

The Influence of Environmental Social Governance, Firm Size, and Profitability on Firm Value

Mayliesya Hielmy Duisyah Rama¹, Veronika Santi Paramita²

Universitas Jenderal Achmad Yani Cimahi, Indonesia ^{1,2}

Correspondent: veronika.santi@lecture.unjani.ac.id ²

Received : Desember 29, 2024

Accepted : January 16, 2025

Published : January 30, 2025

Citation: Rama, M, H, D., & Paramita, V, S. (2025). The Influence of Environmental Social Governance, Firm Size, and Profitability on Firm Value. *Moneta : Journal of Economics and Finance*, 3(1). 19-36. <https://doi.org/10.61978/moneta.v3i1>

ABSTRACT: Global warming has grown significantly in importance as a critical environmental issue in recent years. This trend presents a considerable challenge for businesses. In an effort to increase awareness of sustainability, the Indonesia Stock Exchange launched the SRI-KEHATI Index, a stock index that includes companies that meet ESG criteria. Between 2019 and 2023, the worth of companies included in the index has shown a declining trend. This study examines the relationship of firm value with ESG, firm size, and profitability using secondary data from sustainability reports and financial statements. This study uses a quantitative approach that combines descriptive and causal methodologies. The study's population is 43 companies, a selection of 11 companies was made as samples through purposive sampling techniques. The analysis technique applied is panel data regression. In conclusion, firm value is negatively affected by ESG, although firm size does not have an impact. ROA positively impacts firm value.

Keywords: Firm Value, Environmental Social Governance, Firm Size, Profitability.



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INTRODUCTION

Global warming has grown significantly in importance as a critical environmental issue in recent years, capturing the attention of policymakers, scientists, and the general public alike. The primary contributor to this phenomenon is carbon dioxide, which is discharged into the air from various human activities. Among the major contributors to this increase in carbon emissions are industrial operations, land transformation, deforestation, and the burning of fossil fuels for energy production. These human-driven factors play a central role in accelerating climate change, leading to more extreme weather patterns, increased intensity and frequency of natural disasters, and the looming threat of species extinction as ecosystems become more disrupted.

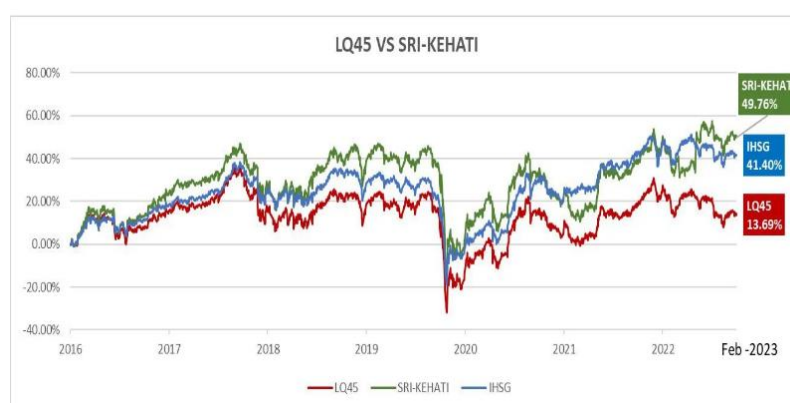
In Indonesia, the level of greenhouse gas emissions demonstrated growth over the past 4 years, despite a notable decline of 5,27% in 2020 due to reduced transportation and industrial activities during the COVID-19 pandemic lockdowns. However, emissions increased again, with an average increase of 4.56% from 2021 to 2023 (commission europa, 2024). The subsequent increase in

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emissions was triggered by industrial activities and high transportation use, thus contributing to the high consumption of fossil fuels (BPS, 2024). This trend presents a considerable challenge for businesses to take greater responsibility in mitigating their environmental impacts. To address this challenge, companies are encouraged to adopt and integrate sustainable business practices by implementing Environmental Social Governance (ESG). These principles are not only designed to lessen the harmful effects of business activities on the environment but also to create long-term value by promoting sustainable growth and responsible resource management. In the modern world, businesses face immense pressure to track and report on more than just their financial success (Ajape & Paramita, 2023).

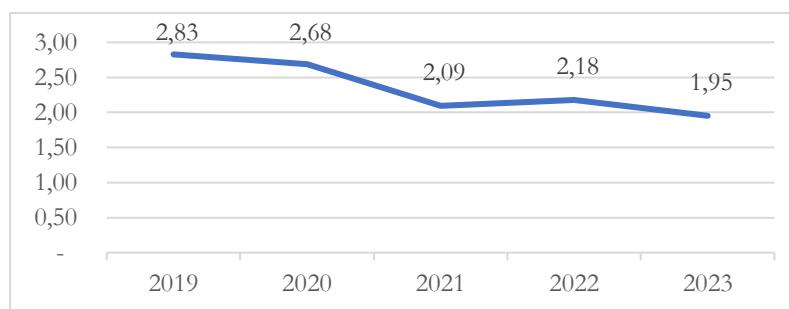
Figure 1. Movement of SRI-KEHATI, IHSG and LQ45 shares



In an effort to increase awareness of sustainability, the Indonesia Stock Exchange launched the SRI-KEHATI Index, which includes companies that meet ESG criteria. The index's stock price movements reflect how investors evaluate company performance. As of February 2023, the index recorded the highest stock movements at 49.76%, compared to IHSG at 41.40% and the LQ45 Index at 13.69%. From 2016 to 2023, the decline was notable in 2020 in light of the COVID-19 epidemic that disrupted the world economy.

Stock price movements are a measure of company value and show how well the company's shares in the SRI-KEHATI Index are performing. The company's value is determined by investors' evaluation of its performance based on its stock market price (Hidayat & Khotimah, 2022). The company's worth increases when the stock price is elevated; this is the expectation of shareholders because it shows an increase in shareholder prosperity (Kolamban et al., 2020). A rise in the value of a company is a sign of improved performance (Gunawan et al., 2024). Tobin's Q serves as a measure of a firm value and an essential metric for assessing management performance and asset management capabilities (Rajagukguk et al., 2019). In 2020-2023, the value of companies proxied by Tobin's Q tends to drop, even if the value of the SRI-KEHATI Index stock movement in February 2023 recorded the most significant movement. The average value of businesses represented by Tobin's Q is shown in the graph below.

Figure 2. Average firm value (Tobin's Q)

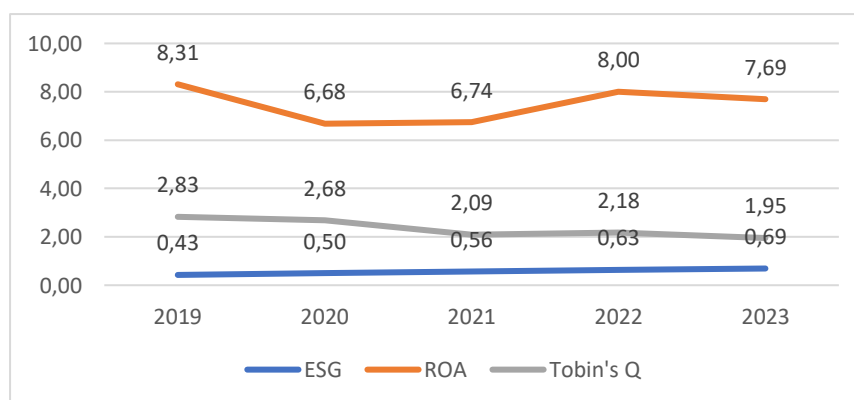


The figure indicates a general downward trend in the average firm value over time. Noteworthy declines occurred in 2021 and 2023. The drop in 2021 was primarily driven by the increase in global raw material prices, particularly metals, energy, and chemicals. This rise in raw material costs led to higher production expenses, which in turn reduced profitability and dampened investor interest (World Bank, 2021). Meanwhile, the decline in 2023 was primarily influenced by interest rate hikes, which diminished the attractiveness of investments. This contributed to a decrease in stock prices across several sectors, including banking, construction, and real estate (Perwita, 2023). Previous research has shown that a variety of factors can affect firm value, with key variables including ESG practices, firm size, and profitability. These factors collectively shape investor perceptions and influence overall business performance, suggesting that addressing sustainability through ESG principles could potentially improve the company's value over time.

According to Yanti & Darmayanti (2019), business size is determined by sales, total equity, or total assets. Click or tap here to enter text. The scale of a big company sends a good signal to investors because it reflects stability, thus attracting investors' attention regarding dividend expectations. This drives stock demand and increases stock price, which implies that firm value increases as well.

Return on Assets, an indicator of financial performance, indicates how successful a business is at generating profits from its assets. Profitable companies draw investors, who may raise the price of stocks and ultimately raise firm value (Susila & Prena, 2019).

Figure 3. Average ESG, Tobin's Q (firm value), and ROA (profitability)



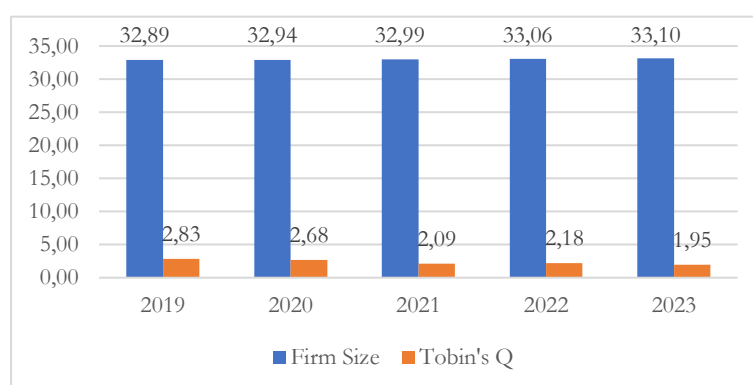
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In the picture above, although the average ESG rose by 0,07 in 2020, the average firm value actually decreased by 0,15. This phenomenon contradicts the theory that good ESG implementation will increase a company's value, indicating a gap between theory and fact (Rohendi et al., 2024).

In keeping with the view that business value will increase proportionally with profitability, the average ROA increased by 0.06 between 2020 and 2021, while the average firm value decreased by 0.59 (Jaya, 2020).

Figure 4. Average firm value and firm size (Tobin's Q)



The above chart shows that the average firm size from 2022 to 2023 has increased by 0,04, but the average firm value has decreased by 0,23. According to signal theory, a large company size sends a positive signal to stakeholders because it can finance its investment to generate profits, thereby increasing investor confidence and ultimately enhancing the company's worth. This indicates a gap between actual conditions in accordance with signal theory (Nurhadimah & Paramita, 2024).

The results were different from those of several previous studies that used ESG variables. (Aydoğmuş et al., 2022; Chang & Lee, 2022) Claim that ESG positively affects corporate value. Nonetheless, studies (Dogi et al., 2024; Rahmah et al., 2024) showed that ESG negatively impacts firm value. Meanwhile, (Rohendi et al., 2024; Xaviera & Rahman, 2023) show that ESG does not influence firm value.

Business value is positively impacted by company size (Adnyani & Suaryana, 2020; Wijaya, 2019). Business value is negatively affected by company size (Hirdinis, 2019). However (Kolamban et al., 2020; Wardhany et al., 2019) said that company value is not influenced by company size.

Research (Dwiastuti & Dillak, 2019; Iman et al., 2021; Wardhany et al., 2019) suggest that profitability increases firm value. Research results (Khotimah et al., 2020; Saddam et al., 2021) show that firm value is adversely affected by profitability. However, (Hidayat & Khotimah, 2022) suggests that firm value is not affected by profitability.

The research examines the relationship between firm value, firm size, profitability and ESG. Based on the description above, researchers plan to investigate the link between ESG, business size, profitability and firm value.

Legitimacy Theory

Dowling & Pfeffer (1975), explained that the company seeks to align its activities and social responsibilities with the norms and expectations of the community in which it operates. This adaptation is crucial for the company to gain acceptance and sustain its existence within its social environment. By obtaining legitimacy, the company can enhance its reputation among the general public and investors, which, in turn, has the potential to raise the company's worth (Mardiana & Wuryani, 2019). This process emphasizes the importance of socially responsible behavior and reputation management in driving long-term business success.

Stakeholder Theory

Freeman (1984) stated that the people or organizations that can have an impact on or influence the accomplishment of an organization's objectives are known as stakeholders. This theory highlights the importance of businesses not only focusing on fulfilling the needs of their shareholders but also on maximizing benefits for other stakeholders, including the community, customers, and employees. By doing so, companies can create value and contribute to shared prosperity, fostering long-term success and positive relationships with various parties involved (Nasution et al., 2024). This broader perspective encourages businesses to adopt more inclusive and sustainable practices.

Signalling Theory

Spence (1973) asserts that a company provides information to external parties, such as financial statements, to show management's outlook on the company's future. This outlook could be either good news or bad news, which can affect investors' responses. Positive signals tend to increase investors' buying interest, which will then drive up stock prices and ultimately boost the company's worth. Meanwhile, negative signals can trigger the opposite response.

Firm Value

According to (Dewi & Sujana, 2019 Noviani et al., 2019 Wijaya et al., 2021), firm value represents an investor's evaluation of the organization's performance as revealed through the stock price, which indicates the company's profit potential. Shareholder prosperity is marked by a high firm valuation (Wardhani et al., 2021). This study uses Tobin's q, a ratio that assesses business worth by comparing a company's market price to the expense of asset replacement. This ratio shows how the market evaluates the company's prospects and the efficiency in asset utilization (Jamaludin, 2024; Reswita & Rahim, 2020).

$$Tobin's\ q = \frac{(MVE + Debt)}{Total\ Assets}$$

Environmental Social Governance

ESG is a standard that integrates environmental, social and governance principles in corporate operations. It not only aims to ensure social sustainability and good governance but also serves as

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an essential basis for corporate decision-making and sustainable investment practices (Aditama, 2022; Radyati et al., 2023:1; Roestanto et al., 2022). ESG measurement is carried out using GRI standards with a calculation method comparing the value of ESG disclosures reported by companies to their total maximum disclosures.

$$ESG = \frac{ESG \text{ disclosure value}}{Maximum \text{ total disclosure}}$$

Firm Size

The company's total holdings are a matrix that shows the company's scale (Aulia et al., 2020; Wibowo & Andayani, 2021). According to Regulation No. 46/M-Dag/Per/9/2009, total assets are divided into three groups. Businesses with a net worth of IDR50 million to IDR500 million are considered small businesses. Meanwhile, medium-sized enterprises have a net worth between IDR500 million and IDR10 billion. Large companies have net worths of more than Rp 10 billion.

$$Size = Ln (Total \text{ assets})$$

Profitability

Profitability is the ability of an organization to produce a profit using all of its resources (Gultom, 2021; Rajagukguk et al., 2019). High profitability reflects good financial performance, which attracts investors. The profitability ratio is represented by ROA, which evaluates a company's potential to produce net profit efficiently through the effective utilization of its total assets (Khamisah et al., 2020; Susanti et al., 2021; Sutrisno, 2017:213).

$$ROA = \frac{Net \text{ Income}}{Total \text{ assets}} \times 100\%$$

Hypothesis Development

The Relationship between Environmental Social Governance and Firm Value

The realization of ESG helps companies gain strong legitimacy in the public's perception, as well as reduce negative stigmas such as environmental pollution issues. ESG is also consistent with the principles of stakeholder theory, which emphasizes the crucial role of safeguarding the interests of different stakeholders, such as the public and employees. This can improve good relationships with stakeholders, which will support the sustainability and success of the company. In addition, a positive image through the implementation of good ESG gives the market a good indication of the company's commitment to sustainability and the company's long-term prospects that could foster greater investor trust. This trust drives demand for stocks, thereby increasing the stock price and eventually raising firm value. ESG enhances the company's value (Adhi & Cahyonowati, 2023; Aydoğmuş et al., 2022; Rahelliamelinda & Handoko, 2024).

H1: Environmental Social Governance has a positive effect on firm value

The Relationship between Firm Size and Firm Value

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The company's large size reflects its high sales and total assets, which provides flexibility in asset management to accelerate growth and increase production capacity. In addition, the company's substantial size is viewed as a positive indicator for investors, as it indicates stability and more significant profit potential. More investors may buy company stock as a result of this boost in confidence, which would raise the stock price and, eventually, the firm's worth. According (Adhi & Cahyonowati, 2023; Adriani & Parinduri, 2024; Rahayu & Paramita, 2023; Sondakh, 2019), a company's size has a favorable impact on its value.

H2: Firm size has a positive effect on firm value

The Relationship between Profitability and Firm Value

High profitability signifies effective operations and the potential for future growth. Highly profitable businesses are considered stable and have good prospects, which can provide investors with a positive signal and then attract investors' interest. High confidence from investors will encourage investors to invest more to get significant profits. The company's shares were in more demand as a result of the increased investor interest, which raised stock prices. The company's value has increased, as evidenced by this rise in the stock price. This shows that profitability which is proxied with ROA positively impacts the company's value, as evidenced by prior research findings by (Adriani & Parinduri, 2024), (Dwiastuti & Dillak, 2019), (Oktavia & Desmiza, 2024), and (Zuhroh, 2019).

H3: ROA has a positive effect on firm value.

METHOD

This study uses a quantitative approach that combines descriptive and causal methodologies. Secondary data was collected from sustainability reports and financial reports of companies included in the SRI-KEHATI Index for 2019-2023. A total of 43 companies constituted the study population, 11 of them were selected as a sample using the purposive sampling technique. This study uses purposive sampling because it enables the selection of businesses that fit specific requirements pertinent to the study's goals. These namely companies regularly provide financial statements and sustainability reports during the study period and are consistently included in the index. This study uses panel data regression because it predicts the value of a company based on the number of companies and the period. Panel data regression analysis was used with the help of E-views 10 software. The steps in analyzing data begin with performing descriptive statistical analysis, followed by the selection of panel data models, panel data regression analysis, classical assumption test, hypothesis test, and determination coefficient analysis.

RESULT AND DISCUSSION

A statistical technique called descriptive statistics is used to examine data by characterizing or elucidating the acquired data in its original form without attempting to make generalizations (Sugiyono, 2013:147). Descriptive statistical analysis provides a preliminary overview of each variable in the study. The technique helps summarize the data on each variable, making it more straightforward to comprehend and analyze. The data provided are mean, median, highest values (maximum), and lowest values (minimum). Here are the findings of the descriptive statistical analysis performed:

Table 1. Descriptive Statistics

	X1	X2	X3	Y
Mean	0.560998	32.99444	7.484182	2.347525
Median	0.546400	32.49320	4.030000	1.134300
Maximum	0.938100	35.31540	36.10000	16.26330
Minimum	0.276400	30.44430	-0.120000	0.863800
Std. Dev.	0.147189	1.609397	8.645269	3.237511
Observations	55	55	55	55

Source: Data processed by the author (2024)

The following explanations are derived from the outcomes of the analysis:

1. Mean of firm value as measured by Tobin's Q (Y) is 2.347525, while the median value is 1.134300. The highest value is 16.26330 and the lowest value is 0.863800.
2. The median and mean values of ESG are 0.546400 and 0.560998. At the same time, 0.938100 and 0.276400 are the greatest and least bounds, respectively.
3. The mean and median values of firm size proxied by firm size are 32.99444 and 32.49320, respectively. 30.44430 and 35.31540 are the minimum and maximum values, respectively.
4. The mean profitability as measured by ROA is 7.484182, while the median value is 4.030000. -0.120000 and 36.10000 are the minimum and maximum values, respectively.

Panel Data Regression Model Selection Test

Chow Test

Table 2. Chow Test

Effects Test	Statistic	d.f.	Prob.
Cross-section F	8.643034	(10,41)	0.0000
Cross-section Chi-square	62.369879	10	0.0000

Source: Data processed by the author (2024)

After selecting FEM based on the Chi-square value of $0.0000 < 0.05$, the Hausman test must be performed.

Hausman Test

Table 3. Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	4.334836	3	0.2275

Source: Data processed by the author (2024)

From the Hausman test results, REM was selected with a random cross-section probability value of $0.2275 > 0.05$. Therefore, performing the Lagrange Multiplier Test is required.

Lagrange Multiplier Test

Table 4 Lagrange Multiplier Test

Null (no rand. effect)	Cross-section	Period	Both
Alternative	One-sided	One-sided	
Breusch-Pagan	30.63995	0.273788	30.91374
	(0.0000)	(0.6008)	(0.0000)

Source: Data processed by the author (2024)

The outcomes of the Lagrange multiplier analysis, which are $0.0000 < 0.05$, led to the selection of the REM.

Panel Data Regression Analysis

The regression analysis will be conducted using the REM model since it is the most effective model following the three tests that were carried out. The outcomes are shown below:

Table 5. Panel Data Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.278974	8.653774	0.610020	0.5446
X1	-2.044883	0.911459	-2.243527	0.0292
X2	-0.120890	0.257858	-0.468825	0.6412
X3	0.294546	0.040818	7.216106	0.0000

Source: Data processed by the author (2024)

The following are the regression equation's findings based on the table:

$$\text{Tobin's } Q = 5,278974 - 2,044883\text{ESG}_{it} - 0,120890\text{SIZE}_{it} + 0.294546\text{ROA}_{it} + \epsilon_{it}$$

The following explanations are based on the above findings:

1. The constant value of 5.278974 indicates that the firm value variable (Y) rises by 5.278974 without the ESG variable (X1), Company Size (X2), and ROA (X3).

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2. The ESG coefficient (X1) is -2.044883. If the X1 variable rises by one unit and all other variables are constant or zero, the company value (Y) decreases by -2.044883.
3. The company size coefficient (X2) has a value of -0.120890. If the X2 value rises by one unit and the values of the other variables remain or are zero, the company value (Y) decreases by -0.120890.
4. 4. The ROA coefficient (X3) has a value of 0.294546. The company value (Y) increases by 0.294546 if the value of variable X3 rises by one unit and the value of the other variables is constant or zero.

Classical Assumption Test

After descriptive statistical analysis has been completed, the subsequent step that needs to be taken is classical assumptions. However, because the model chosen is REM, which uses the GLS technique, the traditional assumption test is not required (Napitupulu et al., 2021).

Hypothesis Test

Partial test

The outcomes of this study's one-way partial hypothesis test (t-test) can be seen below:

Table 6. t Statistical Test Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.278974	8.653774	0.610020	0.2723
X1	-2.044883	0.911459	-2.243527	0.0146
X2	-0.120890	0.257858	-0.468825	0.3206
X3	0.294546	0.040818	7.216106	0.0000

Source: Data processed by the author (2024)

It can be explained as follows based on the outcomes of the hypothesis testing mentioned earlier:

1. The probability value of the ESG variable (X1) is $0,0146 < 0,05$, and the coefficient is -2,044883. So H1 is rejected, pointing to the fact that ESG has a negative influence on firm value.
2. The probability value of the firm size variable (X2) is $0,3206 > 0,05$, and the coefficient is -0,120890. Then, H2 is rejected, pointing to the fact that firm size does not affect firm value.
3. The value of the probability variable ROA (X3) is $0,000 < 0,05$, and the coefficient is 0,294546. Then, H3 is accepted, pointing to the fact that ROA has a positive effect on firm value.

Simultaneous Test

Here are the findings of the study's one-way simultaneous hypothesis testing (test f):

Table 7. F Statistical Test Results

Prob(F-statistic)	0.000000
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Source: Data processed by the author (2024)

The table shows that if the probability value (F-Statistic) is $0.000000 < 0.05$, then H_0 is rejected, meaning that company size, ROA, and ESG influence firm value.

Coefficient of Determination Test

Table 8. Adjusted R2 Test Results

Adjusted R-squared	0.568690
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Source: Data processed by the author (2024)

The Adjusted R-squared value is 0.568690 or 56.8690%. This shows that company size, ROA, and ESG can explain the firm value. The remaining 0.43131 or 43.131% is shaped by variables excluded from this analysis.

The Influence of Environmental Social Governance on Firm Value

Because ESG has a negative impact on the value of companies included in the SRI-KEHATI Index for the 2019-2023 period, the conclusion of this study is not in alignment with signal theory. This theory explains that the implementation of ESG should be a positive signal for investors, indicating that a corporation has adopted sustainability principles and is accountable for the effects of its operations. However, the implementation of ESG by companies is considered to be a burden on the company's resources related to the fulfillment of non-financial guidance. The costs associated with these ESG initiatives are deemed to have the potential to reduce profitability and efficiency. As it may lead to suboptimal use of corporate resources, investing in ESG activities is seen as less profitable for shareholders, thereby lowering corporate value and profitability (Yu & Xiao, 2022). Furthermore, businesses might put social legitimacy ahead of profit maximization, which could lower investors anticipated financial returns, according to legitimacy theory. Economic data that immediately boosts earnings is typically preferred by investors above non-financial data like ESG (Prayogo et al., 2023). As a result, the stock price will drop due to the decline in investor interest, which would ultimately affect the company's value. The findings are substantiated by research by Dogi et al. (2024) that ESG has a detrimental impact on firm value. Nevertheless, the study by Aydoğmuş et al. (2022) proves that ESG has a positive effect on firm value. The market will respond favorably with greater investment interest when the company can meet stakeholder and shareholder expectations on the implementation of ESG, which eventually raises the company's value.

The Effect of Firm Size on Firm Value

The findings show that for 2019-2023, company size does not affect the value of companies included in the SRI-KEHATI Index. This can happen because, despite having a large amount of assets, company assets tend to be accumulated in components such as inventory and receivables, which do not directly raise the value of the company or provide profits (Aeni & Asyik, 2019). In addition, significant total assets can also be accompanied by high external debt used to support operational activities, thereby increasing company risk and lowering investor confidence (Kolamban et al., 2020). Therefore, even though a large firm size provides liquidity in operational

flexibility, this may not have influenced the company's value if its assets and obligations are not managed effectively. These outcomes align with the findings of the study by Wahyuningtyas & Priyadi (2023) and Suhendar & Paramita (2024), which concluded that firm value was unaffected by firm size. However, it is not in line with research conducted by Adnyani & Suaryana (2020), which found that company size has a positive effect on company value, which is supported by signaling theory, suggests that large corporations tend to have more stable financial conditions and are easier to find sources of funding thanks to their significant total assets. This makes the company more appealing to investors, who will then purchase their shares, increasing its value.

The Effect of ROA on Firm Value

For the 2019-2023 timeframe, ROA positively affects the value of businesses included in the SRI-KEHATI Index. The high profitability level, reflected in the large ROA, shows how well the business can make income off of the assets it has. This reflects good operational efficiency and favorable growth prospects. High-profitability companies are viewed as trustworthy and having bright future possibilities, which gives investors a positive signal, according to signaling theory. Demand for the company's shares occurs due to a high level of investor confidence. Greater stock demand results in a higher stock price, which increases the value of the company. ROA increases the return on capital invested in assets, which can affect the business as a whole (Jaya, 2020). In line with the conclusion of Iman et al. (2021), ROA has a positive effect on firm value.

CONCLUSION

The study's outcomes suggest that ESG negatively impacts firm value, indicating that higher implementations of ESG are seen as less profitable for shareholders. Firm size does not have any effect because larger businesses don't necessarily run more efficiently. They can't create as much value as they could if they don't use their assets effectively. Additionally, ROA positively influences the company's value because greater profitability indicates both growth potential and superior operational efficiency. Simultaneously, the variables of ESG, firm size, and ROA can jointly affect the company's value.

According to the study's findings, the researcher can advise businesses to raise the efficiency of their operational processes in order to have the resources necessary to apply ESG and, eventually, boost ROA. The company's worth may rise in the long run if this gain is used in part to support ESG initiatives. This study's limitations include using a research period of only five years and using only three independent variables—of which only two are influential. The researcher's next course of action could be to prolong the study period and substitute the firm size variable with other variables believed to influence the company's value.

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