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The Effect of Diversification and Business Risk on Financial Performance of Manufacturing Companies in the Various Industries Sector on the Indonesia Stock Exchange in 2019-2022

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Abstract

This study aims to analyze the impact of diversification and business risk on the financial performance of various industrial sector manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2019-2022 period using the Path Analysis model. The variables studied were the Herfindahl Index, Return On Assets, and Business Risk. The main data of this research comes from secondary data. The sampling method used purposive sampling method. The results state that diversification affects financial performance, business risk affects financial performance, diversification does not affect business risk, and business risk does not serve as a mediator in the relationship between diversification and financial performance.

Keywords:diversification, business risk, financial performance, herfindahl-hirschman Index, return on assets.

INTRODUCTION

Economic growth in Indonesia is characterized by an increasing number of companies expanding, one of the strategies is through diversification. According to Lupitasari & Marsono (2012), diversification is a strategy used by companies to expand

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their business into other sectors or industries. This strategy attracts the attention of many experts because it provides the potential to increase company profitability, but the results obtained often vary. Some companies are able to achieve significant profits, while others face uncertainties that result in a decline in operational and financial performance. According to Setianto (2020) and Bhatia & Thakur (2018), the main motivations for companies to diversify are to take advantage of new growth and different market opportunities, reduce risk, improve financial performance, and operational efficiency and synergies.

In some literature and previous research, it is explained that not all companies that diversify experience improved performance. Research results by Anthony et al. (2017) and Van Den Berg (2016) show that diversification does not always guarantee an improvement in the company's financial performance, even in some cases it can cause management to lose control which leads to a decrease in business performance. Schommer et al. (2019) found that the performance of companies that try different strategies tends to decline over time.

According to Turiastini & Darmayanti (2017), companies that successfully expand their business by adding new business segments generally show better financial performance than companies that only focus on one type of business. This diversification helps companies reduce the risks inherent in business operations, because if one business segment experiences a decline in performance, other segments can still make a positive contribution to the company's income. Hendiono (2016) supports this view by stating that diversification allows companies to spread risk, therefore companies do not rely on one type of business alone.

However, not all studies support a positive view of diversification. Christiningrum (2015) and Adi Sari et al. (2014) show that diversification can also have a negative impact if not managed properly. Companies that diversify their business too much without paying attention to the fit between the new business line and the core business can face problems in operational and strategic management, which can ultimately harm their financial performance. In addition, according to Sulastri (2009), a high level of diversification by the company does not guarantee an increase in financial performance, because this depends on the ability of each business segment to optimize its opinion.

In addition, it is important for companies to consider business risk in any diversification decision. According to Hanafi (2014), a high level of business risk is often associated with a higher level of profit, but companies must be able to manage these risks

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wisely. Diversification aims to reduce risk, but if management cannot manage the risks that arise well, the expected profits will not be achieved.

Some large companies in Indonesia, such as manufacturing companies operating in the miscellaneous industries sector, often use diversification as a strategy to increase business coverage and reduce risk. The miscellaneous industry sector implements diversification strategies more frequently than other sectors, driven by globalization that demands industry development to remain competitive. The aim is to reduce risk while increasing sustainable earnings.

Objectives

This study aims to determine how diversification and business risk impact financial performance. In addition, through the role of business risk as a mediating variable, this study also analyzes the indirect impact of diversification on financial performance. The subjects of this study are manufacturing companies in the miscellaneous industry sector listed on the IDX, given that this sector has the highest number of companies with the highest level of diversification on the IDX. In addition, this sector has shown resilience and sustainable growth in the face of business competition. Producing a variety of new products, and making acquisitions of competitors or new companies.

LITERATUR ANALYSIS

Market Based View Theory

Market Based View (MBV) theory is a strategic approach that emphasizes the importance of market understanding and competitive positioning in formulating corporate strategy. Simatupang (2013) states that MBV theory comes from a modification of industrial organization theory used in the field of strategic management, Porter (1980, 1996) cited by Simatupang (2013), states that a company's superior performance depends on its unique position in the competitive environment. This environment is influenced by the Five Major Competitive Forces: bargaining power of suppliers, bargaining power of buyers, threat from substitute products, intensity of industry competition, and external threats. Companies should use common approaches such as low cost, product differentiation, or focus to achieve a unique position that results in superior performance and competitive advantage.

According to Hendiono (2016), with a broad scope, a diversification strategy allows companies to take advantage of linkages between value chains that serve various

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industry segments, geographic areas, or related industries, thereby strengthening their financial position and increasing cost efficiency in the face of competition. Thus, for diversification, the Market Based View theory acts as a concept of understanding corporate strategies that aim to improve performance and mitigate business risks.

Diversification

Companies use diversification strategies to establish subsidiaries or new business units in various industries. According to Hendiono (2016), diversification is done to expand markets, add business lines, develop products, and acquire competing companies. To generate a consistent return on investment and enable synergies across operations beyond the results that can be achieved by a single company, the selection of industries for diversification must be attractive enough. Therefore, before determining the new industry to enter, companies need to understand the level of competition in the industry so that the diversification strategy can provide optimal results.

Types of Diversification Strategies

According to Ramdani (2018), diversification strategy types can be divided into two categories, namely related diversification and unrelated diversification. Businesses are considered related or also called concentric strategies when there are strategic linkages across businesses in the value chain that provide comparative value. Meanwhile, if the value chain of a business is so different that there is no relationship that provides competitive value, then the business is considered unrelated.

Financial Performance

In the book Sari (2021) states that financial performance is a condition that describes the company's financial health using various financial analysis tools, which makes it possible to recognize whether the financial condition is good or bad, and reflects the company's overall performance. According to Turiastini & Darmayanti (2017), financial reports can be used as a tool to assess the company's financial performance, which reflects the effectiveness of the organization in allocating and managing its resources.

Company performance is measured to ensure its ability to compete with other companies. One way to measure company performance is to calculate its profitability ratio. According to Fitriana (2024), profitability ratios are metrics used to evaluate or

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compare how well a business collects profits from revenue over a period of time, both to monitor trends in increasing or decreasing performance and to identify factors that influence these changes. Thus, one of the profitability ratios that is often used to measure company performance is Return on Assets (ROA).

Business Risk

According to Ratri & Christianti (2017), business risk is the possibility of the company's inability to overcome its operational costs, which can be affected by the stability of income and expenses. Heru et al. (2023), state that potential risks in the business world can arise from a number of factors originating from both internal and external companies. These risks can affect various fields in the business world, including finance, operations, reputation, and corporate strategy. Thus, one way to measure business risk influenced by these factors is through the BRISK ratio.

The Effect of Diversification on Financial Performance

In developing countries, diversification in different business segments is a common phenomenon and opens up new investment opportunities. According to Ilyas et al. (2014), Eukeria & Favourate (2014), and Turiastini & Darmayanti (2017), diversification strategies have a considerable impact on financial performance. Because, according to Turiastini & Darmayanti (2017), companies that diversify their businesses have the potential to gain benefits, including easy access to supplies and operational synergies that strengthen competitive advantage. In the long run, this diversification is expected to increase financial profitability.

The Effect of Business Risk on Financial Performance

According to Hanafi (2014), companies anticipate a higher level of profit along with an increase in the risk taken, given the positive correlation between risk and profit levels. Zainuddin et al. (2014), Epayanti & Yadnya (2014), and Valentina & Ruzikna (2017), as well as Turiastini & Darmayanti (2017) found similar things, they showed a positive relationship between business risk and financial performance..

The Effect of Diversification on Business Risk

According to the Market Based View theory, companies that implement diversification have the ability to understand the dynamics of the business environment,

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which has the potential to drive performance improvement and risk reduction. A higher level of diversification in a company tends to be inversely proportional to the level of risk. This is because the profits earned through other business segments are able to cover possible losses that may occur. Studies conducted by Hendiono (2016), Manrai et al. (2014), and Turiastini & Darmayanti (2017) support the idea that diversification reduces business risk negatively.

The Effect of Diversification on Financial Performance Through Business Risk

Diversification is used by companies to expand their existing market share, increase the number of segments both in terms of business and geography, or develop a variety of new products. Expanding the marketing range of products, increasing the choice of existing products, opening new branches, and merging or acquiring to increase economies of scale and other benefits are ways that can be used to implement this strategy.

According to Hendiono (2016), Manrai et al. (2014), and Turiastini & Darmayanti (2017), diversification has a negative impact on business risk. That means, to reduce business risk, companies can divide the risk into parts of the business that may experience a decline, so that other parts of the business continue to grow. Conversely, Epayanti & Yadnya (2014), Ilyas et al. (2014), and Zainuddin et al. (2014) argue that business risk has a positive impact on financial performance, or it can be said that an increase in financial performance results from an increase in business risk.

Hyphotesis

Based on the underlying theory and previous empirical findings, the following is the formulation of the research hyphotesis:

H_1: Diversification has a positive and significant effect on financial performance

H_2: Business risk has a positive and significant effect on financial performance

H_3: Diversification has a negative and significant influence on business risk

H_4: Diversification has an indirect effect on financial performance through business risk

RESEARCH METHOD

This study applies a quantitative design that uses the causal associative method. The aim is to see how diversification affects financial performance both directly and

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indirectly through business risk. The sampling of this study was taken from manufacturing companies in the miscellaneous industry sector listed on the IDX in the 2019-2022 period. This study focuses on financial performance as measured by the ROA indicator.

This study utilizes quantitative secondary data from annual reports on manufacturing companies in the miscellaneous industry sector that have been listed on the IDX during the period 2019-2022, which are available at www.idx.co.id. This report includes diversification variables (X), business risk (Y1), and financial performance (Y2). This study focuses on 48 manufacturing companies listed on the IDX during the specified period. The sampling process used purposive sampling, which resulted in 37 companies being selected based on specific criteria. The sample selection stage is based on several criteria, including (1) manufacturing companies in various industrial sectors that consistently publish annual reports on the IDX in the 2019-2022 period, (2) companies that have two or more business segments.

Path Analysis

According to Sugiyono & Susanto (2015), path analysis is an evolution of multiple regression analysis techniques, in other words, this analytical technique uses regression to estimate the relationship between previous theoretical variables.

According to Hamid et al. (2019), this analysis model is used to understand and evaluate the relationship between variables. The aim is to identify the effect of the independent variable on the dependent variable either directly or indirectly, this model also analyzes the causal relationship between variables. Thus, this study focuses on path analysis which assesses how much influence the independent variable has on the dependent variable directly, indirectly, or in total from the independent variable to the dependent. This model provides an opportunity for researchers to measure the overall and simultaneous impact of a set of independent variables on the dependent variable.

The research design of path analysis according to Sugiyono & Susanto (2015) is:

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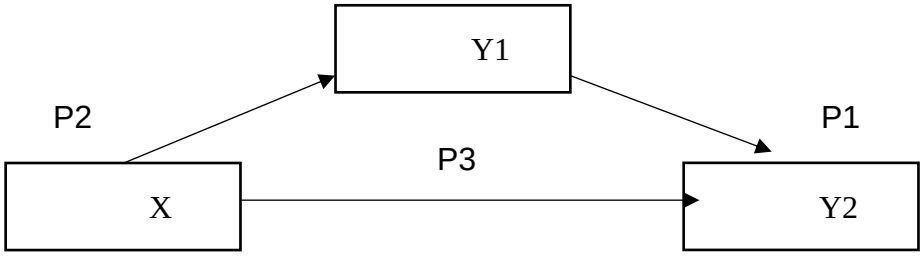


Figure 1 Indirect Relationship Between Variable X Affects Variable Y Through Variable M

The sobel test developed by Sobel (1982) can be used as a test of the mediation hypothesis.

Sobel Test

According to Ghozali (2018), the Sobel Test method is used as a method to evaluate the importance of the influence of mediating variables. In path analysis, the resulting coefficient reflects the direct and indirect effects between variables in the study. The direct effect value is obtained from the SPSS output coefficient, while the indirect effect can be calculated by multiplying the relevant coefficients.

Herfindahl-Hirschman Index (HHI)

To understand the potential competition in the selected new industry, the Herfindahl-Hirschman Index (HHI) is used as a measure of the intensity of market competition. According to Rój (2016), the HHI is used to represent the distribution of firms within an industry, so this variable is most often used to indicate the level of competition within the industry. According to Baker (2001), HHI can be defined as the square of the market share participating in the market. The formula used to calculate the HHI is:

$HHI = \sum segsales^2 / \sum (sales)^2$

Note: segsale refers to sales originating from each part or division of the company, while company sales are referred to as overall sales..

Return on Assets (ROA)

According to Fitriana (2024), ROA is a ratio that shows the return on all assets utilized by the company. ROA is a measuring tool for how well management manages

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investments and shows how productive the company's funds are, both from own capital and loan capital. To calculate ROA, the formula is as follows:

ROA = (Laba Bersih/Total Aktiva) x 100%

Business Risk (BRISK)

According to Mnune & Purbawangsa (2019), BRISK is measured using EBIT divided by total assets, with BRISK units in percent. To calculate BRISK, the formula is as follows:

BRISK = σEBIT/(Total Asset) x 100%

DISCUSSION

Descriptive Statistics

Descriptive statistics are applied to provide a comparative picture of the extreme values, mean, and disperse of data, which includes the minimum, maximum, mean, and standard deviation of the variables under study. The presentation of these statistics allows a deeper understanding of the characteristics of the data distribution, including the range of values and the level of data variability. Table 1 illustrates the results of the descriptive analysis and provides an overview of the trends and distribution of the data found in this study.

Table 1. Statistik Deskriptif

	N	Minimum	Maximum	Mean	Std. Deviation
Diversification	148	.23	2.30	.7700	.38931
Financial Performance	148	-.87	.98	-.0026	.14925
Business Risk	148	-.96	.27	.0017	.13653
Valid N (listwise)	148				

Source: Processed Data*, 2024*

The diversification variable with a sample of 148 shows a range of values between 0.23 and 2.30. PT Indomobil Sukses Internasional Tbk. recorded the lowest diversification of 0.23, while the highest diversification was achieved by PT Polychem Indonesia of 2.30. With a standard deviation of 0.38931 and an average diversification of 0.7700 which

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shows the level of variation and distribution of data liquidity among the samples studied has a homogeneous tendency.

In the variable financial performance section of 148 samples, there is a value range of -0.87 to 0.98. PT Sri Rejeki Isman Tbk. recorded the lowest financial performance of -0.87, while the highest financial performance of 0.98 was achieved by PT Indomobil Sukses Internasional Tbk. The average financial performance of the analyzed sample is -0.0077 with a standard deviation of 0.12548, indicating considerable variability in the financial performance of these companies.

Business risk variable, based on 148 samples, there is a range of values from 0.96 to 0.27. PT Sri Rejeki Isman recorded the lowest financial performance of -0.96. The average observed business risk amounted to 0.0017 with a total standard deviation of 0.13653, indicating a significant variation in the financial performance of some of these companies.

Classical Assumption Test Results

Normalitas Kolmogorov-Smirnov Test

Table 2. Kolmogorov-Smirnov Test Model 1

			Unstandardized Residual
N			147
Normal Parametersa,b	Mean		.0000000
	Std. Deviation		.12672670
Most Extreme Differences	Absolute		.206
	Positive		.131
	Negative		-.206
Test Statistic			.206
Asymp. Sig. (2-tailed)c			.000
Monte Carlo Sig. (2-tailed)d	Sig.		.000
	99% Confidence Interval	Lower Bound	.000
		Upper Bound	.000

Source: Processed Data*, 2024*

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Table 3. Kolmogorov-Smirnov Test Model 2

			Unstandardized Residual
N			147
Normal Parametersa,b	Mean		.0000000
	Std. Deviation		.08730288
Most Extreme Differences	Absolute		.383
	Positive		.383
	Negative		-.295
Test Statistic			.383
Asymp. Sig. (2-tailed)c			.000
Monte Carlo Sig. (2-tailed)d	Sig.		.000
	99% Confidence Interval	Lower Bound	.000
		Upper Bound	.000

Source: Processed Data, 2024

Referring to the KS analysis results shown in table 2 and table 3, it is found that the Asymptotic Significance (2-tailed) value is below the alpha value of 0.05. So it can be interpreted that the distribution of regression model 1 and regression 2 in this study is not normally distributed. However, based on the Central Limit Theorem (CLT) theory, it is said that even if the original data taken from the population is not normally distributed, the sample average of the data will follow a normal distribution if the sample size is large enough or more than 30 samples. This is also supported by the opinions of several experts such as Gujarati et al. (2003) and Ghasemi & Zahediasl (2012). Bowerman et al., 2017) say that, without considering the probability value, the population distribution of all possible samples will approach the normal distribution if the sample size (n) is large enough. Because this study uses 147 samples, so the data can be said to be normally distributed.

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Autocorrelation Test

Table 4. Autocorrelation Test Model 1

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.001a	.000	-.007	.13700	1.239

Source: Processed Data, 2024

Table 5. Autocorrelation Test Model 2

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.812[a]	.659	.654	.08776	1.883

Source: Processed Data*, 2024*

Referring to the autocorrelation test results displayed in table 4, the Durbin Watson value is 1.239, which is within the range of dU = 1.7448 and 4-dU = 2.2551, or 1.7448 > 1.239 < 2.2551 so it is not included in the autocorrelation region. Meanwhile, in table 5, shows the Durbin Watson (DW test) value of 1.883, which is also within the range of dU = 1.7588 and 4-dU = 2.2412 or 1.7581 < 1.883 < 2.2419, so it is included in the autocorrelation-free region. So, it can be concluded that this study has autocorrelation symptoms for the two regression models.

Referring to research conducted by Ashri & Fathihani (2023), to get out of autocorrelation symptoms, the Cochrane-orcutt method is used. According to Ghozali (2018), the Cochrane-Orcutt method is one of the techniques for autocorrelation treatment. To use the Cochrane-Orcutt method, the data is converted to Lag first, so the following results are obtained:

Table 6. Autocorrelation Test Model 1

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.007[a]	.000	-.007	.12716	1.942

Source: Processed Data*, 2024*

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Table 7. Autocorrelation Test Model 2

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.805a	.649	.644	.08791	1.993

Source: Processed Data*, 2024*

Referring to the autocorrelation test results displayed in table 6, the Durbin Watson value is recorded as 1.942, which is within the range of dU = 1.7441 and 4-dU = 2.2559, or 1.7441 < 1.942 < 2.2559. Meanwhile, in table 7, shows the Durbin Watson (DW test) value of 1.993, which is also within the range of dU = 1.7581 and 4-dU = 2.2419 or 1.7581 < 1.993 < 2.2419, so it is included in the autocorrelation-free region. So, it can be concluded that this study does not have autocorrelation symptoms on the two regression models.

Heteroscedasticity Test

Table 8. Heteroscedasticity Test Model 1

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.081	.016		4.983	.000
	Diversification	-.024	.029	-.070	-.851	.396

Source: Processed Data*, 2024*

Table 9. Heteroscedasticity Test Model 2

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.032	.015		2.106	.037
	Diversification	-.014	.019	-.061	-.729	.467
	Business Risk	-.033	.052	-.052	-.630	.530

Source: Processed Data*, 2024*

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Table 8 and table 9 present the results of the Glejser test for each variable, each of which has a significance value of more than alpha 0.05, indicating that the independent variable does not affect the absolute residual value. So the model used shows no indication of heteroscedasticity.

Multicollinearity Test

Table 10. Multicollinearity Model 1

Model		Collinearity Statistics	
		Tolerance	VIF
1	Diversification	1.000	1.000

Sumber: Data Diolah, 2024

Table 11. Multicollinearity Test Model 2

Model		Collinearity Statistics	
		Tolerance	VIF
1	Diversification	1.000	1.000
	Business Risk	1.000	1.000

Source: Processed Data*, 2024*

Table 10 and table 11 show the test results illustrating that the two research models created do not show symptoms of multicollinearity, because the tolerance value for the independent variables is more than 0.10 and the VIF value is less than 10.

Path Analysis

Table 12. Regression Equation Model 1 The Effect of Diversification on Business Risk

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.002	.020		.126	.900
	Diversification	-.003	.034	-.007	-.086	.932

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	R2	0,000				
	F Count	0,007				
	Sig. F	0.932				

Source: Processed Data*, 2024*

Referring to the analysis results in table 12, the structural equation:

Structural equation 1:

$Y1 = ax + e_1$

$Y1 = -0{,}003x + e_1$

The F value of 0.007 with a significance of 0.932, displayed in table 10, shows that diversification cannot predict business risk, because the significance value is above alpha 0.05. Thus, diversification (X) has no positive impact on business risk..

Table 13. Regression Equation Model 2 The Effect of Diversification on Financial Performance Through Business Risk

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.001	.016		.092	.927
	Diversifikasi	-.007	.019	-.019	-.377	.707
	Risiko Bisnis	.884	.054	.805	16.300	.000
	R2	0.649				
	F Hitung	132.912				
	Sig. F	<0,001				

Source: Processed Data, 2024

Referring to the results of model 2 analysis in table 13, the structural equation:

$Y2 = cX + BY1 + e_2$

$Y2 = -0{,}007X + 0{,}884\ Y1 + e_2$

The calculated F value of 132.912 with a significance of less than 0.001, displayed in table 13, indicates that diversification can potentially predict business risk, given the significant value below alpha 0.05. Thus, it can be concluded that diversification and business risk can have a positive impact on financial performance.

Based on tables 12 and 13, the path diagram can be designed first by calculating the standard error value as follows:

$e = \sqrt{1 - (r_i)}\text{^}2$

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$e_1 = \sqrt{1 - (r_1)}\text{^}2$
$= \sqrt{1 - 0{,}000}$ = 1,000
$e_2 = \sqrt{1 - (r_2)}\text{^}2$
$= \sqrt{1 - 0{,}649}$ = 0,351

Referring to the standard error (e1) of 1.000 and (e2) of 0.351, the total coefficient of determination can be calculated in the following way:

$R^2_m = 1 - (e_1)^2 (e_2)^2$
$= 1 - (1{,}000)^2 (0{,}351)^2$
= 0,877

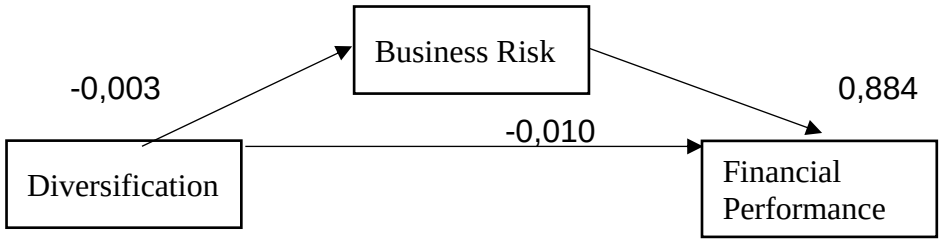
The coefficient of determination is 0.877, indicating that 87.7% of the variation in financial performance can be explained by diversification and business risk, while the remaining 12.3% may come from external factors that are not taken into account in this model.

Table 14 Direct Effect, Indirect Effect, and Total Effect of Diversification (X), Business Risk (Y1), and Financial Performance (Y2)

Variable	Direct Effect	Indirect Effect Through Y1 (a x b)	Total Effect
X → Y1	-0,003	-	0,000
X → Y1 → Y2	-0,007	-0,003	-0,010
Y1 → Y2	0,884	-	0,884

Source: Processed Data, 2024

Based on the explanation of the structural equation that has been mentioned, the path coefficient diagram in this study is presented as follows:



Referring to the explanation in the figure regarding the structural equation, it can be concluded that diversification has a direct effect of -0.003 on business risk. In addition,

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there is an effect between business risk and financial performance of 0.884, the effect of diversification on financial performance of -0.010, and the indirect effect of diversification on financial performance through business risk of -0.003.

Mediation Testing Result Using the Sobel Test

The sobel test is an analytical technique used to measure the significance of the indirect relationship between the independent variable and the dependent variable which is influenced by the mediator variable. In this context, the z value resulting from the calculation is considered significant if its value exceeds 1.96.

To determine the significance of the indirect effect of the z value of the ab coefficient, it can be calculated using the following formula:

z = ab/(Sa)b

z = ((-0,003)(0,884))/0,030

z = -0,088

Table 15. Hasil Uji Sobel

Model	Understandardized Coeff.		Standardized Coeff	t	Sig.
	B	Std. Error	Beta		
X→Y1→Y2	-0,003	0,030	-0,00564	-0,088	-

The analysis results show that H0 is accepted, which indicates that the Y1 variable does not act as a mediating variable. The z value obtained is -0.088, which is below the threshold of 1,96. Therefore, it can be concluded that business risk has no effect on the relationship between diversification and financial performance of manufacturing companies listed on the IDX in the miscellaneous industries sector.

CONCLUSION

Based on the research results above, it is concluded that company diversification does not affect financial performance. This means that when a company diversifies, its financial performance, as measured by ROA, tends not to increase. On the other hand, business risk does impact financial performance. In other words, the higher the business risk faced by the company, the more its financial performance tends to improve.

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In addition, there is a negative correlation between diversification and business risk, indicating that businesses with higher diversification tend to experience lower business risk. Furthermore, business risk does not function as a mediator between diversification and financial performance; diversification only directly affects financial performance. Overall, these findings should be carefully considered because, although diversification may reduce risk, its effect on financial performance is not always positive.

This study is subject to several limitations, one of which is the sample size, comprising only 148 samples. Future researchers are encouraged to explore additional variables that influence company financial performance and to extend the research period.

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