Managing Sustainable business

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Managing Sustainable Business Practices of Indonesian LQ45 Companies

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In the long run, sustainable business will be an important factor in determining the existence of companies. The study employs sustainability report disclosure (SR) as a proxy of sustainable business. LQ45 companies that have a sound financial performance, have enough resources to implement sustainable business. This research attempts to identify the antecedents of SR disclosure among LQ45 companies. The population of this research is all LQ45 companies which publish financial statements in three consecutive years. By using a purposive sampling, this research collects 135 data sources for further analysis. The average of SR disclosure is 16 per cent, with environmental performance achieving 1.3 out of a five-point scale. SR is significantly influenced by environmental performance and the board of directors (BoD). Leveraged negatively, while profitability is positive, influences the environmental performance. The BoDs' concern on environmental performance, sustainable business, and leverage management still needs improving. Government and other related parties should facilitate these companies to implement better sustainable business.

Keywords: *Sustainable business, Sustainability report disclosure, Environmental performance, PROPER, LQ45.*

Introduction

The United Nations has already launched sustainable development goals (SDGs) to achieve a sustainable future. Having been ratified by 193 countries, the 17 SDGs are planned to be achieved by 2030 (Jensen, 2017). These SDGs are intended to solve pivotal social and environmental problems faced by the world's community of today. To achieve the SDGs on schedule, the government and all related parties should actively participate and cooperate synergistically. Littlewood and Holt hypothesize that companies could contribute significantly to SDGs achievements (Littlewood & Holt, 2018). This hypothesis is in line with several grand theories of accounting, that the companies should pay attention to environment and their stakeholders to receive legitimacy (Gray, Kouhy, & Lavers, 1995; Rankin, Stanton, McGowan, Ferlauto, & Tilling, 2012).

To ensure all companies would prosper in the long run, they should consider the economic, environmental and social issues (Kumar, Boesso, Favotto, & Menini, 2012). The previous study concludes that companies' success is not solely determined by their profit, but also by the social and environmental aspects (Ranto, 2015). In addition, environmental issues like carbon emission, ozone layer depletion, hazardous and toxic waste management, endangered animal trade, and climate change currently become more important (Gamble, Hsu, Jackson, & Tollerson, 1996). Therefore, companies should start to perform their operation more advantageously for the environment and social by using the platform of the triple bottom line (3P). In a global business, the 3P concept is deemed the main pillar to realise sustainable development (Elkington, 1998).

The sustainability report — as a proxy of sustainable business — helps organisations to determine their objectives, measure their performance, and manage any changes to ensure their operations are more sustainable. The sustainability report discloses any impacts of companies' operation on the environment, society, and the economy (GRI, 2013). The reason is that companies have the potential to cause negative impacts on the environment and society. Environmental disasters have occurred in various parts of the world, such as those in Bhopal, Chernobyl, and Minamata (Sobur, 2005). Environmental disasters have also occurred in Indonesia, like the cases of the Sidoarjo mud flow and forest fires in Kalimantan and Sumatra.

To reduce any negative impacts of companies' operation on the environment and society, the Government of Indonesia (GoI) has facilitated all companies to implement the Corporate Performance Evaluation Program (PROPER). The purpose of this program is to protect the welfare of the society and environment (Yanto, Hasan, Fam, & Raeni, 2017). Besides participating in PROPER, companies are also required to publish their sustainability report in their annual financial reports. Sustainability reporting is a practice of company reporting by integrating financial performance, and environmental and social reports into one report (Bhatia & Tuli, 2017; Christofi, Christofi, & Sisaye, 2012; Jose, 2017).

This research attempts to identify the model for managing sustainable business among LQ45 companies by considering the important financial and non-financial variables. The study focusses on companies included in the LQ45 group, since these companies have sound financial performance that enables them to implement sustainable business with no significant financial constraint. Companies, government, and other stakeholders would benefit from the study as they could identify the antecedents of sustainable business. It is pivotal for the companies to manage sustainable business to ensure that they would maintain their existence in the long run.

Literature Review

The legitimacy theory states that a company's value system should conform to social values to ensure the company would survive in such a business environment (Rankin et al., 2012). Moreover, Dowling and Pfeffer also contend that an organisation attempts to bring harmony between social values inherent in its activities and behavioural norms existing in society's system (Dowling & Pfeffer, 1975). Therefore, the companies try to convince the society that they run their business in conformance to prevailing norms, rules, and social contracts (O'Donovan, 2002). The legitimacy theory also contends that the society may influence the budget allocation and economic resources that a company has. A company would employ performances based on environmental and social aspects by disclosing environmental information to legitimise their business activities (Ghozali, 2007).

Meanwhile, the stakeholder theory states that a company does not only operate for its own interest, but also for the benefit of related stakeholders (Gray et al., 1995). As stakeholders could gain control of any important economic resources, a company would attempt to fulfil the stakeholders' needs (Ullmann, 1985). Moreover, stakeholders' power is determined by their ability to control resources (Ghozali, 2007; Ullmann, 1985). Consequently, the bigger the stakeholders' power is, the economic, social, and environmental reporting disclosure will be improved.

Environmental Performance and Sustainability Report

A company with excellent environmental performance tends to have a proactive environmental strategy (Clarkson, Li, Richardson, & Vasvari, 2008). Therefore, companies are willing to inform investors and other stakeholders of their environmental strategy through voluntary sustainability disclosure. This strategy potentially enhances a company's value in the stock exchange (Yadav, Han, & Rho, 2016). One example of environmental information a company may disclose is a sustainability report. Studies focussing on the relationship between environmental performance and sustainability report disclosure seem to be limited in number. Connors and Gao (2011) find that environmental performance significantly influences environmental disclosure. In this case, environmental disclosure is one category of sustainability report disclosure (GRI, 2013). As part of a company's commitment to the environment, environmental performance measured by PROPER has a significant impact on the carbon emission disclosure of manufacturing companies in Indonesia (Yanto, Hasan, et al., 2017). PROPER also can be considered as a project for producing environmental information. Therefore, the more environmental information produced, the more environmental report disclosure. Environmental performance may also have positive impacts on sustainability disclosure among LQ45 companies.

H1: A company with better environmental performance may disclose a more extensive sustainability report.

Board of Directors' Roles

One indicator of good corporate governance implementation is lively and productive communication among members of the Board of Directors (BoD). To measure the performance of the BoD, a previous study employed the frequency of the BoD meeting as a proxy (Suryono & Prastiwi, 2011). The BoD has an important role in running a company's business and implementing good corporate governance, including sustainability business. Based on previous research among Sri Lankan companies, the BoD positively influences a company's sustainability report (Mudiyanselage, 2018). In the Indonesian business context, the BoD may have important roles in preparing sustainability report disclosure. The study identifies the roles of the BoD in improving sustainability reports among LQ45 companies, as previous studies focus more on companies in general.

Pursuant to the general guide to good corporate governance, in order to maintain the sustainability of a company's business, the BoD should ensure a company's social responsibilities are fulfilled. A company's good governance may be improved by giving more concern to environmental performance. Nofianti, Uzliawati, and Sarka (2015) contend that corporate governance positively and significantly influences environmental disclosure. As a part of corporate governance, the BoD also plays an important role in improving the environmental performance of manufacturing companies in Indonesia (Yanto, Hasan, et al., 2017). Nevertheless, the studies which focus on the roles of the BoD in improving environmental performance among Indonesian LQ45 companies is still limited in number. Therefore, the current study attempts to identify the contribution of the BoD in enhancing environmental performance among LQ45 companies, as these companies have gained a sound financial performance.

Leverage is a reflection of the external control of good corporate governance (GCG) (Tjandra, 2015). The implementation of GCG in a company is expected to reduce the degree of leverage, since the higher a leverage, the higher the risks a company will face. The implementation of GCG — reflected in the frequency of the BoD meeting — may influence the management's decision of financing derived from debt. Thus, it is expected to reduce the degree of leverage. In other words, the BoD plays important roles in determining a company's debt policy. Previous study finds that the BoD has influence to reduce a company's capital structure (Almania, 2017). However, other research has found the opposite conclusion (Tjandra, 2015). This relationship should be retested with two reasons, i.e. the relationship between the BoD and leverage is inconsistent and the relationship among these variables across LQ45 companies seems to be non-existent. Therefore, the study formulates the following hypotheses:

H2: The Board of Directors influence sustainability reports disclosure.
H3: The Board of Directors significantly influence environmental performance.
H4: The Board of Directors influence leverage.

Financial Determinants

A profitable company would become a public highlight and have more potentials to cause significant positive and negative impacts on the environment and society. Therefore, this company spends any expense to enhance its environmental performance and social responsibility. The objective of this spending is to make stakeholders feel convenience with the company's operation. The higher the companies' profit, the more funding is available. Since LQ45 companies have better financial performance, they would find it easier to improve environmental management. Previous studies have shown that profitability positively influences the PROPER rating as a proxy of environmental performance among manufacturing companies (Yanto, Hasan, et al., 2017). Research on the relationship between profitability environmental performance among LQ45 is limited in number. Therefore, the study needs to retest the causal relationship between profitability with environmental performance.

Companies with a high degree of leverage tend to be at a high financial risk, because they have to provide extra budget for interest and debt payments to their creditors. In this case, management should reduce the company's costs for activities in order to make a high profit (Darlis & Zulmi, 2009). This means that company profit would be allocated to reduce default risk, and thus, environmental performance could be set aside. Connors and Gao (2011) show that there is an association between leverage and environmental performance (Connors & Gao, 2011). However, other research has found that leverage does not influence environmental performance among general manufacturing companies (Yanto, Hasan, et al., 2017).

A cheap source of capital would encourage companies to increase their profitability. A leverage ratio is used to measure how much of a company's assets are funded by debt. The higher this ratio, the greater the amount of loan is used for assets investment to generate profit. Previous research finds that among German companies, leverage is closely correlated with profit, while the same correlation is not found among American companies (Baum, Schäfer, & Talavera, 2007).

The relationship between leverage and profitability is inconsistent, since there are findings that leverage negatively influences profitability (Ahmad, Salman, & Shamsi, 2015). On the other hand, the ratio of debt to asset is positively correlated with profitability, as measured by ROE (Joshua, 2005). In addition, and in research in the Indonesian business context, the impact of leverage on profitability is also inconsistent. Ritonga, Kertahadi, and Rahayu (2014) find that leverage significantly influences profitability. Conversely, leverage does not impact positively on profitability (Yanto, Hasan, et al., 2017). In fact, the main purpose of leverage is to improve a company's profitability. Nevertheless, those causal relationships among LQ45 companies should be retested.

H5: Profitability significantly influences environmental performance.
H6: Leverage negatively and significantly influences environmental performance.
H7: Leverage significantly influences profitability.

The literature review discusses that the sustainability report of LQ45 companies is significantly influenced by environmental performance — measured by the PROPER rating — and the BoD. In addition, previous studies also show that environmental performance is a project conducted by a company to ensure all its businesses are in line with sustainable business principles. The success of such a project depends on the human and financial resources. The BoD may influence the environmental performance and company's leverage. At the same time, leverage and profitability are hypothesized to have significant impacts on environmental performance. Leverage could have a negative influence on the environmental performance, while profitability has a positive influence. Lastly, leverage is hypothesized to have negative impacts on a company's profitability.

Methodology

Population and Sample

The study uses all LQ45 companies listed in the Indonesian Stock Exchange (IDX) as a population. By employing a purposive sampling technique, this research collects 135 data sources from annual reports for the period of 2014–2016, for further analysis. The sample size is expectedly sufficient for the purpose of path analysis (Wolf, Harrington, Clark, & Miller, 2013) and normality testing (Ghasemi & Zahediasl, 2012).

Research Variables

This research employs five variables, consisting of four endogenous variables — three of which are intervening variables — and one exogenous variable. The sustainability report consists of three categories, which are economic, environmental, and social, with 91 indicators (GRI, 2013). The sustainability report is measured by dividing the disclosed items by the number of items based on the GRI. The intervening variables are leverage, profitability, and environmental performance.

The BoD variable is measured by summing up the total BoD meetings in one year. Meanwhile, the leverage is calculated by dividing the total liabilities by total equities. The profitability variable is calculated by dividing the total net profit after tax by total assets. The variable of environmental performance is proxied by the PROPER rating, consisting of five levels, which are black, red, blue, green, and gold. Black is the lowest level with a score of one and gold is the highest level with score of five (KEMENLHK, 2015).

Data Analysis

The study employs descriptive, correlation, and path analyses. The descriptive analysis describes the research variables, while the correlation identifies the relationship between two variables without any intervention from other variables' correlations. To test the theoretical model, the path analysis is employed to evaluate the effects of the exogenous variable on the endogenous variables.

To assess the model fitness, this research uses the goodness of fit tests, consisting of chi-square, GFI, AGFI, CFI and RMSEA. A fit model has to have chi-square with $p>0.05$, as an indicator that the proposed model conforms to the empirical data (Byrne, 2001; Ghozali, 2008; Yanto, Yulianto, Sebayang, & Mulyaga, 2017). The GFI is an index to measure the fitness of a model with covariance matrix with a minimum value of 0.90, for a model to be considered as fit (Ghozali, 2008). Meanwhile, the CFI measures the comparison between the sample of zero covariance model (Hopper, Coughlan, & Mullen, 2008) and the minimum value of the CFI should be more than 0.9. Finally, RMSEA is an index to measure the tendency of chi-square to reject a model using a big sample. The fitness value of RMSEA is less than or equal to 0.08 (Ghozali, 2008).

Results and Discussion

Descriptive Analysis

The descriptive analysis (Table 1) shows that the average score of the environmental performance is 1.3 (black), and that sustainability disclosure is 0.16. This shows that the scores of the environmental performance and sustainability report of LQ45 companies are still considerably low. The average of the BoD meeting is 27 times in a year, while the profitability is approximately 0.087 (8.7 per cent). The average of leverage is 2.15, indicating that these variables averagely have a relatively high value.

Table 1: Summary of descriptive analysis

Variable	Minimum	Maximum	Mean	Std. Deviation
Board	0.00	104.0	27.015	20.569
Profitability	-0.047	0.856	0.087	0.110
Leverage	0.001	18.635	2.148	2.925
Env. Performance	0.000	4.000	1.304	1.636
Sustain. Report	0.000	0.956	0.159	0.230

Correlation Analysis

The BoD's meeting has a positive and significant relationship with leverage (0.297, $p<0.05$) and the sustainability report (0.505, $p<0.05$), but the BoD's meeting does not significantly correlate with environmental performance with r coefficient of -0.026 ($p>0.05$). Leverage has a negative and significant relationship with environmental performance (-0.286, $p<0.05$) and companies' profitability (-0.220, $p<0.05$). Meanwhile, profitability has a positive relationship with environmental performance (0.218, $p<0.05$). The environmental performance correlates positively with the sustainability report (0.304, $p<0.05$). More detailed information is presented in Table 2 below.

Table 2: Correlation matrix

Variable	Board	Profit	Leverage	Env. Perf.	Sus Rep
Board	1				
Profit	-0.166	1			
Leverage	0.297**	-0.220*	1		
Env. Perf.	-0.026	0.218*	-0.286**	1	
Sus Rep	0.505**	-0.027	0.199*	0.304**	1

Path Analysis

The path analysis (Table 3) shows that the sustainability report of LQ45 companies is influenced by environmental performance (0.32, $p<0.05$) and the frequency of the BoD meeting (0.51, $p<0.05$). In turn, environmental performance proxied by PROPER is influenced by profitability (0.17, $p<0.05$), and negatively influenced by leverage ratio (-0.27, $p<0.05$). In addition, the frequency of the BoD meeting does not influence the environmental performance with a beta of 0.08, ($p>0.05$).

The BoD have an important role in determining the rate of leverage with a beta coefficient of 0.30 ($p<0.05$), but it does not influence the environmental performance. In turn, leverage has a negative influence on profitability (-0.22, $p<0.05$). In addition, leverage negatively and significantly impacts on environmental performance with a beta of -0.27 ($p<0.05$). Albeit, it is a small magnitude, profitability has significant impacts on environmental performance with a beta of 0.17 ($p<0.05$).

Table 3: Result of path analysis

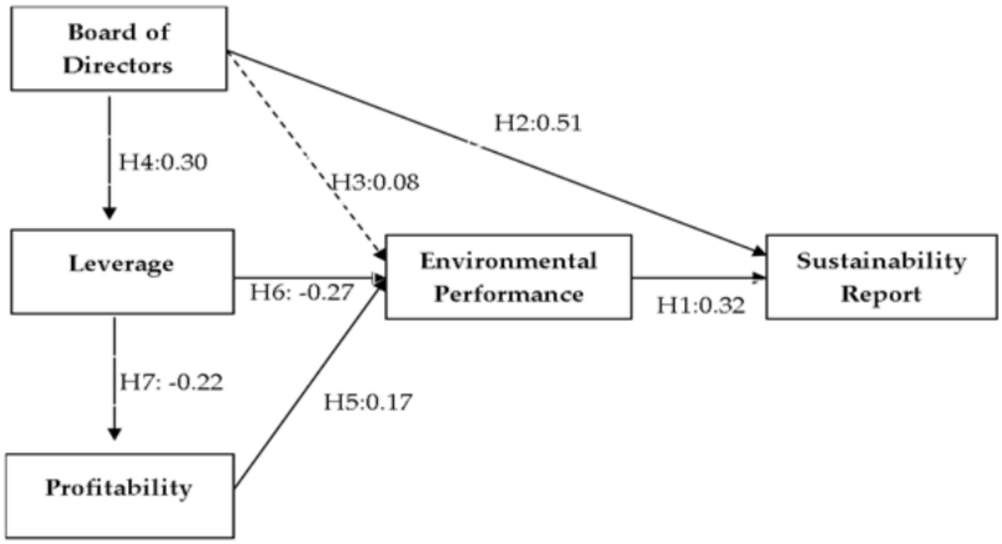
Hypothesis	Variable			Estimate	P	Remark
H1	Sus Rep	<---	Env Perf.	0.32	***	Accepted
H2	Sus Rep	<---	BoD	0.51	***	Accepted
H3	Env Perf.	<---	BoD	0.08	0.331	Rejected
H4	Leverage	<---	BoD	0.30	***	Accepted
H5	Env Perf.	<---	Profit	0.17	0.041	Accepted
H6	Env Perf.	<---	Leverage	-0.27	0.002	Accepted
H7	Profit	<---	Leverage	-0.22	0.009	Accepted

*** significant at the 0.001 level

Hypothesis Testing

This research includes seven hypotheses, six of which are accepted, and one hypothesis which is rejected. Figure 1 shows that the roles of environmental performance and the BoD are pivotal in determining sustainability report disclosure. The environmental performance of LQ45 companies is positively influenced by companies' profitability. Nevertheless, environmental performance is negatively influenced by companies' leverage rate. All in all, environmental performance, BoD, leverage, and profitability have important roles in improving sustainable business among Indonesian LQ45 companies. Figure 1 provides a clearer picture about the empirical model.

Figure 1. Antecedents of Sustainability Report Disclosure



Goodness of Fit Test

The results of path analysis show that the chi-square value meets the requirements for model fit ($\chi 2$=6.42, p=0.093) with 2.14 CMIN/d.f. Likewise, RMSEA shows a value of 0.092, which means that only RMSEA has unsatisfied performance. The analysis results present the GFI and AGFI values respectively at 0.981 and 0.907, while the NFI and CFI values are 0.936 and 0.962. Therefore, this study concludes that the theoretical model developed by this research is mostly supported by empirical data.

Discussion

This research finds that the sustainability report (SR) is influenced by environmental performance among Indonesian LQ45 companies. Previous studies show that environmental performance not only influences the sustainability report, but also positively impacts on environmental reporting disclosure (Connors & Gao, 2011) and carbon emission disclosure — as a part of environmental disclosure — among manufacturing companies in Indonesia (Yanto, Hasan, et al., 2017). These findings indicate that PROPER is a considerably important tool for government to control the negative impacts of companies' operation on the environment and community. However, the average rate of environmental performance which is measured by PROPER, is still 1.3 or 'black', meaning that many LQ45 companies have yet to implement a sound environmental strategy. Clarkson et al. (2008) propose that companies should have a proactive environmental strategy. Even though, environmental performance significantly affects the sustainability report, but LQ45 companies only report 16 per cent of sustainability indicators. These findings indicate that Indonesian LQ45 companies need to improve their sustainable business by balancing their business strategy with economic, environmental, and social aspects, as suggested by the GRI (2013).

The BoD also influences the SR, which means that the BoD's concern regards the width of the company's SR. A similar study finds that the BoD significantly and positively affects the SR, albeit a low percentage of LQ45 companies' SR (Mudiyanselage, 2018). However, the BoD's activities do not influence environmental performance. It is most likely that the BoD only concentrates on the SR instead of the information production process through environmental and social projects in the company. This finding is not in line with the results of a previous study, that the BoD has significant effects on environmental performance (Nofianti et al., 2015; Yanto, Hasan, et al., 2017). Considering low SR disclosure, the unsatisfying rate of PROPER, and the insignificant roles of the BoD in improving environmental performance, the government needs to affirm all LQ45 companies to implement PROPER better, as part of a company's responsibilities to the society and environment.

This research also finds that profitability positively and significantly influences environmental performance. This shows that a company with higher profitability tends to have better environmental performance. This finding confirms the previously discussed theory. Based on the legitimacy theory (Rankin et al., 2012), a company would emphasise in performance of environmental and social aspects (Ghozali, 2007; Yanto, Hasan, et al., 2017). PROPER is considered as a project which needs sources of funding and power. Therefore, a prolific company tends to improve PROPER performance.

The result of the analysis shows that a company's leverage negatively and significantly influences environmental performance. This indicates that a company with a higher leverage, would have a lower environmental performance. This company may concentrate on increasing profit to pay debt and interest. Therefore, funds for implementing environmental projects are decreasing. A previous study shows this type of company will reduce its costs of activities (Darlis & Zulmi, 2009), so that it will not breach any debt payment. Nevertheless, research on State-owned enterprises shows that leverage insignificantly influences environmental performance (Widarsono & Hadiyanti, 2015).

The insignificant influence of the BoD — proxied by the number of meetings held by the BoD — to environmental performance could be an indicator that the BoD's attention to environmental performance is still considerably low. It is more likely that the BoD has more concern with conventional tasks — to improve shareholders' prosperity — than for environmental and social welfare. The frequency of the BoD meeting significantly influences leverage, which means that the BoD's meeting topic lacks of focus on leverage reduction. Tjandra (2015) also found the same result. Actually, the BoD could play an important role in improving the company's capital structure (Almania, 2017). However, the BoDs' role in controlling leverage is still not optimal. This problem might be caused by the condition that management has frequent meetings, but they did not act optimally for shareholders' prosperity (Varun, 2014). Theoretically, during the implementation of the GCG principles, as reflected in the meeting frequency, the BoD would be able to influence the management's decision of financing derived from debt. It may be possible that the decision of any financing from an external or a third party is not absolutely determined by the BoD's meeting. It is likely that other indicators, such as the company's financial performance, are used more as the main consideration.

The hypothesis testing shows that leverage significantly influences profitability. Theoretically, leverage aims at improving a company's profitability, but it is difficult to predict how the relationship of leverage and profitability behaves. There are three types of findings of the relationship between these two variables: leverage positively influences profitability (Baum et al., 2007; Joshua, 2005; Ritonga et al., 2014), leverage negatively influences profitability (Ahmad et al., 2015), and leverage is not related to profitability (Baum et al., 2007; Yanto, Hasan, et al., 2017). Based on these findings, further research should focus on determining optimal leverage which still has a positive impact on profitability.

Although the LQ45 companies are those with financial performance above average, they still have an agenda to be concerned about. The companies should integrate more financial and sustainability performance (Kumar et al., 2012). The BoD members have not discussed much about environmental performance (PROPER), indicated by the insignificant influence of the BoD's meeting on PROPER. Besides, these companies do not have good achievements in environmental performance and sustainability reporting disclosure. To continuously run a good operation in the long run, these companies should improve the harmony of values they follow with the prevailing values in the society (Dowling & Pfeffer, 1975; Rankin et al., 2012), and provide its stakeholders benefits (Gray et al., 1995). All in all, LQ45 companies still need to work harder to ensure their businesses will be more sustainable by paying more attention to their stakeholders (Gray et al., 1995), and the company's legitimacy (Rankin et al., 2012), and in line with SDGs (Jensen, 2017).

Conclusion

The environmental performance of LQ45 companies is not satisfying (1.3 or black), while their sustainable business — proxied by sustainability report disclosure — is still considerably low (16 per cent). It means that these companies may have difficulties in implementing sustainable business. This is more likely due to the BoD's lack of concern for environmental performance and sustainable business. The BoD of LQ45 companies are only concerned about the company's financial performance aspect to improve its achievement at capital market. To ensure a company's smooth operation in the long run, a company should begin to be concerned about environmental performance, sustainable business, and leverage management. The government and Indonesia Chartered Accountant (IAI) should arrange a regulation to set sustainability reporting as a mandatory requirement instead of voluntary, as it has been so far.

To manage sustainable business, LQ45 companies should improve their environmental performance by providing more opportunities to the BoD's to work more on PROPER. Leverage negatively, while profitability positively, influences environmental performance. In addition, these companies should manage their debt more intensively to ensure debt will not become an extra burden for companies. To ensure LQ45 companies will contribute significantly to the achievement of SDGs in 2030, they should pay more attention not only to their profitability, but also to environmental performance (PROPER), the BoD, and leverage.

This research only observes the LQ45 companies' financial statement for three consecutive years. This observation might be insufficient; thus, further research needs to have more years of observation. The number of the BoD's meetings in a year may not be an accurate proxy for measuring the BoD's performance. Therefore, future research needs to find other proxies to measure the performance of the BoD. It is necessary to conduct further research to determine optimal leverage which still has a positive impact on a company's profitability.

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