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Determinants of Firm Financial Performance: Panel Data Evidence from LQ45 Companies in Indonesia

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Abstract: This study aims to examine the factors affecting the financial performance of companies included in the LQ45 index on the Indonesia Stock Exchange by integrating macroeconomic stability and market-based indicators. Financial performance is measured by return on equity, while the independent variables include inflation, exchange rate, price-to-book value, dividend yield, and firm size. This study employs a quantitative approach using panel data from 37 companies over the period 2021 to 2025. The data are analyzed using panel regression with model selection conducted through Chow test, Lagrange Multiplier test, and Hausman test. The results indicate that the fixed effect model is the most appropriate model. Partially, price-to-book value, dividend yield, and firm size have a positive and significant effect on financial performance, while the exchange rate has a negative and significant effect. Inflation does not have a significant effect on financial performance. These findings indicate that firm-specific factors play a more dominant role than macroeconomic variables in determining financial performance. This study contributes to financial literature in emerging markets and provides insights for investors and policymakers in decision making.

Keyword: Financial Performance, Price-To-Book Value, Dividend Yield, Firm Size, Exchange Rate

INTRODUCTION

The performance of firms in capital markets has become an increasingly important issue, particularly in emerging economies such as Indonesia. As one of the most dynamic capital markets in Southeast Asia, the Indonesian Stock Exchange (IDX) plays a crucial role in facilitating investment and economic growth. Companies included in the LQ45 index represent the most liquid and fundamentally strong firms, making them a relevant proxy for analyzing corporate financial performance.

Firm financial performance, commonly measured by Return on Equity (ROE), reflects a company's ability to generate profits for its shareholders and is widely used to evaluate managerial efficiency (Brigham & Houston, 2010). However, firm performance is influenced not only by internal factors but also by broader macroeconomic conditions and market-based indicators.

From a macroeconomic perspective, the Arbitrage Pricing Theory explains that systematic factors such as inflation and exchange rates play an important role in determining firm performance (Chen et al., 1986; Ross, 2013). Inflation affects purchasing power, production costs, and economic stability, while exchange rate fluctuations influence firm revenues and costs, particularly for firms engaged in international trade (Dornbusch et al., 2014; Mankiw, 2019). Empirical evidence shows inconsistent findings, where some studies report significant effects of inflation and exchange rates on firm performance, while others find insignificant relationships (Aryantini & Jumono, 2021; Rahim et al., 2025).

From a market-based perspective, Signaling Theory suggests that financial indicators convey important information about firm quality to investors. Price-to-Book Value (PBV) reflects market valuation relative to book value and is often associated with growth expectations (Damodaran, 2012), while dividend yield represents returns to investors and signals financial strength. In line with Dividend Theory, dividend payments are considered a positive signal of firm performance (Gordon, 1963; Modigliani & Miller, 1963). In addition, firm size reflects economies of scale and access to financial resources, which are expected to enhance profitability (Damodaran, 2012).

Despite the strong theoretical foundation, empirical findings remain inconclusive, particularly in the Indonesian context. Some studies report that inflation and exchange rates significantly affect firm performance, while others find weak or insignificant effects (Dithania & Suci, 2022; Suhartini et al., 2024). Similarly, the effects of PBV, dividend yield, and firm size on financial performance vary across studies (Hanif et al., 2020; Ontoraël et al., 2024; Syafitri, 2025). These inconsistencies highlight a research gap in understanding the combined effects of macroeconomic and firm-specific variables.

Furthermore, most previous studies tend to examine macroeconomic factors and firm-specific variables separately rather than integrating them into a comprehensive analytical framework. In addition, limited studies focus specifically on LQ45 companies using panel data approaches, which are more robust in capturing both cross-sectional and time-series variations (Baltagi, 2021; Gujarati & Porter, 2020).

This study offers several novelties. First, it integrates macroeconomic variables and firm-specific factors into a unified panel data framework, which is rarely addressed simultaneously in prior studies. Second, it focuses on LQ45 companies as a proxy for highly liquid and fundamentally strong firms in an emerging market context. Third, it provides recent empirical evidence covering the period 2021–2025, capturing post-pandemic economic dynamics.

Based on the theoretical and empirical considerations, inflation and exchange rates are expected to influence firm financial performance as macroeconomic factors, while Price-to-Book Value, dividend yield, and firm size are expected to have a positive relationship with financial performance as firm-specific indicators.

Therefore, this study aims to examine the determinants of firm financial performance by integrating macroeconomic stability and firm-specific factors using a panel data approach on LQ45 companies in Indonesia. The findings are expected to contribute to the development of corporate finance literature and provide practical implications for investors and policymakers in emerging markets.

METHOD

This study employs a quantitative research approach with a causal explanatory design to examine the determinants of firm financial performance. A quantitative approach is appropriate as it allows for objective measurement and statistical testing of relationships among variables, while the explanatory design aims to identify causal relationships between macroeconomic stability, market factors, and firm performance (Creswell, 2022).

The population of this study consists of all companies included in the LQ45 index listed on the Indonesian Stock Exchange (IDX). Initially, 45 companies were identified as the population; however, based on purposive sampling criteria particularly data completeness during the observation period 37 companies were selected as the final sample. The study uses panel data covering the period from 2021 to June 2025, combining cross-sectional and time-series dimensions, which provides more informative data and improves estimation efficiency (Baltagi, 2021; Gujarati & Porter, 2020).

The variables used in this study consist of one dependent variable and several independent variables. The dependent variable is firm financial performance proxied by Return on Equity (ROE), while the independent variables include inflation, exchange rate, Price-to-Book Value (PBV), dividend yield, and Size. ROE reflects the firm’s ability to generate profit from shareholders’ equity (Brigham & Houston, 2010). Inflation represents macroeconomic stability (Mankiw, 2019), while exchange rate reflects external economic conditions (Dornbusch et al., 2014). PBV and dividend yield capture market-based signals (Damodaran, 2012; Gordon, 1963), and firm size reflects economies of scale and access to resources (Damodaran, 2012). The operational definitions of variables are presented in Table 1.

Table 1. Operational Definition of Variables

Variable	Operational Definition	Measurement / Formula	Unit	Data Source
Return on Equity (Y)	A financial performance indicator measuring the firm's ability to generate profit from shareholders' equity. (Brigham & Houston, 2010; Ross, 2013)	ROE = Net Income / Total Equity	Percentage (%)	IDX Company Fact Sheet LQ-45
Inflation (X ₁)	The rate of increase in the general price level reflects macroeconomic stability. (Blanchard et al., 2021; Mankiw, 2019)	Consumer Price Index (CPI, annual %)	Percentage (%)	Statistics Indonesia
Exchange Rate (X ₂)	The value of Indonesian Rupiah against the US Dollar indicating external economic conditions. (Dornbusch et al., 2014)	JISDOR (IDR/USD)	Rupiah/USD	IDX Company Fact Sheet LQ-45
Price to Book Value (X ₃)	A market ratio reflects firm valuation relative to its book value. (Damodaran, 2012; Ross, 2013)	PBV = Market Price per Share / Book Value per Share	Ratio (x)	IDX Company Fact Sheet LQ-45
Dividend Yield (X ₄)	The ratio of dividends paid relative to stock price, indicating investor return. (Gordon, 1963; Modigliani & Miller, 1963)	Dividend Yield = Dividend per Share / Market Price per Share	Percentage (%)	IDX Company Fact Sheet LQ-45
Size (X ₅)	The scale of a company reflects its economic capacity and access to resources. (Damodaran, 2012)	Size = Ln (Total Assets)	Log (IDR)	IDX Company Fact Sheet LQ-45

The panel regression model used in this study is formulated as follows:

$$ROE_{it} = \beta_0 + \beta_1 Inflation_{it} + \beta_2 Exchange\ Rate_{it} + \beta_3 PBV_{it} + \beta_4 Dividend\ yield_{it} + \beta_5 Size_{it} + \varepsilon_{it}$$

To determine the most appropriate estimation model, several model selection tests are conducted. The Chow test is used to compare the Common Effect Model (CEM) and Fixed Effect Model (FEM), the Lagrange Multiplier (LM) test is used to compare CEM and Random Effect Model (REM), and the Hausman test is used to select between FEM and REM (Baltagi, 2021).

To ensure the validity of the regression results, several diagnostic tests are conducted, including multicollinearity, heteroskedasticity, and autocorrelation tests. Multicollinearity is examined using the Variance Inflation Factor (VIF), while heteroskedasticity and autocorrelation tests are applied to ensure that the model satisfies the assumptions of classical linear regression (Gujarati & Porter, 2020). These tests are essential to ensure that the estimation results are unbiased and reliable.

RESULT AND DISCUSSION

The descriptive statistics of the research variables during the period 2021–June 2025 reveal important trends in firm financial performance, macroeconomic conditions, and market indicators among LQ45 companies. Overall, the data indicate dynamic interactions between internal firm factors and external economic conditions.

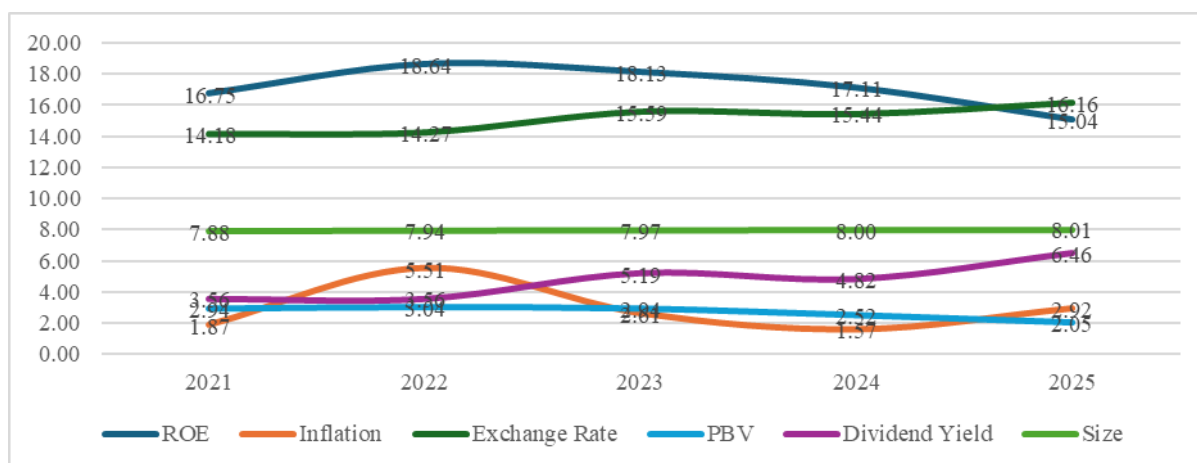


Figure 1. Trends of ROE, Inflation, Exchange Rate, PBV, Dividend Yield, and Firm Size of LQ45 Companies (2021– June 2025)

Firm financial performance, measured by Return on Equity (ROE), shows a fluctuating trend. ROE increased from 16.75% in 2021 to 18.64% in 2022, followed by a gradual decline to 15.04% in June 2025. This pattern suggests that firms experienced a post-pandemic recovery phase, followed by increasing pressures on profitability.

Inflation fluctuated significantly, rising sharply in 2022 before stabilizing in subsequent years, indicating relatively controlled macroeconomic conditions. In contrast, the exchange rate shows a consistent upward trend, reflecting a depreciation of the Indonesian Rupiah, which may increase operational costs for firms with foreign exposure.

From a market perspective, Price-to-Book Value (PBV) shows a declining trend, indicating weakening market valuation and investor confidence over time. Conversely, dividend yield exhibits an increasing trend, suggesting that firms may use dividend policies to maintain investor attractiveness. Meanwhile, firm size shows steady growth, indicating expansion and stability among LQ45 companies.

To determine the most appropriate panel data estimation model, the Chow test, Lagrange Multiplier (LM) test, and Hausman test were conducted. The summary of these tests is presented in Table 2.

Table 2. Summary of Panel Data Model Selection Tests

Test	Hypothesis	Statistic	Prob.	Decision	Conclusion
Chow Test (CEM vs FEM)	H ₀ : CEM is appropriate	F = 5.1668 $\chi^2 = 154.1479$	0.0000 0.0000	Reject H ₀	FEM is better than CEM
LM Test (CEM vs REM)	H ₀ : No random effects	BP = 9.5894 (Cross-section) BP = 11.3720 (Both)	0.0020 0.0007	Reject H ₀	REM is better than CEM
Hausman Test (FEM vs REM)	H ₀ : REM is appropriate	$\chi^2 = 81.7608$	0.0000	Reject H ₀	FEM is better than REM

Source: Processed Data Using EViews 13 (2025).

The Chow test results indicate that the Fixed Effect Model (FEM) is preferred over the Common Effect Model (CEM), as the probability value is statistically significant ($p < 0.01$), suggesting the presence of firm-specific effects. The LM test further shows that the Random Effect Model (REM) is more appropriate than CEM, indicating the existence of panel effects.

However, the Hausman test results reveal that FEM is more appropriate than REM ($p < 0.01$), indicating that individual effects are correlated with the explanatory variables. Therefore, the Fixed Effect Model is selected as the most appropriate model for this study, as it provides consistent and efficient estimates.

Table 3. Summary of Panel Data Regression Results

Variable	CEM (EGLS)	FEM (EGLS)	REM (GLS)
PBV	2.9797*** (15.70)	0.9789*** (3.74)	3.1703*** (24.94)
Log (Size)	0.4306*** (3.38)	9.3497*** (4.09)	-0.0106 (-0.02)
Dividend Yield	0.5843*** (9.89)	0.2627*** (3.62)	0.5449*** (7.57)
Exchange Rate	0.0421 (0.18)	-1.1191*** (-3.50)	-0.3018 (-0.46)
Inflation	0.2042* (1.66)	0.0355 (0.30)	0.2154 (0.60)
Constant (C)	-3.8265 (-0.88)	-141.2266*** (-3.62)	10.1463 (0.75)
R-squared	0.7416	0.8980	0.7315
Adjusted R-squared	0.7344	0.8688	0.7240
F-statistic	102.735***	30.712***	97.521***
Prob (F-stat)	0.0000	0.0000	0.0000
Durbin-Watson	1.204	1.890	1.281

Notes:

t-statistics are in parentheses

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

Source: Processed Data Using EViews 13 (2025).

Based on the results of the model selection tests, the Fixed Effect Model (FEM) is identified as the most appropriate estimation model. Therefore, the regression analysis focuses on the FEM results as the primary basis for interpretation. For completeness and comparison purposes, the estimation results of the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM) are presented in Table 3.

The FEM results indicate strong explanatory power, with an Adjusted R² of 0.8688, suggesting that the independent variables explain a substantial proportion of variation in financial performance. In addition, the Durbin–Watson statistic (1.890) is closer to the ideal value of 2 compared to the CEM and REM models, indicating that the FEM model has a lower risk of autocorrelation and provides more reliable estimates. Overall, firm-specific variables appear to play a more dominant role compared to macroeconomic variables, providing a basis for further interpretation.

The results underscore the importance of internal firm characteristics in shaping financial performance in emerging markets.

Price-to-Book Value and Financial Performance

The role of Price-to-Book Value (PBV) reflects investor confidence and future growth expectations embedded in market valuation. Firms with higher PBV tend to be perceived as having stronger fundamentals and better prospects, which enhances their ability to attract capital and improve operational performance. This interpretation is consistent with Signaling Theory, where market-based indicators serve as signals of firm quality. Empirical evidence in Indonesia by (Hanif et al., 2020; Sidauruk et al., 2022) supports this view, showing that PBV positively influences firm profitability and value. Internationally, (Fama & French, 1992) also highlight the importance of valuation metrics in explaining firm performance, reinforcing PBV as a forward-looking indicator.

Beyond signaling effects, PBV can also be interpreted as a reflection of market efficiency, where stock prices incorporate available information about firm fundamentals and future performance. In this context, firms with higher PBV are more likely to benefit from lower cost of capital and greater financing flexibility, enabling them to undertake value-enhancing investments. This perspective is supported by investment-based views of firm valuation, which suggest that market expectations influence corporate investment decisions and ultimately shape financial performance. Empirical evidence by (Chen et al., 1986; McConnell & Servaes, 1995) further indicates that firms with favorable market valuations tend to achieve superior performance due to better alignment between market expectations and managerial decisions.

Firm Size and Financial Performance

Firm size represents the scale of operations and reflects a firm's capacity to utilize resources efficiently. Larger firms generally benefit from economies of scale, stronger bargaining power, and greater access to external financing, which enhances their profitability. In addition, larger firms tend to be more resilient to economic shocks due to diversified operations and stable revenue streams. This finding is consistent with (Setiawan & Sha, 2022; Syafitri, 2025) in the Indonesian context. At the international level, (Rajan & Zingales, 1995) argue that larger firms have better access to capital markets, while (Beck et al., 2005) show that firm size reduces financial constraints and improves performance, particularly in developing economies.

Beyond scale advantages, firm size is also associated with organizational capability and strategic flexibility in managing complex business environments. Larger firms tend to possess more sophisticated management systems, better risk management practices, and greater ability to invest in innovation and technology, which can further enhance long-term performance. From a resource-based view, firm size reflects the accumulation of valuable resources and capabilities that provide competitive advantage. Empirical evidence by (Penrose, 1997) and more recent studies such as (Beck et al., 2005) suggest that larger firms are better positioned to exploit growth opportunities and sustain performance due to their superior resource endowment and institutional support.

Dividend Yield and Financial Performance

Dividend yield reflects the firm's ability to distribute earnings to shareholders and signals financial strength and stability. Firms that consistently pay dividends are often perceived as having stable cash flows and strong profitability. This interpretation aligns with Dividend Theory, which suggests that dividend payments convey positive information about firm performance and prospects. Empirical studies in Indonesia by (Ontorael et al., 2024) confirm that dividend policy strengthens investor confidence. International evidence from (Denis & Osobov, 2008; Kent Baker & Powell, 2012) also shows that dividend-paying firms tend to exhibit better performance and lower uncertainty.

Beyond its signaling role, dividend yield can also be viewed as a mechanism to mitigate agency problems between managers and shareholders. By distributing earnings as dividends, firms reduce the availability of free cash flow that might otherwise be used for inefficient investments or managerial opportunism. This perspective is rooted in agency theory, which emphasizes the role of dividend policy in aligning managerial actions with shareholder interests. Empirical evidence by (Jensen & Meckling, 1976) supports this argument, suggesting that dividend payments serve as a disciplinary mechanism that enhances corporate governance and efficiency. Additionally, (La Porta et al., 2000) show that firms operating in environments with stronger investor protection tend to distribute higher dividends, reinforcing the link between dividend policy, governance quality, and firm performance.

Exchange Rate and Financial Performance

Exchange rate movements reflect external economic conditions that influence firm performance, particularly for firms exposed to international transactions. Currency depreciation increases the cost of imported inputs and foreign-denominated liabilities, thereby reducing profitability. This interpretation is consistent with the Arbitrage Pricing Theory, which identifies exchange rates as a key systematic risk factor. Empirical evidence from Indonesia by (Lestari et al., 2020) supports this finding, while international studies such as (Bartram, 2008; Jorion, 1990) demonstrate that exchange rate volatility significantly affects firm value and profitability.

Beyond its direct cost implications, exchange rate fluctuations also influence firm performance through uncertainty and risk exposure channels. Volatility in exchange rates can create unpredictability in cash flows, investment planning, and financial reporting, which may lead firms to adopt more conservative strategies and reduce expansion activities. Firms with limited hedging capabilities are particularly vulnerable to such fluctuations, resulting in higher financial risk and lower profitability. Empirical evidence by (Allayannis & Ofek, 2001) suggests that firms engaging in hedging strategies are better able to mitigate exchange rate risk, while studies by (Kiyamaz, 2003) indicate that exchange rate volatility can significantly affect firm value depending on the degree of international exposure.

Inflation and Financial Performance

The role of inflation appears to be limited in influencing firm financial performance, suggesting that firms can adapt to moderate changes in price levels. Firms may adjust pricing strategies, manage costs, and maintain operational efficiency to mitigate inflationary pressures. This finding is consistent with (Dithania & Suci, 2022; Lestari et al., 2020), which show that inflation does not significantly affect firm performance in Indonesia. International evidence by (Boyd et al., 2001) also indicates that moderate and predictable inflation does not necessarily harm firm profitability.

Beyond its direct impact, inflation may influence firm performance indirectly through its interaction with other macroeconomic variables, such as interest rates and consumer purchasing power. When inflation is stable and anticipated, firms can incorporate expected cost changes into their pricing and financial planning, thereby minimizing its adverse effects. However, in conditions of high or volatile inflation, uncertainty may disrupt investment decisions and reduce demand, ultimately affecting profitability. Empirical studies by (Bruno & Easterly, 1998; Fischer, 1993) suggest that inflation only becomes detrimental to economic and firm performance when it exceeds certain thresholds, indicating that moderate inflation can be absorbed without significantly impairing firm outcomes.

Based on these findings, the hypotheses proposed in this study are partially supported. Firm-specific factors, including Price-to-Book Value, firm size, and dividend yield, play a significant role in enhancing financial performance. In contrast, exchange rate movements

represent a key external risk factor that negatively affects firm outcomes, while inflation shows a limited impact. These results indicate that internal firm characteristics are more dominant than macroeconomic variables in explaining financial performance in emerging markets.

This pattern suggests that firm-level strategic decisions, market positioning, and financial policies are more decisive in driving profitability than external macroeconomic fluctuations. In emerging markets, where structural inefficiencies and information asymmetry are often present, firm-specific factors tend to have a stronger influence on performance outcomes. Consequently, these findings reinforce the importance of strengthening internal financial management, improving market valuation, and maintaining investor confidence as key strategies for sustaining firm performance.

CONCLUSION

This study examines the determinants of firm financial performance by integrating macroeconomic stability and firm-specific factors using a panel data approach on LQ45 companies in Indonesia. The findings reveal that firm-specific variables, namely Price-to-Book Value, firm size, and dividend yield play a more dominant role in explaining financial performance compared to macroeconomic variables. Exchange rate fluctuations are found to negatively affect firm performance, while inflation shows no significant impact.

This study contributes to the corporate finance literature by providing empirical evidence that firm-specific factors outweigh macroeconomic variables in determining financial performance within an emerging market context. By integrating macroeconomic and firm-level variables into a unified panel data framework, this study extends existing research that often examines these factors separately. The findings also reinforce the relevance of signaling theory, dividend theory, and Arbitrage Pricing Theory in explaining firm performance, while highlighting the stronger explanatory power of internal firm characteristics.

From a managerial perspective, the results suggest that firms should focus on strengthening internal financial fundamentals, enhancing market valuation, and maintaining consistent dividend policies to improve performance. Firms should also actively manage exchange rate risk through hedging strategies and financial risk management practices.

From a policy perspective, the findings highlight the importance of maintaining exchange rate stability to support corporate performance, particularly in emerging markets. Policymakers are also encouraged to create a stable macroeconomic environment that supports firm growth while improving market transparency and investor confidence.

This study has several limitations that should be acknowledged. First, the analysis is limited to companies included in the LQ45 index, which represent large and highly liquid firms. As a result, the findings may not fully generalize to small and medium-sized enterprises or firms in other sectors. Second, this study includes a limited number of macroeconomic variables, focusing only on inflation and exchange rate, which may not capture the full spectrum of macroeconomic influences on firm performance.

Future research is recommended to extend this study by incorporating additional variables, such as interest rates, corporate governance, and Environmental, Social, and Governance (ESG) factors, to provide a more comprehensive analysis. In addition, cross-country studies are encouraged to compare the determinants of firm performance across different institutional and economic environments. Further research may also explore the use of advanced methodologies, such as machine learning or dynamic panel models, to enhance the robustness of empirical findings.

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