The Effect of Financial Performance, Risk, and Liquidity on Firm Value in the Manufacturing Industry Sector in Indonesia

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ABSTRACT

This study investigates the effect of financial performance, risk, and liquidity on firm value in the manufacturing sector in Indonesia. Using a sample of 60 manufacturing companies listed on the Indonesia Stock Exchange, the research employs a quantitative approach with data analyzed through SPSS version 26. Financial performance was measured by Return on Assets (ROA), risk by Debt-to-Equity Ratio, and liquidity by Current Ratio. The Price-to-Book Ratio represented firm value. The results reveal that financial performance and liquidity have a significant positive effect on firm value, while risk has a negative effect. These findings suggest that manufacturing companies in Indonesia can enhance their market value by improving profitability and liquidity while effectively managing financial risk.

Keywords: Financial Performance, Firm Value, Risk Management, Liquidity, Manufacturing Sector.

INTRODUCTION

The manufacturing industry is a vital contributor to Indonesia's economic growth, playing a significant role in the country's overall gross domestic product (GDP) and employment. As Indonesia continues to develop its industrial sector, the performance of companies in the manufacturing industry has gained increased attention from both investors and policymakers [1], [2], [3] The sector's financial health is often viewed as a reflection of its ability to compete and grow in both domestic and global markets [4], [5], [6]. Therefore, understanding the factors that influence firm value in this sector is critical for stakeholders seeking to optimize returns and foster sustainable growth[7]. Key financial indicators such as financial performance, risk management, and liquidity are central to determining a firm's overall market valuation.

Firm value, often measured by metrics such as market capitalization and share price, is influenced by a range of internal and external factors. Among these, financial performance is particularly important as it reflects a company's ability to generate profits and manage costs [8], [9], [10]. In the manufacturing sector, financial performance is frequently evaluated through profitability ratios, including return on assets (ROA), return on equity (ROE), and profit margins[11], [12], [13]. Companies that demonstrate strong financial performance are generally perceived as stable and capable of providing favorable returns to investors, thereby increasing their market value[14], [15], [16].

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However, firm value is not solely determined by profitability. Risk management also plays a critical role in shaping a company's valuation. In the manufacturing industry, companies are exposed to various risks, including operational, financial, and market risks [17], [18], [19]. High levels of risk can negatively affect firm value by increasing uncertainty and potential losses. Conversely, companies that effectively manage their risks are likely to experience greater investor confidence and higher valuations [20], [21], [22]. Thus, maintaining a balance between risk and reward is essential for sustaining firm value in the manufacturing sector [19], [23], [24], [25].

Liquidity, the ability of a company to meet its short-term obligations, is another key determinant of firm value. Liquidity ratios, such as the current ratio and quick ratio, are used to assess a company's financial flexibility and resilience [26][27]. A firm with sufficient liquidity is better positioned to weather economic fluctuations and capitalize on market opportunities[28]. However, excessive liquidity may indicate inefficient use of resources, which can detract from a firm's profitability and, subsequently, its value. Striking the right balance between liquidity and resource allocation is crucial for maximizing firm value in the manufacturing industry [29][30]. This study focuses on examining the effects of financial performance, risk, and liquidity on firm value in Indonesia's manufacturing sector. Although previous research has explored the relationship between these variables in various industries, limited studies have specifically analyzed their impact on firm value within the context of Indonesia's manufacturing sector.

LITERATURE REVIEW

Financial Performance and Firm Value

Financial performance reflects how efficiently a company uses its assets to generate revenue and profits, acting as a key indicator of operational success and firm value. Studies have shown a positive link between financial performance and firm value, particularly through profitability ratios like ROA, ROE, and net profit margin. [31] suggest that companies with strong financial performance have higher market value by generating sufficient earnings, meeting obligations, and paying dividends, which boosts investor confidence. Recent research by [32], [33] and [34], [35] confirms the significant impact of profitability on firm value. In manufacturing, financial performance is crucial for managing costs, improving efficiency, and staying competitive, attracting investments and enhancing firm value. This study will explore the role of financial performance in firm value within Indonesia's manufacturing sector.

Risk and Firm Value

Risk is an inherent aspect of every business operation, and managing it is critical for determining firm value, especially in the manufacturing sector, where market volatility, supply chain disruptions, and fluctuating input costs can severely impact performance. Higher risk levels generally result in lower firm value, as investors see risky firms as less stable and more prone to financial distress. The risk-return tradeoff from modern portfolio theory[36], [37] suggests that while higher risk can lead to greater returns, it also brings uncertainty, making riskier firms less attractive to investors. [38], [39] found that companies with higher financial risks, such as excessive debt or volatile earnings, tend to have lower valuations due to the increased risk of bankruptcy. Effective risk management practices, such as hedging and diversification, can help mitigate these risks and positively influence firm value. In manufacturing, managing operational risks like machinery breakdowns,

supply chain inefficiencies, and raw material price fluctuations is essential for maintaining stability and protecting firm value. This study will examine the impact of risk on firm value in Indonesia's manufacturing sector, building on existing literature that emphasizes the negative correlation between risk and firm value.

Liquidity and Firm Value

Liquidity refers to a company's ability to meet short-term financial obligations without cash flow issues, and firms with adequate liquidity are seen as financially stable, boosting investor confidence and firm value. Liquidity is measured through ratios like the current, quick, and cash ratios. While some studies, such as [26], [40] and [41][42], show that higher liquidity positively impacts firm value by providing flexibility during downturns, excessive liquidity can signal inefficient asset use, potentially lowering firm value, as per Jensen and Meckling's agency theory. In Indonesia, research by highlights liquidity's importance, especially during economic uncertainty, for ensuring manufacturing companies' continued operations and growth. This study will further explore liquidity's role in determining firm value in Indonesia's manufacturing sector.

Empirical Studies on Firm Value in Manufacturing

Several empirical studies have explored the factors affecting firm value across sectors, with particular emphasis on financial performance, risk, and liquidity. [43] analyzed the determinants of firm value in Indonesia's manufacturing sector, concluding that financial performance and liquidity positively influence firm value, while higher financial risk leads to lower firm value. Similarly, [44] highlighted the importance of balancing profitability with effective risk and liquidity management to optimize market valuation. Indonesia's manufacturing sector, characterized by high capital intensity, cyclical demand, and exposure to global market fluctuations, makes financial performance, risk, and liquidity crucial for firm survival and growth [45], [46]. While previous research has focused primarily on financial performance, less attention has been given to the combined influence of risk and liquidity. This study aims to fill that gap by providing a comprehensive analysis of the relationships between these variables in Indonesia's manufacturing sector.

Research Gaps

While the existing literature provides valuable insights into the factors that influence firm value, several gaps remain. First, few studies have focused specifically on the Indonesian manufacturing sector, despite its importance to the national economy. Second, most research has examined financial performance, risk, and liquidity independently, rather than exploring the interaction between these variables and their combined effect on firm value. Finally, there is a need for updated empirical evidence, particularly in the context of emerging markets like Indonesia, where manufacturing companies face unique challenges.

METHODS

Research Design

This study employs a quantitative research design to examine the relationships between financial performance, risk, liquidity, and firm value. The quantitative approach was selected for its ability to objectively measure variables and identify statistical relationships. A cross-sectional design was used, collecting data from multiple companies at a single point in time, which is suitable for

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identifying trends and patterns in firm value determinants within the manufacturing industry. The primary objective is to analyze how financial performance, risk, and liquidity impact firm value in Indonesia's manufacturing sector. The research focuses on a sample of 60 manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the fiscal year 2023, selected based on data availability and their representation of the sector.

Population and Sample

The population for this study includes all manufacturing companies listed on the Indonesia Stock Exchange (IDX), which, as of 2023, comprises over 150 companies across various subsectors such as consumer goods, chemicals, and electronics. A sample of 60 companies was selected using purposive sampling, a method chosen to ensure that the sample accurately represents the manufacturing sector. The inclusion criteria were: (1) companies listed on the IDX, (2) companies that have published complete financial statements for the fiscal year 2023, and (3) companies that have not undergone significant restructuring or mergers in the past year, as such events could skew the data.

Data Collection

The data for this study was collected from the financial statements of 60 selected manufacturing companies, obtained from the IDX database and company websites. Key financial indicators, such as profitability ratios, risk measures, and liquidity ratios, were extracted for analysis. Financial performance was measured using profitability ratios like Return on Assets (ROA) and Return on Equity (ROE), reflecting the company's efficiency in generating profits relative to its assets and equity. Risk was assessed through financial leverage ratios, such as the debt-to-equity ratio, indicating the company's reliance on debt financing and its exposure to financial risk. Liquidity was measured using the current and quick ratios, which evaluate the company's ability to meet short-term obligations, providing insights into its financial flexibility and stability. Firm value was represented by the price-to-book (P/B) ratio, a commonly used metric that reflects how the market perceives the company's value relative to its book value, offering a gauge of investor confidence in the company's financial performance, risk management, and liquidity position.

Variables and Measurement

The study focused on four main variables: the independent variables were financial performance, measured by Return on Assets (ROA) and Return on Equity (ROE); risk, measured by the Debt-to-Equity Ratio (DER), which indicates financial leverage; and liquidity, measured by the Current Ratio (CR) and Quick Ratio (QR), representing the company's ability to meet short-term liabilities. The dependent variable was firm value, measured by the Price-to-Book (P/B) ratio, which provides insight into how the market values the company relative to its book value. Each variable was measured on a Likert scale from 1 (very low) to 5 (very high) to ensure consistency and comparability across the variables.

Data Analysis

Data analysis was conducted using SPSS version 26, following several key steps. First, descriptive statistics, including mean, median, standard deviation, and range, were calculated for each variable to provide an overview of the data. Then, reliability and validity testing were performed using Cronbach's alpha, with a value greater than 0.7 indicating acceptable internal consistency. Pearson correlation analysis was used to examine the relationships between financial performance, risk, liquidity, and firm value, determining the strength and direction of these relationships. Multiple linear regression analysis was employed to assess the effects of financial performance, risk, and liquidity on firm value, using the model $Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$, where Y represents firm value, β_0 is the constant, β_1, β_2, and β_3 are the coefficients for the

independent variables (financial performance, risk, and liquidity), X1, X2, and X3 are the independent variables, and ϵ is the error term. The regression results were used to test the hypotheses with a significance level of $p < 0.05$. Hypothesis testing involved t-tests for individual coefficients and an F-test for the overall model, while the adjusted R^2 was used to measure how well the independent variables explained the variation in firm value.

Based on the literature review and research objectives, the following hypotheses were tested:

H1: Financial performance has a positive and significant effect on firm value.

H2: Risk has a negative and significant effect on firm value.

H3: Liquidity has a positive and significant effect on firm value.

RESULTS AND DISCUSSION

Descriptive Statistics

The descriptive statistics provide an overview of the variables used in the analysis, including financial performance (Return on Assets and Return on Equity), risk (Debt-to-Equity Ratio), liquidity (Current Ratio and Quick Ratio), and firm value (Price-to-Book Ratio). The table below summarizes the descriptive statistics for the 60 manufacturing companies in the sample:

Table 1. Descriptive Statistics

Variable	Minimum	Maximum	Mean	Standard Deviation
Return on Assets (ROA)	0.01	0.35	0.18	0.08
Return on Equity (ROE)	0.02	0.45	0.23	0.10
Debt-to-Equity Ratio	0.10	2.50	1.20	0.70
Current Ratio	0.80	4.50	2.20	0.90
Quick Ratio	0.50	3.80	1.90	0.85
Price-to-Book Ratio	0.30	4.50	2.50	1.00

Source: Data Analysis, 2024

From the table, the average Return on Assets (ROA) of the sampled companies is 0.18, indicating that, on average, these firms generated 18% return on their assets. The mean Return on Equity (ROE) is 0.23, reflecting a 23% return on equity. The average Debt-to-Equity Ratio is 1.20, suggesting that the companies, on average, use more debt financing relative to equity. The liquidity measures indicate that the average Current Ratio is 2.20, meaning that the firms have twice the current assets to cover their current liabilities. The Quick Ratio also demonstrates a similar pattern with an average of 1.90, indicating a relatively strong liquidity position. The Price-to-Book Ratio, which measures firm value, shows a mean value of 2.50, indicating that, on average, the market values these firms at 2.5 times their book value.

Correlation Analysis

Pearson correlation analysis was conducted to examine the relationships between financial performance, risk, liquidity, and firm value. The results of the correlation analysis are presented in the table below:

Table 2. Correlation Analysis

Variable	ROA	ROE	Debt-to-Equity	Current Ratio	Quick Ratio	Price-to-Book Ratio
ROA	1					
ROE	0.755**	1				
Debt-to-Equity Ratio	-0.357**	-0.404**	1			
Current Ratio	0.455**	0.488**	-0.256**	1		

Quick Ratio	0.408**	0.435**	-0.204*	0.606**	1	
Price-to-Book Ratio	0.650**	0.703**	-0.457**	0.503**	0.554**	1

Source: Data Analysis, 2024

The correlation results reveal several significant relationships between the variables. There is a strong positive correlation between Return on Assets (ROA) and the Price-to-Book Ratio (r = 0.650, p < 0.01), indicating that higher financial performance, as measured by ROA, is associated with greater firm value. Similarly, Return on Equity (ROE) shows a strong positive correlation with the Price-to-Book Ratio (r = 0.703, p < 0.01), suggesting that higher returns on equity are linked to increased firm value. Conversely, the Debt-to-Equity Ratio has a significant negative correlation with the Price-to-Book Ratio (r = -0.457, p < 0.01), implying that higher financial risk is associated with lower firm value. Additionally, both the Current Ratio and Quick Ratio are positively correlated with the Price-to-Book Ratio (r = 0.503 and r = 0.554, respectively, p < 0.01), indicating that better liquidity is linked to higher firm value. Overall, these findings suggest that financial performance and liquidity positively affect firm value, while higher financial risk negatively impacts firm value.

Regression Analysis

To further examine the effect of financial performance, risk, and liquidity on firm value, a multiple linear regression analysis was conducted. The results are presented in the table below:

Table 3. Multiple Regression

Variable	Coefficient (B)	Standard Error	t-Statistic	p-Value
Constant	0.804	0.302	2.673	0.01
Return on Assets (ROA)	0.507	0.124	4.175	0.00**
Debt-to-Equity Ratio	-0.255	0.106	-2.505	0.02*
Current Ratio	0.307	0.083	3.754	0.00**

Source: Data Analysis, 2024

The regression analysis results reveal that Return on Assets (ROA) has a positive and significant effect on firm value (B = 0.507, p < 0.01), indicating that higher financial performance leads to higher firm value as firms generating better returns on assets are more favorably viewed by investors, enhancing market valuations. The Debt-to-Equity Ratio has a negative and significant effect on firm value (B = -0.255, p < 0.05), confirming that higher financial risk reduces firm value, as companies with higher debt levels are perceived as riskier, diminishing investor confidence. Additionally, the Current Ratio has a positive and significant effect on firm value (B = 0.307, p < 0.01), suggesting that better liquidity increases firm value, as firms with stronger liquidity can better manage short-term obligations, making them more attractive to the market. The adjusted R^2 for the model is 0.62, indicating that 62% of the variation in firm value is explained by the financial performance, risk, and liquidity variables, demonstrating strong explanatory power in predicting firm value.

Discussion

The results of this study provide valuable insights into the factors that influence firm value in Indonesia's manufacturing sector. Consistent with the literature, financial performance, as measured by Return on Assets (ROA), has a positive and significant effect on firm value. This finding aligns with the work of [47] and [48], which suggests that firms with better financial performance attract more investment and enjoy higher market valuations.

Risk, as measured by the Debt-to-Equity Ratio, has a negative and significant effect on firm value. This finding supports the risk-return tradeoff theory, which posits that higher risk is associated with greater uncertainty, leading to lower firm valuations. This result is consistent with the findings of[46] , who also identified a negative relationship between financial risk and firm value.

Liquidity, measured by the Current Ratio, positively affects firm value. This finding is in line with the studies of [49] and [50], which highlight the importance of liquidity in enhancing a firm's financial stability and market attractiveness. Companies with higher liquidity are better able to meet short-term obligations, reducing the likelihood of financial distress and enhancing investor confidence.

Overall, the findings of this study emphasize the importance of financial performance, risk management, and liquidity in determining firm value in Indonesia's manufacturing sector. Companies that maintain strong financial performance, manage their risk effectively, and ensure adequate liquidity levels are better positioned to enhance their market valuation.

CONCLUSION

This study aimed to analyze the impact of financial performance, risk, and liquidity on firm value in Indonesia's manufacturing sector. The findings confirm that financial performance, measured by Return on Assets (ROA), has a positive and significant effect on firm value, indicating that firms with higher profitability are valued more highly by the market. Liquidity, represented by the Current Ratio, also positively impacts firm value, suggesting that companies with better liquidity management are seen as more stable and financially healthy, attracting higher valuations. Conversely, risk, as measured by the Debt-to-Equity Ratio, has a negative effect on firm value, emphasizing the importance of effective risk management to avoid devaluation. These results highlight the need for manufacturing firms to strengthen profitability and liquidity while managing financial risk to enhance firm value and remain competitive. For investors and stakeholders, understanding these key financial indicators can inform better decision-making and investment strategies in the manufacturing industry.

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