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The Effect of Diversification of Revenue, Profitability, and Firm Size on the Value of Banking Companies

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Abstract

This research investigates how revenue diversification, profitability, and firm size influence banking company valuations listed on Indonesia Stock Exchange during 2020-2023. Employing quantitative methodology with secondary data from 144 banking institutions selected through purposive sampling, multiple linear regression analysis was conducted using SPSS 26. Grounded in signaling theory, this investigation examines fundamental variables as signals communicating company prospects to investors. Results indicate revenue diversification demonstrates insignificant negative effects on firm value, profitability exhibits significant positive impacts, while firm size shows significant negative influences. Simultaneously, these three variables significantly affect firm value with Adjusted R^2 reaching 55.1%. These findings advance signal theory development and offer practical implications for investors and bank management regarding corporate value enhancement strategies within Indonesia's banking sector during critical economic periods.

Keywords: banking, firm size, firm value, profitability, revenue diversification

Introduction

Indonesia's banking sector evolution demonstrates remarkable expansion, characterized by increasing institutional numbers and diversified product offerings. As financial intermediation institutions, banks maintain vital roles in sustaining economic stability and driving national development. Within capital market contexts, banking company valuations represent primary indicators utilized by investors during investment decision-making processes. Corporate value reflects market perceptions regarding company prospects and performance, substantially influenced by internal factors including revenue diversification, profitability, and organizational size (Martinez & Silva, 2021; Anderson & Thompson, 2022).

However, inconsistency phenomena emerged between variable changes and company valuations throughout 2020-2023. Several banks experienced declining valuations despite profitability and size increases, creating apparent contradictions. These discrepancies reveal significant research gaps requiring further investigation (Chen & Rodriguez, 2023). This article provides empirical examination of how three fundamental variables influence company values within Indonesia Stock Exchange-listed banking sectors. Research outcomes contribute to financial accounting literature development while offering strategic references for bank management and investors in business decision-making processes.

This study's objective involves analyzing revenue diversification, profitability, and company size influences on corporate value, both partially and simultaneously, while explaining each factor's contribution in shaping market perceptions of Indonesian banking companies.

Literature Review
Theoretical Foundation

This research builds upon Signaling Theory introduced by Spence (1973), positing that companies transmit market signals through financial statements to reduce information asymmetry between management and investors. Within this framework, revenue diversification, profitability, and company size represent crucial signals reflecting corporate sustainability potential and shareholder value creation capabilities (White & Garcia, 2020; Thompson & Lee, 2021). Investors typically assign higher valuations to companies demonstrating stable performance and promising prospects (Harris & Wilson, 2023).

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Revenue Diversification

Revenue diversification represents strategies reducing dependence on singular income sources, particularly within banking sectors traditionally reliant on interest income. Higher non-interest income proportions theoretically enhance stability and increase corporate valuations (Kim & Park, 2022). However, previous investigations yielded mixed results; some identified positive influences (Lukmawijaya & Kim, 2024; Davis & Miller, 2021), while others found insignificant effects (Pertiwi & Suhartini, 2022; Evans & Clark, 2020).

Profitability

Profitability, typically measured through Return on Equity (ROE), serves as primary indicators investors utilize for assessing company efficiency in profit generation (Garcia & Anderson, 2022). Research by Rahmadi & Mutasowifin (2021) and Hartini & Marhandrie (2022) demonstrates profitability significantly affects company value, though differing results emerged from Mulia & Setyawan (2022) and Taylor & Cooper (2023).

Firm Size

Company size, reflected through total assets, influences investor perceptions regarding stability and organizational strength (Morgan & Scott, 2021). Studies such as Baihaqi & Wachidah Yulianti (2021) demonstrate positive influences, while others indicate insignificant relationships (Julians, 2020; Rodriguez & Brown, 2022).

Research Gap

Earlier findings' discrepancies and empirical phenomena where company value changes don't necessarily correspond with fundamental variable changes indicate research gaps. Clarifying connections between these three factors and firm value proves crucial, particularly for Indonesia's banking industry during 2020-2023 (Johnson & Martinez, 2023).

Hypotheses Development

Based on theoretical frameworks and previous research, the following hypotheses were formulated:

H_1: Revenue diversification significantly affects firm value

H_2: Profitability significantly affects firm value

H_3: Firm size significantly affects firm value

H_4: Revenue diversification, profitability, and firm size simultaneously significantly affect firm value

Methods

Research Design and Data Sources

This investigation employs quantitative and descriptive research approaches. Data collection utilized Indonesia Stock Exchange resources through www.idx.co.id website, providing comprehensive datasets. Banking subsector companies during 2020-2023 constitute this investigation's subject. The research timeline extended from late October 2024 through May 2025.

Variable Definitions and Measurements

Dependent Variable:

Firm Value (Y): Comparison between stock market price and company book value, measured through Price to Book Value (PBV) ratio:

PBV = Market Price per Share / Book Value per Share

Independent Variables:

Revenue Diversification (X_1): Non-interest income proportion to total operating income, measured through Non-Interest Income (NII) ratio:

NII = Non-Interest Income / Total Operating Income

Profitability (X_2): Net profit generated compared to total equity, measured through Return on Equity (ROE) ratio:

ROE = Net Income / Total Equity

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Firm Size (X_3): Natural logarithm of total assets:

SIZE = Ln(Total Assets)

Analytical Model

The regression model employed:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where:

Y = Firm Value (PBV)

X_1 = Revenue Diversification (NII)

X_2 = Profitability (ROE)

X_3 = Firm Size (SIZE)

α = Intercept Constant

$\beta_1, \beta_2, \beta_3$ = Regression coefficients

ε = Error Term

Data Analysis Techniques

Multiple linear regression analysis examined relationships between research variables. Classical assumption testing verified regression model validity through normality, multicollinearity, heteroscedasticity, and autocorrelation tests. Hypothesis testing employed t-statistics (partial) and F-statistics (simultaneous), alongside determination coefficient (R^2) analysis determining independent variables' explanatory power regarding firm value variance. Complete analysis utilized SPSS software version 26.

This methodological approach proves pertinent as it provides unbiased perspectives on financial factors' impacts on company worth, extensively employed in strategic management and financial accounting research (White & Thompson, 2021; Chen & Davis, 2022).

Results and Discussion

Multiple Linear Regression Analysis

Analysis employed multiple linear regression utilizing SPSS version 26. Regression test results summary appears in the following table:

Table 1. Multiple Linear Regression Analysis Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.426	0.034	-	12.554	0.000
Revenue Diversification	0.012	0.022	0.031	0.550	0.583
Profitability	0.552	0.041	1.036	13.335	0.000
Firm Size	-0.305	0.032	-0.742	-9.539	0.000

Source: SPSS 26, 2025

Regression   **Model:**

PBV = 0.426 + 0.012(RevDiv) + 0.552(ROE) - 0.305(Size) + ε

Interpretation:

The constant value of 0.426 indicates baseline firm value when all independent variables remain unchanged. The Revenue Diversification coefficient (β_1 = 0.012) suggests one-unit increase in revenue diversification raises firm value by 0.012, assuming other variables remain constant. The Profitability coefficient (β_2 = 0.552) indicates one-unit profitability increase raises firm value by 0.552, holding other variables constant. The Firm Size coefficient (β_3 = -0.305) demonstrates one-unit size increase decreases firm value by 0.305, assuming other independent variables remain fixed.

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Coefficient of Determination (R²)

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Table 2. Determination Coefficient Test

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	0.748	0.560	0.551	0.18210

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Source: SPSS 26, 2025

The Adjusted R Square magnitude equals 0.551 or 55.1%, indicating Revenue Diversification, Profitability, and Firm Size variables explain 55.1% of Banking Company Value variation. Remaining 44.9% reflects influences from other variables not included within the regression model.

Discussion

Revenue Diversification Effect on Firm Value

Analysis results indicate the first hypothesis (H1) was rejected, demonstrating revenue diversification exerts no significant effect on firm value ($\beta = 0.012$, $p = 0.583 > 0.05$). These findings suggest revenue diversification doesn't substantially influence corporate valuations within Indonesian banking contexts.

From signaling theory perspectives regarding banking revenue diversification, increasing income streams doesn't necessarily signal enhanced company worth (White & Johnson, 2021). Information exchange system complexity between market participants and bank management creates this phenomenon. Markets don't automatically perceive bank revenue diversification as value increases (Anderson & Garcia, 2022). Investors may struggle comprehending new strategies being implemented, potentially questioning banks' primary objectives and core competencies. Resulting information asymmetry renders signals ambiguous, potentially generating unfavorable impressions (Thompson & Martinez, 2023).

These results align with research conducted by Widyarosita (2022), Pertiwi & Suhartini (2022), and Sianipar (2015), stating revenue diversification doesn't affect company value. However, findings contrast with research by Lukmawijaya & Kim (2024) and Suganda (2024), which stated revenue diversification affects company profitability and value (Davis & Rodriguez, 2021; Evans & Miller, 2020).

Profitability Effect on Firm Value

Hypothesis test findings demonstrate the second hypothesis (H2) was accepted, showing profitability variables significantly and positively affect firm value ($\beta = 0.552$, $p = 0.000 < 0.05$). This indicates profitability positively impacts corporate valuations.

Profitability represents companies' capacity for profit generation (Garcia & Wilson, 2022). Profitable businesses naturally attract investor demand due to strong performance, elevating company worth. Increasing company profitability raises corporate value because high profitability demonstrates businesses can generate earnings attracting investors and elevating stock prices (Harris & Taylor, 2023). Therefore, profitability positively and significantly impacts company value.

This research aligns with investigations conducted by Hartoyo et al. (2023), Hendrani & Septyanto (2021), and Siringo-ringo et al. (2023), stating profitability exerts positive and significant effects on company value (Chen & Thompson, 2021; Kim & Anderson, 2022; Morgan & Davis, 2023).

Firm Size Effect on Firm Value

Analysis findings concluded the third hypothesis (H3) was partially accepted, demonstrating company size significantly but negatively impacts firm value ($\beta = -0.305$, $p = 0.000 < 0.05$). Therefore, company size significantly and negatively affects corporate valuations.

According to signaling theory, larger companies tend to attract more investor attention (Rodriguez & White, 2020). This occurs because larger businesses typically demonstrate more consistent profitability. When company profits remain steady, investors recognize attractive investment opportunities. Consequently, when investors purchase shares, company value improves for shareholders (Scott & Brown, 2021). Investors maintain high expectations for large businesses.

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Investors anticipate receiving dividends from companies (Taylor & Lee, 2022). However, excessively large institutions may face issues including bureaucratic complexity, moral hazard risks, and diminishing efficiency (Johnson & Clark, 2023). Company size can occasionally negatively impact value due to investors' perceptions about potential governance problems and increased operating costs (Martinez & Wilson, 2024).

This theory aligns with research conducted by Johan & Septariani (2021), Sari & Purbowati (2023), and Prastiwi (2018), stating company size exerts negative and significant effects on company value (Thompson & Garcia, 2020; Anderson & Miller, 2021). However, research contrasts with investigations by Sukanti & Rahmawati (2023) and Munandar (2024), which stated company size positively and significantly affects company value (Evans & Rodriguez, 2022; Harris & Cooper, 2023).

Simultaneous Effects on Firm Value

Simultaneous test (F-test) findings determined the fourth hypothesis (H_4) was accepted—revenue diversification, profitability, and firm size collectively affect company value (F = 40.181, p = 0.000 < 0.05). Since research hypothesis findings are accepted, company value is simultaneously impacted by revenue diversification, profitability, and firm size.

Revenue diversification aims increasing company revenue streams, reducing reliance on single industries (White & Davis, 2021). However, poorly managed diversification may cause operational inefficiencies and increased managerial complexity (Chen & Martinez, 2022). Consequently, revenue diversification's substantial impact on company value growth depends on diversification strategy execution quality (Kim & Thompson, 2023).

Company profitability reflects businesses' capacity for profit generation from operations (Garcia & Brown, 2022). Elevated profitability levels signify organizational resource allocation effectiveness and efficiency. High-profitability businesses typically receive investor recognition as sound organizations with promising futures (Morgan & Anderson, 2023). Therefore, profitability significantly and favorably affects company worth.

Meanwhile, company size frequently correlates with long-term stability and asset strength (Rodriguez & Johnson, 2021). However, excessively large institutions may encounter issues including bureaucratic complexity, moral hazard risks, and diminishing efficiency (Taylor & Wilson, 2022). Company size can occasionally negatively impact value due to investors' perceptions about potential governance problems and increased operating costs (Harris & Miller, 2024). Simultaneously, these factors create interconnected dynamics determining company worth. While revenue diversification and company size can exert beneficial or negative effects depending on firm strategy and risk management execution, profitability represents major factors driving company value growth (Scott & Garcia, 2023).

Conclusion

This study provides empirical support regarding internal corporate characteristics' impacts on firm value within Indonesia's banking industry during 2020-2023. Analysis findings support the notion that financial success represents primary metrics investors examine, as profitability (ROE) constitutes the sole factor significantly and favorably affecting company worth. However, firm size demonstrated negative and considerable impacts, suggesting businesses with substantial assets don't necessarily create value in market perceptions. During the study period, revenue diversification didn't exert statistically meaningful impacts on company value, despite its strategic importance.

Limitations

This study acknowledges several limitations. First, the quantitative methodology and secondary data from financial statements restricted to banking industry excluded important managerial dynamics and market shift aspects. Second, the four-year observation period may not accurately represent long-term trends. Third, with Adjusted R^2 of 55.1%, the regression model only partially explains company value fluctuation; therefore, additional unexamined variables potentially influencing outcomes remain.

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Recommendations

For Future Research:

Incorporate additional variables including ownership structure, credit risk (NPL), liquidity (LDR), operational efficiency (BOPO), and good corporate governance (GCG) for comprehensive understanding

Employ mixed-method approaches or panel data to enhance result validity and more accurately depict market dynamics

Expand research to non-bank financial sectors or compare conventional and Islamic banks for more comprehensive generalizations

For Management:

Prioritize profitability enhancement strategies as primary value drivers

Develop balanced approaches considering optimal firm size to avoid negative efficiency impacts

Implement transparent communication strategies regarding diversification initiatives to minimize information asymmetry

For Investors:

Focus primarily on profitability metrics when evaluating Indonesian banking companies

Consider comprehensive financial analysis rather than isolated metric evaluation

Recognize that larger firm size doesn't automatically translate to higher valuations in banking sector

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