

# Environmental Disclosure effect with the Cost of Capital

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**Abstract:** The aim of this study was to discuss the possible relationship between nature and the disclosure of environmental responsibility and cost of capital as an indicator of financial performance economic corporation, in five main division; In the second section after the introduction of what has been disclosed environmental and economic institutions to address and motives; in section III dedicate an indicator of capital appreciation and methods of cost, we have tried in part IV discussion and analysis of the relationship between disclosure environmental and cost of capital (theories and determinants), and have been in the fifth section display the most important conclusions and recommendations.

The paper concluded that environmental disclosure would reduce the cost of capital, and through the agency mechanism cost asymmetry in information, and in light of an efficient financial market investors and it provides a great deal of environmental awareness.

**Keywords:** Environmental Disclosure effect, economic institutions.

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## 1. INTRODUCTION

Received environmental management practices for increasing interest by managers at a global level in the past two decades has been the author of this Interest in the study of the relationship between the economic performance of the institutions and between environmental responsibility and disclosure. This concern was reflected in many of the contract International conferences, scientific studies and research.

Traditional accounting theories poured the bulk of their attention on the financial aspects, and that service to financial decision-makers only, while the recent trend in Accounting Studies (positive theory of accounting), especially in light of the International Financial Reporting Standards IFRS it tends to expand the scope of the framework

Accounting service to include all categories of society and the Pacific (stakeholders) Stakeholders who are active inside the enterprise.

Some of those who admits to prepare accounting standards in some developed countries like the United States and some European and Asian countries that there is a widening

Interested groups within the organization matters, and realize that they have to meet the needs of those categories of non-financial information because it is clear that the financial information could be helpful to financial decisions makers but may be useless for decision-makers and other environmental such as resolutions.

Therefore, this paper aimed to discuss the possible relationship between nature and the disclosure of environmental responsibility and cost of capital as an indicator of financial performance Economic Corporation, in five fundamental areas:

- The general framework for the study.
- Environmental disclosure of economic institutions and motives.
- Capital appreciation and methods of cost.
- The relationship between environmental disclosure and cost of capital analysis (Theories and determinants).
- Conclusions and recommendations.

## 2. FRAMEWORK FOR STUDY

Financial aims to maximize the value of the enterprise, which is a multi-dimensional variables and function, and among the most important contemporary variables variable

Disclosure of environmental responsibility in the presence of accounting standards do impose environmental disclosure, which we will try to discuss it in this paper and it. Under the following main problem:

To what extent the existence and nature of the relationship between environmental disclosure and cost of capital?

Fall under this major problem five sub-problems, namely:

1. What is meant environmental disclosure and what are the most important motives?
2. What is the most important measurement of the cost of capital models?
3. What are the determinants and theories that attempted to explain the relationship between environmental disclosure and cost of capital?

### **The importance of studying:**

This topic is of great importance, and for a number of reasons can be identified in the following points:

1. Addresses a topic most important current topics that the e cares about the environmental dimension of economic performance, especially in light of the adoption of financial and accounting system In Libya, which is based on International Financial Reporting Standards IFRS.
2. Attention to modern financial management goal of maximizing enterprise value through the reduction in the cost of capital.
3. This paper relies on a modern theories, especially the theory of legitimacy, the agency Theory, cost information, the theory of the economy Political.

### **The Objectives of the study:**

The most important objectives of this paper in the following points:

1. Trying to environmental performance linked to economic performance.
2. Highlighting the impact of environmental disclosure on the cost of capital.
3. Presentation and analysis of the literature of the subject of the impact of environmental disclosure on the cost of capital.

## 3. LITERATURE STUDY

Many studies have touched on the subject of environmental disclosure and cost of capital, the study of Khwaiter (2002) to identify the Current practices by working in Saudi Arabia institutions regarding environmental accounting and the extent of disclosure of environmental information and so by answering a number of research questions. Nnual cost of capital, which are written in the acquired assets bill the actual interest rate is not possible to determine which is the nominal interest rate sector the cost of capital or discount rate used (Prof. Dr. ERDOĞAN Murat, 2011, Ref No.27, P, 279). It represented the primary means of data collection in the questionnaire that was distributed to the CFOs the one hundred largest Saudi company, which included a number of questions that relate to what you are doing those institutions accounting of activities related to the environment, then followed so make some personal interviews with some CFOs to get more in-depth information. As it was the most important results that have been reached the decline in the level of practicing environmental accounting and disclosure of environmental information by institutions operating in the Kingdom compared to institutions operating in developed countries, and that for many reasons is carried at the level of social awareness of environmental matters, and the lack of adequate attention from relevant government agencies and legislative bodies environment accounting, and lack of interest by the departments and institutions to take the initiative to adopt policies and procedures lead to environmental measurement and analysis and presentation of the effects of practicing these institutions for their activities on the environment. and it was the most important recommendations study the need to raise awareness among managers of the importance of environmental issues and the need for different institutions adopting environmental policies that would help to minimize the negative effects of practicing institutions for

their activities on the environment, as well as the recommendation to develop mechanisms of action leading to the commitment of institutions disclose environmental information periodically and orderly manner.

The other study (Martinez. and Déjean 2009) explain problematic what the impact of the strong environmental institutions to disclose the cost of Capital? Applied where the study was conducted on a sample French SBF250 index institutions, where it was noted that the environmental topics that draw attention institutions are: pollution, nature and sources of renewal, and environmental determinants related to disclosure are: the size of the institution, and the number of Leverage financial analyst's observers of the company. This study did not conclude that the institutions that discloses the environment will not necessarily get you on the cost of capital.

According to A. B. Lopes and R. C. de Alencar (2010) study, the study focused on the environmental aspect and cost of capital.

Where researchers tried to test the relationship between environmental disclosure and cost of capital for Brazilian enterprises listed on Sao Paulo Stock Exchange during the five years

1998, 2000, 2004 and 2005, and to test hypotheses researchers used (data Panel) the 50 shares with the most liquid for the year 2005 within the 11 sectors except financial institutions, for a sample size of 276 Show (years, company). Concluded study indicated that there is an inverse relationship between environmental disclosure and cost of capital for the institutions studied, and this relationship is more pronounced for institutions which received attention and follow-up by financial analysts and a dispersion of ownership among shareholders. Therefore, features of Capital Companies are summarized as follows:

Rather than the party capital of the company is at the forefront, there is a legal entity.

Partners can be real or legal persons, Company of the death of one partner, bankruptcy or be placed under interdiction, the case does not end the Company's activities or the activities of this event affected, The company's management, control and self-authorized company representative unit It fulfilled by responsibility of the partners and they have committed to put the company with capital ratios (Prof. Dr. ERDOĞAN Murat, 2002, Ref No.27, P, 4).

#### **What is environmental disclosure of economic institutions and motives?**

Disclosure comprehensive sense disclosure of confidential information and authorization.

The accounting disclosure is the commitment to publish all the facts and information related to the institution and that would influence an investor's decision.

The environmental disclosure is that the method or the way in which organizations can inform all the community on its various activities environmental content the financial statements or reports there to an appropriate tool to achieve this, as the United States considers and UK of subjecting more interested in the environmental performance of the institution to disclose the accounting countries, where the two countries focused on specializing in professional organizations. As well as the Committee on Securities of the need to disclose the environmental impact in terms of cost and yield, as recommended by the Committee on Accounting Standards, UK the need for disclosure of environmental information and report on the disclosure of the institution for the costs and benefits resulting from those activities. Also has some studies have shown that there are some institutions in Australia and New Zealand have attempted to disclose their activities in the field of environmental disclosure.

the reason of interest of accounting disclosure of environmental basis of that information on the environmental performance of a financial nature and quantity; making it directly affect the financial position of the institutions and the result of their activities, The financial statements should reflect the actual and potential obligations that result from a lack of commitment enterprise environment protection laws.

#### **Motivated to disclose environmental information and economic institutions:**

The accounting disclosure in its current form does not meet the needs of users of information and data relating to social responsibility towards the institution environmental protection, and then there was an urgent need to develop the standard of disclosure in accounting thought to include environmental disclosure in the form of supplements lists, Traditional reports, or in the form of lists and reports of independent (International Accounting Standards) leading to increased efficiency of the operation of information by decision makers, and then rationalize their decisions concerning the evaluation of financial assets and economic performance, taking into account the economic responsibility and environmental the institution.

There are some factors impact on environmental disclosure which are summarized as follows:

1. Build a better relationship between the institution and its stakeholders; such as government agencies, shareholders and employees of the institution, Customers, suppliers, financiers, pressure groups, and the use of disclosure as a means to inform the community as a whole that the institution based on the voluntary disclosure of environmental information.
2. Trying to improve the image of the institution within the community who engaged in its activity, especially for organizations that have been heard for damage caused as a result of the occurrence of accidents or environmental disasters which lead to confidence and respect of the community and individuals in institutions, then it is increased demand for their products and the expansion of its investments; which is reflected in its impact on the end result of its activity and its money, and the value of it.
3. Prepare for the application of environmental laws and regulations which would require disclosure of environmental information and is expected to be binding on all institutions.
4. Use disclosure as a means to gain access to advanced competitive position in the field of enterprise activity, and maintain on its case.
5. Get the distinct tax treatment in terms of the exemption or reduction of taxes imposed on them, the United States and one of the first countries interested in encouraging institutions to protect the environment.
6. Reduce the cost of production because of material support or low-cost financing or distinctive tax treatment thereby increasing the size of the enterprise activity, preassigned organization using its resources as efficiently as possible while protecting the environment from the harmful effects of pollution help on Increase Profits.
7. The disclosure of environmental expenditures separately in the financial statements will allow measurement of benefit such as helping investors clearly see the policies applied by the Foundation for Environmental Protection, and then rationalize their decisions related to the institution.
8. The existence of standards governing the measurement and disclosure of accounting within the environmental performance of organizations, environmental disclosure is not required in the past, local legislative rules or universal, and therefore did not care about the accounting profession only in recent years.

It shows through the foregoing that the environmental disclosure must be private in a negative impact on the environment institutions, and are many strict laws and regulations that get rid of the waste from polluting industries governing the operations of issuance, as well as the need to provide disclosure of these institutions About pollution mandatory and the reasons for the institution meet its obligations in the field of pollution control. The disclosure of institutions for its achievements in environmental performance to achieve trust more to achieve satisfaction social performance, and that by responding to the wishes of customers in the provision of environmentally friendly products, and to improve the image of the institution and its reputation, as well as the competitiveness of enterprises in the field of quality in general, the quality of the environmental performance support In particular.

#### **Methods for estimating the cost of capital:**

The cost of capital the most important restrictions set for the decision to select all of the financial structure and investment projects represent it represents the link between cost of capital and the enterprise value; On the point of funding leveraged clear and explicit cost, unlike the financing funds own (equity) where the cost of implicit and explicit, shareholder partner in the profit and loss; which means that the cost of equity is a perception of a minimum to be achieved, which represents the goal of financial march in the absence of conflicts of interest to achieve shareholder satisfaction.

The cost of equity in the minimum rate of return to be achieved from the investment project so as to compensate this rate deprivation for the postponement of the use of his money (time element), and the risk posed to his money. The cost of capital is affected by many factors, among them

1. Distributions paid and expected annual flows.
2. The prevailing interest rate on the money market.
3. Enterprise Activity and risks.
4. The efficiency of the Board of Directors (governance) and the distribution of capital

5. Shares prices of similar institutions.
6. Monetary policy and the economic and political events.

There are several models to measure and estimate the cost of capital, Such as:

- Dividend discounted model (Shapiro and Gordon): the cost of common stock by the entrance in the rate at which equals between the market value of the stock and flows novel.
- Capital asset balance model (CAPM): This model allows determining the rate at which imposed represents the algebraic sum of the risk-free rate of return as compensation for the time element, as well as regulatory and market risk weighted by sensitivity factor  $\beta$ , Despite the importance of CAPM model in determining the rate of return and imposed heavy use by practitioners in practice, but it has a number of criticisms which the most important are summarized in the following points, Dependence on the financial market efficiency hypothesis and the theory that remain, dependence on historical data, supposed to the relationship between the rate of return and systemic risk, dependence on a single factor to explain the rate of return, diversification and the stability of the hypothesis  $\beta$ .
- Model MEA / APT: A proposal is considered a form APT by ROSS 1976 circular model CAMP, the latter is assumed that the rate of return of the security is linked to the market risk for this paper, and is a function in one factor is the systemic risk, while APT assumes that the grant or premium.

The APT model based on a number of assumptions, most important of which are summarized in the following points:

- Do not, and there are fees and taxes.
- There are no transaction costs.
- There are the determinants of short selling.
- Individuals have homogeneous beliefs and believe that the revenue produced by a linear model of several variables.
- The price of one.

Three factors model (Fama et French): This model is the results of a field study, it concluded that the rate of return should be determined Three factors as well as the market rate of return; the rate of capitalization the stock market to property rights PBR the difference between the yield of the securities of large and small capitalization and liquidity as well.

Hammon et Jaquilat model: Where he proved that the rate of return is determined by variables CAPM and variable model as well as liquidity and that were non-existent for the same capitalization big the stock market securities and significant For securities with small capitalization and the stock market determined Furthermore liquidity host of factors, most notably the size, dispersion, size of the deal, the difference between the price purchase and sale price.

The balance of the capital asset information model (ICAPM): According to Merton this model dropping a efficient market assumptions and of the lack of cost information.

### **The analysis relationship between environmental disclosure and cost of capital (theories and determinants):**

#### **1. Theories:**

Some researchers support the study of the relationship between environmental disclosure and cost of capital on a number of the most important contemporary theories: the theory of legitimacy, Agency Theory (stakeholders), the theory of political economy, the theory of asymmetric information.

#### **Legitimacy Theory:**

means the legitimacy of the legal and administrative terms to its members and all the provisions of the law and that the State shall not depart from its borders, and the requirements of this principle is that the administration respects the provisions of the law in its actions, and only promised to work illegally and had been contraindicated. The basis of the principle is subject to different political, social and economic conditions in the various countries.

### **Stakeholder Theory:**

The main goal of the theory of the agency is to clarify how the Contracting Parties to contracts designed to reduce the associated costs and reducing conflicts of Interests between the parties to the agency relationship and try to link their interests, making the agent works for the benefit of the client, Depending on the agency theory and environmental disclosure to reduce conflict between stakeholders leads through the reduction of the degree of asymmetry in the information; and reducing conflict works to reduce agency costs that reduce the cost of capital.

### **The cost of Information Theory:**

With the cost of information theory can be considered to have the cost information is a commodity, and environmental disclosure is to increase the supply of information and thus lower cost. Lower cost of information leads to a reduction of the cost of capital and maximize enterprise value.

### **Political Economy Theory:**

Political economy theory show the inequality in the distribution of powers as those powers concentrated in the hands of the owners of capital and at the expense of other groups of society.

## **2. Analysis of Specific Factors Environmental Disclosure**

Field studies indicate the presence of many of the specific process and environmental factors disclosure, which relates to the characteristics of the institution that environmental disclosure among the most important of these factors are summarized as follows:

1. Economic performance.
2. The degree of dispersion of ownership.
3. The degree of international activity.
4. The proportion of debt.
5. Political vision
6. The nature of the sector.
7. Systemic risk.
8. Governance.
9. Follow-up to the institution's shares by financial analysts.

## **4. CONCLUSIONS AND RECOMMENDATIONS**

### **Conclusions:**

The paper concluded the following results:-

- The decline in the level of lead practicing environmental accounting and disclosure of environmental information by the institutions to the high cost of head money under the financial market provides a measure of efficiency and investors with the awareness of environmental matters.
- The low level of social awareness of environmental matters that would lead to higher cost of capital.
- The lack of adequate attention from the relevant government agencies and legislative bodies' environment accounting and lack of interest by the departments and institutions to take the initiative to adopt policies and procedures lead to environmental measurement and analysis and presentation of the effects of practicing these institutions for their activities to environment.

### **Recommendations:**

- ❖ The need to raise awareness among managers of the importance of environmental issues and the need for different institutions adopting environmental policies that will help reduce the negative effects of practicing institutions for their activities on the environment.



- ❖ The development of mechanisms lead to the commitment of institutions to disclose environmental information periodically and orderly manner.
- ❖ Obliging institutions by regulators to disclose environmental accounting step in a new financial accounting system.
- ❖ To encourage research in the positive accounting theory and social accounting, topics related to environmental disclosure.

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