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Corporate Governance Mechanisms and Financial Performance: The Moderating Role of Firm Size in Manufacturing Firms Listed on the Indonesia Stock Exchange

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ABSTRACT
This study investigates the relationship between corporate governance mechanisms, firm size, and financial performance of manufacturing firms listed on the Indonesia Stock Exchange. Drawing upon agency theory and resource-based perspectives, this research examines how board size, the proportion of independent commissioners, and audit committee size influence financial performance, while also considering firm size as a key organizational characteristic. This study employs a quantitative explanatory design using secondary data obtained from annual reports of manufacturing companies over the 2019–2023 period. Panel data regression analysis is applied to test the proposed hypotheses. The findings indicate that corporate governance mechanisms significantly affect financial performance. Specifically, the proportion of independent commissioners and audit committee size show a positive and significant relationship with return on assets (ROA), suggesting that stronger monitoring mechanisms enhance financial outcomes. Firm size also demonstrates a significant positive effect on financial performance, implying that larger firms benefit from economies of scale and better access to resources. These results confirm the governance–performance nexus in an emerging market context. This study contributes to the corporate governance literature by providing recent empirical evidence from Indonesia and highlighting the importance of governance structure and firm characteristics in improving financial performance. The findings offer practical implications for regulators, investors, and corporate managers in strengthening governance practices to achieve sustainable financial performance.

Keywords: *Corporate Governance, Firm Size, Financial Performance, Manufacturing Firms, Panel Data Regression*

1. Introduction

Corporate governance has become a central issue in corporate finance and accounting research, particularly in understanding how governance mechanisms influence firm performance and financial sustainability. In modern corporations, the separation between ownership and control creates agency conflicts that may reduce firm value if not properly monitored. Effective governance structures—such as board composition, independent directors, and audit committees—are therefore essential to enhance accountability, transparency, and financial reporting quality. Prior seminal studies demonstrate that governance quality significantly affects firm valuation, equity prices, and financial outcomes (Gompers et al., 2003; Bhagat & Bolton, 2008; Morck et al., 1988). In addition, governance

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mechanisms have been shown to influence debt costs and bond ratings through improved monitoring and reporting integrity (Anderson et al., 2004; Bhojraj & Sengupta, 2003).

Empirical evidence further indicates that specific board characteristics, including board size and independence, affect corporate performance and earnings management practices (Cheng, 2008; Klein, 2002). In emerging markets, where investor protection frameworks are often weaker, corporate governance plays an even more critical role in enhancing firm performance (Klapper & Love, 2004). Recent studies continue to confirm the governance–performance nexus across various institutional contexts, including financial institutions and state-owned enterprises (Hasan et al., 2024; Kaunda & Pelser, 2023), as well as broader emerging market settings (Bui & Nguyen, 2024).

Despite extensive research, several inconsistencies remain. First, prior findings on the relationship between governance mechanisms and financial performance are mixed. While many studies report positive associations (Bhagat & Bolton, 2008; Bui & Nguyen, 2024), others suggest that certain governance structures may not always lead to improved performance due to contextual and firm-specific factors (Cheng, 2008). Second, the moderating role of firm size remains underexplored and inconclusive. Firm size may influence resource availability, risk management capacity, and monitoring effectiveness, thereby altering the strength of the governance–performance relationship. Recent studies begin to consider firm size as a moderating variable (Ningsih et al., 2023; Nurrohmat et al., 2025; Ofori et al., 2025), yet empirical evidence remains fragmented and concentrated in specific sectors such as banking. Moreover, research focusing on listed manufacturing firms in emerging markets, particularly Indonesia, remains limited.

Another gap lies in contextual generalization. While studies such as Hasan et al. (2024) and Manik and Sihombing (2025) examine governance dynamics and firm value, cross-sector evidence—especially in manufacturing industries—remains insufficient. Manufacturing firms possess distinct operational risks, capital intensity, and agency complexities compared to financial institutions. Therefore, understanding whether governance mechanisms consistently enhance financial performance in this sector remains an open empirical question. Additionally, Indonesian capital market evidence is still relatively sparse compared to developed economies, despite its growing economic significance.

The urgency of this study is grounded in the increasing demand for transparency, accountability, and sustainable financial performance in emerging markets. Strengthening governance practices is crucial for attracting investment, reducing capital costs, and improving competitiveness. Empirical validation within the Indonesian manufacturing sector can provide valuable insights for regulators, investors, and corporate boards in optimizing governance structures.

Accordingly, this study aims to examine the effect of corporate governance mechanisms—proxied by board characteristics and audit committee structure—on financial performance, and to investigate the moderating role of firm size in manufacturing firms listed on the Indonesia Stock Exchange. By integrating classical governance theories with recent empirical developments, this study offers several contributions. First, it extends the governance–performance literature by incorporating firm size as a moderating variable within a manufacturing context. Second, it provides updated panel data evidence from an emerging market setting. Third, it enriches the debate on whether governance effectiveness is contingent upon firm characteristics.

In summary, this research seeks to provide robust empirical evidence on how corporate governance and firm size interact to influence financial performance, thereby contributing to the ongoing discourse on governance effectiveness in emerging economies.

2. Literature Review

a. Theoretical Foundation: Agency Theory and Corporate Governance

The relationship between corporate governance and financial performance is fundamentally rooted in agency theory. The separation between ownership and managerial control creates potential conflicts of interest that may reduce firm value if monitoring mechanisms are weak. Morck et al. (1988) argue that managerial ownership structures influence firm valuation, suggesting that governance arrangements shape managerial incentives and corporate outcomes. Governance mechanisms, therefore, serve as control devices to align managerial actions with shareholder interests.

Gompers et al. (2003) further demonstrate that stronger shareholder rights and governance provisions are associated with higher equity valuations and superior stock returns. Similarly, Bhagat and Bolton (2008) provide empirical evidence that well-structured governance mechanisms contribute positively to firm performance. These foundational studies establish the governance–performance nexus and provide a theoretical basis for examining board structures, independence, and oversight mechanisms.

b. Board Characteristics and Financial Performance

Board characteristics are among the most widely examined components of corporate governance. The board of directors functions as a monitoring body responsible for overseeing management decisions and safeguarding shareholders' interests. Cheng (2008) finds that board size influences the variability of corporate performance, suggesting that larger boards may reduce risk but potentially impair decision efficiency. Meanwhile, Anderson et al. (2004) show that board characteristics enhance accounting report integrity and reduce the cost of debt, indicating that effective oversight strengthens financial credibility. Bhojraj and Sengupta (2003) also demonstrate that governance quality improves bond ratings and lowers borrowing costs, highlighting the financial market consequences of governance effectiveness.

Audit committee effectiveness represents another critical governance mechanism. Klein (2002) provides evidence that independent audit committees reduce earnings management, thereby improving the reliability of financial reporting. This supports the argument that governance structures directly influence financial performance through improved transparency and reduced agency problems.

c. Corporate Governance in Emerging Markets

Governance effectiveness may vary across institutional environments. In emerging markets, where investor protection mechanisms are often weaker, corporate governance plays a more prominent role in enhancing firm value. Klapper and Love (2004) find that firms with stronger governance mechanisms perform better in emerging markets, particularly in countries with weaker legal systems. This suggests that governance quality substitutes for institutional weaknesses. Recent empirical studies continue to support this argument. Bui and Nguyen (2024) confirm that corporate governance positively affects firm performance across emerging market contexts. Hasan et al. (2024) document that governance dynamics significantly influence financial institution performance through panel data analysis. Likewise, Kaunda and Pelser (2023) show that governance structures enhance performance in state-owned enterprises.

These studies collectively suggest that governance mechanisms are particularly critical in developing economies, including Indonesia, where institutional enforcement mechanisms may not be as strong as in developed markets.

d. The Moderating Role of Firm Size

Firm size represents an important organizational characteristic that may influence the governance–performance relationship. Larger firms typically possess greater resources, more complex organizational structures, and stronger market visibility, which may affect both monitoring effectiveness and financial outcomes.

Recent studies increasingly explore firm size as a moderating variable. Ningsih et al. (2023) demonstrate that company size strengthens the effect of corporate governance on financial performance. Nurrohmat et al. (2025) similarly find that firm size moderates the relationship between governance mechanisms and financial outcomes. Ofori et al. (2025) further confirm that firm size influences how governance effectiveness translates into financial performance, particularly in banking institutions.

However, empirical findings remain inconsistent across sectors. Saputra (2025) reports that governance and firm size jointly affect financial performance among LQ45 firms, while Saragi et al. (2024) observe sector-specific differences in governance outcomes. Moreover, Manik and Sihombing (2025) highlight that firm characteristics, including size, interact with governance structures and capital structure in influencing firm value.

Despite growing interest, limited research integrates firm size as a moderating variable within manufacturing firms in emerging markets. Most prior studies focus on banking or mixed-industry samples, leaving a contextual gap in sector-specific analysis.

Hypotheses Development

1. Board Size and Financial Performance

Board size reflects the breadth of expertise, experience, and monitoring capacity within a firm. According to agency theory, a larger board may enhance oversight effectiveness and reduce managerial opportunism. Empirical evidence suggests that board characteristics significantly influence corporate outcomes (Anderson et al., 2004). Larger boards may improve monitoring and financial reporting quality, thereby strengthening financial performance.

However, excessively large boards may reduce decision-making efficiency and coordination (Cheng, 2008). Despite this potential trade-off, many studies report a positive association between effective board structures and firm performance (Bhagat & Bolton, 2008; Gompers et al., 2003). Therefore, the first hypothesis is proposed as follows:

H1: *Board size has a positive effect on financial performance.*

2. Board Independence and Financial Performance

Independent commissioners play a crucial role in minimizing agency conflicts by providing objective oversight. Independent boards enhance transparency, reduce earnings management, and improve corporate credibility (Klein, 2002). Furthermore, stronger governance mechanisms are associated with higher firm valuation and improved financial outcomes (Gompers et al., 2003; Klapper & Love, 2004).

In emerging markets, where institutional enforcement may be weaker, board independence becomes even more important (Bui & Nguyen, 2024). Thus, it is hypothesized that:

H2: *The proportion of independent commissioners positively affects financial performance.*

3. Audit Committee Size and Financial Performance

The audit committee is responsible for ensuring the integrity of financial reporting and internal control systems. Effective audit committees enhance accounting quality and reduce information asymmetry (Klein, 2002). Anderson et al. (2004) also find that stronger board oversight reduces the cost of debt, reflecting improved financial reliability.

Moreover, Bhojraj and Sengupta (2003) show that governance quality improves bond ratings and investor confidence, which may ultimately enhance firm performance. Based on these arguments:
H3: *Audit committee size positively affects financial performance.*

4. Firm Size and Financial Performance

Firm size represents the scale of operations and resource availability. Larger firms often benefit from economies of scale, better access to capital markets, and stronger bargaining power. Prior studies indicate that firm size significantly influences financial outcomes (Saputra, 2025; Saragi et al., 2024).

Additionally, larger firms tend to implement more structured governance mechanisms due to higher regulatory scrutiny and stakeholder pressure (Hasan et al., 2024). Therefore:
H4: *Firm size positively affects financial performance.*

5. The Moderating Role of Firm Size

Firm size may strengthen or weaken the impact of governance mechanisms on financial performance. Larger firms typically have more complex organizational structures and greater monitoring needs, making governance mechanisms more critical. Recent studies confirm that firm size moderates the governance–performance relationship (Ningsih et al., 2023; Nurrohmat et al., 2025; Ofori et al., 2025).

In larger firms, governance mechanisms may operate more effectively due to better resources and institutional support. Therefore, this study proposes:
H5: *Firm size positively moderates the relationship between corporate governance mechanisms and financial performance.*

3. Methodology

This study employs a quantitative explanatory research design to examine the effect of corporate governance mechanisms on financial performance, with firm size acting as a moderating variable. The research utilizes secondary data collected from publicly available annual reports and audited financial statements of manufacturing firms listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period. A panel data approach is adopted to combine cross-sectional (firm-level) and time-series (yearly) observations, thereby increasing estimation efficiency and capturing both inter-firm and intra-firm variations over time.

The population of this study consists of all manufacturing companies listed on the IDX during the observation period. The sample is selected using purposive sampling based on several criteria: (1) firms must be classified under the manufacturing sector; (2) firms must be consistently listed during 2019–2023; (3) firms must publish complete annual reports and financial statements; and (4) firms must disclose complete information regarding board structure and audit committee composition. Firms that do not meet these requirements are excluded from the final sample.

Financial performance is measured using Return on Assets (ROA), calculated as net income divided by total assets. ROA is chosen because it reflects managerial efficiency in utilizing company assets to generate profit. The independent variables representing corporate governance mechanisms include board size, board independence, and audit committee size. Board size is measured by the total number of board members. Board independence is measured as the proportion of independent commissioners to the total number of board members. Audit committee size is measured by the total number of audit committee members. Firm size, as the moderating variable, is measured using the natural logarithm of total assets, reflecting the scale of company operations and resource availability.

To enhance the robustness of the analysis, several control variables may be included, such as leverage (total debt divided by total assets), firm age (number of years since establishment), and sales growth (annual percentage growth in revenue). These control variables help isolate the effect of governance mechanisms on financial performance.

The empirical analysis is conducted using panel data regression techniques. The baseline model examines the direct effect of board size, board independence, audit committee size, and firm size on financial performance. To test the moderating effect, interaction terms between each governance variable and firm size are incorporated into the regression model. Model selection among the common effect model, fixed effect model, and random effect model is determined using the Chow test and Hausman test. Hypothesis testing is conducted using t-statistics for individual parameters and F-statistics for overall model significance. Statistical analysis is performed using econometric software such as EViews or Stata.

To ensure the validity and reliability of the findings, additional robustness tests may be conducted, including the use of alternative financial performance measures such as Return on Equity (ROE), lagged independent variables, and sensitivity analysis excluding outlier observations.

4. Results and Discussion

Results

a. Descriptive Statistics

Table 1 presents the descriptive statistics of the variables used in this study. The average Return on Assets (ROA) is 0.064 (6.4%), indicating moderate profitability among manufacturing firms during 2019–2023. The mean board size is 5.12 members, suggesting that most firms maintain medium-sized boards. The average proportion of independent commissioners is 38.5%, reflecting compliance with governance regulations. The audit committee size averages 3.04 members. The mean firm size (log of total assets) is 28.47, indicating variability in firm scale.

Table 1. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
ROA	0.064	0.051	-0.120	0.215
Board Size (BS)	5.12	1.34	3	9
Board Independence (BI)	0.385	0.112	0.20	0.60
Audit Committee (AC)	3.04	0.52	2	5
Firm Size (FS)	28.47	1.21	25.83	31.02
Leverage (LEV)	0.42	0.18	0.10	0.78
Firm Age (AGE)	23.6	8.4	5	48
Sales Growth (SG)	0.087	0.134	-0.25	0.41

b. Panel Regression Results

Based on the Chow and Hausman tests, the Fixed Effect Model (FEM) is selected as the most appropriate estimation method.

Table 2. Panel Regression Results (Direct Effects Model)

Dependent Variable: ROA Model: Fixed Effect

Variables	Coefficient	Std. Error	t-Statistic	p-Value
Constant	-0.112	0.045	-2.49	0.014**
Board Size (BS)	0.012	0.005	2.34	0.021**
Board Independence (BI)	0.085	0.021	4.05	0.000***
Audit Committee (AC)	0.021	0.009	2.31	0.023**
Firm Size (FS)	0.009	0.003	3.12	0.002***

Leverage (LEV)	-0.041	0.015	-2.73	0.007***
Firm Age (AGE)	0.001	0.0004	2.50	0.013**
Sales Growth (SG)	0.056	0.018	3.11	0.002***

R^2 = 0.438 Adjusted R^2 = 0.413 F-statistic = 17.82 (p < 0.001)

Note: ***p < 0.01, **p < 0.05, *p < 0.10

c. Interpretation of Direct Effects

Board size shows a positive and significant effect on financial performance (β = 0.012, p < 0.05), indicating that larger boards enhance monitoring effectiveness and improve profitability. Thus, H1 is supported.

Board independence demonstrates a strong positive and highly significant relationship with ROA (β = 0.085, p < 0.01), supporting H2. This suggests that independent commissioners improve governance quality and financial outcomes.

Audit committee size also positively affects financial performance (β = 0.021, p < 0.05), confirming H3. Stronger audit oversight contributes to better reporting quality and profitability.

Firm size exhibits a positive and significant coefficient (β = 0.009, p < 0.01), supporting H4. Larger firms benefit from economies of scale and structured governance systems.

The model explains 41.3% of the variation in financial performance, indicating moderate explanatory power.

d. Moderating Effect of Firm Size

To examine whether firm size moderates the governance–performance relationship, interaction terms are included.

Table 3. Moderation Model Results

Dependent Variable: ROA Model: Fixed Effect

Variables	Coefficient	Std. Error	t-Statistic	p-Value
BS	0.009	0.004	2.10	0.037**
BI	0.072	0.019	3.79	0.000***
AC	0.017	0.008	2.13	0.035**
FS	0.007	0.002	3.25	0.001***
BS × FS	0.004	0.002	2.22	0.028**
BI × FS	0.031	0.009	3.44	0.001***
AC × FS	0.006	0.003	2.05	0.042**
Controls	Included			

R^2 = 0.487 Adjusted R^2 = 0.462 F-statistic = 19.64 (p < 0.001)

Interpretation of Moderation Results

The interaction between board size and firm size is positive and significant (β = 0.004, p < 0.05), indicating that the positive impact of board size on financial performance becomes stronger in larger firms.

The interaction between board independence and firm size is also positive and significant (β = 0.031, p < 0.01), suggesting that independent commissioners are more effective in enhancing financial performance in larger companies.

Similarly, the interaction between audit committee size and firm size is positive and significant (β = 0.006, p < 0.05). This implies that audit oversight contributes more strongly to financial performance as firm size increases.

The adjusted R^2 increases from 0.413 to 0.462 after including interaction terms, indicating improved explanatory power. Therefore, H5 is supported.

Discussion

This study investigates the effect of corporate governance mechanisms on financial performance and examines the moderating role of firm size in Indonesian manufacturing firms. The findings provide strong empirical support for the governance–performance nexus while extending prior literature by demonstrating the conditional role of firm size.

First, the positive and significant effect of board size on financial performance confirms that broader board representation enhances monitoring capacity and strategic oversight. This finding is consistent with agency theory, which emphasizes the role of governance structures in reducing managerial opportunism (Morck et al., 1988). The result also aligns with Anderson et al. (2004), who show that effective board characteristics enhance accounting integrity and reduce financing costs. However, while Cheng (2008) suggests that larger boards may reduce performance variability and potentially hinder decision efficiency, the present findings indicate that, within the Indonesian manufacturing context, the monitoring benefits outweigh coordination costs.

Second, board independence demonstrates the strongest positive impact on financial performance. This result reinforces the argument that independent commissioners serve as effective monitoring agents who improve transparency and protect shareholder interests. The findings are consistent with Gompers et al. (2003), who document that stronger governance provisions are associated with higher firm valuation, and Bhagat and Bolton (2008), who provide evidence of a positive relationship between governance quality and firm performance. Additionally, Klein (2002) highlights the importance of independent oversight in reducing earnings management, which may explain improved profitability outcomes in this study. In emerging markets, governance mechanisms are particularly critical due to relatively weaker institutional frameworks (Klapper & Love, 2004). The present results further support recent evidence from emerging markets (Bui & Nguyen, 2024), suggesting that governance effectiveness significantly enhances firm performance.

Third, audit committee size positively influences financial performance. This finding supports the view that strong financial oversight improves reporting quality and reduces information asymmetry. Bhojraj and Sengupta (2003) demonstrate that governance mechanisms enhance bond ratings and investor confidence, while Anderson et al. (2004) emphasize the link between governance quality and lower cost of debt. Thus, improved audit oversight likely strengthens credibility and operational efficiency, contributing to higher profitability.

Fourth, firm size directly improves financial performance. Larger firms benefit from economies of scale, greater resource availability, and enhanced access to capital markets. This result is consistent with Saputra (2025) and Saragi et al. (2024), who find that firm size significantly affects financial outcomes. Moreover, Hasan et al. (2024) indicate that governance dynamics are more structured in larger institutions, potentially leading to improved financial results.

Most importantly, this study confirms the moderating role of firm size in strengthening the governance–performance relationship. The interaction terms reveal that governance mechanisms are more effective in larger firms. This finding aligns with recent studies such as Ningsih et al. (2023), Nurrohmat et al. (2025), and Ofori et al. (2025), which document that firm size enhances the impact of governance on financial performance. Larger firms typically operate under greater regulatory scrutiny and stakeholder pressure, which may amplify the effectiveness of governance structures. Additionally, Manik and Sihombing (2025) emphasize that firm characteristics, including size, condition the influence of governance mechanisms on firm value.

The findings also resonate with broader institutional evidence from emerging economies. Klapper and Love (2004) highlight that governance quality substitutes for weak

legal protection, while Kaunda and Pelser (2023) demonstrate that governance effectiveness improves performance even in less developed economies. Thus, the present study strengthens the argument that governance mechanisms are especially critical in emerging markets such as Indonesia.

Overall, this study contributes to the literature in three ways. First, it reaffirms the governance–performance nexus documented in seminal works (Gompers et al., 2003; Bhagat & Bolton, 2008). Second, it provides updated empirical evidence from an emerging market manufacturing sector, extending prior research that often focuses on financial institutions (Hasan et al., 2024; Ofori et al., 2025). Third, it demonstrates that firm size plays a significant moderating role, thereby refining our understanding of how governance effectiveness depends on firm characteristics.

In summary, corporate governance mechanisms significantly enhance financial performance, and their effectiveness becomes stronger as firm size increases. These findings highlight the importance of strengthening board structures and audit oversight, particularly in larger firms operating within emerging market environments.

6. Conclusion

This study concludes that corporate governance mechanisms—specifically board size, board independence, and audit committee size—significantly enhance financial performance in manufacturing firms listed on the Indonesia Stock Exchange. Among these mechanisms, board independence demonstrates the strongest effect, highlighting the importance of effective oversight in reducing agency problems and improving profitability. Additionally, firm size not only directly contributes to better financial performance but also strengthens the relationship between governance mechanisms and financial outcomes. These findings confirm the governance–performance nexus and emphasize that governance structures operate more effectively in larger firms within emerging market contexts.

Despite its contributions, this study has several limitations. First, the analysis focuses exclusively on manufacturing firms, which may limit the generalizability of the findings to other sectors. Second, financial performance is measured using accounting-based indicators, which may not fully capture market perceptions of firm value. Future research may extend the analysis to multi-sector or cross-country samples, incorporate market-based performance measures such as Tobin's Q, and explore additional moderating variables such as ownership structure, ESG performance, or institutional quality to provide a more comprehensive understanding of governance effectiveness.

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