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The Effect of Firm Sizes on Firm Performance: GCG Mechanism and CSR Disclosure as Intervening Variables in an Indonesian Study

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This research aims to investigate the impact of firm size to GCG mechanism, CSR disclosure and firm performance. This study asks if there any impacts from firm size, GCG mechanism, and CSR disclosure to firm performance. The study aims also to determine if GCG mechanisms and CSR disclosure can mediate the impact of firm size to firm performance. This research uses questionnaire data for hypothesis testing and Structural Equation Modelling (SEM) to find out the impact of firm performance through GCG mechanism and CSR disclosure as a mediating variable. The result of this empirical study suggests reward, trust, job satisfaction, and knowledge sharing predispose an employee a high-standard performance of achieving firms obejctive and targets. Further, reward does not affect employee performance indirectly in terms of knowledge sharing, while trust predisposes an employee to performing well through knowledge sharing. We also found job satisfaction does not affect employee performance through knowledge sharing indirectly. The conclusions offer the academic literature new information and recommendations for a firm seeking high level employee performance. A firm that intensifies reward, trust, and job satisfaction would also build a good knowledge sharing activity to their employee therefore improve firm performance. The research applies institutional theory to propose the relationship of firm size to firm performance and the mediation effect of GCG mechanism and CSR disclosure.

Key words: *Firm size, firm performance, GCG mechanism, CSR disclosure.*

Introduction

A firm's performance shows their ability to manage and control resources. 'Firm performance' is an indicator of whether a firm can carry out its functions and operations in accordance with the management plans and objectives. Firm size is often used as one of the variables that is understood to affect a firm's financial performance. Large companies are more trusted by investors and are believed to be able to attract greater capital to improve firm operations and optimise firm performance (Purnomosidi, 2014). Firm size can be measured using the natural logarithm of the total assets of the firm and the natural logarithm of total firm sales in one period (Pervan and Višić, 2012). Purnomosidi (2014) states that firm size measured through total assets and total sales affect firm performance. In contrast, Niresh and Velnampy (2014) found that firm size had no influence on firm performance. The inconsistency of the results from these previous studies form a research gap. Therefore, researchers want to examine further the influence of firm size on firm performance by including other variables as mediating variables, including Good Corporate Governance and Corporate Social Responsibility.

Good Corporate Governance (GCG) is an important issue for Indonesia with no exception. According to Muda et al. (2018), Indonesia's GCG appears to be a solution to its agency problems. Agency problems arise in the relationship between capital owners and managers (Jensen and Meckling, 1976). The corporate governance mechanism of a firm can be measured by various methods such as the size of the board of commissioners, board of directors, independent commissioners, institutional ownership, managerial ownership, and others. Waseem et al (2011) examined the relationship between firm size and GCG showing a positive and significant influence. Larger companies are considered capable of implementing better corporate governance. Effective GCG systems in a firm can minimise abuse of authority through management, and focus more on improving firm performance (OECD, 2004). The statement is in accordance with the results of several studies conducted on the effect of GCG mechanisms on firm performance. Research conducted by Mashitoh and Irma (2013), Ahmed and Hamdan (2015), Manafi et al., (2015) and Kurniaty et al., (2018) concluded that GCG can improve financial performance. In addition to the corporate governance mechanism, CSR disclosure may also mediate the relationship between firm size and firm performance. CSR disclosure is also a necessity for a firm. Its relationship to firm performance and firm size is part of a firm's characteristic and cannot be avoided.

The disclosure of CSR activities is based on the theory of legitimacy which confirms that companies continue to ensure that their operations are in accordance with the rules and norms that apply in society (Deegan, 2002). Razak and Mustapha (2013) argue that corporate social responsibility (CSR) has emerged as an important factor to deliver success in business today. Large-scale companies (Large Firm) are also expected to have large social responsibilities as well. Larger companies have various advantages compared to smaller companies (Orlitzky, 2016). Accordingly, Nawaiseh (2015) stated in his research that firm size has a positive influence on disclosure of social responsibility.

CSR also attracts positive responses from stakeholders. Stakeholders assume that the current business role is not limited to profits but also includes elements of corporate social responsibility (Mahoney and Roberts, 2007). Therefore the disclosure of a firm's responsibility has an impact on the financial performance of a firm. Research that mentions the influence of Corporate Social Responsibility activities on firm performance has also been widely carried out including that by Saleh (2011). In his research on the effect of CSR activities on firm performance he provides empirical evidence that the application of CSR has a significant positive effect on financial performance. Ghelli (2013) corroborates with the results of the study by finding empirical evidence that CSR can improve financial performance, and that financial performance also affects CSR.

Corporate Social Responsibility cannot be separated from the role of GCG. Good governance mechanisms in companies can be a supporting infrastructure for CSR practices and disclosures (Murwaningsari, 2012). In addition, the existence of Good Corporate Governance mechanisms can reduce asymmetric information. If asymmetric information can be handled, it will avoid the occurrence of adverse selection or moral hazard which is a consequence of companies that do not practice and disclose CSR (Klapper and Inessa, 2002). Murwaningsari (2012) conducted research on 126 companies in the Capital Market Reference Center (PRPM) which showed that Good Corporate Governance observed through managerial and institutional ownership had an influence on the disclosure of corporate social responsibility. The firm's desire to minimize information asymmetry makes these two things closely related. The mechanism of GCG and CSR activities is not an integration of several integral parts in a firm, but a continuum (unity) (Murwaningsari, 2012).

The existence of the relationship between firm size, Good Corporate Governance, CSR, and firm performance motivates researchers to use these two variables in mediating the relationship between firm size and firm financial performance. This research puts firm size into a single independent variable in order to test the direct effect on firm performance and is mediated by GCG and CSR. The sample used in this study is drawn from manufacturing companies listed on the Indonesian Stock Exchange. The manufacturing sector is the sector that has the highest number of issuers on the Indonesian Stock Exchange and is the most varied sector. Therefore, conducting research in the manufacturing sector is considered best by this research to describe the condition of public companies in Indonesia.

The remainder of this paper is structured as follows: Section 2 develops the research hypotheses; Section 3 describes the sample and variables; Section 4 specifies the empirical result; and Section 5 summarises the paper and presents some concluding remarks.

Literature Review and Hypothesis Development

Firm Size and Firm Performance

The firm size is expressed in total assets, sales, and number of workers. The greater the total assets, sales, and number of workers, the greater the size of the firm (Waseem et al 2011). Of the three variables, the value of assets is more stable compared to the number of workers and sales in the measurement of company size. Waseem et al., (2011) argues that firm size can determine a firm's ability to obtain external party funding. Large firms are believed to have a high level of efficiency and lower financial leverage. Ease getting funding will increase a firm's capital. Firms that have large capital are considered to have good performance and good future prospects (Purnomosidi et al., 2014). However, research conducted by Fachrudin (2011); Niresh and Velnampy (2014) stated the opposite. Firm size had no effect on firm performance. From the explanation above, we propose the following hypothesis:

H1: Firm size is positively related to firm size

Firm Size and Good Corporate Governance Mechanism

Klapper and Love (2002) suggest two alternative views related to the relationship between firm size and the Good Corporate Governance mechanism. The first view is that larger firms tend to have more complex agency problems so that a more stringent Good Corporate Governance mechanism is needed. The second view is that firms with smaller scale tend to have better growth opportunities so that more external funding is needed. The need for more external funds can only be achieved if smaller-scale companies have good mechanisms for implementing Good Corporate Governance. Waseem et al. (2011) stated in his research that firm size has a positive effect on the GCG mechanism. Firms with a larger size tend to be a public concern than firms with small scale. This encourages firms with a larger scale to implement better Good Corporate Governance. Based on the information above, the following hypothesis can be developed:

H2: Ukuran perusahaan Berpengaruh Positif Terhadap Mekanisme GCG

Firm Size and Corporate Social Responsibility Disclosure

Legitimacy theory explains that there is a link between firm size and CSR disclosure area. The results of the study conducted by Gray et al. (1995) concluded that large firms have a lot of operational activities, thus causing greater social and environmental impacts compared to small firms. This brings large firms to disclose a broader scope of social information. Large firms also theoretically face a greater political risk when carrying out social responsibility to gain attention in the community (Sembiring 2005). In addition, large firms will also experience the pressure of shareholder attention to social programs made by the firm so that the disclosure of corporate social responsibility is increasing. However, this differs from research conducted by Ebringa et al. (2013) which states that firm size has a negative effect on CSR. From the description above, the following hypothesis can be formulated:

H3: Firm Size Has Positive Impact On CSR Disclosures

Good Corporate Governance Mechanism and *Corporate Social Responsibility Disclosure*

In accordance with agency theory assumptions, firm which has separated management and ownership functions are vulnerable to agency problems, where agency problems have a negative relationship with firm performance. Jensen and Meckling (1976) argue that one way to reduce agency conflict is by implementing Good Corporate Governance. The better corporate governance, the more productive managers actions to improve firm performance. In the application of good corporate governance there is transparency principle. One form of transparency is the widespread disclosure of information about the firm's social responsibility.

In addition, Murwaningsari (2012) argues that companies with good governance will also give a positive response to binding rules, one of which is article 74 paragraph 1 and article 66 paragraph 2 of Law No. 40 of 2007 concerning Limited Liability Companies which obliged companies to submit information regarding corporate social responsibility. Harjoto and Jo (2011) in their research showed that managerial ownership as a proxy for Good Corporate Governance had a significant positive effect on CSR. But in a study conducted by Razak and Mustapha (2013) and Javed (2012) no relationship was found between GCG and CSR. From the description above, the hypothesis can be drawn as follows:

H4: GCG mechanism is positively related to CSR disclosure

Good Corporate Governance Mechanism and Firm Performance

Corporate governance is a system that regulates and controls firm activities in order to improve firm performance (Shleifer and Vishny, 1997). Investors tend to avoid firms with bad predicate in corporate governance. Investors believe that firms that implement good corporate governance mechanisms have sought to reduce the risk, thereby increasing the firm's financial performance. The research by Ahmed and Hamdan (2015) provides empirical evidence that the greater size of the board of directors, the stronger incentive to manage the firm. Therefore they have the potential to influence firm performance. Good management by the board of directors will reduce agency problems. Mashitoh (2013) found empirical evidence that a larger sized board of commissioners will produce more objective decisions and realise the effectiveness of managing the company. Other research conducted by Coskun and Sayilir (2012), and Peters and Bagshaw (2014), found empirical evidence that the mechanism of GCG has no influence on financial performance. Likewise, Wardhana et al., (2017) found that GCG has no effect on stock returns. Based on the description, this hypothesis is proposed:

H5: GCG Mechanism is positively related to Firm Performance

***Corporate Social Responsibility Disclosure and* Firm Performance**

CSR is a form of commitment a business community makes to act ethically on an ongoing basis, to contribute to economic improvement, along with improving the quality of life of employees and their families as well as to improving the quality of the local community and the wider community. The sustainability of the firm will be guaranteed if the company pays attention to the social and environmental dimensions. A surrounding community resistance, in various places and times, has surfaced against the firms that do not pay attention to social, economic and environmental aspects of life. In contrast, good relations between the community and a firm will gather support from that community. This support is reflected in customer loyalty to the firm and employees who work optimally for the benefit of the firm, so as to improve firm performance (Saleh et al., 2011).

The statement is in line with the results of research conducted by Rajput et al., (2012), Ghelli, (2013) and Ahamed et al., (2014), which states that CSR has a positive effect on financial performance. While research conducted by Aras et al. (2010), and Mwangi and Jerotich (2013) alike, finds other results that CSR has no effect on financial performance. Based on this description, the hypothesis is proposed:

H6: CSR Disclosure is positively related to firm performance

Firm Size, Firm Performance, and Corporate Social Responsibility Disclosure

Large firms have larger assets and sales, so they have a greater environmental and social impact. Therefore, larger firms will make broader social responsibility disclosures to gain more social trust, and to guarantee the firm's sustainability (Gray et al. 1995). Large firms will also receive more attention from the market and stakeholders so they are required to pay more attention to their corporate social responsibility disclosure (Sembiring, 2005). Ghelli (2013) argues that when firms express broad social responsibility, it will guarantee a firm's sustainability. They will obtain broad support and legitimacy from the community. The company will also get a positive assessment from the market and stakeholders. Positive assessment by the market will build consumer confidence in the firm. Consumers are more loyal and trust the firm's products or services. Customer loyalty might increase a firm's sales and profits so that the firm's performance increases as well. From the explanation above which states that company size influences CSR and CSR influences company performance, conclusions can be drawn and an hypothesis is formulated as follows:

H7: Firm Size is positively related to firm performance, and CSR disclosure as an intervening variable.

Firm Size, Firm Performance, and Good Corporate Governance mechanism

Large firms have greater bargaining power than small firms. Large firms can obtain capital more easily to improve firm operations (Waseem et al. 2011). Meilic et al. (2014) stated that larger firms would improve performance more easily. The larger firm size will be noticed more by investors. Larger firms supported with good corporate governance are more capable of ensuring that their operation is running well and properly (Wiagustini and Ni Putu 2015). Other research conducted by Roziq and Herdian (2013) also states that the application of improved governance will always increase investor confidence in investing and improving firm performance. From the explanation above which states that firm size affects firm performance, firm size affects GCG, and GCG affects firm financial performance, conclusions can be drawn and the following hypothesis formulated:

H8: Firm Size Has a Positive Impact on Firm Performance with GCG Mechanism as an Intervening Variable

Firm Size, Firm performance, Good Corporate Governance mechanism, and Corporate Social Responsibility Disclosure

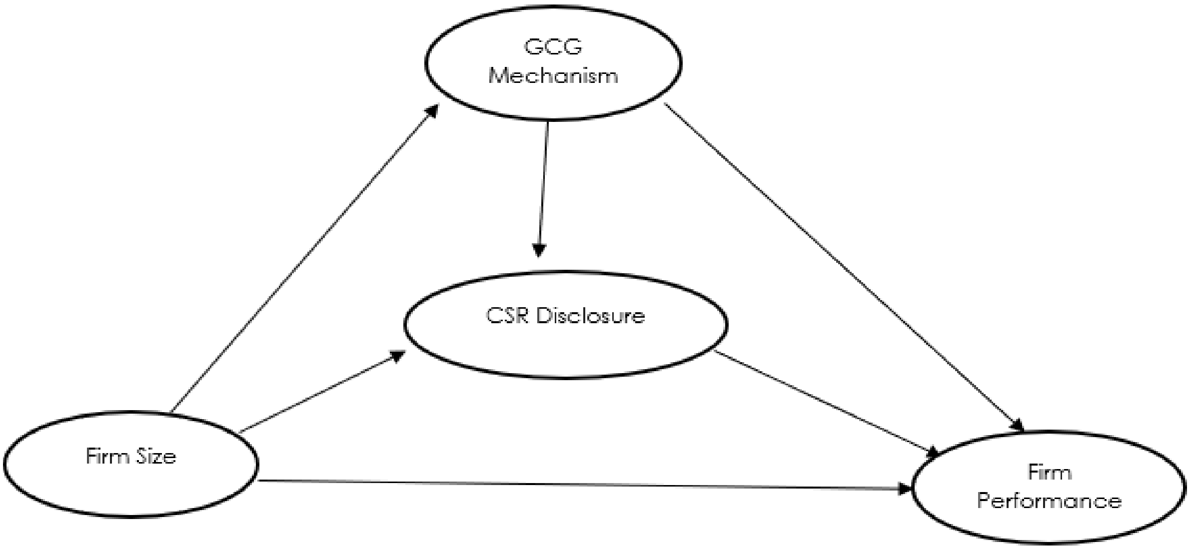
Bigger firm size brings more opportunities for information asymmetry, which may increase a firm's Agency Cost and reduce their performance. Large firms should be able to minimise information asymmetry by improving corporate governance. This is in line with the results of a study by Waseem et al. (2011) which states that firm size has a positive effect on good corporate governance. Firms with good governance will enter the public spotlight. Investors in these firms will encourage companies to expand their social responsibility disclosure (Murwaningsari, 2009). Disclosure of broader social responsibility will increase market and stakeholder confidence thereby increasing sales and facilitating corporate funding (Ahamed et al., 2014). Increased sales will increase profitability ratios as an indicator of firm performance. From the explanation above which states that firm size influences GCG, GCG influences CSR, and CSR influences firm financial performance, the next hypothesis is formulated as follows:

H9: Firm Size Has a Positive Impact on Firm Performance with GCG Mechanisms and CSR Disclosures as Mediation Variables

Methodology and Measurement

To test the hypotheses proposed in this study, we use secondary data of financial statements and annual reports attached to the Indonesian Stock Exchange (IDX). The sample in this study was composed of 130 companies in the manufacturing sector listed on the Indonesian Stock Exchange in 2016 (Non-Financial) which presented a full 2016 annual report and financial report. Based on the explanation that has been described, we propose a conceptual framework as follows:

Figure 1. Conceptual Framework



Variable Measurement

Firm Size

Firm size is measured by the natural logarithm of total sales and also the natural logarithm of the firm's total assets (Niresh and Velnampy, 2014).

$$Firm\ Size = Ln\ (Total\ asset)\ or\ Ln\ (Total\ Sales)$$

Firm Performance

Financial performance in this study is defined as the firm's ability to manage and control its resources (Hamid and Elvin, 2016; Utama & Mirhard, 2016; Harymawan et al., 2019). Widiyanti et al., (2019) states that firm performance is a measurement that shows the success of a firm’s management in achieving their goals. Here are 2 (two) proxies of financial performance used in this study:

$$ROA = \frac{Net\ Profit}{Total\ Asset}$$

and

$$ROE = \frac{Net\ Profit}{Total\ Equity}$$

Good Corporate Governance Mechanism

Good Corporate Governance in this study is defined as a set of regulations governing the relationship between shareholders, creditors, the government, employees and other internal and external stakeholders relating to their rights and obligations to regulate and control the company (FCGI). The GCG mechanism variable used consists of 6 (six) proxies, such as board of commissioners size, board of directors size, the ratio of independent commissioners, the audit committee ratio, institutional ownership, and audit quality. The Board of Commissioners size is measured using the number of BOC members of a company (Elvin and Hamid, 2016; Andriana and Pangabean, 2017). The Audit Committee is measured by counting the number of audit committee members in the firm's annual financial statements listed in the corporate governance report (Andriana and Pangabean, 2017). Institutional Ownership is measured using the proportion of total share ownership by other institutions compared to the number of shares outstanding (Elvin and Hamid, 2016). Audit quality is measured using a dummy variable, ie. clients audited by the big four KAP will be given a value of 1, while clients that are audited by a non-big four KAP will be given a value of 0.

Corporate Social Responsibility

CSR variables in this study will be measured using Global Reporting Initiative (GRI) index. The checklist method is carried out to see the disclosure of social responsibility by the firm. Firms that disclose social responsibility items will be given a value of 1, while those who do not disclose are given a value of 0 (Sudana and Arlindania, 2011). The CSR index of each firm is obtained by summing the items rating of each firm divided by the number of performance indicator items determined by GRI. The formula used in this study is:

$$CSRD = \frac{\sum ij}{Nj}$$

CSRD	: Corporate Social Responsibility Disclousure
$\sum ij$	: Number of items disclosed by the firm
Nj	: The number of items that should be disclosed

Result and Structural Model

In this study, we use convergent validity, composite reliability and average variance extracted (AVE) to measure reliability and assess the validity of each discriminant (Sholihin and Ratmono, 2013: 67). In convergent validity testing, the main thing that must be met is the loading factor of each indicator – it must be greater than 0.70 so that it might be determined as valid. If the loading factor has a value between 0.40 - 0.70, the indicator must be retested to see the effect of the indicator removal on AVE and composite reliability. The limits for each are 0.50 and 0.70 (Sholihin and Ratmono, 2013: 66-67). Table 1 below shows the results of combined cross-loading between constructs.

Table 1: Combined Loading of Construct Result

Construct	Item	Loading Factor	Category
Firm Size	Ln asset	0,951	Reliable
	Ln Sales	0,951	Reliable
GCG Mechanism	Uk. Directors	0,840	Reliable
	Uk. Commissioner	0,850	Reliable
	Audit Quality	0,502	Unreliable
	Independent Commissioner	-0,258	Unreliable
	Audit Committee	-0,334	Unreliable
CSR Disclosure	Economy	0,395	Unreliable
	Environment	0,771	Reliable
	Social	0,736	Reliable
	Product	-0,078	Unreliable
Firm Performance	ROA	0,865	Reliable
	ROE	0,865	Reliable

The results above show that not all variables have a value above the required loading factor limits. These items include KI, KA, KIND, KOMA, EKO, PROD which must be excluded before calculating AVE and Composite Reliability. The results after excluding items that do not meet the convergent validity are presented in Table 2 below:

Table 2: Hasil Combined Loading, AVE, and Composite Reliability

Construct	Item	Loading Factor	AVE	Composite Reliability	Category
Uk. Perusahaan	Ln asset	0,951	0,951	0,949	Reliable
	Ln Sales	0,951			Reliable
Mekanisme GCG	Uk. Directors	0,840	0,904	0,900	Reliable
	Uk. Commissioners	0,850			Reliable
Pengungkapan CSR	Environment	0,771	0,570	0,769	Reliable
	Social	0,736			Reliable
Kinerja Perusahaan	ROA	0,865	0,865	0,856	Reliable
	ROE	0,865			Reliable

Based on the results above, all the variables listed have met the provisions of validity and reliability. The composite reliability value of the four variables in sequence is 0.949; 0,900; 0.919; 0.769 and 0.856. While the AVE value of each variable in sequence is 0.951; 0.904; 0.570; 0.865. Thus, we conclude that composite reliability and discriminant validity are acceptable.

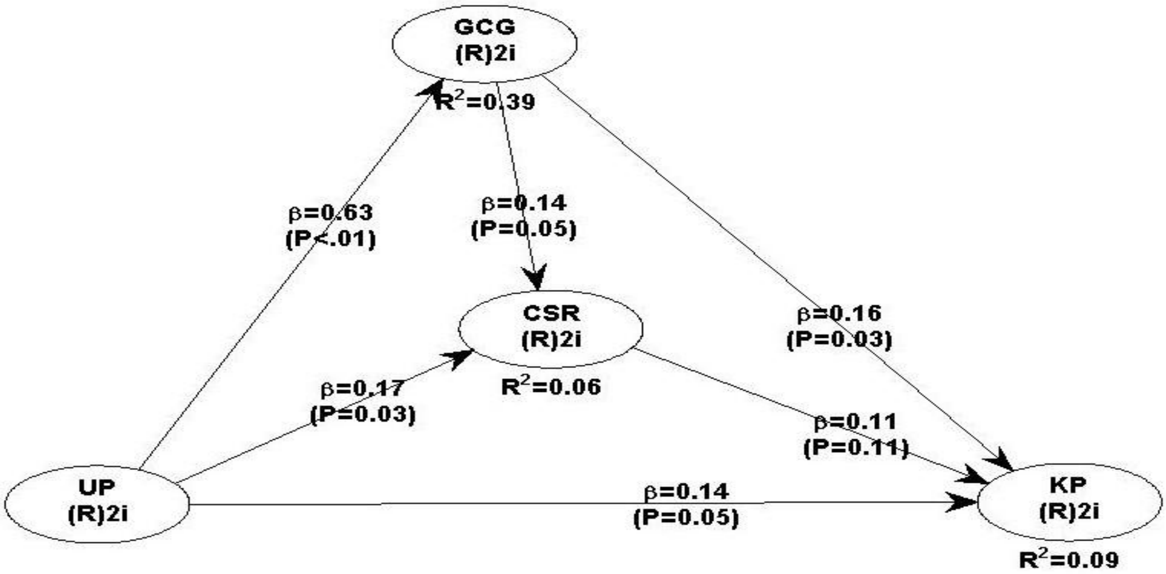
Hypothesis Testing

In this study, we use structural equation modelling (SEM) in developing conceptual frameworks and evaluating the hypothesis. In addition, we use the WarpPLS application version 6.0 for Windows © to do the analysis. Mainly, the researcher looks at the direct effect of company size on firm performance before the inclusion of mediation variables. The results obtained are as follows:

Figure 2. Direct Effect

This figure shows that the direct effect between firm size (UP) on firm performance (KP) is positive and significant with a coefficient value of 0.23 and p value <0.01, meaning that hypothesis 1 is accepted. Furthermore, we, the researchers used the full model by entering two mediating variables, namely the GCG mechanism and CSR disclosure. The processed results are as follows:

Figure 3. Full Model indirect Effect



From these pictures, conclusions can be drawn as set out in the following table:

Table 3: Structural Model Result

Full Models								
Variabel	Path to				Path to			
	GCG		KP		CSR		KP	
	ß	P value	ß	P value	ß	P value	ß	P value
UP	0,63	(<0,01)	0,14	(0,05)	0,17	(0,03)	0,14	(0,05)
GCG			0,16	(0,03)	0,14	(0,05)		
CSR							0,11	(0,11)
R^2	0,392		0,086		0,062		0,086	

Based on the table we have some information that can determine whether the hypotheses proposed in this study are accepted or rejected:

Hypothesis 2 is accepted, that Firm Size (UP) has a positive effect on the GCG mechanism Hypothesis 3 is accepted, that Firm Size (UP) has a positive effect on CSR Disclosures with Hypothesis 4 is accepted, that the GCG mechanism has a positive influence on CSR Disclosures. Hypothesis 5 is accepted, that the GCG mechanism has a positive effect on Firm Performance (KP). Hypothesis 6 is rejected, that CSR disclosure has no effect on Firm Performance (KP). Hypothesis 7 is accepted, that the indirect effect of UP to KP by mediating Good Corporate Governance (GCG) shows a significant indirect effect of Path Coefficients.

Table 4: P values of indirect effect for path with 2 segments

	UP	CSR	GCG	KP
UP				
CSR	0,078			
GCG				
KP	0,090*		0,407	

Based on the VAF calculation in Table 4, it can be stated that the GCG mechanism mediates some of the influence between company size on company performance because the VAF value is 0.304 or 30.4% which means above 20% and below 80%.

Table 5: VAF Calculation of Hypothesis 7

Indirect Effect	0,63 x 0,16 = 0,018
Direct Effect	0,23
Total Effect	0,3308
VAF (Indirect Effect / Total Effect)	0,3308 / 0,1008 = 0,304

Hypothesis 8 is rejected. The indirect effect of UP to KP by mediating CSR Disclosure shows the insignificant indirect effect of Path Coefficients and p-values from UP to CSR of 0.17 and 0.03 while Path Coefficients and p-values of CSR to KP by 0.11 and 0.11. Hypothesis 9 is also rejected. The direct effect from UP to KP shows a significant effect of 0.23 with a p value of 0.01. After puting GCG and CSR variables into the model to identify indirect effects, namely UP to GCG, GCG to CSR, CSR to KP. The indirect effect with the path is not significant because the CSR path to the KP Path coefficients and p values are 0.11 and 0.11 (p> 0.1). This is supported by the P values of indirect effects for paths with 3 segments showing no significant effect that is equal to 0.429. Therefore hypothesis 9 is also rejected.

Conclusion

In this study, we examine the relationship between firm size and firm performance by including two intervening variables, namely the GCG mechanism and CSR Disclosure. The results show that firm size has a positive effect on the mechanism of GCG and CSR Disclosure. Firm size and GCG mechanism also have a positive effect on company performance, while CSR disclosure has no effect on firm performance. GCG mechanism influences CSR disclosure. This study also proves that the mechanism of GCG can mediate the influence of firm size on firm performance. This study also shows that CSR disclosure cannot mediate the effect of firm size on performance, therefore GCG mechanism and CSR disclosure simultaneously cannot mediate the effect of firm size on firm performance.

This study has several limitations. Firstly, there are invalid indicators in the GCG mechanism variables, namely independent commissioners (KOMIND), audit committees (KOMA), audit quality (KA), and institutional ownership (KI). Other invalid indicators are CSR disclosure indicators namely Product dimension (PROD) and Economic dimension (EKO). Secondly, not all manufacturing companies listed on the Indonesian Stock Exchange are research samples. There are 13 companies that do not meet the criteria. Finally, we hope this research can be useful for employees, policy makers, researchers, and practitioners, and can be a reference for future research.

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