ATLANTIS PRESS

Advances in Economics, Business and Management Research, volume 73

5th Annual International Conference on Accounting Research (AICAR 2018)

Impact of Corporate Governance on Company's Performance with Sustainability Reporting as an Intervening Variable in Indonesia

Nera Marinda Machdar
Faculty of Business, Accounting Department
Institut Teknologi dan Bisnis Kalbis
Jakarta, Indonesia
nera.marinda@kalbis.ac.id

***Abstract*—This study aims to examine the effect of corporate governance on the company's performance with sustainability reporting as an intervening variable in Indonesia. The population of this study is a manufacturing company listed on the Indonesian Stock Exchange for the period 2010-2015. The sample selection used purposive sampling method and resulted in 102 manufacturing firms listed on the Indonesia Stock Exchange. The results show that: (1) Corporate governance with audit committee as a proxy affects sustainability reporting of economic and environmental dimensions, and does not affect sustainability reporting of the social dimension. Furthermore, institutional ownership, managerial ownership and independent board of commissioners do not affect sustainability reporting of economic, environmental, and social dimensions. (2) Corporate governance with audit committee as a proxy affects the company's performance, while institutional ownership, managerial ownership and independent board of commissioners do not affect the company's performance (3) Sustainability reporting of economic, environmental and social dimensions do not affect the company's performance. The contribution of this study provides the theoretical addition of knowledge as well as a completion the previous studies. The findings are expected to help regulators formulate government policy decisions that promote corporate governance and sustainability reporting on the company's performance, thereby making the entity more responsive to changes in sustainability activities. Similarly, the results of research provide input for stakeholders as a consideration in decision making.**

Keywords—corporate governance; sustainability reporting; company's performance

I. INTRODUCTION

Corporate governance issues have arisen at the beginning of the company's founding. However, this issue received great attention because of the wave of CEO dismissals in the 1990s and after the massive bankruptcy of firms in developing countries. The issue of corporate governance in Indonesia has been a concern after the Asian Financial Crisis of 1997. Corporate governance is an important part of achieving economic performance and growth that allows increased investor confidence. Corporate governance systems should function effectively within the enterprise and across the economy help to create the trust and existence of a market economy [1,2]. Corporate governance and sustainability development require global collaboration, especially coordination of joint strategies and best decisions. Sustainability reporting is also one of the Sustainable development has many aspects to consider if sustainability must be maintained [3]. From an environmental dimension, the most important factor to achieve superior stock market performance is the company's environmental efficiency and environmentally friendly behavior. From an economic point of view, development that does not pay attention to the inequality of income and the provision of basic needs for all beings is a process that will eventually cause major problems. On the social dimension, employee relations and good employee satisfaction contribute to better stock market performance.

In recent years, sustainability-focused activities have become very important for companies, customers, employees, the financial community, regulators, policymakers, and non-governmental organizations [4]. According to the International Finance Corporation (IFC), sustainability is an action or action to achieve business success in the long term period and contribute to economic and social development, a healthy environment, and a stable society [5]. Sustainability reporting has become an increasingly common practice in companies' efforts to respond to the expectations and critiques of stakeholders who want to get better information about the social and environmental impacts of business activities [6]. Sustainability reporting has grown and become one of the most important things for any organization [7]. Although sustainability reporting is not a new concept, but how to implement it is not systematic [8].

Stakeholders are aware that global warming is affecting planetary surface and climate change. Excessive and unwise use of earth's natural resources causes climate change, pollution, habitat loss, excessive species exploitation, and the spread of invasive species or gene [9]. Sustainability reporting is a complex process because it contains many indicators to assess nonfinancial performance. However, most of the data and metrics used in sustainability reporting are unregulated and often subjective and this differs from financial reporting [10]. Despite the many environmental and social issues in Indonesia, there is no mandatory reporting guideline for Indonesian companies in producing environmental and social information for stakeholders [11].

Based on the above description, researchers are motivated to formulate research questions that are (a) Does corporate governance affect company performance? (b) Does sustainability reporting affect company performance, (c) Does corporate governance affect sustainability reporting? By looking at the phenomenon of the occurrence of scandalous fraud committed by many large scale companies and the results of inconsistent research from previous researchers, this study aims to analyze (a) the effect of corporate governance on corporate performance, (b) the effect of sustainability reporting on company performance, and (c) the effect of corporate governance on sustainability reporting.

The contribution of this research is expected to provide theoretical addition of knowledge as well as complement the previous studies on the influence of corporate governance on corporate performance with the sustainability reporting of economic, environmental and social dimension as intervening variable in manufacturing companies in Indonesia. Furthermore, this study is expected to help policy makers and regulators formulate government policy decisions that promote corporate governance and sustainability reporting on corporate performance, thereby making the entity more responsive to changes in sustainability activities. Similarly, the results of research can provide input for stakeholders as a consideration in decision making.

A. *Theoretical Framework*

1) Stakeholder theory: The company's primary strategic goal is to achieve the ability to align the diverse needs of multiple stakeholders in the company [12]. Stakeholders can develop and agree on corporate strategic decisions regarding business policies [13]. Management must still take into account the interests of stakeholders when implementing business strategies [14]. There are various stakeholder groups with differing and sometimes contradictory expectations [15]. Stakeholder theory states that company goals are not merely oriented to intensify the value of the owner, but also others who are interested in the company [16, 17]. Stakeholder theory is one of the main theories that are widely used to underlie sustainability report research [3].

2) Legitimacy theory: Legitimacy theory indicates that the expectations of society in general must be met by the organization, not just the requirements of the owner or investor as in agency theory [15]. It affirms that the company continually strives to ensure it operates within the existing norms in the society or environment in which the company is located, and the company's activities are legitimately accepted [18]. In other words, the organization can only continue if the organization only operates following a value system commensurate with its own community value system [19]. In accordance with legitimacy theory, the organization continues its operations and ensure its survival only if community expectations are met [20]. Thus, the level of organizational legitimacy is the most important for its survival [15].

B. *Company Performance*

Companies must maintain business continuity both in the short and long-term in order to achieve organizational goals. Company performance can be measured through profitability ratios. Profitability is the ability of a company to make a profit [21]. One tool measures profitability using return on assets (ROA). This ratio measures the rate of return of a business over all assets or describes the efficiency of the resources used in the enterprise [22]. When ROA is positive then the company is able to give a profit, and vice versa when ROA is negative then not able to generate profit for the company [21].

1) Corporate governance: Corporate governance is a system that regulates and controls companies that are expected to increase the value of the company to shareholders [23, 24]. Companies that have high institutional ownership require information disclosure of corporate social responsibility in addition to company financial information [25]. The disclosure of corporate social responsibility can be used as a source to attract new institutional shareholders because the company has a work plan related to social responsibility [26]. The existence of institutional investors can be an effective monitoring mechanism in every management decision. This is due to institutional investors engaged in the strategic taking of companies [27]. Corporate ownership is the contribution of residual claims and decision controls that have consequences on corporate behavior and demarcates or limits relationships between shareholders and independent management [28].

The role of the audit committee to maintain transparency in companies is very important. Audit committee assists the effectiveness in carrying out the duties and responsibilities of the commissioner towards the company's management [29]. The effectiveness of the audit committee leads to an increase the company's performance [30]. The establishment of an audit committee is intended to overhaul the financial system and uphold the integrity of financial statements [31]. Managerial ownership is the proportion of shareholders owned by management so that management participates in the making and decision of a company [25]. The greater the ownership of management, the greater the management's attention to the interests of the management and welfare of shareholders [32].

The existence of independent commissioners on the board of commissioners is expected to prevent company management from committing fraud in the presentation of financial statements [29]. Board of commissioners has a controlling function on the performance of management, although the control function has not been properly implemented [25]. This is because the majority ownership pattern in Indonesia is still concentrated in the controlling shareholder and has a greater percentage of ownership compared to the percentage of minority ownership [32].

2) Sustainability reporting: Basically, sustainability reporting is an extension of corporate social responsibility by incorporating environmental. Sustainability reporting is a report that contains the sustainability of the company's performance in three dimensions: economic, environmental and social dimensions [28]. First, economic sustainability is defined as the innovation that is able to produce goods and services continue to maintain the sustainability of government. This is also to avoid the occurrence of sectoral imbalances that can damage agricultural production and industry. Second, environmental sustainability is defined as sustainability to maintain resource stability, avoidance of natural resource exploitation and environmental absorption, biodiversity maintenance, airspace stability, and other ecosystem functions. Third, social sustainability is defined as a system of achieving equality in the provision of social services including health, education, gender, and political accountability.

3) Development of hypotheses: Large companies are generally under intense pressure from stakeholders, so it is expected to be more persuasive to disclose economic, social and environmental information as a part of sustainability reporting. Corporate governance and sustainability reporting factors are at the core of corporate and business strategy, and part of daily operational activities [1]. Economic, environmental and social disclosure is an important factor when evaluating the sustainability of investment opportunities, and the allocation of capital [33, 34]. The company's ability to communicate with stakeholders, who can increase corporate profits [7].

Many previous studies suggest that corporate governance mechanisms play an important role in the quality of sustainability reporting and performance [35]. Institutional ownership tends to actively seek to gain support from other powerful stakeholders [35]. Moreover, the composition of the board positively influences sustainability reporting [36]. There is an inverse relationship between environmental disclosure and ownership structure [28]. This means that non-institutional ownership should be encouraged to grow at a faster rate so that positive impacts are reflected in the disclosure of environmental information. Moreover, the ownership of boards, and foreign ownership do not affect disclosure of sustainability [24, 37]. Based on the explanation of previous research results, this research formulated the following first hypothesis:

H1: Corporate governance affects sustainability reporting of economic, environmental, and social dimensions.

An empirical study of the influence of corporate governance on corporate performance has been largely done by previous researchers, but it is evident that the results of the research are inconsistent. There is a positive relationship between corporate governance and company performance [38]. Moreover, audit committee size, independence, and gender diversity have a positive and significant influence on company performance [37]. However, institutional ownership does not affect the company performance [39] and managerial ownership does not affect the company performance [32]. In order to deal with this inconsistency of results, this research proposes the second hypothesis:

H2: Institutional ownership, audit committee, managemet ownership and independent commissioners affect the company's performance.

Previous research has proven that the effect of sustainability reporting on company performance gives inconsistent results. 78% of publications report show a positive relationship between corporate sustainability and financial performance [40]. Furthermore, most literature dominates the reporting of the sustainability of social dimensions compared to environmental and economic dimensions. Meanwhile, there is a clear expectation from stakeholders for the company to disclose all environmental items [11]. The sustainability reporting of the economic, environmental and social dimensions was positively related to the financial performance measured by using return on assets [8] and [41]. However, the disclosure of sustainability reporting of economic, environmental and social dimensions do not affect the company's performance [42]. Based on it, this research formulated the third hypothesis:

H3: Sustainability reporting of economic, environmental, and social dimensions affects the company’s performance

II. METHOD

A. Selection and Data Collection

This study uses the secondary data, namely annual report and audited financial statements of all manufacturing companies listed on the Indonesia Stock Exchange with the observation period 2010-2015. The sample uses purposive sampling technique based on the following criteria: (1) Manufacturing companies listed on Indonesia Stock Exchange during 2010-2015 period. (2) Companies that publish audited financial statements and annual reports with the financial year of 31 December no later than 30 April after the book year on the Indonesia Stock Exchange. (3) Manufacturing companies that do not suffer from capital deficiencies. This research data is obtained from Indonesian Capital Market Directory (ICMD), and IDX Website www.idx.co.id. Corporate social and corporate disclosure data with Global Reporting Initiative (GRI) indicators are obtained from the https://www.globalreporting.org/ site.

B. Measurement of Variable Operations

The dependent variable is the company’s performance, which is proxied by return on asset. ROA measures the company's ability to generate profits earned by the company in connection with the assets owned by the company. ROA is calculated as net income/total assets [21].

Intervening variables use sustainability reporting of economic, environmental and social dimensions. These are measured by GRI G3. Based on it, there are a total of 91 items that must be disclosed, consisting of 9 items of economic aspects, 34 items of environmental aspects, and 48 items of social aspects. The calculation uses a dummy variable. If the company performs disclosure in accordance with the indicator is given score 1, and vice versa if the company does not do disclosure assessed with score 0. Furthermore, the score of each item is calculated by: the number of items disclosed from each aspect / number of items listed in GRI G3.

Independent variables are corporate governance consist of institutional ownership, audit committees, managerial ownership and independent commissioners. Institutional ownership is the ownership of shares by other institutions or institutions that come from outside the company. Institutional ownership divides the number of shares owned by the institution with number of shares outstanding [25]. Audit committee measurement uses the number of audit committee members [30]. Management ownership divides the number of shares owned by managers or directors to total outstanding shares [25]. The independent commissioner's measurement is compared the number of independent commissioners with the total number of board of commissioners in the company [25].

C. Data Analysis Method

The research model consists of 3 analyzes: (1) corporate governance affects sustainability reporting, (2) corporate governance affects the company's performance, (3) sustainability reporting affects the company's performance. Data analysis method is multiple regression analysis using EVIEWS 8. The model of research as follows:

$$ECSR_{it} = \beta 0 + \beta 1KI_{it} + \beta 2KA_{it} + \beta 3KM_{it} + \beta 4DKI_{it} + \varepsilon_{it} \quad (1)$$

$$ENSR_{it} = \beta 0 + \beta 1KI_{it} + \beta 2KA_{it} + \beta 3KM_{it} + \beta 4DKI_{it} + \varepsilon_{it} \quad (2)$$

$$SSR_{it} = \beta 0 + \beta 1KI_{it} + \beta 2KA_{it} + \beta 3KM_{it} + \beta 4DKI_{it} + \varepsilon_{it} \quad (3)$$

$$ROA_{it} = \beta 0 + \beta 1KI_{it} + \beta 2KA_{it} + \beta 3KM_{it} + \beta 4DKI_{it} + \varepsilon_{it} \quad (4)$$

$$ROA_{it} = \beta 0 + \beta 5ECSR_{it} + \beta 6ENSR_{it} + \beta 7SSR_{it} + \varepsilon_{it} \quad (5)$$

Description: $ECSR_{it}$ = sustainability reporting of economic dimension firm i in year t, $ENSR_{it}$ = sustainability reporting of environmental dimension firm i in year t. SSR_{it} = sustainability reporting of social dimension firm i in year t, ROA_{it} = return on asset firm i in year t, KI_{it} = institutional ownership firm i in year t, KA_{it} = audit committee firm i in year t, KM_{it} = Managerial ownership firm i in year t, DKI_{it} = Independent board of commissioner firm i in year t, ε_{it} = Error of firm i in year t, β = Constants.

III. Results and Discussion

A. Descriptive Statistics Test Results

Table 1 presents descriptive statistics for all the variables used in this study. The company's performance (ROA), managerial ownership (KM) and sustainability reporting of social dimension (SSR) have a standard deviation value greater than the average value. This indicates that the company's performance, managerial ownership and sustainability reporting of social dimension of the sample have positive values and there is considerable variation in both variables. The sustainability reporting of environmental dimension (ENSR) have slightly higher differences for the mean values compared to the standard deviation values. This means that the sustainability reporting of environmental dimension in most of the sample companies is not varied.

TABLE I. DESCRIPTIVE STATISTICS TEST RESULTS

	ROA	KI	KA	KM	DKI	ECSR	ENSR	SSR
Mean	0.064679	0.691466	0.307190	0.027367	0.381102	0.336057	0.154680	0.073366
Median	0.040185	0.732844	0.333333	0.000000	0.333333	0.333333	0.133333	0.100000
Maximum	0.657201	0.984730	0.333333	0.700026	0.800000	0.777778	0.833333	0.300000
Minimum	-0.619345	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Std. Dev.	0.102208	0.214370	0.089690	0.084300	0.120152	0.158583	0.104481	0.074989
Observations	612	612	612	612	612	612	612	612

Source: Data is processed with Eviews 8

Description: ROA = return on total assets, KI = institutional ownership, KA = audit committee, KM = managerial ownership, DKI = independent board of commissioners, ECSR = sustainability reporting of economic dimension, ENSR = sustainability reporting of environmental dimension, and SSR = sustainability reporting of social dimension.

Corporate governance variables (KI, KA, and DKI) and sustainability reporting of economic dimension (ECSR) have considerable differences to mean values compared to standard deviation values. This shows that corporate governance with institutional ownership, audit committees and independent board of commissioners and the sustainability reporting of economic dimension of sample companies varies considerably.

B. Analysis of Research Results

1) Corporate governance and sustainability reporting: The result of the t-statistical test of the effect of corporate governance on sustainability reporting is presented in Table 2. It can be seen that by using the sustainability reporting of the economic dimension, only the audit committee variable (KA) has t-statistics 1.976623 (positive direction) with a significance value of 0.0486. This indicates that the audit committee influences the sustainability reporting of the economic dimension. Whereas the independent institutional and independent ownership variables have a negative direction, and managerial ownership has a positive but insignificant direction. It means that three variables do not affect the sustainability reporting of the economic dimension.

TABLE II. RESULTS OF EFFECT OF CORPORATE GOVERNANCE ON SUSTAINABILITY REPORTING

Variable	Expectation	Coefficient	Std Error	t-Statistic	Prob	P value
			Dependent Variable ECSR			
C		0.459669	0.06044	7.605366	0	
KI	+	-0.178708	0.078134	-2.287198	0.0226	
KA	+	0.117027	0.059205	1.976623	0.0486	**)
KM	+	0.245312	0.203687	1.204358	0.229	
DKI	+	-0.112056	0.048244	-2.322701	0.0206	
Adjusted R^2	0.762283					
			Dependent Variable ENSR			
C		0.118097	0.046243	2.553818	0.0109	
KI	+	0.055965	0.059781	0.936159	0.3496	
KA	+	0.113134	0.045299	2.497518	0.0128	**)
KM	+	0.148136	0.155843	0.950548	0.3423	
DKI	+	-0.107379	0.036912	-2.909083	0.0038	**)
Adjusted R^2	0.679412					
			Dependent Variable SSR			
C		0.173973	0.039962	4.353466	0	
KI	+	-0.110127	0.051661	-2.131731	0.0335	
KA	+	0.037434	0.039146	0.956282	0.3394	
KM	+	-0.114283	0.134674	-0.848592	0.3965	
DKI	+	-0.086143	0.031898	-2.700593	0.0072	
Adjusted R^2	0.535247					

Source: Data is processed with Eviews 8

Description: ROA = return on total assets, KI = institutional ownership, KA = audit committee, KM = managerial ownership, DKI = independent board of commissioners, ECSR = sustainability reporting of economic dimension, ENSR = sustainability reporting of environmental dimension, and SSR = sustainability reporting of social dimension. *P* value ***<1%, **<5%, *<10%.

Based on sustainability reporting of environmental dimension, the audit committee has a t-statistic of 2.497518 (positive direction) with a significance value of 0.0128. It shows that the audit committee has a positive effect on the sustainability reporting of environmental dimension. Moreover, institutional ownership and managerial ownership have a positive direction but insignificant, while independent commissioner has a negative direction. These mean that institutional ownership, managerial ownership and independent board of commissioners have no effect on the sustainability reporting of environmental dimension. By using the sustainability reporting of the social dimension, the audit committee has a positive direction and insignificant. While the institutional ownership, managerial ownership and independent board of commissioners have a negative direction and insignificant. It means that institutional ownership, audit committee, managerial ownership and independent board of commissioners do not affect the sustainability reporting of social dimension.

Based on the above explanation, it can be concluded that the audit committee only affects the sustainability reporting of economic and environmental dimensions, and does not affect the sustainability reporting of social dimension. Furthermore, institutional ownership, managerial ownership and independent board of commissioners do not affect the sustainability reporting of economic, environmental, and social dimensions. The results of this study are in line with findings of [37] which corporate governance functions have not been efficient and effective. Corporate governance in Indonesia does not currently utilize the sustainability reporting in key priorities. The management does not yet have a high understanding and awareness of sustainability reporting. Stakeholders in Indonesia have not seen the elements reported in sustainability reporting as a consideration in making decisions.

2) Corporate governance and corporate performance: The results of t-statistics of corporate governance on corporate performance are presented in Table 3. The audit committee has a positive direction with significance value of 0.0087. This means that the audit committee influences the corporate performance. This result is in accordance with the result of [30]. The audit committee is able to control and oversee the manager's opportunist actions within the company and supervise the company's compliance with laws and regulations relating to the company's activities.

TABLE III. RESULTS OF EFFECT OF CORPORATE GOVERNANCE ON COMPANY PERFORMANCE

Variable	Expectation	Coefficient	t-Statistic	Prob.	P value
		Dependent Variable: ROA			
C		0.008743	0.378492	0.7052	
KI	+	0.01887	0.9 16674	0.3597	
KA	+	0.128619	2.630295	0.0087	**)
KM	+	-0.087159	-1.662568	0.0969	
DKI	+	0.01512	0.415204	0.6781	

Source: Data is processed with Eviews 8

Description: ROA = return on total assets, KI = institutional ownership, KA = audit committee, KM = managerial ownership, DKI = independent board of commissioners. *P* value ***<1%, **<5%, *<10%.

Institutional ownership and independent board of commissioners have a positive direction but insignificant. Furthermore, managerial ownership has a negative direction. These show that institutional ownership, managerial ownership, and independent board of commissioners do not affect the company's performance. This result is in line with [39, 32] which institutional ownership and managerial ownership do not affect the company's performance. Institutional ownership and independent board of commissioners have not been able to control and supervise the manager's opportunist actions within the company. Furthermore, the greater the managerial ownership, the greater the desire of management to increase the interests of shareholders and their own interests. Managerial ownership tends to cover opportunistic management actions.

Based on the hypothesis analysis described above, it can be summarized that only audit committee has an effect on company performance, while institutional ownership, managerial ownership and independent board of commissioners have no effect on company performance. In other words, corporate governance does not affect the company's performance. This result is not in line with the findings of [38] that corporate governance affects the company's performance. Corporate governance is a system that regulates and controls companies that are expected to provide and increase the value of the company to shareholders [23]. However, the facts are not appropriate because the possibility of corporate governance is not working properly.

3) Sustainability reporting and company performance: The result of the t-statistical test of sustainability reporting on the company's performance is presented in Table 4.

TABLE IV. RESULTS OF EFFECT OF SUSTAINABILITY REPORTING ON COMPANY PERFORMANCE

Variable	Expectation	Coefficient	t-Statistic	Prob.	P value
Dependent Variable: ROA					
C		0.075776	8.731593	0.0000	
ECSR	+	0.042424	1.362243	0.1737	
ENSR	+	-0.10143	-2.741451	0.0063	
SSR	+	-0.131739	-2.881202	0.0041	

Source: Data is processed with Eviews 8
Description: ROA = return on total assets, ECSR = sustainability reporting of economic dimension, ENSR = sustainability reporting of environmental dimension, and SSR = sustainability reporting of social dimension. *P* value ***<1%, **<5%, *<10%.

Sustainability reporting of economic dimension has a positive direction and insignificant. Then, sustainability reporting of environmental and social dimensions have a negative direction and significant. It means that the sustainability reporting of economic, environmental and social dimensions does not affect the company's performance. The result of this study is in line with [8, 14, 42]. It should be realized that the high return of assets is influenced by the increase or decrease in profit after taxes derived from sales and total assets owned by the company. Should, the disclosure of economic, environmental and social issues is an important factor when evaluating the sustainability of investment opportunities, and the allocation of investor capital [34]. However, this fact is not suitable with the conditions in Indonesia because the disclosure of economic, environmental and social dimensions is still voluntary yet compulsory. Investors are not affected the disclosure of economic, environmental and social dimensions, as there are many other factors to be considered in decision making. In other words, investors more attract on market-based measures than accounting-based measures [43].

IV. CONCLUSION

This study aims to examine the effect of corporate governance on corporate performance with sustainability reporting as an intervening variable in manufacturing companies in Indonesia. The results of the study are as follows: First, only corporate governance with audit committee proxy affects the economic and environmental dimensions, and does not affect the sustainability reporting of the social dimension. Furthermore, institutional ownership, managerial ownership and independent board of commissioners do not affect the sustainability reporting of economic, environmental, and social dimensions. Second, only audit committee affect company performance, while institutional ownership, managerial ownership and independent board of commissioners do not affect the company's performance. In other words, corporate governance does not affect the company's performance. Third, the sustainability reporting of economic, environmental and social dimensions do not affect the company performance.

This study has an implication from a theoretical perspective, i.e. corporate governance provides positive benefits to company performance, in particular the audit committee and independent board of commissioners. The value assigned by stakeholders in terms of corporate image to companies that carry out sustainability reporting that disclose economic, social, and environmental activities should affect the company's performance.

This study uses a content analysis method. It is subjective by the researcher and can provide interpretative errors. The future research needs to consider disclosures in other media such as stand-alone company reporting, and websites.

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