CHAPTER I

INTRODUCTION

A. Problem Background

In this modern world of technology, corporate reporting is mostly done digitally. The internet gives companies new opportunities to explore in terms of information sharing. This replaces the traditional ways of communication among companies, investors and stakeholders. Companies often save costs by using less paper and improve their financial reporting strategies by using these new technologies. Companies are now able to share more information and users can easily obtain the data they need from the companies' respective websites.

The use of the internet enables information to be disseminated worldwide and thus facilitate the improved availability of financial information in particular, so encouraging investment (Aly *et al.*, 2010: 183). However, according to Almilia (2009: 87), financial reporting via a website is more complicated than hardcopy channel because of the continuous exposure of information to unauthorized change. The company must ensure the security of the financial information when it is presented via this channel.

In recent years there has been an extensive growth in the use of the internet. Many companies have set up their own websites to publish information. This type of disclosure is voluntary and unregulated by professional bodies and institutions in many countries, particularly developing countries. In most cases the information disclosed on the Web has already appeared in printed forms. (Almilia, 2009). Although in Indonesia it has become a mandatory form of information disclosure. The Indonesian Capital Market and Financial Institutions Supervisory Agency ("BAPEPAM-LK") has issued a rule No. X.K.6, dated on 1st August 2012 which regulates the mandatory disclosure of information in issuers' and public company's annual reports in their websites.

The emergence and growth of internet drastically facilitates firms to communicate with a broader audience through their website. According to Prabowo and Angkoso (2006: 92), this fact enables websites to serve as an improvement of firms' image, a marketing device, or means to transfer firm-related information. The website as an informational device, has two advantages that are absent in conventional (print based) ones. Firstly, information contained in corporate website can be accessed throughout the world at significantly low cost. Secondly, it is more possible for firms to continuously update their information also at low cost. These mutual advantages give way to growing reliance on internet as an informational device.

The use of the Internet allows companies to increase the number of information users, as well as to offer higher quality information at a lower cost than the information supplied by using traditional media. In this sense, the possibility of disclosing information on the Internet is considered by the companies as a new source of competitive advantages. It could allow them to improve their image to investors and other stakeholders, to reduce the capital costs and to increase the company' market value at a lower cost of elaborating and communicating information. (Bonsón and Escobar, 2002: 31)

According to Bonsón and Escobar (2006: 300), using the Internet allows a company to provide online, large volume of information which users can access on demand in function of their particular area of interest. Some of the companies that first created their web pages mainly for reasons of corporate image are coming to realize the possibilities of obtaining competitive advantages from their use, and this is reflected in the continuous growth in the number of companies world-wide that are beginning to utilize their Web pages to distribute accounting information, thus appreciably improving both the quantity and quality of the information provided.

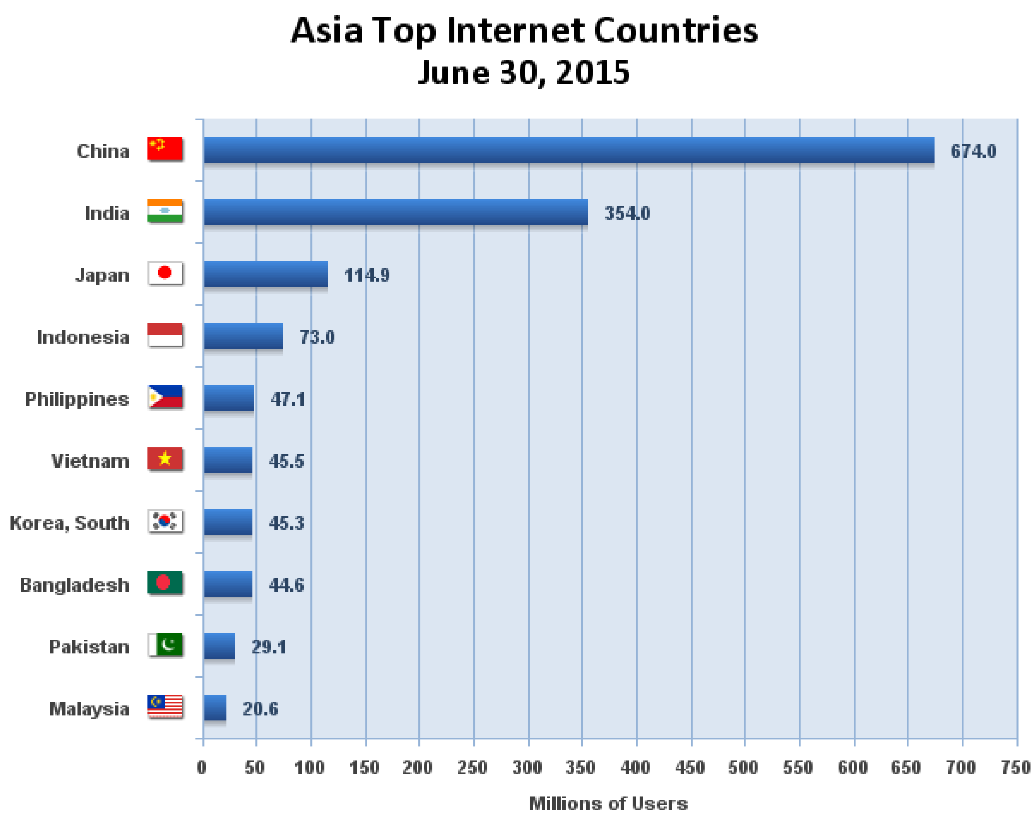
All in all, taking into account the potential of the internet as a reporting medium, IFR practices have the ability "to enhance the qualitative characteristics of disclosure" (Debreceny *et al.*, 2002: 376), thereby enhancing the usefulness of that disclosure. Bonsón and Escobar (2006: 304) acknowledged this possibility explicitly by indicating that, the application of these new technologies to the corporate reporting systems allows companies to have access to many more potential users, to personalize the information provided taking into account different profiles, to facilitate its understanding for those users who may not be trained to interpret accounting information and finally, to increase its quantity and quality (comparability, relevance, completeness, clarity, etc.).

Based on the survey from http://www.internetworldstats.com/ that was done for the period June 2015, it is stated that internet users in Asia has reached up to 47.8% and for Indonesia, a country with a total population of 255,993,674 (by estimation), the total number of internet users are 73,000,000. The increase of internet users in Indonesia has been recorded and presented in the table in

Supplement 1. Based on the results described above, it is said that Indonesia stands fourth in Asia's top internet users; this can be seen in figure 1.1:

Figure 1.1

Asia's Top Internet Countries



Source: http://www.internetworldstats.com/stats3.htm

The recent rapid development of the World Wide Web has provided a user-friendly platform from which companies may, if they choose, communicate with a large and growing number of financial information consumers. (Ettredge *et al.*, 2001: 149).

Prior researches that have examined the association between the level of internet reporting and firm's size have found significant positive associations. Xiao *et al.* (1996: 218) explained this association as follows: Large companies are more likely than small ones to use IT [Information Technology] to improve financial reporting to meet the greater demand for information. Ashbaugh *et al.* (1999) noted that economies of scale suggest that large firms are more likely to post-financial reports on web sites. This is because larger firms usually have more products and have more complex distribution networks which require larger and more complex management information systems and databases for management control purposes. Other researches that show a positive significant relationship are Marston, 2003; Oyelere *et al.*, 2003; Craven and Marston, 1999; Xiao *et al.*, 2004; Almilia, 2008; Aly *et al.*, 2010 and Anna, 2013.

Hail (2002) suggested that audit quality is an important factor in improving firms' overall reporting practices. In addition, Xiao *et al.* (2004: 200) argued that international audit firms are more likely to facilitate the diffusion of innovative practices, such as internet reporting. In prior researches, a positive association between audit type and disclosure was found by Bonsón and Escobar, 2006; Xiao *et al.*, 2004; Kelton and Yang, 2008. Other researchers found no significant association. (Hossain *et al.*, 1995; Hassan *et al.*, 1999 and Joshi & Al-Modhahki, 2003)

Empirical evidence regarding the association between leverage and internet reporting is inconclusive. A positive association was found in Ettredge *et al.* (2002) and Ismail (2002), while Brennan and Hourigan (1998), Debreceny *et al.* (2002), and Xiao *et al.* (2004) found that leverage has no significant association to internet financial reporting. Management could voluntarily disclose on the internet to allow creditors to monitor constantly the affairs of the company and help them assess the ability of the company to pay its obligations on time. Ismail (2002) added that although there are extra costs associated with dissemination of corporate information on the internet, this dissemination might provide more up-to-date reliable information to creditors and would in return reduce agency costs.

In contrast, Oyelere *et al.* (2003: 57) found that leverage does not explain the decision to use internet for corporate financial reporting. They explained that this may be due to differences between internet reporting and the traditional print-based financial reporting environment and culture, manifested in the differences of costs, benefits and demand and supply structures of the two environments. Other researchers that found no association of leverage and IFR (Almilia, 2008; Alali and Romero, 2012 and Yolana *et al.*, 2013).

Signaling theory suggests that profitable companies have an incentive to disclose more information, to signal the firm's profitability to investors to support management continuation of their positions and levels of compensation (Oyelere *et al.*, 2003). Prior research has examined the association between profitability and the extent of disclosure; however, the results are mixed. For example, Pirchegger and Wagenhofer (1999) found that profitability affects internet reporting of Austrian companies, but it does not affect that of German companies. Marston and Polei (2004) and Oyelere *et al.* (2003) found that profitability is not associated with internet reporting. Ismail (2002) found that profitability may increase the likelihood of the firm publishing financial information via the internet when this variable is within a particular range. Researchers that found a positive significant association (Aly *et al.*, 2010; Ismail, 2002 and Hassan *et al.*, 1999). Researchers that found no association (Oyelere *et al.*, 2003; Almilia, 2008 and Anna, 2013)

Abd-ElSalam (1999: 64) argued that companies, according to signaling theory, will disclose more information if their liquidity ratio is high, to distinguish themselves from other companies with less favourable liquidity. Several studies have examined the relationship between liquidity and the extent of disclosure. However, again the results are mixed. For instance, Oyelere *et al.* (2003: 55) found that liquidity is considered one of the primary determinants of internet financial reporting among New Zealand companies and found a positive relationship between company liquidity and voluntary use of internet reporting. However, Wallace *et al.* (1994) found that companies with lower liquidity provide more information in their annual reports. Other disclosure studies have found no association between internet financial reporting and liquidity (Ahmed and Courtis, 1999; Chan and Wickramasinghe, 2006 and Prasetya and Irwandi, 2012).

Xiao *et al.* (2004) found a positive association between companies with foreign listing and internet reporting. Debreceny *et al.* (2002) found that US listing is positively associated with internet reporting, while foreign listing is negatively associated. The high standards of disclosure and regulations in the USA, for example, Securities and Exchange Commission's rule fair disclosure may have induced firms listed in the USA to adopt internet reporting compared to other firms that are not listed in the USA (Debreceny *et al.*, 2002). On the other hand, Oyelere *et al.* (2003) found no association between internet financial reporting and foreign listing.

Companies that have been listed longer, provides more publicity information than the newly listed companies. More experienced companies have a tendency to change their method of reporting financial information in accordance with the development of technology to attract investors through the use of IFR. Lestari and Chariri (2007: 8) found positive significant association of listing age and IFR, whereas Prasetya and Irwandi (2012) found no significant association.

The use of the internet enables information to be disseminated worldwide and thus facilitate the improved availability of financial information in particular, so encouraging investment. The purpose of this research is to investigate the potential factors that may affect the level of corporate internet reporting by manufacturing companies listed on the Indonesia Stock Exchange, therefore the title of this research is, **"Factors Influencing the Disclosure of Internet Financial Reporting in the Websites of Manufacturing Companies Listed on Indonesia Stock Exchange for the period of 2014."**

B. Problem Identification

Based on the problem background outlined in the previous pages, this study intends to examine the relationship of Firm Size, Audit Firm, Leverage, Profitability, Liquidity, Foreign Listing and Listing Age with Internet Financial Reporting. The formulation of the problems in this research is as follows:

1. Does *Firm Size* influence the disclosure of financial information through the Internet?
2. Does *Audit Firm* influence the disclosure of financial information through the Internet?
3. Does *Leverage* influence the disclosure of financial information through the Internet?
4. Does *Profitability* influence the disclosure of financial information through the Internet?
5. Does *Liquidity* influence the disclosure of financial information through the Internet?
6. Does *Foreign Listing* influence the disclosure of financial information through the Internet?
7. Does *Listing Age* influence the disclosure of financial information through the internet?

C. Problem Limitation

Based on the identification of the problems mentioned above, the researcher has limited the problems to be studied as follows:

1. Does *Firm Size* influence the disclosure of financial information through the Internet?
2. Does *Audit Firm* influence the disclosure of financial information through the Internet?
3. Does *Leverage* influence the disclosure of financial information through the Internet?
4. Does *Profitability* influence the disclosure of financial information through the Internet?
5. Does *Liquidity* influence the disclosure of financial information through the Internet?

D. Research Limitation

In conducting this research, there are some limitations. The first is the limited time and energy invested in the research. The second is that the subject of the research is based on only those financial statements of manufacturing companies listed on the Indonesia Stock Exchange and whether they have a website which discloses their financial information and other information required to conduct this research.

In this research, the researcher limits the period of the research object, namely the financial statements only up to one accounting period which is for the year ended December 31, 2014.

E. Problem Formulation

Based on the identification and limitations of problems that have been explained earlier, the problem formulation of this research is, "How do Firm Size, Audit Firm, Leverage, Profitability and Liquidity influence the financial information disclosed through the internet by manufacturing companies listed in the Indonesia Stock Exchange?"

F. Research Objectives

This study has been conducted to build models that can explain the various factors:

1. Whether *Firm Size* influence the disclosure of financial information through the Internet.
2. Whether *Audit Firm* influence the disclosure of financial information through the Internet.
3. Whether *Leverage* influence the disclosure of financial information through the Internet.
4. Whether *Profitability* influence the disclosure of financial information through the Internet.
5. Whether *Liquidity* influence the disclosure of financial information through the Internet.

G. Research Benefits

This research is expected to be beneficial to:

1. Regulators

   Being one of the many sources or references for setting regulations in the practices related to the disclosure of financial statements on the company websites within manufacturing companies.

2. For Academic Purposes

   Hopefully, the results of this study can provide insight and knowledge on the disclosure of corporate financial information through company websites in the internet.

3. For Further Research

   Results of this study for further research can be used as a source of reference and information that discusses about the factors that influence the disclosure of Internet Financial Reporting in the websites of manufacturing companies which are listed in Indonesia Stock Exchange.