reputation/image for companies that have a good environmental management performance (Hardjasoemantri, 2011). There are five ranks of PROPER, the highest rank is gold, followed by green, blue, red and black rank. A company with gold color will get a reward since it has met international standard for environmental excellence. (Lopez, et. al., 2004) 2.2 Stakeholder Power and Environmental Performance Stakeholder power can be classified into shareholder power, creditor power, dan government power (Elijido, 2007; Liu & Anbumozhi, 2009;

Lu and Abeysekera, 2014). Management will identify **the** necessities **of stakeholder and** **28**

disclose any information to maintain their support (Dobbs and Staden, 2016). Increasing awareness on

environmental activities has put more pressure **on companies to communicate information regarding** these **activities and respond to several** requisites set **by stakeholders.** **3**

Hughes (2000) found that corporate's equity value which got environmental impact tends to fall in the investors' view. Capital providers must concern themselves with how companies manage risks of

environmental, social and governance (ESG) and its **influence on** **5**

the company's financial feasibility (Bubna-Litic, 2007). Global institutional investor made a document containing information that investors needed from a company where they will invest in to analyze risk and business opportunities resulting from

climate change (The **Global Framework for Climate Risk Disclosure,** **5**

2006). According to (Li, et. al. 2017), companies are faced with more stringent government regulation must be more efficient in investing and utilize their resources to address environmental issues. In Indonesia, the government expect companies to pay attention to environmental issues. This is evident by the issuing of the Peraturan Pemerintah Number 47/2012 regarding Social and Environmental Responsibilities of Corporations

which explicitly states that social and environmental responsibilities are obligations of companies which operations are in or related to natural resources sector. Companies who do not execute these responsibilities will be penalized in accordance to the law. Creditors are imperative stakeholder whose influence must be managed. As a company depend more on loan

> **financing to fund capital projects, the** 41

company's management will

> **be expected to respond to creditors' expectations** in regard to **the** company's **role in socially responsible activities** 15

(Robert, 1992). The more a company depends on loan financing, the more likely it's going to try to do environmental strategies in its strategic planning decisions such that it will be considered a company with low risk (Elijdo, 2007). Companies utilize

> **environmental disclosure to** elevate **their status,** providing **information to stakeholders** in regard to **their activities** 3

(Khlif,et al., 2015). Thus, CER reporting is driven by power and expectations of stakeholders (Khlif, et al., 2015; Hossain and Alam, 2015; Papagiannakis and Lioukas, 2012). There is no solid conclusion from the prior studies, Elijido (2007) found that the shareholders' power and government power affected environmental performance, while creditors' power did not. Lu and Abeysekera (2014) showed that eventhough the pressure of several stakeholders are weak. However, from the above explanation, we argue that there is a strong influence of stakeholder power in driving companies to have good

> **environmental performance. Based on the above** 40

analysis, the hypothesis implied in this research is H1 :

> **There is a positive association between** stakeholder power **and environmental** performance. 2.3 **Environmental** Performance **and** 20

Financial Performance CER implementation dramatically contributes to better company reputation, leading the company toward open report reporting, assisting in forming a circle of environmental information with good economic performance (Zhongfu

> **,et. al., 2011).** Li **et. al.** (2017) **stated that a** 31

company's active involvement in environmental performance could assist in building a better company reputation, meeting stakeholders' interests, attracting more investors, thereby increasing financial performance. Customers give rewards to environmentally responsible companies by demanding more product or paying extra to the company, which translates to the main source of income 5 | P a g e for the company, while the government penalize companies which violate environmental regulations (Arbelo, et. al., 2014). Economic Performance and Environmental Performance are directly related to management quality. Managers will act in regard to the company long- term interests to carry out corporate social responsibility and adopting proactive strategy to regulate environmental pollution (Al-Tuwaijri, 2004). Companies which try to reduce cost will incur higher explicit cost (payment to bonds' holders), inducing competitive disadvantage (Waddock and Graves, 1997). By doing so, companies will obtain support from several stakeholders who offers several

facilities and resources, which will help increase company's **financial performance** **11**

(Li, 2017).

Based on the above arguments, the following **can be hypothesized:** H2: **There is a positive** association **between** environmental performance **and** **14**

financial performance. 3. Research **Methodology 3.1 Data and Sample This** **6**

research adopts

Ullmann's three-dimensional framework (1985) **in** **1**

order to explain stakeholder power. It was represented by

shareholder power, creditor power and government power. **1**

Companies that consistently follow PROPER in 2010-2017, listed in Indonesia Stock Exchange (IDX) and have the necessary data for research are selected as the research sample. There are 1,924 companies that follow PROPER during the period of 2010 to 2017. Of the 1,924 companies enrolled in PROPER, there were 1,811 companies that consistently followed PROPER and the remaining 113 were not consistent. Of the 1,811 companies, only 52

companies are listed on the Indonesia Stock Exchange, while the 36

remaining 1,752 are not listed. Since there are no data available for private companies, this research applies only to listed companies. The sample that met the criteria during the years 2010-2017 were 472 observations, however after removing some of the missing values, the remaining data is 266 observations. 3.2 Model of Analysis This study includes several control variables that proved as the determinant of the company performance. The control variables consist of firm size, level of competitiveness 6 | P a g e and firm age. Larger firm sizes are more diversified (Pandey, et al 2004), have more access to equity markets and have more internal financial accumulation than smaller firms (Titman and Wessels, 1988). Level Competitiveness (COMP), according to Schmidt (1997) the higher the level of competition increase the threat of liquidation. This threats encourage

managers to work harder to improve the internal efficiency of their companies. However, the 21

impact of competition will lower when companies have dominant external shareholders (Nickell, 1997). Firm Age (AGE), the older business tends to provide an accumulation of experience and knowledge to the owner, which can provide the ability to manage corporate finance (Karadag, 2017). Owners become more advanced and experienced in negotiating

with providers of capital, as their business develops (Ang, 1992). 10

The analysis model of this research is expressed in the model as follows: The following model 1 is used to test hypothesis 1: , = 0 + 1

,−1 + 2 ,−1 + 3 ,−1 + 4 ,−1 + 5 ,−1 + 6 ,−1 + (1) 2

To test hypothesis 2, we used two model, the first model includes environmental performance and the second model excludes the environmental performance, as below: Model 2.1 , = 0 + 1

,−1 + 2 ,−1 + 3 ,−1 + 4 ,−1 + 5 ,−1 + 6 ,−1 + 7 ,−1 2

+ (2) Model 2.2 , = 0 + 1

,−1 + 2 ,−1 + 3 ,−1 + 4 ,−1 + 5 ,−1 + 6 ,−1 2

+ (3) Where: , : company environmental performance i in period t; , : financial performance of company i in period t; ,−1 ,−1 7 | P a g e : the strength of shareholder in company

i in period t; : the strength of the 42

creditor at

firm i in period t; ,−1 : the power of government at firm i in period t; 7

,−1 : firm size

i in period t; ,−1 39

: level of competitiveness of

firm i in period t; ,−1 : age of firm i in period t; 7

3.3 Operational Definition Table 1: Operational Definition 33

Variable Measurement Corporate Environmental Responsibility Performance (PROPER) Environmental responsibility is measured using the PROPER rating taken from the Kementerian Lingkungan Hidup (KLH) where the gold rating is given a value of five, green is a value of four, blue is given a value of three, red is given a value of two and black is given a value of one. Sarumpaet, et. al (2017) Stakeholder Power Ullmann (1985) three-dimensional framework model consisting of

shareholder power (SP), creditor power (CP), and government power (GP). Shareholder power (SP) is measured by the 1

percentage of ownership of firm i held by shareholder holding 5% or more of total shareholding at period t. The creditor power (CP) 9

is measured by dividing

the average debt to equity ratio (D / E). 1

Government power (GP) will be assigned a value of 1 for high profile industry and 0, otherwise. High profile industries

are those in mining and resource industries, **energy,** buildings **and** forests / **paper products,** transportation / **logistics, steel and heavy** metals **and chemical** 1

industries. Financial Performance (FP)

Financial performance is measured by ROA 12

(Elijido, 2007) Net Income ROA =

Total Assets Firm Size (FS) Firm **size is** measured using **the** total **logarithm of assets** 12

(Li, et al., 2017). Level Competitiveness (COMP) Level Competitiveness (COMP) is measured by Herfindahl Index (HI) which is an index of concentration in an industry. High score is an indication of high concentration levels or low competition and low score indicates high competition (Nawrocki, 2010). COMP = S12 + S22 + S32 + ⋯ + Sn2 Firm Age (AGE)

AGE is explained **by** the **number of years since the** company **was listed on the** Indonesia **Stock Exchange** 13

(IDX). 4. Results There is 51 listed companies from the period 2010-2017 that consistently enrolled in the PROPER Program, among them are some prominent companies that have a good reputation in their environmental responsibility such as PT Unilever

Indonesia Tbk, PT Holcim **Indonesia Tbk, PT Indocement Tunggal Prakarsa Tbk** and **PT** Bukit Asam **(Persero) Tbk.** 2

These companies often earned gold rank from the PROPER and were awarded as the best environmentally responsible companies. Overall, 51 firms that consistently involve in PROPER have a moderate PROPER's rank. It implies that the companies have enough concern to their environmental problem. Firms sample, on average are able to create return as of 7.56 from their assets. Environmentally responsible companies in this study are in the moderate level of competition, have ample experience in their industry and have relatively similar size. The summary of main statistic

is presented in Table 1. Table 1: Summary Statistics Variable 19

ROA EPS PROPER SP CP GP FS COMP AGE Mean Median 7,56 5,66 313, 67,0 3,17 3,00 2,18 2,00 26,7

3,57 0,513 1,00 9,81 9,85 0,454 0,400 19,3 21,0 S.D. Min 10,2 -19,7 611, -758, 0,530 2,00 1,50 1,00 44,8 0,00 0,501 0,00 0,611 8,52 0,239 0,126 8,54 0,00 Max 43,9 4,03e+003 4,50 7,00 328, 1,00 11,0 0,967 38,0 Table 2 groups companies by PROPER ranking. It exhibits

that the higher the PROPER ranking, **the better the** company **performance** **35**

as expected. The power of shareholder, creditor and government seem linier with the PROPER ranking, though creditor power become slightly lower for Gold ranking group compare to Green ranking group. There is seem no different in firm size, level of competitivennes and age among sample groups. Table 2: Profile of companies based on PROPER Ranking PROPER N % ROA SP CP High GP Low FS COMP AGE

Gold (5) Green (4) Blue (3) Red (2) **34**

Total 16 39 196 15 266 6.02% 14.66% 73.68% 5.64% 12.688 11.489 6.673 4.222 1.500 1.897 1.690 1.000 37.141 48.161 23.242 17.146 14 29 85 9 2 10 111 6 10.227 10.150 9.729 9.440 0.420 0.531 0.437 0.617 19.500 20.538 19.337 14.409 We proposed two hypothesis in this study, the first is stakeholder power has a positive association with the environmental performance. Our argumentation is that companies need to maintain the stakeholders' interest in order to get their support to companies operation. Therefore, companies continue to struggle to meet the needs of stakeholders. The results support for the two proxies of stakeholder power, that is shareholder power and government power, each significant at < 0.01, while creditor power does not verified. However, creditor power still

has a positive coefficient though **it is not statistically significant.** **23**

This finding consistent with Elijido (2007) who found that creditor power did not affect environmental performance. Lu and Abeysekera (2014) showed that eventhough the pressure of several stakeholders are weak, however it had an influence company's disclosure related to environmental performance. The first model of hypothesis 2 is also supported, in which PROPER statistically significant at <0,01. The higher the environmental performance, the better the financial performance. The result confirms that there is a significant contribution of the

environmental performance to the financial performance. The second model **of** **6**

hypothesis 2 proves the opposite, where the stakeholder power have negatively effect to the firm performance. The direct effect of stakeholder power does not prove, it seems that there is an indirect effect of stakeholder power to the firm performance, since there is a positive association of stakeholder power to the environmental performance (hypothesis 1) and environmental performance to firm performance (the first model of hypothesis 2). Table 3: Summary of Hypothesis Tests Model 1 Model 2 Model 3 Const PROPER SP CP GP FS COMP AGE R2 Adj R2 F PROPER Coef -0.303 0.146 0.000 0.248 0.319 -0.022 -0.0010 0.188 0.169 9.924 p-value ROA Coef -52.981 4.25 *** -1.186 -0.106 *** -6.563 *** 5.147 6.249 0.131 0.383

0.366 *** 22.748 p-value *** *** *** *** *** *** ** ** *** ROA Coef -51.049 -1.296 -0.106 -5.682 6.278 6.891 0.13 0.342 0.327 22.265

p-value * *** *** *** *** *** ** *** *p < 0.1; **p< 0.05; ***p< 0.01** 17

5. Discussion Capital providers concern with how companies manage risks of

environmental, social and governance (ESG) and its **influence on** 5

the company's financial feasibility, since it may affect to a company's capability to attract equity or loan capital (Bubna-Litic, 2007). Global institutional investor made a document containing information investors needed to analyze risk and business opportunities resulting from

climate change (The **Global Framework for Climate Risk Disclosure,** 5

2006). Companies with widespread ownership possess good environmental performance in accordance to their strategy to attract investors (Elijido, 2007). According to Li, et. al. (2017), companies are faced more stringent government regulation must become more efficient in investing and utilize it to address environmental issue. Companies utilize

environmental disclosure to elevate **their status,** providing **information to stakeholders** in regard to **their activities** 3

(Khlif et al., 2015). Thus, CER reporting is driven by power and expectations of stakeholders (Khlif et al., 2015; Hossain and Alam, 2015; Papagiannakis and Lioukas, 2012). Environmental attitudes are significantly related with behavior and belief towards global warming (Bord, et. al. 2000). Companies must take initiative to shoulder the responsibility towards the environment through the management system on the company environment, a mechanism for environmental governance, and introducing a system to evaluate environmental performance (Li, et. al. , 2017). However, managers usually focused on short term results, staying unfocused to long term perspective (Madsen and Ulhoi, 2004). It is needed the outside power, such as from shareholders, creditor and government to push the concern of management on environmental problems. This finding supports a couple of earlier reasearches that said CER gives positive influence to the financial performance of the company. Companies

that choose to improve their environmental performance significantly over time are likely **to experience** an improvement **in their financial resources and** their **management capabilities** 4

(Clarkson, et. Al., 2011). Implementation of CER contributes greatly to better reputation of the company,

leading the company towards open report, helping to build an environmental circle on information and good economic performance (Zhongfu, et. al., 2011). Companies

proactive in supporting social responsibilities **and** enviromental conservation **(SRES corporations)** is featured **by higher** 8

scale of profit compared to their industrial sector (Akron, 2015). 6. Conclusion Nowdays, environmental problem become world wide issue and the stakeholders' awareness to this issue are also increasing. It has caused the external pressure for managers to address this issue. This study finds that stakeholder power especially shareholders power and government power successfully encourages management to care about the environmental problems arising from the results of its business. However, the pressure from the creditor is quite weak in this study so it is not significant to press managers to achieve good environmental performance.This study also find that good environmental performance significantly affect firm performance. Companies that achieve good environmental performance have better financial performance. This finding supports a number of prior studies. The results imply how the power of stakeholders including government effectively push the companies to comply with the rule. However, we cannot prove the direct influence of stakeholders power on the financial performance. Future research can verify this issue and explore another stakeholders power such as customer, employee and local community. References Afsah, S., Laplante, B., & Wheeler, D. (1997). REGULATION IN THE INFORMATION AGE. Indonesian Public Information Program, 1-11. Akron, D. (2015). Corporate social responsibility, environmental leadership and financial performance. Social Responsibility Journal, 131-148. Almilia, L., & Wijayanto, D. (2007). Pengaruh environmental performance dan environmental disclosure terhadap economic performance. Al-Tuwaijri, S., Christensen, T., & Hughes II, K. (2004). The relations among environmental disclosure, environmental performance, and economic performance: a simultaneous equations approach. Accounting, Organizations and Society, 447–471. Arbelo, A., Pérez-Gómez, P., Rosa-González, F., & Ramos, L. (2014). Eco-Efficiency: Environmental Performance vs Economic Performance. Vol. 2, No. 4, pp. 2328-2185. Belal, A., & Owen, D. (2007). The views of corporate managers on the current state of, and future prospects for, social reporting in Bangladesh: an angagement-based study. Accounting, Auditing & Accountability Journal, 472-494. Bubna-Litic, K. (2007). using climate change to illustrate the. Corporate social responsibility:. Cai, L., & He, C. (2014). Corporate environmental responsibility and equity prices. Journal of Business Ethics. Chariri, A., & Ghozali, I. (2007). Teori Akuntansi. Semarang: Universitas Diponegoro. Christmann, P. (2000). Effects of "Best Practices" of Environmental Management on Cost Advantage: The Role of. Academy of Management Journal, 663-680. Clarkson, P., Li, Y., Richardson, G., & Vasvari, F. (2011). Does it really pay to be green? Determinants and consequences of proactive environmental strategies. Journal Accounting Public Policy, 122-144. Concepción, G.-A., Rivera-Torres, P., & Murillo-Luna, J. (2012). Stakeholder pressure and environmental proactivity: Moderating effect of competitive. Management Decision, 189-206. Dobbs, S., & Staden, C. (2016). Motivations for coprporate social and environmental reporting: New Zealand evidence. Sustainability Accounting, Management andn Policy, 449-472. Elijido-Ten, E. (2007). Applying stakeholder theory to analyze corporate environmental. Asian Review of Accounting, 164-184. Heikkurinen, P. (2010). Image differentiation with corporate environmental responsibility. Corporate Social Responsibility and Environmental Management. Hillman, A., & Keim, G. (2001). Shareholder value, stakeholder management, and social issues: what's the bottom line? Strategic Management Journal, 125-139. Holtbrügge, D., & Dögl, C. (2012). How international is corporate environmental responsibility? Journal of International Management, 180–195. Hossain, D. M. (2010). Climate Change and Corporate Environmental. SSRN Electronic Journal, VOLUME 7, ISSUE 4. Hughes, K. (2000). The Value Relevance of Nonfinancial Measures of Air Pollution in

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