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The Effect of Corporate Governance on Financial Performance with the Company Size as a Moderating

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Abstract: **Ii Agency conflict can cause a decline in the company's financial performance. Agency theory states that the application of corporate governance can minimize agency conflicts and can improve corporate financial performance. This study aims to obtain empirical evidence of the influence of corporate governance on financial performance with company size as a moderating variable. This research was conducted on companies listed in the Kompas 100 index in 2017-2018. The sample research method used was purposive sampling. The number of companies that met the criteria was 74 companies with 148 observations. Data analysis techniques used are confirmatory factor analysis and Moderated Regression Analysis. Based on the results of the study note that corporate governance and company size have a positive effect on the company's financial performance. The study also found that company size strengthened the influence of corporate governance on the company's financial performance. The results of this study support the agency theory which states that the application of corporate governance can improve corporate spatial performance.**

Keywords: **Corporate governance, agency theory, company size and financial performance.**

I. INTRODUCTION

Kompas 100 is an index that is officially published by the Indonesia Stock Exchange (IDX) in collaboration with the Kompas newspaper. The Kompas 100 index consists of 100 shares of public companies traded on the Indonesia Stock Exchange. This index measures the price performance of 100 stocks that have good liquidity and large market capitalization. The selected stocks to be included in the Kompas 100 index in addition to having high liquidity, as well as a large market capitalization value, are also stocks that have good fundamentals and performance (Djumena, 2019).

Behind good fundamentals and good performance, it turns out that there are several out of 100 companies included in the Kompas 100 Index experiencing liquidity problems until they are declared bankrupt.

The case of PT Tiga Pilar Sejahtera and PT Waskita Karya is an example of a company included in the Kompas 100 index where there is agency conflict in it. Company management has its own interests outside the interests of its shareholders. The two companies did not implement good corporate governance (Indriati, 2018).

The mechanism of controlling ownership and disclosure in corporate governance can be used in reducing agency conflicts within the company (Rahayu, Nurdiwaty, and Solikah, 2018). Managerial ownership mechanisms, institutional ownership and the size or number of boards can reduce conflicts of interest between stakeholders and increase investor confidence (Ayem, 2016).

According to research conducted by Lutfi (2017), Kusumaningrum (2018), Yusuf (2018) and Malik and Makhdoom (2016) state that institutional ownership, managerial ownership, independent board of commissioners and audit committee have a positive effect on the company's financial performance. In contrast to research conducted by Syofria and Rima (2018), Assenga et al (2018) and Destriana et al (2015) stated that institutional ownership, managerial ownership, independent board of commissioners and audit committees had no effect on the company's financial performance.

Based on the description of the results of the study, it is still found differences in the results of research from previous researchers due to other factors outside the research model that can affect financial performance. This difference resulted in researchers wanting to re-examine the effect of corporate governance by adding the company size variable as a

moderating variable. The choice of company size as a moderating variable intends to test whether this variable can later strengthen or weaken corporate governance on financial performance. The greater the size of the company, there is a tendency that more investors are attracted to the company because it is considered to have a more stable financial condition (Novisheila, 2019). The purpose of this research is to empirically examine the effect of corporate governance on financial performance by adding company size as a moderating variable.

Agency theory is a theory that is built based on the agency relationship between agent and principal. According to Jensen and Meckling, the agency relationship is defined as an agreement, where there are one or more principal parties who employ agents, where agents are expected to be able to perform several services on behalf of principals (D. W. Utami & Syafruddin, 2015). The existence of agency conflict makes the principal necessary to supervise and control the agent's behavior to match what is expected by the principal (Bhat, Chen, Jebran, & Bhutto, 2018). Corporate governance is one way that shareholders can use to monitor and control agent behaviour (Putri & Sukartha, 2016). Corporate governance can be used to reduce the possibility of management to increase their interests by using information asymmetry. Supervision tools such as corporate governance, facilitate the alignment of interests between shareholders and management (Gunawan, 2015). Alignment of the interests of both parties will reduce the company's agency costs and will certainly improve company performance (Schäuble, 2019).

Based on agency theory, corporate governance is one way that shareholders can use to monitor and control agent behavior (Putri & Sukartha, 2016). According to research conducted by Rahayu (2018), Asna (2017) and Lutfi et al (2017), Kangmartono et al (2018), Indriati (2018) and Rahmawati (2017) state that institutional ownership, managerial ownership, independent board of commissioners and the audit committee has a positive effect on financial performance.

H1: Corporate governance has a significant positive effect on financial performance.

Based on the theory of a company signal that has a larger size will try to create good performance to be reported on the financial statements. This is because the size of the company will always try to provide good information related to the condition of the company as a signal used for the basis of investment decision making from investors (Putra and Sumadi, 2019). Research conducted by Hendratni et al (2018), Maharani (2018) and Azzahra and Fate (2019) support the theory where the results of the study state that firm size has a positive effect on the company's financial performance

H2: Company size has a positive effect on financial performance.

Based on signal theory, management will try to give a signal to investors about information about the company. The larger the company will give a strong impetus to management to provide correct information and avoid information asymmetry between management and users of financial statements. The bigger the company, the company will implement good corporate governance by supervising (Putra and Sumadi, 2019). The greater the size of the company shows the company is experiencing growth. Companies that develop and implement good corporate governance will improve company performance and respond positively by investors (Lestari & Wirawati, 2018). According to research conducted by Putra and Sumadi (2019) states that company size strengthens the influence of corporate governance on financial performance.

H3: Firm size reinforces the influence of corporate governance on financial performance.

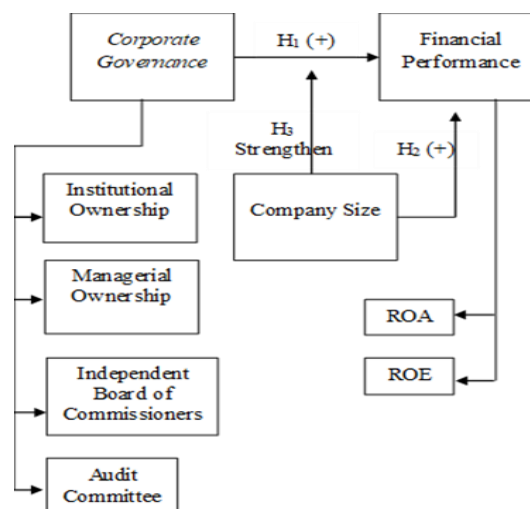

Figure 1: Conceptual Framework

II. RESEARCH METHODS

This research uses a quantitative approach in the form of associative. The location of this research is on the Indonesia Stock Exchange (IDX). IDX was chosen as a research location because IDX has complete and well-organized financial statement data. The object of this research is corporate governance which is proxied by institutional ownership, managerial ownership, the composition of independent commissioners and the composition of the audit committee. Secondary data in this study are the annual financial statements of companies listed on the Kompas 100 index in 2017-2019. The population in this study are companies included in the Kompas 100 index in 2017-2019. The sample in this study used a probability sampling technique with a purposive sampling method in which the company was selected with certain conditions, namely: Listed as Kompas 100 index companies in 2017-2018, published annual financial statements in 2017-2018, had data regarding institutional ownership, managerial ownership, independent board of commissioners and audit committee. Based on the sampling criteria, a sample of 74 companies was obtained with 148 observations. The data analysis technique used in this study is Moderated Regression Analysis (MRA). MRA is a special application of multiple linear regression, which in its regression equation contains the element of interaction or multiplication between two or more independent variables (Novisheila, 2019). Data will be analyzed with the help of the Statistical Package for Social Science (SPSS) program.

III. RESULT AND DISCUSSION

Confirmatory factor analysis is used to project corporate governance with indicators of institutional ownership, managerial ownership, independent board of commissioners and audit committee. It also looks for factors that project financial performance with indicators of return on assets (ROA) and return on equity (ROE).

Table 1: KMO Test Results

		Corporate governance variable	Financial Performance Variable
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0,544	0,500
Bartlett's Test of Sphericity	Approx. Chi-Square	22,338	106,879
	df	6	1
	Sig.	0,001	0,000

Source: Research data, 2020

The test results shown in Table 1 show the Kaiser-Meyer-Olkin (KMO) value of 0,544 is greater than 0.5. This concludes that all indicators of corporate governance, namely institutional ownership, managerial ownership, independent board of commissioners and audit committee have sufficient samples for factor analysis, making it feasible to continue testing. Financial performance indicators that ROA and ROE also has sufficient samples for the analysis of factors, making it feasible to continue testing.

Table 2: MSA Values for Corporate Governance Variables

		KI	KM	IND	KA
Anti-image Correlation	KI	0,501a	0,045	0,022	0,029
	KM	0,045	0,646a	0,085	0,102
	IND	0,022	0,085	0,534a	-0,330
	KA	0,029	0,102	-0,330	0,533a

Source: Research data, 2020

Table 3: MSA Values for Financial Performance Variables

		ROA	ROE
Anti-image Correlation	ROA	0,500a	-0,721
	ROE	-0,721	0,500a

Source: Research data, 2020

In Tables 2 and 3 the MSA values of each variable are greater than 0,5. This means that each corporate governance ratio and financial performance deserve to be used for further analysis.

Table 4: Communalities Values for Corporate Governance Variables

	Initial	Extraction
KI	1,000	0,826
KM	1,000	0,509
IND	1,000	0,602
KA	1,000	0,613

Source: Research data, 2020

Table 4 shows that all the values of communalities in the study indicators have values greater than 0,5. In the Communalities table the KI indicator has a figure of 0,826 meaning 82,6% of the variance of the corporate governance variable can be explained by the institutional ownership factor (KI) formed, as well as other variables. Because the KI ratio has the highest communalities value compared to the KM, IND and KA ratios, the KI ratio is appropriate to be used to represent corporate governance variables.

Table 5: Value of Communalities for Financial Performance Variables

	Initial	Extraction
ROA	1,000	0,861
ROE	1,000	0,861
Extraction Method: Principal Component Analysis.		

Source: Research data, 2020

Table 5 shows that all the values of communalities in the study indicators have values greater than 0,5. In the communalities table the ROA and ROE indicators have a figure of 0,861, meaning that 86,1% of the variance of financial performance variables can be explained by the ROA and ROE factors formed. Because the value of communalities of ROA and ROE is the same, then to choose the best ratio in measuring financial performance, it is seen from the Percentage of Variance value.

Table 6: Percentage of Variance Values for Corporate governance

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative%	Total	% of Variance	Cumulative%
ROA	1,721	86,065	86,065	1,721	86,065	86,065
ROE	0,279	13,935	100,000			

Source: Research data, 2020

The total initial eigen value indicates the relative importance of each factor in calculating the variance of each indicator to be analyzed. The composition of the eigen value is always sorted from large to small, with the criterion that the number of eigen values below one is not used to count the number of factors formed. From table 6, it can be seen that there is one factor formed, this can be seen from the eigen value of a factor greater than one, while the next factor has an eigen value less than one, so it is not taken into account in this process. Therefore, what is taken into account for the analysis of company performance in this study is the first factor, namely ROA. The value of the Percentage of Variance ROA ratio is appropriate to be used to represent financial performance variables.

Table 7: Normality Test Results

		Unstandardized Residual
N		148
Normal Parametersa, b	The mean	0,0000000
	Std. Deviation	0,85739333
Most Extreme Differences	Absolute	0,080
	Positive	0,080
	Negative	-0,067
Kolmogorov-Smirnov Z		0,969
Asymp. Sig. (2-tailed)		0,304

Source: Research data, 2020

The results of tests on the multiple linear regression equation in Table 7 show that the Asymp value. Sig (2-tailed) 0.304 is greater than the level of significant, which is 5 percent (0,05). So it can be concluded that the residual value in the regression model tested has normal distribution.

Table 8: Multicollinearity Test Results

Variable	Tolerance	VIF
Corporate governance	0,934	1,070
Company Size	0,934	1,070

Source: Research data, 2020

Based on Table 8 it can be seen that the VIF and Tolerance values, which show that there are no Tolerance values of more than 0,1 (10 percent) or VIF values less than 10. Therefore based on Tolerance and VIF values in the analysis model is not found the presence of multicollinearity symptoms.

Table 9: Autocorrelation Test Results

Dl	Du	DW	4-du	Conclusion
1,6902	1,7729	1,889	2,227	Free autocorrelation

Source: Research data, 2020

Table 9 shows the Durbin-Watson value of 1,869, then with a significance level of 5% and the number of samples as much as n = 148 and the number of variables tested as many as 3, the values of dl = 1,6902 and du = 1,7729 were obtained. Thus the results of the autocorrelation test with the criteria du <DW <4-du are 1,7729 <1,889 <2,227, it can be concluded that the regression model created does not contain the autocorrelation symptom.

Table 10: Heteroscedasticity Test Results

Variable	Significance	Conclusion
Corporate governance	0,160	Heteroscedasticity free
Company Size	0,448	Heteroscedasticity free
GCG Interactions * SIZE	0,187	Heteroscedasticity free

Source: Research data, 2020

Table 10 shows that the significance value of all independent variables and control variables in this study has a value greater than α = 0,05. Therefore, it can be concluded that there were no symptoms of heteroscedasticity in the data of this study.

Table 11: Results of Moderation Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	0,041	0,073		0,560	0,577
	Corporate governance	0,328	0,103	0,238	3,174	0,002
	Company Size	0,174	0,077	0,166	2,246	0,026
	GCG Interactions * SIZE	0,457	0,103	0,337	4,419	0,000

Source: *Research data, 2020*

Based on the results of the moderation regression analysis as presented in Table 11, then the structural equation can be formed as follows:

$Y = \alpha + \beta 1X + \beta 2Z + \beta 3XZ + e$

$Y = 0{,}041 + 0{,}328\ X + 0{,}174\ Z + 0{,}457XZ + e$

Table 11 shows that all variables have a positive regression coefficient, this means that all variables have a positive influence on financial performance variables.

Table 12: Determination Coefficient Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0,556a	0,309	0,294	0,86627847

Source: *Research data, 2020*

The test results give results in which the adjusted R2 is obtained (adjusted coefficient of determination) in table 12 is 0,294. This means that variations in financial performance can be significantly influenced by corporate governance variables (X), company size (Z), and interaction of corporate governance with company size (XZ) by 29,4 percent, while the remaining 70,6 percent is explained by factors other factors not explained in the research model.

Table 13: Test Results F

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	48,277	3	16,092	21,444	0,000a
	Residual	108,063	144	0750		
	Total	156,340	147			

Source: *Research data, 2020*

The results of the F test (F test) show that the calculated F value of 21,444 with a significance of P value 0,000 that is smaller than $\alpha = 0{,}05$, this means that the model used in this study is feasible. This result gives the meaning that all independent variables namely corporate governance (X), company size (Z), and interaction variables between corporate governance and company size (XZ) are able to predict or explain phenomena of financial performance. This means that simultaneously corporate governance (X), company size (Z), and interaction variables between corporate governance and company size (XZ) have a significant effect on financial performance.

The first hypothesis (H1) states that corporate governance has a significant positive effect on financial performance. Based on the results of the analysis of the influence of corporate governance on financial performance obtained a significance value of 0,002 with a positive regression coefficient of 0.328. Significance value of 0,002 <0,5 indicates that H1 was accepted. This result means that corporate governance has a positive and significant effect on financial performance.

The second hypothesis (H2) states that company size has a significant positive effect on financial performance. Based on the results of the analysis of the effect of company size on financial performance obtained a significance value of 0,026 with a positive regression coefficient of 0,174. The significance value of 0,026 <0,05 indicates that H2 was accepted. This result means that company size has a positive and significant effect on financial performance.

The third hypothesis (H3) states that company size strengthens the influence of corporate governance on corporate financial performance. Based on the analysis of the effect of corporate governance on financial performance with company size as a moderating variable, a significance value of 0,002 with a positive regression coefficient of 0,328 was obtained. The significance value of the moderating variable (β2) of firm size is 0,026 (significant) and the significant value of the interaction variable between corporate governance and company size (β3) is significant at 0,000, this indicates the moderating variable is a type of partial moderation (quasi moderation).

The results of the moderation regression analysis showed that the positive corporate governance regression coefficient (β1) was 0,328 and positive β3 was 0,457, which indicates a direct relationship, then the company size variable is a moderating variable that strengthens the effect of corporate governance on financial performance.

IV. CONCLUSION

Based on the results of the analysis and discussion presented in the previous chapter, it is concluded that corporate governance and company size have a positive effect on the company's financial performance. These results support the agency theory which states that the implementation of corporate governance in the company will minimize agency conflicts that occur and can improve the company's financial performance. These results also support the signal theory which states that company size can be a signal for investors so that the larger the company, the company will improve its financial performance. This study also found that company size strengthened the influence of corporate governance on corporate financial performance. These results explain that the larger the company, the company will increase supervision through the implementation of corporate governance so that the company's financial performance is also increasing. The limitation of this study is that the sampling was only on the Kompas 100 index and within a span of two years. The next researcher can expand the research location by covering indexes or other sector companies listed on the IDX and expanding the year of observation.

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