Board Independence, Environmental Disclosure, and Firm Value

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ABSTRACT

This study aims to examine the effect of board independence and environmental disclosure on firm value. Board Independence is measured using the proportion of Independent Commissioner, and environmental disclosure is measured using Indonesian Environmental Reporting (IER) index, and firm value is measured by Tobin's Q. The sample of this research includes 134 companies over a period of 2009-2013, which were collected by using purposive sampling method. This study employes mutiple linear regression method to analize the observations. The result shows that both the board independence and environmental disclosure significantly effect firm value. These results confirm the argument that independency and transparency as a pilars of corporate governance increase firm value.

Keywords: firm value, board independence, environmental disclosure, corporate governance.

1. INTRODUCTION

This study aims to examine the influence of board independence and environmental disclosure on firm value. Board independence is measured using Independent Commissioner's as proxy, environmental disclosure is measured using Indonesian Environmental Reporting (IER) Indexs as proxy. The firm value in this study is measured using Tobin's Q.

Companies suffered a decline in value due to reaction from investors and stakeholders in various countries (Blacconiere and Patten, 1994; detiknews.com). Enron's case in the United States (Lukviarman, 2004), Union Carbide in India (Blacconiere and Patten, 1994), and PT. Lapindo Brantas in Indonesia (detiknews.com), all has experience a decline in company value as a result of the company's management that inflicts financial loss to their stakeholders. This fact shows evidence that in carrying out their activities companies should pay attention to their stakeholders' interests and protect their stakeholders.

Firm value shows stakeholder's perception on level of success of a company in managing their resources as a form of stakeholder's trust toward the company. Firm value can be measured from various criteria, one of them is through stock price (Sudiyatno, 2010). Stock price shows the level of stakeholder's trust toward the company, so that the

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increase of firm value is an achievement for the management, investment objectives, and also improve the welfare of all stakeholders (Sudiyatno, 2010).

This study measures the value of firms using Tobin's Q proxy. This ratio can provide information regarding debt, share capital, and corporate assets required by investors and stakeholders (Sukamulja, 2004). The increase of corporate value is the result obtained by the company because of stakeholder's trust (Letza, Sun, and Kirkbride, 2004; Lukviarman, 2005). Research conducted by Kaplan and Reishus (1990), Hermalin and Weisbach (1991), Yermack (1996), Agrawal and Knoeber (1996), Subrahmanyam, Rangan and Rosenstein (1997), Millstein and MacAvoy (1998), Vafeas and Theodorou (1998), Bhagat and Black (1999), and Bhagat and Black (2002) analyze various agency issues between the principle and agent faced by companies in some Anglo Saxon countries.

Those previous studies have not found consistent results due to the differences in legal models and regulations regarding the implementation of corporate governance in a country. This research is conducted to examine the effect of Independent Commissioner on firm value in a developing country by using different theoretical perspective that is stakeholders theory perspective.

The results of previous studies on the effect of environmental disclosure on corporate value is still inconsistent. Research conducted by Clarkson, Fang, Li, and Richardson (2011) proves that social disclosure including the disclosure of the environment in it positively affects the cost of capital which is one of the proxies of firm value. However, Shane and Spicer (1983), Blacconiere and Patten (1994), and Richardson and Welker (2001) find environmental disclosure negatively affects the value of the stock market. Lastly, Freedman and Jaggi (1982) and Cormier and Magnan (2007) find that environmental disclosure has no effect on firm value.

Previous research has also linked firm value with board independence. Among the researches, studies conducted by Kaplan and Reishus (1990) and Millstein and MacAvoy (1998) concluded that Independent Commissioners has an ability to increase firm value. However, research conducted by Yermack (1996), Agrawal, and Knoeber (1996), Subrahmanyam, Rangan, and Rosenstein (1997), and Bhagat and Black (1999) find that Independent Commissioners may reduce firm value. Further, Hermalin and Weisbach (1991), Vafeas and Theodorou (1998), and Bhagat and Black (2002) find no influence of the Independent Commissioner on the value of the firm.

The inconsistencies of previous research results can be caused by a variety of reasons, one of which is the different types of information revealed by the company. Environmental disclosure in developed countries is mandatory disclosure, while for some developing countries including Indonesia, environmental disclosure is still included in voluntary disclosure (Suhardjanto, 2008). In terms of the benefit of disclosed environmental information are, for investors the information is used to lower the cost of capital (Richardson and Welker, 2001), whereas for other stakeholders the information is a necessity in its efforts to implement trust-based relationships with companies (OECD, 2004; KNKG, 2006). Based on the above description, this research uses voluntary disclosure of the environment and its benefits to stakeholders.

The explanation above is supported by the result of previous researches. Preston and Sapienza (1990), Hilman and Keim (2001), Benson and Davidson (2010), and Jiao (2010) prove that stakeholders has an ability to increase firm value. Dhaliwal et al. (2014) use stakeholder variables as a moderating variable of influence of corporate social

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responsibility (CSR) disclosure on cost of equity capital (CoEC) and proves that stakeholders may strengthen the influence of CSR disclosure on CoEC. Berrone, Surroca, and Tribo (2007) examine stakeholders as a mediating variable in the relationship between corporate ethics and firm performance and find that stakeholders mediates the influence of company ethics on company performance.

This study is prepared by refering to previous research conducted by Dhaliwal et al. (2014), but it has several differences, among others, firstly, this study focuses on one of the variables of corporate governance; the role of Independent Commissioner to give an idea of its role in protecting the interests of stakeholders. Secondly, this study is conducted on one type of industry in a developing country and did not compare it with other countries as research Dhaliwal et al. (2014) performed. Thirdly, this study measures the value of firms using Tobins Q. Tobins Q proxy is the ratio of the firm's market value in lieu of the cost of the asset (Chung and Pruitt, 1994).

2. LITERATURE REVIEW

Stakeholders are groups or individuals who can influence or be influenced by the company in its effort to realize its objectives (Freeman, 1984). With a more comprehensive perspective, Clarkson (1995) defines stakeholders as individuals or groups who own claims, ownership, rights, and interests with past, present, and future corporate activities. Thus the stakeholders are individuals or groups who have rights and interests with the company's activities in the past, present, and future.

Stakeholder theory is a theory that describes good relationships and trust between companies and stakeholders in a sustainable manner in realizing company's goals. Based on the perspective of stakeholder theory, the objective of a company is to improve the welfare of all stakeholders and no longer focused on increasing shareholder welfare (Lukviarman, 2005). Stakeholders are parties that must be considered by the company, because stakeholders has an ability to affect the survival of the company. The implementation of corporate governance is one of the company's efforts to maintain good relations and trust of its stakeholders (Lukviarman, 2005).

Companies that always pay attention to the needs and interests of its stakeholders is a stakeholders-oriented company (Dhaliwal et al., 2014). The manifestation of attention toward stakeholder’s needs and interests lies in the implementation of the vision, roles, and responsibilities of a company. Stakeholders-oriented companies are stronger and more influential in carrying out their activities, responsive to the demand for information and providing quality information (Dhaliwal et al., 2014). Based on the description, we can conclude that stakeholders-oriented company-has an ability to strengthen the influence of corporate governance on corporate value. This study is designed to examine the influence of board governance and environmental disclosure on corporate value with stakeholders orientation as a moderating variable.

Independent Commissioner is a part of corporate governance structure (Zulfikar et al., 2017, Amin et al., 2017). KNKG (2006) states that Independent Commissioner is a member of the Board of Commissioners who is not affiliated with the management, other members of the Board of Commissioners, and the controlling shareholder, and is free from business or other relationships that may affect his ability to act independently or act solely for the benefit of the company. Independent Commissioner is an independent person who is placed in the position of commissioner of the company, independent from any relationship that may

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affect their decision (Law No. 40 of 2007 on Limited Company article 120). Independent Commissioners function is to monitor management behavior, encourage information disclosure, and improve the quality of decision making, so that corporate strategic objectives can be achieved (Zahra and Pearce II, 1989). OECD (2004) states that Independent Commissioners can realize the effectiveness of supervision in the management of the company, so that good relationships and trust from stakeholders can be maintained on an ongoing basis and managers can work optimally in increasing firm value. Thus Independent Commissioners are individuals who oversee the management of a company and act to protect the interests of stakeholders.

Previous research on the effect of the Independent Commissioner on firm value shows inconsistent results. Kaplan and Reishus (1990) and Millstein and MacAvoy (1998) prove that Independent Commissioners has an ability to increase firm value. While research by Yermack (1996), Agrawal and Knoeber (1996), Subrahmanyam, Rangan, and Rosenstein (1997), and Bhagat and Black (1999) find that the existence of Independent Commissioners may decrease firm value. Furthermore, the research of Hermalin and Weisbach (1991), Vafeas and Theodorou (1998), and Bhagat and Black (2002), find no influence of Independent Commissioner on corporate value.

In the perspective of stakeholder theory, Independent Commissioner plays a role in overseeing the management of the company and ensuring that the company has protected and concerned with the interests of stakeholders and meet all of stakeholders' needs including the need for the availability of quality information. Thus it can be concluded that the more Independent Commissioners in the company, the interests of stakeholders will be more protected (KNKG, 2006), and in turn will increase stakeholders' trust. The higher the stakeholders' trust in a company, the higher the company's value (OECD, 2004). Based on the description above, the hypothesis of this research is as follows:
H1: Independent Commissioner positively affects firm value.

The implementation of corporate governance must be based on several principles in order to achieve the desired. One of the principles of corporate governance is transparency. Transparency is the disclosure of corporate information to those who need or have an interest in the company (OECD, 2004). The number of environmental problems that occur as a result of business activities (Walhi, 2011) encourages companies to disclose information about the environment. The availability of information about the environment is company's efforts in maintaining a trust-based relationships with its stakeholders (OECD, 2004).

The more information disclosed by the company, the higher the level of stakeholder's trust toward the company. If these conditions can continue to be maintained on an ongoing basis, then the trust-based relationship between the company and its stakeholders will be better, which in turn has an impact on increasing the firm value. This argument is supported by Richardson and Welker (2001) opinion that environmental disclosure increases corporate value, as stakeholders need higher number and more transparent information regarding corporate social performance and responsibility.

The results of previous studies provide mixed evidence. Clarkson et al., (2011) prove that environmental disclosure positively affects the cost of equity capital. Shane and Spicer (1983), Blacconiere and Patten (1994), and Richardson and Welker (2001) find environmental disclosure negatively affects stock market value, while Freedman and Jaggi

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(1982), and Cormier and Magnan (2007) find that environmental disclosure has no effect on profit and firm value.

Based on the above description, it can be concluded that stakeholders will appreciate companies that have responsibility for their operational activities, especially those related with the environment, otherwise stakeholders' trust will be lost, if the company's operational activities ignore environmental factors. Thus can be formulated the following research hypothesis:

H2: Environmental disclosure positively affects firm value

3. RESEARCH METHOD

The population in this study consisted of all manufacturing firms in Indonesia during the observation years. The sample used in this study consisted of all industrial companies and basic chemicals listed in Indonesia Stock Exchange (IDX) during the period of 2010-2013, which published their annual reports each year. There are 134 companies that meet the criteria of this study sample, the sample size should be at least ten times the number of variables analyzed in the study (Sekaran and Bougie, 2013)

This study used multiple linear regression method in analyzing data. Secondary data is obtained from journals, Indonesian Capital Market Directory (ICMD), www.idx.co.id, and respective company's sample website.

4. RESULT AND DISCUSSION

The results of this study are presented in Table 1. The first hypothesis of this study examines whether Independent Commissioner positively affects firm value. The ρ-value of the first hypothesis shows level of significance $\rho < 0.05$, with β_1 coefficient of 1.979. This results indicate that the Independent Commissioner (BI) has a positive effect on firm value. The results of this study support previous research conducted by Kaplan and Reishus (1990) and Millstein and MacAvoy (1998). However, the results of this study contradict the research conducted by Yermack (1996), Agrawal and Knoeber (1996), Subrahmanyam, Rangan, and Rosenstein (1997), and Bhagat and Black (1999) who find that the existence of Independent Commissioners can lower firm value.

This results confirm the perspectives of stakeholder theories, that the Independent Commissioner plays a role in overseeing the management of the company and ensuring that the company has protected and concerned toward the interests of their stakeholders and meet all its needs including the need for the availability of quality information. The results of this study also support the argument that the more Independent Commissioners in the company, the interests of stakeholders will be further protected (KNKG, 2006), thus, in turn increasing stakeholder trust and boost the increase in firm value (OECD, 2004).

Table 1. Results of Data analysis

$$FV = \beta_0 + \beta_1 BI + \beta_2 IER + \beta_3 ROA + \beta_4 TI + \beta_{5\text{-}7} Dummy\_2011\text{-}2013 + \varepsilon$$

Variabel	*Predicted Sign*	*Coefficient*	*p-value*	
Intercept		7.888	0.000	
BI	+	1.979	0.000	***
IER	+	2.640	0.080	*
ROA		4.530	0.000	***

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TI	-0.554	0.000	***
Dummy_2011	-0.102	0.661	
Dummy_2012	0.016	0.944	
Dummy_2013	-0.054	0.817	
Adj. R^2	0.263		
F-Statistic	28.330		
Prob (F-statistic)	0.000		
N	536		
***,**,* shows significance on percentage of1%; 5%; 10% respectively			

The ρ-value of the second hypothesis shows significance of $\rho < 0.05$, with β_2 coefficient of 2,640. The results of this study indicate that the disclosure of the environment (IER) has a positive effect on firm value. The results of this study support previous research conducted by Richardson and Welker (2001), Cormier and Magnan (2007), Schadewitz and Niskala (2010), Suhardjanto and Nugraheni (2012), Clarkson, Fang, Li, and Richardson (2013), and Serveas and Tamayo (2013).

The results of this study confirm the argument that the availability of information about the environment is company's efforts in running trust-based relationships with its stakeholders (OECD, 2004). Thus the results of this study support the argument that the more environmental information disclosed by the company, then the trust-based relationship between the company and stakeholders will be better, which in turn has an impact on increasing the firm value.

5. CONCLUSION, LIMITATION, AND SUGESTION

Based on the analysis in the previous chapter, the researchers can draw the following conclusions:

1. This study focuses on one of the variables of corporate governance that is the role of Independent Commissioner to provide an overview of its role in protecting the interests of stakeholders. The results show a prove that Independent Commissioners has an effect on the firm value.
2. This study examines the effect of environmental disclosure on firm value. Environmental disclosure is measured using Indonesian Environmental Reporting (IER) Indexs. The results of this study show that environmental disclosure affects the value of companies in Indonesia.

This research conclusions have several limitations as follows:

1. This research uses environmental disclosure variables, but researchers do not discuss about the quality of items disclosed by the sample companies. The number of items disclosed does not indicate the quality of corporate information disclosure.
2. This study does not consider the occurrence of endogenous problems in the research model.

This research proposed the following suggestion:

1. This study uses environmental disclosure which is a voluntary disclosure. We suggest regulator to provide guidance in the implementation of environtmental disclosure.

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Therefore the effectiveness and objectives of environtmental disclosure can be achieved optimally.

2. Further research may use other measurement indexes to provide an overview of the company's corporate disclosure practices in Indonesia.

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