SOCIAL DISCLOSURE PRACTICES BY JAKARTA STOCK EXCHANGE LISTED ENTITIES

Fitra Roman Cahaya
Curtin University of Technology, Australia

Dr. Stacey A Porter*
Curtin University of Technology, Australia

Associate Professor Alistair M Brown
Curtin University of Technology, Australia

*Address for correspondence:
School of Accounting
Curtin University of Technology
Perth, Australia, 6845

Ph: 61-8-9266-2375
Fx: 61-8-9266-7196
Stacey.Porter@cbs.curtin.edu.au

Abstract

This study examines the relationship between specific company characteristics and the extent of voluntary social disclosure practices of 100 *Jakarta Stock Exchange* (JSX) listed entities for the 2004 financial year.

While descriptive statistical analysis indicates that the overall mean of voluntarily social disclosures is low at 14.15%, multiple regression analysis reveals that company size and international operations are positive and significant predictors of this disclosure. It appears companies with these characteristics disclose more social information in their annual reports to satisfy the interests of a greater number of key stakeholders through annual report disclosures.

Introduction

The aim of this paper is to throw further light on the social disclosure practices of Indonesian listed companies. Cahaya, Porter and Brown's (2006) recent work on the extent of voluntary social disclosure practices by JSX listed entities using the *Global Reporting Initiative* (GRI) as the basis for a simplified social disclosure index showed that JSX companies disclosed low levels of overall social disclosures. It was a significant piece of work because it canvassed reasons for the relatively low levels of disclosure in an Indonesian setting and identified components of the GRI where JSX reporting was completely silent (for example, on the GRI components of *Child Labour*, *Forced and Compulsory* Labour, and *Disciplinary Practices*).

This study extends that work by examining the relationship between specific company characteristics (company size, leverage, economic performance, complexity of business, and international operations) and the extent of voluntary social disclosure practices of 100 JSX listed entities for the 2004 financial year. This is an important extension because while the descriptive statistics provided by Cahaya, Porter and Brown (2006) offered insights into the motivations for the non-disclosure of social issues by JSX listed companies, together with an extensive commentary on how the GRI was a useful benchmark in an Indonesian setting, it did not discuss possible explanatory predictors of the level of JSX social disclosure practices. This study rectifies the situation by looking at the explanatory power of Indonesia's company characteristics on social disclosures.

Accordingly, the following research question is posed: Are there any relationships between the quantity of voluntary social information disclosed in the annual reports and company size, leverage, economic performance, complexity of business, and international operations?

This research provides several contributions to the accounting literature. It increases the knowledge of social disclosure studies of developing country entities and provides explanatory insights into the level of social disclosures generated by JSX

companies. It also improves understanding about the characteristics of companies listed on JSX and the underlying theory of voluntary social disclosure.

Following this introduction, this paper is organized as follows. The next section discusses the theoretical framework adopted in the study, reviews prior social disclosure studies and develops the paper's hypotheses. The research methodology section presents the research methods used in the study, including details of the sample selection, disclosure index and the GRI indicators. This is followed by a 'Results' section which outlines both descriptive and inferential results of the study. The paper culminates in a discussion of the implications of, and the conclusions from, the findings.

Literature review and hypotheses development

Based on descriptive statistics, Cahaya et al. (2006) argued that both managerial and ethical branches of stakeholder theory played a role in the level of social disclosures generated by JSX companies. Indonesian companies, they claimed, identify, manage, and inform a wide range of stakeholder groups not only to win over perceived important groups of society in order to manage them for the benefit of the company but also to serve the needs of all stakeholder groups who have an ethical right to be informed about how the company will affect them.

This argument is examined further by next considering some company specific characteristics (company size, leverage, economic performance, complexity of business, and international operations) which have appeared as useful explanatory factors under the stakeholder theory umbrella in determining the level of company social disclosure practices (Brammer & Pavelin 2004; Craig & Diga 1998; Haniffa & Cooke 2002; Purushothaman, Tower, Hancock & Taplin 2000).

Company size

Large companies tend to be more visible to the public and therefore subject to greater pressure from external parties (Brammer & Pavelin 2004; Brown & Deegan 1998). To respond and manage this situation, and consistent with stakeholder theory, firms identify the most important groups of stakeholders and voluntarily disclose relevant information to them (Henderson, Peirson & Harris 2004). Therefore, it can be argued that larger firms voluntarily disclose more information as they have a greater number of stakeholders with different interests. For instance, the local community may be interested in information about community involvement whereas labour unions may consider employees' health and safety issues to be just as important. Most prior studies suggest a positive relationship between company size and the level of social disclosure (Adams, Hill & Roberts 1998; Brammer & Pavelin 2004; Gao, Heravi & Xiao 2005; Hossain, Perera & Rahman 1995; Meek, Roberts & Gray 1995; Purushothaman, Tower, Hancock & Taplin 2000). Accordingly, this study hypothesizes that:

H1 There is a positive relationship between company size and the extent of voluntary social disclosure in annual reports

Leverage

Stakeholder theory posits that leverage is positively associated with the level of social disclosure (Purushothaman, Tower, Hancock & Taplin 2000). Prior studies conclude that companies see creditors as important stakeholders whose influences could be managed (Barton, Hill and Sundaram 1989; Cornell & Shapiro 1987). Roberts (1992, p. 602) argues that companies' social responsibility activities are assessed by creditors. According to Purushothaman, Tower, Hancock & Taplin (2000, p. 123), creditors assess companies' social information to maintain their confidence in these companies. Thus, companies with a greater degree of leverage disclose more

social information. However, prior studies report mixed results on the direction of the relationship between leverage and social disclosure. Some studies find that leverage is positively associated with the level of social disclosure (Cornell & Shapiro 1987; Craig & Diga 1998; Meek et al., 1995; Purushothaman, Tower, Hancock & Taplin 2000; Roberts 1992) whereas other studies find no relationship between the two (Cormier & Gordon 2001; Kusumo 1998). Therefore, this study predicts a non-directional hypothesis:

H2: There is an association between leverage of the company and the extent of voluntary social disclosure in annual reports

Economic performance

Stakeholder theory postulates that there is a positive association between economic performance and social disclosure practices (Purushothaman, Tower, Hancock & Taplin 2000). Consistent with Ullman (1985), satisfactory financial performance helps companies contribute to socially responsible activities such as donations to local communities and establishment of employee training programs. Furthermore, such companies have greater financial support for voluntarily disclosing information which is relevant to various stakeholders (Meek, Roberts & Gray 1995). As with leverage, previous studies show inconsistent results in relation to the direction of the relationship between economic performance and social disclosure practices. Some studies show a positive association (Cochran & Wood 1984; Roberts 1992; Ullman 1985) whereas a study undertaken by Patten (1991) indicates a negative relationship between the two. Accordingly, this study hypothesizes:

H3: There is a relationship between economic performance and the extent of voluntary social disclosure in annual reports

Complexity of business

Complexity of business refers to the structural complexity faced by a company due to the existence of one or more subsidiaries (Haniffa & Cooke 2002). This variable has also been referred to as the parent company relationship (Cooke 1989a, 1989b).[1] This study argues that complexity of business is relevant for explaining the level of social disclosure within the stakeholder theory framework because a company which has a subsidiary usually has more stakeholders. Larger numbers of stakeholders means additional differing interests and expectations that a company should meet. Thus, it is expected that an Indonesian company which has a more complex business structure (i.e. greater numbers of subsidiaries) discloses more social information in its annual report. As prior studies have not found a relationship between complexity of business and disclosure practices (Cooke 1989a, 1989b; Haniffa & Cooke 2002), this study proposes a non-directional hypothesis:

H4: There is an association between complexity of business and the extent of voluntary social disclosure in annual reports

Extent of international operations

Meek, Roberts & Gray (1995) argue that the increased internalization of operations results in a larger proportion of foreign stakeholders in the company. An Indonesian company, for instance, will potentially have foreign consumers, employees, and investors if this company opens branches in foreign countries. As there are a greater number of stakeholders, the level of social disclosure is expected to increase. However, as with leverage and economic performance, the results of prior studies are mixed. A study completed by Zarzeski (1996) found a positively significant relationship between international operations and disclosure practices whereas Meek, Roberts & Gray

[1] In Haniffa and Cooke (2002), complexity of business actually refers to structural complexity faced by a company because of the number of subsidiaries. As Indonesian companies do not always have subsidiaries, the definition of complexity of business in this study focuses on the existence of subsidiaries, not the number of subsidiaries.

(1995) and Craig and Diga (1998) did not find a relationship between the two. Accordingly, this study proposes a non-directional hypothesis:

H5: There is a relationship between international operations and the extent of voluntary social disclosure in annual reports

Industry type

In addition to the independent variables examined in the five hypotheses above, this study employs industry type as a control variable as prior researchers have argued that industry type may act as an intervening variable and therefore should be controlled (Cowen, Ferreri & Parker 1987; Roberts 1992). According to Dye and Sridhar (1995), companies tend to disclose information in accordance with the peculiarities of their industry. Consumer-oriented industries (e.g. services), for example, may disclose more information on consumer satisfaction issues to enhance their corporate image among market consumers (Cowen, Ferreri & Parker 1987). On the other hand, labour intensive industries (e.g. manufacturing) are more likely to provide more disclosure on employee issues to reflect sensitivity to their particular problems (Haniffa & Cooke 2005). Therefore, it is expected that the inclusion of industry type as the control variable in this study will help explain social disclosure practices of JSX listed entities.

Methodology

A sample of 100 publicly listed entities was randomly chosen from a population of 331 companies from the Jakarta Stock Exchange (JSX) for the financial year ending 2004 (Jakarta Stock Exchange 2004). The selection of the sample companies was based on the accessibility of annual reports from the JSX website and the clarity of those reports' presentation in the Adobe Reader file.[2]

This study adopted a simplified disclosure index to measure the extent of social disclosure[3]. A number of studies have noted that a disclosure index seems to be more suitable for measuring the level of disclosure in developing countries whose set of economic, political and social conditions are very different from those of developed countries (Brown, Tower & Taplin 2004; Nurhayati, Brown & Tower 2006). The use of a simplified index is deemed suitable for such countries because the index avoids penalizing companies for a non-disclosed item when it is not relevant to them (Cooke 1991; Meek, Roberts & Gray 1995; Nurhayati 2005). Furthermore, it has been argued that generally a disclosure index enables researchers to gain a very useful insight into the level of information disclosed by companies (Cooke & Wallace 1989; Hossain, Perera & Rahman 1995).

Following Cahaya, Porter & Brown (2006), GRI social indicators were adopted in this study for its high international profile with a primary focus on the content of sustainability reporting (Adams 2004). GRI social indicators consist of four categories (*Labour Practices and Decent Work*, *Human Rights*, *Society*, and *Product Responsibility*) and, for the purpose of this study, are sub-categorized into 20 items.[4]

The measurement techniques for the independent variables are based on past studies (Craig & Diga 1998; Haniffa & Cooke 2002, 2005; Meek, Roberts & Gray 1995; Nurhayati 2005; Zarzeski 1996). The

[2] In addition to the ease of obtaining listed entities' annual reports (accessible from the JSX website), these entities play a crucially important role within the Indonesian economy and gain considerable interest from key stakeholders (Nurhayati 2005).

[3] The disclosure index adopted in this study is un-weighted and considered less subjective. Moreover, each disclosure item in the checklist is considered equally important and relevant to all sample companies (Craig & Diga 1998, p. 258).

[4] There are twenty-one social items available from the 2002 GRI guidelines. However, this study only uses twenty GRI social indicators as the disclosure checklist because the first GRI indicator, *Employment*, is a mandatory item of GRI Section 1 on employee benefits. Thus, this item is excluded from the study.

hypotheses on these possible determinants of social disclosure practices are tested by using multiple regressions. Table 1 presents the measurement technique for the independent and control variables.

Table 1: Measurement technique of the independent and control variables

Independent Variable	Control Variable	Measurement		Data Type
Company Size		Total assets		Continuous
Leverage		Total liabilities divided by total equity		Continuous
Economic Performance		Return on Assets (ROA)		Continuous
Complexity of Business		Dichotomous Scale	0= No subsidiaries 1= Yes – Do have a subsidiary	Dichotomous
International Operations		Dichotomous Scale	0= No foreign sales, foreign subsidiaries or foreign branch offices 1= Has foreign sales, foreign subsidiaries or foreign branch offices	Dichotomous
	Industry Type[5]	Dichotomous Scale	0= Non services 1= Services	Dichotomous

Results

Table 2 shows a summary of the descriptive statistics of the continuous independent variables.[6] *Company Size*, as measured by total assets, ranges from 262 million Rupiah to approximately 248,155,827 million Rupiah, with mean total assets of about 10,945 billion Rupiah.

Table 2: Descriptive statistics of continuous variables

Continuous variables	Minimum	Maximum	Mean	Standard deviation
Company Size (in million Rupiah)	262	248,155,827	10,945,051	34,130,485
Leverage (in %)	4.15	1430.17	217.45	305.13
Economic Performance (in %)	0.47	26.90	5.96	5.37

The range between the minimum and the maximum *Leverage* (the ratio of total liabilities to total equity) is 4.15% to 1430.17%.[7] The mean of 217.45% suggests that, on average, the amount of money borrowed by JSX listed entities is 117.45% more than the amount of equity they have. Accordingly, it indicates that Indonesian listed companies rely extensively on the funds borrowed from creditors in running their businesses. Interestingly, the mean of *Economic Performance* 5.96% indicates that, on average, Indonesian listed entities have improved their economic performance over the time period 2001, 2002 and 2003 by an average of 2%. Nurhayati (2005) claims that the very low mean of ROA for 2001-2003 shows that many Indonesian companies had not fully recovered from the effects of the 1997 Asian economic crisis. However, in this study, JSX listed entities' ROA for 2003-2004 has improved by about 4%.[8] This might be due to the significant improvement of economic performance in Indonesian finance industries from 2003 to 2004 (Kinerja Perusahaan Multifinance Membaik 2004)

For the categorical independent variables (*Complexity of Business* and *International Operations*), which are essentially

[5] Sample companies were initially classified into 9 JSX's categories: 1 = Agriculture, 2 = Mining; 3 = Basic industry and chemicals, 4 = Miscellaneous industry, 5 = Consumer goods industry, 6 = Property and real estate, 7 = Infrastructure, utilities and transportation, 8 = Finance, 9 = Trade, services and investment. Because the number of sample companies was unevenly distributed into the respective categories, a reclassification of industry type into a dichotomous classification (non-services and services) was therefore conducted. JSX's categories 1 to 7 were classified as non-service industries with categories 8 and 9 classified as service industries.

[6] Before performing the statistical analysis, the data was independently verified by three postgraduate students majoring in accounting. The purpose of this verification was to ensure the accuracy of the data.

[7] The very high leverage was calculated as follows: total liabilities divided by total equity = $\frac{17,456,975 million}{1,220,621 million}$ = 14.3017 = 1430.17%

[8] In Nurhayati (2005), the figure of the average ROA is about 4% lower than this study's figure. This might be because the averaged period of ROA is different. In Nurhayati's (2005) study, ROA is averaged over three financial year periods (2001, 2002, and 2003). In this study, ROA is averaged over two financial year periods (2003 and 2004). The 4% increase in the value of averaged ROA indicates that there is a gradual improvement in the economic performance of Indonesian listed entities from 2001 to 2004.

dichotomous, it was found that 31% of sample companies do not have subsidiaries and 69% do have subsidiaries, ranging from one to 89 subsidiaries. It was also found that 67% of sample companies do not have international operations while 33% have international operations. For the dichotomous control variable (*Industry Type*), the descriptive statistics reveal that 31% of sample companies are classified as non-services with 69% classified as services.

Table 3 illustrates that all 100 sample companies disclose some social information in their annual reports with a mean of social disclosure level of 14.15% (approximately 2.83 out of 20 items), suggesting that social disclosure practices by Indonesian companies listed on JSX are low.[9] Further analysis reveals that the lowest social disclosure level (5%) was made by 37 companies while the highest social disclosure level (40%) was made by three companies.

Table 3: Descriptive statistics of social disclosure practices

Dependent variable	**Minimum (%)**	**Maximum (%)**	**Mean (%)**	**Standard deviation (%)**
Social disclosure index (%) of all 100 sample companies	5	40	14.15	10.05

Determinants

One-Way ANOVA tests were performed to examine whether there are any statistical differences in the means of the level of social disclosure across the categorical variables, namely *Complexity of Business, International Operations,* and *Industry Type*. The results of ANOVA are summarized in Table 4.

Table 4: Overall social disclosure practices and specific social disclosure items across categorical variables[10]

	Complexity of Business (Sig.)	**International Operations (Sig.)**	**Industry Type (Sig.)**
Overall social disclosure practices	0.114	0.001**	0.272

**significant at 5% level

The results in Table 4 show that there are significant differences in the means of social disclosure practices between companies for *International Operations*. Conversely, *Complexity of Business* and *Industry Type* are not significant predictors of overall social disclosure practices.

Hypotheses 1-5 were tested using multiple regressions by the complete method.[11] Table 5 shows the predictive power of the regression model. The *P*-value of the overall model of 0.000, which is smaller than the 0.01 significance level, shows that the regression model is highly predictive of the level of social disclosure. The value of the adjusted R-square 0.426 indicates that the variation of social disclosure practices can be explained by the variation of the five independent variables and the control variable as much as 42.6%.

Table 5: Predictive power of the multiple regression model

	Overall Model *P*-value	**R-Square**	**Adjusted R-Square**	**Standard error of the estimate**
Model of social disclosure Complete regression	0.000*	0.458	0.426	0.53685

*Significant at 1% level

[9] Although the extent of social disclosure (14.15%) found in this study is low, it is higher than an Indonesian study by Nurhayati, Brown & Tower (2006) on natural environmental disclosures. Nurhayati, Brown & Tower (2006) found that the level of disclosures was 9%, with only 37 out of 100 sample entities disclosing natural environmental information. This may imply that Indonesian companies are placing a greater priority on social issues.

[10] *Child Labour, Forced and Compulsory Labour, Disciplinary Practices, Bribery and Corruption, Political Contributions, Advertising*, and *Respect and Privacy* were excluded from the analysis because none of the sample companies disclosed these items.

[11] To ensure that the results of the multiple regression were truly representative of the sample and that the best results could be obtained (Hair, Anderson, Tatham, and Black 1998), this study ran an assumption test first before conducting multiple regression. The assumptions to be tested consist of multicollinearity, normality, linearity, outliers, and homoscedasticity. Initially, the result of the assumption test (not shown for brevity) suggested that the assumption of normality was not met. Data of all continuous variables were therefore transformed into natural logarithm. After this transformation, all of the assumptions were met and the multiple regression analysis could be performed and discussed.

The results of hypothesis testing of the five independent variables, presented in Table 6 shows that *Company Size* and *International Operations* are statistically significant at the 1% and 5% levels respectively. Consistent with Hypothesis 1, the positive coefficient of *Company Size* reveals a positive relationship between this variable and the level of social disclosure. The other independent variables (*Leverage, Economic Performance, and Complexity of Business*) and the control variable (*Industry Type*) were not found to be significant.

Table 6: Results of complete multiple regression

Variable	*P*-value	Coefficient
Company Size	0.000*	0.177
Leverage	0.208	0.074
Economic Performance	0.245	0.072
Complexity of Business	0.103	-0.224
International Operations	0.031**	0.285
Industry Type (Control Variable)	0.496	-0.086

Legend: *significant at 1% level; **significant at 5% level

Discussion

Company Size was a significant predictor of social disclosure practices. Larger companies tend to be more visible to the public and therefore subject to greater pressure from outside parties such as labour unions (Brammer & Pavelin 2004). As claimed by Tambunan & Purwoko (2002), Indonesian labour unions can function as an effective controller of whether regulations in relation to labour are fully implemented by employers. It is also argued that larger companies' operations affect a greater number of stakeholders and therefore those companies are socially accountable to them and potentially identify a number of different social interests to be disclosed. This is consistent with stakeholder theory. Thus, the positive significance of *Company Size* may imply that bigger Indonesian companies undertake and disclose those activities in their annual reports in order not only to satisfy the pressure from stakeholders but to inform all stakeholders of their social commitment.

Similar to *Company Size*, *International Operations* was found to be a positive significant predictor of the extent of social disclosure. This finding is consistent with Zarseski (1996) and strengthens the evidence that *International Operations* do explain social disclosure practices in contrast to prior studies that found no significant relationship between the two (Craig & Diga 1998; Meek, Brown & Gray 1995). One explanation is that Indonesian companies with international operations potentially have a greater number of stakeholders. Consequently, and consistent with stakeholder theory there are more stakeholders with rights to be provided with social disclosure. Data from the JSX shows that 41% of total trading for the 2004 financial year was made by foreign investors (Jakarta Stock Exchange 2004) from a number of different countries such as Singapore, Malaysia, US, and Hong Kong (Dharmasaputra 2004; Haikal 2004). Thus, it is implied that Indonesian companies heed foreign stakeholders' information needs as they considerably contribute to not only the companies' financing but also the achievement of long term objectives, particularly for their operations in foreign countries. In addition, as much of the foreign investment comes from developed nations it could be argued that foreign stakeholders may be concerned or prefer different social issues from local (Indonesian) stakeholders. This latter point may highlight why certain items such as child labour, and bribery and corruption for example, are not disclosed by Indonesian companies. Many foreign investors might consider these to be unimportant in the context that in their own countries, abuse of child labour, and high levels of bribery and corruption do not exist or are minimal and therefore these are not social issues of concern. Thus, the provision of more social disclosure for satisfying both foreign and Indonesian stakeholders potentially explains the increase in the level of social disclosure by JSX listed entities and possibly the type of disclosure.

This study found that *Leverage* does not significantly affect the extent of social disclosure. This finding is consistent with Cormier & Gordon (2001), Kusumo (1998), and Meek, Brown & Gray (1995). According to Kusumo (1998) another insignificant

relationship between *Leverage* and the quantity of voluntary environmental and social accounting disclosure is partially explained by the unique closeness of business interrelationships including lending in the Indonesian context. *Economic Performance* was also not significant for the level of social disclosure. This finding is consistent with studies by Purushothaman, Tower, Hancock & Taplin (2000) and Kusumo (1998). It is possible that the association between *Economic Performance* and the level of social disclosure does exist but not in a cross-sectional study (McGuire, Sundgren & Schneeweis 1988; Purushothaman, Tower, Hancock & Taplin 2000).

Complexity of business was also found to be insignificant. This finding is consistent with studies by Haniffa and Cooke (2002), and Cooke (1989a; 1989b). One reason is that the link between JSX listed parent companies and their subsidiaries in relation to corporate social responsibility activities is weak or that subsidiaries hide particular social information behind the good image of other subsidiaries or the parent company itself.[12] The control variable, Industry Type was not significant.

In summary, the results highlight that *Company Size* and *International Operations* are significant predictors of social disclosure by Indonesian listed entities. The positive significant relationship of these two variables and the level of social disclosure imply that larger Indonesian companies with more diversified stakeholders have a stronger commitment to undertaking and disclosing those activities in their annual reports. Within the stakeholder theory framework, this commitment exists due to the greater number of stakeholders larger companies deal with, are accountable to, and possibly identify with. In contrast, smaller companies disclose less social information as they transact with fewer stakeholder groups.

[12] According to Cooke (1989a) companies with more subsidiaries may hide information by aggregation.

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