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THE EFFECT OF PROPRIETARY COSTS TOWARDS THE QUALITY OF SUSTAINABILITY REPORTS MODERATED BY OWNERSHIP STRUCTURE IN THE COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE FOR THE PERIOD OF 2013-2016

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ABSTRACT

This research aims to examine the effect of proprietary costs towards the quality of sustainability reports and the moderating effect of ownership structure on proprietary costs with the quality of sustainability reports. Based on previous research, one of the factors that affect companies to limit disclosure of information which impacting the quality of published sustainability reports is proprietary costs, and to minimize this effect by percentage or total ownership structure. The population in this research is based on data from the Global Reporting Initiative (GRI) for the period of 2013-2016. The samples in this research are determined by purposive sampling technique in which they are 92 sustainability reports from 36 companies listed on the Indonesia Stock Exchange. This research is analyzed using regression analysis and moderated regression analysis. The results show that proprietary costs have a positive effect on the quality of sustainability reports and foreign ownership moderates the negative effects of proprietary costs on the quality of sustainability reports.

Keywords: : *Proprietary Costs*, Ownership Structure, and Quality of Sustainability Reports.

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1. INTRODUCTION

Companies in today's business practices are facing with not only in how to be responsible in economic matters but also in social and environmental issues. The company's attention to social and environmental issues is marked by an increase in environmental disclosure, which develops into social responsibility disclosure and is now better known as sustainability reports. Along with the increase in sustainability reports, it encourages shareholders' interest in the company’s quality of information disclosed by the company. The quality of the sustainability reports published by the company influences the decision making of investors or shareholders. The quality of the sustainability reports is the information available in the sustainability reports that allows investors or shareholders to form opinions and make better judgments about the performance of a company (Global Reporting Initiative, 2016).

Several previous research with the backgrounds in developed countries (Cohen, 2002; Cohen, 2003; Munshi & Dutta, 2016; Ganesan, 2017; Bachoo, 2013; Prencipe, 2004; Sanchez & Ferrero, 2017; Fathi, 2013) have examined the factors that can affect the quality of financial reports or sustainability reports such as financial performance, audit assurance, corporate governance, corporate value, and proprietary costs. Disclosure of information by companies is closely related to the emerging costs from the disclosure or proprietary costs. Consideration of proprietary costs becomes a concern for the company which leads a trade-off to arise in making decisions related to disclosure (Sanchez & Ferrero, 2017).

Cohen (2002) conducts a research regarding the effect of proprietary costs on the quality of financial reports, and the results show that companies with high levels of proprietary costs will disclose high quality financial reports. The high quality of financial information provided can reduce the cost of capital and certain types of companies tend to provide more information to the public (Harris, 1998). This concurs with signaling theory which states that companies which disclose the information to the public is seen as a signal to investors about the company's situation (Spence, 1973). Likewise in sustainability reports, companies with high proprietary costs will disclose their sustainability reports with high quality to show the company's sustainability commitment and attract investors who are concerned with environmental social responsibility issues.

However, there is another factor that can affect the quality of financial reports or sustainability reports, which is the company's ownership structure. According to Gracia-Torea (2016), the company's share ownership structure plays a relevant role in determining the level of company’s disclosure. The type of share ownership of a company has different access to information. For instance, companies with family ownership have the means and abilities to obtain the information needed so that anything relates to the disclosure of information tends to be low (Fathi, 2013).

In this research, ownership structure is a variable that moderates the effect between proprietary costs and the quality of sustainability reports. The ownership structure referred to in this research is share ownership controlled by foreign or domestic institutions or individuals. According to Haladu (2016), companies with domestic ownership of disclosure in sustainability reports tend to be low compared to foreign ownership.

However, according to Meutia (2017) who states that foreign ownership in Indonesia does not reveal much social and environmental information in annual reports, especially if foreign ownership is consolidated with the parent company in the country of origin and the percentage of ownership is small. Thus, companies that limit disclosure in sustainability reports because of proprietary costs will disclose the quality of their sustainability reports when the foreign ownership structure in the company is high. Likewise, companies with domestic ownership will consider proprietary costs which make them disclose low quality sustainability reports.

Based on the description above, this research is conducted based on two main problems. First, referring to several previous research (Bachoo, 2013; Amran, 2014; Munshi & Dutta, 2016; Krivacic, 2017) regarding the quality of sustainability reports with research backgrounds in developing countries, especially in Indonesia, is still very rarely done. Second, based on the previous research (Cohen, 2002; Prencipe, 2004; Gisbert, 2014; Sanchez & Ferrero, 2017; Pisano, 2018; Cohen, 2003) regarding the effect of proprietary costs on the quality of sustainability reports, is still rarely done too. This research takes the context of sustainability reports on the companies in Indonesia by taking companies listed on the Indonesia Stock Exchange for the period of 2013-2016 as the research focus.

In summary, based on the explanation above, this research aims to find answers to research questions regarding whether proprietary costs affect the quality of sustainability reports and whether ownership structure moderates the effect of proprietary costs on the quality of sustainability reports. The article is divided into five parts. The first part is an introduction which describes the background and problem formulation. Followed by the second part, which is hypothesis development contains the theories that underlie the research as well as literature review related to the formulation of the hypothesis. The third part contains research methods covering types of data, sources of data, sampling methods, operational definitions, and measurement of variables, as well as the used empirical model. The fourth part discusses the research results and answers the research objectives through hypothesis testing and discussion of research findings. The fifth part contains conclusions, suggestions, implications, and limitations of the research.

2. LITERATURE REVIEW

Legitimacy Theory

Legitimacy theory states that organizations or companies have an obligation to ensure that they operate within the boundaries and norms prevailing in society (Deegan, 2000). Companies that consider the importance of sustainability to the company's success may be interested in demonstrating their sustainability commitment to stakeholders by providing sustainability reports (Ching, 2017).

Signaling Theory

Companies that carry out sustainability reports are seen as a signal to stakeholders or investors that the company is actively participating in environmental social responsibility practices to achieve sustainable development which will ultimately increase the company's reputation, company value and is a signal related to management quality (Hapsoro, 2003). 2017). Moreover, disclosure of information in sustainability reports is considered a signal to provide additional information to the capital market about the financial situation and environmental social responsibility activities to reduce asymmetric information and influence the decision-making process (Nilipour, 2017).

Proprietary Costs Theory

Proprietary costs theory asserts that in the absence of costs associated with disclosure, companies have an incentive to voluntarily disclose relevant information to the public to reduce asymmetric information and the capital costs (Prencipe, 2004). Thus, the company considers not only the benefits of such disclosure but also the costs associated with the disclosure.

Agency Theory

Agency relationships are based on contracts between shareholders as principals and managers as agents (Jensen & Meckling, 1976). The existence of a conflict of interest between the two parties is because the agent acts not in accordance with the interests of the principal, resulting in agency costs and asymmetric information.

Sustainability Reports Quality

Sustainability reports is the practice of reporting organizations or companies regarding their economic, environmental, and social impacts including positive and negative contributions in achieving sustainable development (Global Reporting Initiative, 2016). Based on GRI data in 2018, sustainability reports in Indonesia have experienced rapid development, as noted around 91 companies that have carried out sustainability reports. According to the Global Reporting Initiative (2016), the quality of sustainability reports is the information available in the reports that allows investors or shareholders to form opinions and make better judgments about the performance of a company.

Proprietary Costs and Quality of Sustainability Reports

Companies have incentives to make public disclosure to reduce asymmetric information. However, companies have a disincentive to fully disclose information in sustainability reports due to the costs arising from such disclosure (Pisano, 2018). The existence of proprietary costs associated with disclosures made by managers and the nature of these costs also determine disclosure of information level (Verrecchia, 1990).

Disclosure of information in sustainability reports represents a significant cost (proprietary costs) for the company if it is made available to the public (Cormier, 2001). However, in the context of developing countries, namely in Indonesia, there are rules that regulate the importance of environmental disclosure as described in the Limited Liability Company Law No. 40 Article 74 of 2007 which states that companies that carry out business activities in the field or related to natural resources are obliged to carry out social and environmental responsibilities. Thus, the disclosure of environmental social responsibility in companies in Indonesia tends to be high (Gunawan, 2015).

The level of proprietary costs determines the quality of a company's sustainability reports. The higher the proprietary costs, the more the company will increase the disclosure of information in sustainability reports based on signaling theory. As it is attested that the company discloses high quality sustainability reports as a signal to the public or investors that the company commits to a sustainable development, provides additional information about the financial situation, and shows that the company actively participates in environmental social responsibility practices which will ultimately increase the company's reputation and value (Connelly, 2011; Ching, 2017; Nilipour, 2017; Hapsoro, 2017).

H_1 : proprietary costs have a positive effect on the quality of sustainability reports.

Proprietary Costs, Ownership Structure and Quality of Sustainability Reports

Proprietary costs arise from disclosure made by companies and the nature of these costs determines the disclosure of information level (Verrecchia, 1990). So, the higher the proprietary costs bore by the company, the lower the quality of the sustainability reports that will be published. However, information restrictions caused by proprietary costs can be minimized by the ownership structure of an organization or company. The company's share ownership structure plays a relevant role in determining the level of company's disclosure (Gracia-Torea, 2016).

The ownership structure in this research is based on a citizenship perspective, in which domestic and foreign ownership. The number or percentage of the company's ownership structure in terms of domestic and foreign ownership will tend to consider the existing proprietary costs so that they would disclose their sustainability reports with low quality. This is because the nature of proprietary costs and domestic share ownership affects the company's policy in disclosing the information and even though the characteristics of foreign ownership are more focused on social and environmental issues, foreign ownership of companies in Indonesia do not consider social and environmental issues which in turn has an impact on disclosure in sustainability reports.

H_{2a} : domestic ownership moderates the negative effect of proprietary costs on the quality of sustainability reports.

H_{2b} : foreign ownership moderates the negative effect of proprietary costs on the quality of sustainability reports.

3. RESEARCH METHOD

Population and Sample

The population used in this research are companies in Indonesia listed on the Global Reporting Initiative (GRI). The sampling method used in this research is purposive sampling or purposeful sampling which is conducted by taking samples from the population based on certain criteria (Hartono, 2013).

Data collection technique

This research uses secondary data in the form of sustainability reports and annual reports collected from the official website of the Indonesia Stock Exchange (IDX) at www.idx.co.id, the Global reporting initiative (GRI) at www.globalreporting.org, and the websites of the studied companies.

Empirical Model

To test hypotheses 1 and 2 using regression analysis, with the following equation model.

$$SRQ_i = \propto + \beta_1 PC_i + \beta_2 Profit_i + \beta_3 Size_i + \beta_4 Lev_i + \beta_5 Sector_i + \varepsilon \ldots \quad (1)$$

$$SRQ_i = \propto + \beta_1 PC_i + \beta_2 SK_i + \beta_3 PC_i{}^{*} SK_i + \beta_4 Profit_i + \beta_5 Size_i + \beta_6 Lev_i + \beta_7 Sector_i + \varepsilon \quad \ldots (2)$$

Operational Definition and Measurement of Variables

Dependent Variable

The quality of the sustainability reports is the information available in the sustainability reports that allows stakeholders to make better performance assessments about an organization or company (Global Reporting Initiative, 2016). The measurement of the sustainability reports quality variable refers to the research of Munshi & Dutta (2016) by using the sustainability disclosure index according to the G4 sustainability reports guidelines which consists of disclosure of specific standards containing three sustainability indicators, which are economic, environmental, and social.

Companies that fully report on specific standard disclosure of the three indicators are given 2 points, companies that report only partial on general standard disclosure of and subsections of all three indicators are given 1 point, and companies that do not report specific standard disclosure are given 0 point. Each period of sustainability reports, the scores assigned to each disclosure sub-section of the indicator (economic, environmental and social) are added to obtain the total of the disclosure scores (TDi) and then divided by the maximum score (Mi). Total Disclosure (TDi) for sustainability indicator is calculated as follows.

$$\boldsymbol{TD_i = \sum_{s=0}^{n} d_s}$$

The Sustainability Disclosure Index (SDI) for each company is calculated by adding up the total disclosure score (TDi) of all indicators, then divided by the total disclosure item, which is 91. The following is the formula for calculating the Sustainability Disclosure Index (SDI)).

$$\boldsymbol{SDI = \sum TD_i / 91}$$

Independent Variable

Proprietary costs are costs associated with disclosing company information including private information in voluntary disclosure that could potentially damage the company's competitive position in the product market (Sanchez & Ferrero, 2017). Measurement of proprietary costs variable uses the industrial concentration ratio, that is the Herfindahl index.

$$\boldsymbol{Herfindahl\ Index = \left[\frac{S_i}{S}\right]^2}$$

Moderating Variable

Domestic ownership structure is the share of a company that is owned or controlled by domestic, such as individuals or Indonesian legal entities. Foreign ownership is the share of a company that is owned or controlled by foreign investors. The measurement of the ownership structure variable is divided into two based on the number or percentage of share ownership by domestic and foreign (Luo, 2006).

Control Variable

Profitability is measured using return on equity, company size is measured using the log of total assets of the studied company, company sector is measured using binary variables for each company sector, and leverage is measured using the ratio of debt to total equity.

4. RESULTS AND DISCUSSION

Data Collection Result

Table 1. Sample Selection Process

Information	Total
Total sustainability reports of Indonesian companies in GRI	224
Companies in the financial sector	(51)
Companies that are not listed on the IDX	(71)
Incomplete data	(10)
Total company sustainability reports that meet the sample criteria	92

Source: Global reporting initiative and Indonesia Stock Exchange (2018)

The total sustainability reports for Indonesian companies based on GRI (2018) data are 224 sustainability reports from 91 Indonesian companies listed on GRI. Furthermore, as much as 132 sustainability reports are excluded from the research sample consisting of 51 sustainability reports from companies in the financial sector, 71 sustainability reports from companies not listed on the Indonesia Stock Exchange, and 10 sustainability reports from companies with incomplete data. Thus, the samples that meet the criteria in this research are 92 sustainability reports from 36 companies listed on the Indonesia Stock Exchange.

H Hypothesis Testing Results

Table 2. Results of Regression Analysis

Variables	**Model 1**		**Model 2**	
	B	**t-count**	**β**	**t-count**
Independent:				
PC	0,021**	1,686	0,119*	3,230
Control:				
PROFIT (%)	0,002	1,278	0,001	0,496
SIZE (Rp)	-3,297	-0,874	-6,568**	-1,752
LEV (%)	-9,142	-0,130	-6,887	-0,012
SECTOR	-0,041*	-2,280	-0,034**	-1,972
Moderation:				
SK				
- Domestic (%)			0,002	1,314
- Foreign (%)			0,003*	2,039
Interaction:				
PC*Domestic			-0,001	-1,376
PC*Foreign			-0,002*	-3,491
R Square (R^2)	0,121		0,253	
F-Count	2,364*		3,079*	

Notes: N=92; *p<0,005 **p<0,010

Table 3. Summary of Hypothesis Test Results

Hypothesis	**Findings**	**Conclusions**
H1: Proprietary costs have a negative effect on the quality of sustainability reports	Significantly positive	H1 supported
H2a: Domestic ownership moderates the negative effect of proprietary costs on the quality of sustainability reports	Insignificant	H2a unsupported
H2b: Foreign ownership moderates the negative effect of proprietary costs on the quality of sustainability reports	Significant	H2b supported

Discussion

Based on the results of the regression analysis, it shows that proprietary costs as proxied by the Herfindahl Index have been shown to significantly and positively affects the quality of sustainability reports. This indicates that companies with high proprietary costs will disclose their sustainability reports with high quality. So, it can be concluded that hypothesis 1 is supported.

The result is in line with the result of research by Cohen (2002) which states that companies with high proprietary costs will disclose high quality financial reports based on signaling theory (Connelly, 2011; Ching, 2017; Nilipour, 2017; Hapsoro, 2017). Furthermore, Harris (1998) in his research states that certain companies disclose more social and environmental information than other companies. In Indonesia itself, there are rules regarding the importance of environmental disclosure which are outlined in the Limited Liability Company Law No. 40 Article 74 of 2007 which notes the companies that conduct business activities in the field or related to natural resources are obliged to carry out social and environmental responsibilities.

Based on the results of regression analysis, hypothesis 2a (H2a) shows that domestic ownership is proven to be insignificant as it moderates the negative effect between proprietary costs and the quality of sustainability reports, which makes H2a is unsupported. These results indicate that the percentage or total domestic ownership of companies in Indonesia has no effect on the company's decision to disclose information in the sustainability reports because domestic ownership does not consider the information contained in the sustainability reports as a consideration in their investment decisions (Gracia-Torea, 2016).

Furthermore, the results of the regression analysis of hypothesis 2b (H2b) show that foreign ownership significantly and negatively moderates the effect of proprietary costs on the quality of sustainability reports. So, it can be concluded that H2b is supported. This indicates that companies with high levels of proprietary costs will disclose their sustainability reports with low quality when foreign ownership in the company is high. In this case, according to Gunawan (2015) and Meutia (2017) in their research state that the parties which greatly affect companies in Indonesia in disclosing environmental social information are organizations or communities that focus on environmental social issues, and foreign ownership of companies in Indonesia tend not to consider socio-environmental information into their investment decisions and do not disclose so much social-environmental information, especially if foreign ownership is consolidated with the parent company in the country of origin which resulting in a small percentage of foreign ownership. Based on the results of the regression analysis of the foreign ownership variable, it is proven to have a significant positive effect on the quality of the sustainability reports. This result is in line with the results of research conducted by Haladu (2016) and Gracia-Torea (2016). Furthermore, the results of the regression analysis on the control variables show that the the company’s size and the company's sector have a significant negative effect on the quality of sustainability reports. This evidence supports the previous research (Prencipe, 2004; Sanchez & Ferrero, 2017).

5. CONCLUSION

Proprietary costs have been proven to have a significant positive effect on the quality of sustainability reports. Companies with domestic ownership do not moderate the effect between proprietary costs and the quality of sustainability reports. Foreign ownership has been shown to be significantly negative in moderating the effect of proprietary costs on the quality of sustainability reports. The company’s size and the company’s sector variables as the control variable are proven to have a significant negative effect on the quality of the sustainability reports. Foreign ownership has been shown to significantly and positively affects the quality of sustainability reports.

Research Implications

There are three implications in this research. First, the research empirically contributes by adding the literature on the quality of sustainability. In this research, the factors that affect the quality of sustainability of a company are proprietary costs, foreign ownership, company's size, and company's sector as well as ownership structure which moderate the effect of proprietary costs on the quality of sustainability reports. The results of this research also strengthen the results of previous research, in which by Cohen (2002) that states companies with high proprietary costs will disclose high quality sustainability reports. The results also strengthen the results of research by Haladu (2016) and Gracia-Torea (2016) which attest that companies with high foreign ownership will disclose high quality sustainability reports. Second, for the practitioners, the results of this research contribute to companies in Indonesia that have implemented sustainability reports to improve the quality of the reports and as a motivator for the sample and non-sample companies to continue implementing sustainability reports. Third, for readers, the results of this reseach can provide an overview of the quality of sustainability reports on companies in Indonesia, especially those which listed on the Indonesia Stock Exchange that may help for further research or as a reference regarding the measurement of sustainability reports quality and proprietary costs.

Research Limitations and Suggestions

This research has several limitations. First, the samples of companies are still relatively small, with only 36 companies from the total companies listed on the Indonesia Stock Exchange. Future research is expected to expand or add research samples in hoping to improve data distribution and better results. Second, the issue of sustainability reports is still very interesting to examine, especially in developing countries. Therefore, research on the quality of sustainability reports has not yet represented the development of sustainability reports in developing countries, especially in Indonesia, as can be seen that the variables used in this research are only 1 independent variable and 1 moderating variable and a small sample of companies. Future research is expected to add other variables beyond the variables used in this research, such as tax avoidance, market reaction, and audit assurance. Future research is also expected to expand research on the topic of sustainability reports, for example comparing the extent of disclosure of sustainability reports by sector of the company or country, as well as comparing sustainability reports on companies that have and have not yet been audited.

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