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The Influence of Income Diversification and External Risk on Financial Performance and Stock Prices of Banks Listed on the Indonesia Stock Exchange

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ABSTRACT: *This study aims to examine the influence of Income Diversification and External Risk on the Financial Performance and Stock Prices of Banks Listed on the Indonesia Stock Exchange. The research sample consists of 23 banking companies listed on the Indonesia Stock Exchange. Data analysis was conducted using the Structural Equation Model (SEM) approach with the SmartPLS software. The findings reveal that income diversification has a direct negative effect on the financial performance of banking companies, though this effect is not statistically significant. Conversely, income diversification has a direct positive effect on stock prices, with the analysis indicating statistical significance. External risk shows a direct positive impact on financial performance but does not reach the level of statistical significance. Likewise, external risk has a direct negative effect on stock prices, though it is also not statistically significant. Financial performance demonstrates a direct positive impact on stock prices, with statistically significant results. Additionally, there is a negative indirect effect of income diversification on stock prices through financial performance, which is not statistically significant. In contrast, external risk has a positive indirect effect on stock prices through financial performance, with statistical significance. These findings highlight the complex relationships between income diversification, external risk, financial performance, and stock prices of banking companies on the Indonesia Stock Exchange.*

KEY WORD: *Income Diversification, External Risk, Financial Performance, Stock Prices.*

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I. INTRODUCTION

The stock prices of banking companies listed on the Indonesia Stock Exchange (IDX) serve as indicators of these companies' market value, with prices determined by the forces of supply and demand. When investors show strong interest in purchasing shares of a specific bank, the stock price tends to rise, while it declines if many investors decide to sell. These stock price fluctuations reflect a range of influencing factors, including the financial performance of banks, broader economic conditions, regulatory decisions, and market sentiment. As noted by Prawiranegara and Setiawati (2017), fluctuations in stock prices can be impacted by the bank's internal performance as well as external economic factors. For instance, investor sentiment around a bank's performance and growth potential can significantly influence stock prices, with positive financial performance often translating into increased stock prices.

Financial performance is tightly linked with stock prices, as good financial results typically bolster investor confidence. A crucial indicator of a bank's financial health is the non-performing loan ratio, where a lower ratio suggests effective risk management and supports a stable investment outlook. Natalia (2015) highlights that financial indicators, such as loan-to-deposit ratio, capital adequacy ratio, and operational efficiency, are essential metrics for evaluating a bank's ability to manage its resources effectively and support profitable outcomes. High operational efficiency, reflecting a bank's ability to manage operational costs effectively, can result in increased profitability, which is positively viewed by investors and can lead to stock price appreciation. Further supporting this notion, research by Yustyarani and Yuliana (2020) indicates that the efficient allocation of resources and reduced operational costs are correlated with an improvement in a bank's financial performance, which can subsequently increase stock prices.

In managing economic volatility, many banks turn to income diversification as a strategic response, aiming to reduce reliance on traditional interest income, which is often subject to fluctuations in loan interest rates. This strategy includes developing fee-based income streams as an alternative source of revenue. Fee-based income has gained traction in the banking sector as technology advances, with digital banking services, credit card programs, and other innovations becoming profitable revenue channels (Prawiranegara & Setiawati, 2017). According to Kumar et al. (2019), income diversification into non-interest sectors has helped banks reduce credit risk and manage overall financial risk more effectively, highlighting its importance in maintaining financial stability. Gurbuz et al. (2013) and Brahmana et al. (2018) further affirm that income diversification can positively influence a bank's financial performance by stabilizing revenue streams and providing a buffer against potential revenue losses from interest income, ultimately supporting a healthier financial position.

A growing body of research underscores the impact of income diversification and external risks on financial performance and stock prices, with financial performance often serving as a mediating variable. Studies by Smith and Johnson (2020) and Li and Wang (2018) demonstrate that diversification strategies positively affect banks' profitability metrics, such as Return on Assets (ROA) and Return on Equity (ROE), leading to long-term financial stability and improved stock prices. Similarly, research by Natalia et al. (2016) and Jiang and Han (2018) shows that income diversification enhances market value and stock price stability, as banks diversify revenue beyond interest income, benefiting from more stable cash flows and decreased sensitivity to interest rate fluctuations. Notably, Wijaya and Sari (2015) found that income diversification not only boosts profitability but also helps reduce the risks banks face, though Suharno (2016) cautions that the benefits of diversification may vary depending on each bank's specific business context.

External risks, including macroeconomic factors such as exchange rates, inflation, and interest rates, also play a critical role in shaping banks' financial performance and stock prices. Research by Khurram et al. (2018) and Ashenafi et al. (2013) highlights the significance of external factors, with inflation and exchange rates shown to affect a bank's profitability and efficiency. Hamid et al. (2020) found that adverse macroeconomic conditions could reduce ROA and ROE, increasing financial strain on banks. Political risk, as discussed by Sari and Wijaya (2019), negatively impacts financial performance by increasing operating costs, disrupting business operations, and diminishing profitability. Kurniawan and Setiawan (2018) further found that macroeconomic instability substantially influences financial outcomes, while Pratiwi and Suryanto (2017) showed that political uncertainty can deter investment, adversely affecting banks' earnings and stock prices.

The influence of external risk on stock prices is equally noteworthy. Istanti (2022), Nugroho et al. (2020), and Paragina and Leon (2020) found that macroeconomic fluctuations, such as changes in interest rates and currency exchange rates, lead to stock price volatility. Al-Mohana and Al-Khazali (2017) identified political risk as a significant factor affecting stock prices in Arab markets, where investor confidence is often shaken by political uncertainties. Similarly, Chen, Chen, and Ku (2016) concluded that geopolitical risk negatively impacts global stock prices, as investors become more risk-averse during uncertain periods.

Financial performance serves as a critical mediating variable, bridging the relationship between external risk and stock prices, as well as between income diversification and stock prices. Studies by Brastama et al. (2020), Dinu and Bunea (2022), and Hac et al. (2021) validate that financial metrics like ROA, ROE, and other financial ratios significantly impact stock prices by shaping investors' perception of a company's financial health. Tanjungsari (2018) and Rusdiyanto et al. (2018) found that financial ratios, such as the capital adequacy ratio and net interest margin, influence stock prices as these indicators reflect financial stability, which is valued by investors.

This empirical foundation underscores the importance of financial performance in linking external factors and internal strategies, such as income diversification, to stock prices in the capital market. These findings emphasize the necessity for banks to manage external risks and implement effective income diversification strategies to enhance financial performance and attract investors, thus creating value and stability in the stock market. Consequently, this study seeks to deepen the understanding of these dynamics by examining the hypothesis that financial performance mediates the relationship between external risks, income diversification, and stock prices of banking companies on the IDX.

The study also investigates the phenomenon of income overconcentration risk, where banks risk becoming overly dependent on certain income streams if income diversification is not managed wisely. According to Alamsyah et al. (2015), improper implementation of diversification strategies may expose banks to overconcentration in specific sectors or products, heightening their overall portfolio risk. External risks, such as exchange rate volatility and global uncertainties, are additional challenges faced by banks listed on the IDX. For instance, fluctuations in currency values can affect the valuation of assets and liabilities, creating adverse effects on financial performance (Hadad, Wimboh, & Arianto, 2018). As Goeltom (2017) notes, Indonesia's economic crises have historically impacted the banking sector, leading to necessary regulatory adjustments and transforming Bank Indonesia's status to an independent institution.

By addressing these challenges, this study aims to provide empirical evidence on whether income diversification and external risks significantly impact financial performance, subsequently affecting stock prices of banking companies listed on the IDX. The objectives of this study are to explore the direct effects of income diversification and external risks on financial performance, examine their direct effects on stock prices, and assess the mediating role of financial performance. This research not only fulfills the author's requirements for a Master's degree in Management from Universitas Mulawarman but also provides insights for banking industry stakeholders and contributes to the academic literature on Indonesia's banking industry. The findings are expected to assist banks in strategically managing income diversification and external risks to strengthen financial performance and achieve favorable stock price outcomes, ultimately supporting a stable and resilient banking sector.

II. LITERATURE REVIEW

Income Diversification and Financial Performance

The impact of income diversification on the financial performance of banks listed on the Indonesia Stock Exchange (IDX) can be understood through several mechanisms and factors that play a vital role in the dynamics of the banking industry. In this context, income diversification refers to a bank's strategy to expand its revenue sources by offering a variety of products and services, including non-interest products such as insurance, asset management, and other financial services.

Income diversification can help banks reduce their dependence on a single source of income, particularly interest from loans. By having a broader range of revenue sources, banks have the potential to generate more stable earnings, even during volatile market conditions. Offering a variety of products and services enables banks to mitigate credit risk, as they are less reliant on any particular sector or customer. Diversifying the loan portfolio can be a crucial step in managing credit risks that may arise from economic sectors facing difficulties.

Additionally, diversification opens opportunities for banks to expand their markets and strengthen their competitive position. By providing various products that meet customer needs, banks can attract more clients and increase their market share. Offering a range of products and services can also help banks optimize the use of their resources and infrastructure, creating operational efficiencies, especially if income diversification is managed effectively. Through income diversification, banks can improve their overall financial performance.

Financial performance may be positively influenced if diversification aligns well with market demands. With multiple revenue sources, banks can respond more effectively to changes in the business environment, including interest rate fluctuations, economic conditions, and other external factors. Income diversification can also help banks reduce risks stemming from external factors, such as exchange rate fluctuations, inflation, and interest rate changes.

A diverse income portfolio can provide protection against shifts in external conditions. Income diversification in the banking sector on the IDX may have a significant impact on financial performance. However, the effectiveness of this diversification depends on the proper implementation of strategies, a deep understanding of the market, and robust risk management capabilities. Comprehensive financial performance analysis and continuous monitoring of the effects of income diversification are essential for understanding and optimizing its impact on the banking sector within Indonesia's capital market.

Empirical studies supporting the relationship between these variables include the following: The influence of income diversification on financial performance is supported by Brahmana et al. (2018), Gurbuz et al. (2013), and Ismail et al. (2020), who found that income diversification significantly affects financial performance. According to Smith & Johnson (2020), banks that successfully implement income diversification strategies tend to achieve higher Return on Assets (ROA) and Return on Equity (ROE) compared to less diversified banks. Li & Wang (2018) found that income diversification can contribute positively to long-term financial performance. The research by Kumar et al. (2019) also suggests that banks that diversify their income into non-interest sectors tend to have lower risk levels, especially concerning credit risk and market risk. Based on the relationship between these variables, the first hypothesis in this study is proposed as follows:

H1: The hypothesis is accepted if Income Diversification significantly influences the Financial Performance of Banks listed on the Indonesia Stock Exchange.

Income Diversification and Stock Prices

The impact of income diversification on the stock prices of banking companies can be influenced by several factors. Various empirical studies have attempted to identify the relationship between income diversification and bank stock prices. Effective income diversification that improves the financial performance of banks can positively contribute to stock prices. If income diversification helps increase bank profits, growth, or efficiency, this can create positive sentiment in the stock market, which is reflected in higher stock prices. Diversification through business innovation or expansion into new segments can also generate growth expectations in the stock market. When investors perceive these measures as strategic and likely to boost future profits, they respond by increasing the bank's stock prices.

Income diversification can also be seen as a risk management strategy. Banks that reduce their reliance on a single income source may be more resilient to market fluctuations and specific business risks, which can enhance investor confidence and drive up stock prices. The cyclical period of the banking industry may also affect how the market values income diversification. During periods of growth in the banking industry, investors place a higher valuation on companies that capitalize on diversification opportunities. It is essential to note that the impact of income diversification on stock prices can vary depending on the economic context, the bank's business strategy, and current financial market conditions.

Empirical studies supporting the relationship between these variables include the following: The effect of income diversification on stock prices is supported by research from Yustyarani & Yuliana (2020), Natalia et al. (2016), and Jiang & Han (2018), which found that income diversification has a significant impact on stock prices. Research by Simetris & Darmawan (2019) shows that income diversification positively and significantly affects firm value. However, Suharno (2016) found that income diversification does not significantly impact stock prices. Wijaya & Sari (2015) found that income diversification has a positive and significant effect on profitability and a negative and significant effect on risk. Based on the relationships between these variables, the second hypothesis in this study is proposed as follows:

H2: The hypothesis is accepted if Income Diversification significantly influences the Stock Prices of Banks listed on the Indonesia Stock Exchange.

The Effect of External Risk on Financial Performance

The impact of external risk on the financial performance of banks can vary based on several factors, including the specific type of external risk and how banks manage it. External risks that may affect the financial performance of banks listed on the Indonesia Stock Exchange (IDX) include currency risk, interest rate risk, market risk, political and legal risk, and global financial crises. **Currency risk** arises when banks engage in international transactions or are exposed to currency fluctuations, with exchange rate changes potentially impacting the value of a bank's assets and liabilities. Interest rate risk affects a bank's net interest margin, which is the difference between the interest earned on loans and the interest paid on deposits. Fluctuations in interest rates can thus influence the bank's net income. Market risk involves the influence of global market conditions, such as shifts in the global economy, which may affect the value of a bank's investment portfolio. This market volatility can lead to investment losses or reduce asset values.

Political and legal risks include uncertainties in government policies or regulatory changes that could impact banking operations. These risks present uncertainties that may negatively affect financial performance. Furthermore, global financial crises can destabilize banks by triggering economic and financial instability, as seen in past global economic or banking crises, which often exert additional pressure on banks' financial performance.

To address these challenges, banks must implement effective risk management strategies to identify, assess, and manage external risks. Financial derivatives and portfolio diversification are commonly used in comprehensive risk management strategies. Additionally, banks need to ensure capital resilience and maintain effective liquidity management to withstand external risks. For investors and analysts, understanding how banks manage these risks and whether they have robust policies to counter external challenges is essential. Fundamental analysis, alongside monitoring economic and policy trends, provides valuable insights for assessing the potential impact of external risks on the financial performance of banks listed on the IDX.

Empirical studies support the relationship between these variables. Research by Khurram et al. (2018), Ashenafi et al. (2013), and Hamid et al. (2020) indicates that external risk has a significant impact on financial performance. Further, Sari and Wijaya (2019) found that political risk has a significant negative effect on financial performance, as measured by the return on assets (ROA) ratio. Kurniawan and Setiawan (2018) showed that macroeconomic risk, indicated by inflation, interest rates, and exchange rates, significantly and negatively affects financial performance, while Pratiwi and Suryanto (2017) similarly found that political risk has a significant negative impact. Based on these findings, this study proposes the following hypothesis:

H3: The hypothesis is accepted if External Risk significantly influences the Financial Performance of Banks listed on the Indonesia Stock Exchange.

The Effect of External Risk on Stock Prices

The impact of external risk on the stock prices of banking companies listed on the Indonesia Stock Exchange (IDX) can be complex and varies depending on specific factors in each situation. External risks may influence banking stock prices in several ways. Global Market Sentiment: Changes in global economic conditions or events such as international financial crises can affect overall market sentiment. During times of global market pressure or uncertainty, investors may choose to sell their shares, including banking stocks, which can drive stock prices down. Currency Exchange Risk: If banks are exposed to currency risk, exchange rate fluctuations can impact the value of their assets and liabilities. Changes in currency value can create valuation risks and affect financial performance, potentially leading to stock price movements. Interest Rate Risk: Significant changes in interest rates can affect banks' net interest margins and investment returns, which, in turn, can place pressure on stock prices.

National Economic Crises: External factors such as economic recessions, changes in government policy, or national financial crises can influence the health of the banking sector and, consequently, banking stock prices on the IDX. Political and Legal Risks: Changes in political or legal policies, including new banking regulations, can significantly impact banking performance and may be reflected in stock price fluctuations. Global Regulatory Changes: Shifts in global financial regulations can influence how banks operate and invest, which can also impact stock prices. IDX investors often pay special attention to these factors and conduct thorough risk analysis. If banks manage external risks effectively, this can boost investor confidence and positively impact stock prices. Conversely, uncertainty or inadequate risk management can exert negative pressure on stock prices. It is important to remember that the stock market is dynamic, and its responses to various external risks can change over time. Therefore, investors must stay updated on economic news, events, and policies that may affect the banking sector and the market as a whole.

Empirical studies supporting the relationship between these variables include the following: The effect of external risk on stock prices is supported by Istanti (2022), Nugroho et al. (2020), and Paragina & Leon (2020), who found that external risk significantly influences stock prices. Research by Al-Mohana & Al-Khazali (2017) shows that political risk has a significant negative effect on stock prices in Arab stock markets. Sari & Wijaya (2019) found that political risk has a significant negative effect on financial performance, while Chen, Chen, & Ku (2016) found that geopolitical risk has a significant negative effect on global stock prices. Based on these variable relationships, the fourth hypothesis in this study is proposed as follows:

H4: The hypothesis is accepted if External Risk significantly influences the Stock Prices of Banks listed on the Indonesia Stock Exchange.

The Effect of Financial Performance on Stock Prices

The financial performance of banks has a significant impact on stock valuation and price movements on the Indonesia Stock Exchange (IDX). Investors critically evaluate various financial performance indicators as reflections of the health and resilience of banking companies. One key indicator is net income. An increase in net income is often seen as a positive signal and can drive stock prices up, while a decline in income may exert negative pressure. Additionally, the net interest margin is an essential factor. A bank's overall performance is often assessed by how effectively it manages the difference between the interest income received from loans and the interest expenses paid on deposits. A healthy net interest margin enhances profitability, which can, in turn, support an increase in stock prices.

The capital adequacy ratio is another crucial factor for investors, as it reflects the bank's ability to withstand risk and indicates the level of financial stability. Investors are generally more inclined to invest in banks with a strong capital adequacy ratio, as this suggests that the bank has sufficient reserves. Operational efficiency, reflected in the ratio of operating expenses to operating income, is also important. A lower ratio indicates better operational efficiency, which can enhance the bank's competitiveness and potentially be reflected in stock prices. Asset growth, dividends, and capital return policies are additional factors influencing banking performance valuation. Consistent asset growth can build investor confidence, while attractive dividends and clear capital return policies can appeal to income-seeking investors.

External factors can also impact bank stock prices on the IDX. Global economic conditions, interest rate changes, and geopolitical risks are examples of external factors that may create market uncertainty and affect banking stock prices. By conducting a thorough analysis that considers these aspects, investors can gain a more holistic understanding of a bank's performance and prospects, thereby enabling them to make more informed and strategic investment decisions.

Empirical studies supporting the relationship between these variables include the following: The effect of financial performance on stock prices is supported by Brastama et al. (2020), Dinu & Bunea (2022), and Hac et al. (2021), who found that financial performance significantly impacts stock prices. Research by Tanjungsari (2018) shows that financial performance has a simultaneous and significant effect on stock prices. Similarly, Aspriyadi (2020) found that financial performance has a significant simultaneous effect on stock prices. Research by Rusdiyanto, Soetedjo, Susetyorini, & Wibowo (2018) also supports that financial ratios simultaneously have a significant impact on stock prices. Based on these variable relationships, the fifth hypothesis in this study is proposed as follows:

H5: The hypothesis is accepted if Financial Performance significantly influences the Stock Prices of Banks listed on the Indonesia Stock Exchange

The Effect of Income Diversification on Stock Prices through Financial Performance

This study examines the impact of income diversification on the stock prices of banking companies, with financial performance acting as a mediating variable. The goal is to understand how income diversification can influence stock prices via the financial performance it generates. Income diversification refers to a bank's ability to earn revenue from various business sources, such as credit, loans, investments, and other financial services. Income diversification can be measured by the ratio of non-interest income to the bank's total income, indicating that income diversification positively influences financial performance. Financial performance acts as a mediator in the relationship between income diversification and stock prices, suggesting that improved financial performance will mediate the relationship between income diversification and stock prices. Bank stock prices are market indicators reflecting investor perceptions of company value. Stock prices can be measured by the banking sector stock index or individual stock prices of selected banking companies, indicating that better financial performance driven by income diversification will positively impact stock prices.

Income diversification in banking, which involves expanding revenue sources through various products and services, plays a crucial role in shaping stock prices on the Indonesia Stock Exchange (IDX). This concept can impact banking financial performance, creating an effect on stock prices. Diversification can provide income stability by reducing dependence on a single type of business or sector, thereby mitigating the potential impact of market fluctuations or recessions. This stability can translate into more stable stock prices, instilling confidence in investors. Additionally, diversification can help reduce credit risk by spreading the loan portfolio across different sectors or segments. Good credit risk management and portfolio diversification can create strong performance, reflected in higher stock prices. Diversification may also drive product and service innovation, opening new revenue growth opportunities. Growth from new segments or innovation can positively impact stock prices.

Business growth can be accelerated through diversification, whether into new or geographic segments offering growth opportunities. Consistent and sustainable growth creates a positive perception among investors, which can positively influence stock prices. Well-managed diversification can also improve operational efficiency, reducing additional operational costs arising from dependence on a single type of business or segment. The effect of income diversification depends on how well the bank manages its risk and diversity. Good risk management and appropriate diversification can enhance financial performance and stock prices, while inadequate risk management or inappropriate diversification can have a negative impact. Therefore, a thorough analysis of financial reports, business strategies, and banking risk management policies is essential to understand how income diversification can impact bank stock prices on the IDX.

The relationship between variables in this study is supported by several empirical studies. For example, Quyen et al. (2021) found that income diversification affects financial performance, mediated by bank size, ownership structure, and the financial crisis. Suleiman & Gunu (2020) showed that income diversification influences financial performance. Simetris & Darmawan (2019) found that income diversification has a significant positive effect on firm value. Research by Sari & Wijaya (2015) indicates that income diversification positively and significantly influences profitability while significantly reducing risk. Kurniawan & Setiawan (2018) found that external risk significantly influences financial performance. Macroeconomic risk has a significant negative impact on financial performance, while industry risk and market risk have a significant positive effect on financial performance. Based on these relationships, the sixth hypothesis in this study is proposed as follows:

H6: The hypothesis is accepted if Income Diversification significantly influences Stock Prices through the Financial Performance of Banks listed on the Indonesia Stock Exchange.

The Effect of External Risk on Stock Prices through Financial Performance

External risk includes factors beyond the control of a company that can impact financial performance, such as changes in government policy, currency fluctuations, financial market instability, regulatory changes, or global economic events. External risk can be measured using indicators like market volatility or systemic risk indices. The hypothesis suggests that external risk negatively impacts financial performance. Financial performance acts as a mediator in the relationship between external risk and stock prices. The hypothesis states that higher external risk will negatively affect financial performance. A company's stock price reflects investor perceptions of its value and can be measured using sectoral stock price indices or individual stock prices of selected companies. The hypothesis posits that poorer financial performance, impacted by external risk, will negatively affect stock prices.

The impact of external risk on the stock prices of banks listed on the Indonesia Stock Exchange (IDX) can involve complex relationships between external factors and a bank's financial performance. External risks, such as changes in global interest rates, currency fluctuations, or geopolitical uncertainties, can exert pressure on banks' financial performance. For instance, currency exchange rate changes can affect the value of a bank's assets and liabilities, while interest rate fluctuations can influence net interest margins and investment returns. Banks' responses to these external risks may be reflected in their financial performance, which in turn affects stock prices. Banks with effective risk management strategies and well-diversified portfolios are more resilient to external pressures. Conversely, banks that struggle to manage external risks may experience declines in financial performance, creating market uncertainty and negatively impacting their stock prices. Additionally, external risks can create uncertainty and shift market expectations regarding banking prospects. Investors tend to respond sensitively to changes in external conditions and may question a bank’s resilience and adaptability to a changing environment. Therefore, analyzing how banks manage and respond to external risks is key to understanding their potential impact on stock prices on the IDX.

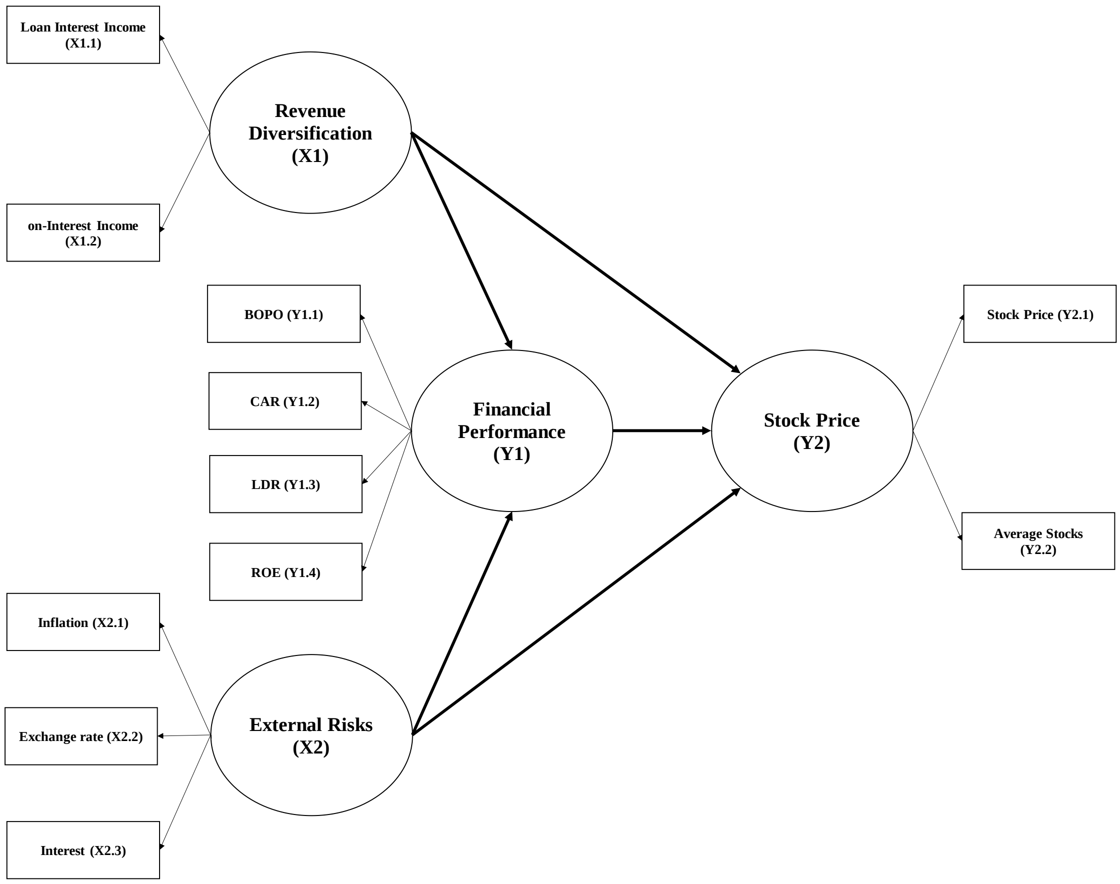
The relationship between external risk, financial performance, and stock prices in banking is dynamic and complex. Investors and analysts must closely monitor changes in external factors and how banks manage these risks to make informed and strategic investment decisions in the IDX stock market. The relationship between these variables is supported by several empirical studies. For instance, Hartuti et al. (2022) suggest that investors should consider a company's solvency ratio before purchasing shares, as a higher solvency ratio can increase stock prices. Nugraha & Artini (2022) found that Return on Assets positively impacts the stock prices of automotive and component subsector companies on the IDX, while the Current Ratio and Debt to Equity Ratio have a negative effect.

Research by Al-Mohana & Al-Khazali (2017) shows that political risk has a significant negative impact on stock prices in the Arab stock market. Sari & Wijaya (2019) found that political risk significantly negatively affects financial performance, indicating that political instability can decrease investor confidence, disrupt business activities, and increase operational costs. Chen, Chen, & Ku (2016) found that geopolitical risk significantly negatively impacts stock prices in the global stock market, suggesting that geopolitical events can generate fear, uncertainty, and risk aversion among investors. Based on the relationship between these variables, the seventh hypothesis in this study is proposed as follows:

H7: The hypothesis is accepted if External Risk significantly influences Stock Prices through the Financial Performance of Banks listed on the Indonesia Stock Exchange.

Based on the formulation of hypotheses, the research model proposed by the authors is as shown in Figure 1.

Figure 1: Conceptual Framework



Source: Result of author's analysis, 2024

III. RESEARCH METHODOLOGY

This quantitative study uses secondary data and applies the SEM-PLS (Structural Equation Modeling Partial Least Squares) method for analysis. The primary goal is to examine the effect of income diversification and external risk on stock prices, with financial performance serving as a mediating variable. Financial data, sourced from audited annual reports of companies listed on the Indonesia Stock Exchange (IDX), and stock price data obtained from reliable platforms such as the IDX website, are utilized in this study. By using a quantitative approach and SEM-PLS, the research systematically tests hypotheses, offering a deeper understanding of the relationships among the variables. The findings aim to contribute new insights into the impact of income diversification and external risk on stock prices through financial performance within IDX-listed companies.

To ensure clear and precise measurement of concepts, the study provides operational definitions for each variable. *Income diversification* refers to a bank's revenue sources, which may include loan interest (interest income) and fees or commissions (non-interest income). *External risk* encompasses macroeconomic factors such as inflation, exchange rates, and interest rates, which can impact financial performance and stock prices. *Financial performance* is assessed through indicators like BOPO (Operational Expense to Operating Income), CAR (Capital Adequacy Ratio), LDR (Loan to Deposit Ratio), and ROE (Return on Equity), which collectively reflect operational efficiency, capital adequacy, credit risk management, and equity returns. Lastly, *stock price* is measured by the company's closing or average stock price over a specified period, capturing the market's perception of the company's value.

The study's population includes all banking companies listed on the IDX from 2018-2022. Using purposive sampling, the sample selection focuses on banks with available audited financial reports during this period, ensuring the sample represents the research objectives. Data for the study are collected via non-participant observation, with financial reports obtained from the IDX and Bank Indonesia websites, covering the period from 2018 to 2022. SEM-PLS is chosen as the analytical tool due to its effectiveness in handling complex models with latent variables, its suitability for both reflective and formative measurement models, and its robustness to non-normal data distributions. The SEM-PLS process involves model building, hypothesis testing, and evaluation, which is conducted using WarpPLS software to examine the relationships between income diversification, external risk, financial performance, and stock prices. The choice of SEM-PLS is further supported by its flexibility with smaller sample sizes, allowing significant statistical results even when data is limited. Prior research, such as studies by Laksmiwati et al. (2023), Hidayat et al. (2022), and Budiningsih et al. (2022), reinforces the selection of SEM-PLS as an effective tool for analyzing the relationships in this study.

IV. RESULT AND DISCUSSION

Data Analysis

The first-stage model evaluation focuses on the measurement model. Examination of the PLS-SEM estimation for the measurement model allows the researcher to evaluate the reliability and validity of the constructs. Multivariate measurement involves using multiple variables to measure a concept indirectly. Evaluation of the measurement model includes tests of internal consistency reliability, indicator reliability, convergent validity and discriminant validity as shown in Table 1. There are two methods that can be used to measure reliability of a construct, namely Cronbach's alpha or composite reliability. However, the use of Cronbach's alpha tends to provide a lower estimated value so that PLS-SEM is recommended to use composite reliability. Indicator reliability on PLS-SEM is measured from the outer loading value which shows the correlation between the indicator and its construct. Convergent validity in constructs can be measured using AVE. Discriminant validity can be measured from cross loading or the loading value of other constructs is a comparison to the value of the outer loading indicator associated with a construct where the required loading indicator value must be more than the cross-loading value.

Table 1: Evaluation of Measurement Model

Variables	Indicators	Loadings	Composite Reliability	AVE	Cross Loading
Revenue Diversification (X_1)	X_{1_1}	0,633	0,603	0,633	Yes
	X_{1_2}	0,633			
External Risks (X_2)	X_{2_1}	0,989	0,924	0,895	Yes
	X_{2_2}	0,849			
	X_{2_3}	0,842			
Financial Performance (Y_1)	Y_{1_1}	1,000	1,000	1,000	Yes
Stock Price (Y_2)	Y_{2_2}	0,678	0,630	0,678	Yes
	Y_{2_3}	0,678			

Source: Calculated using SmartPLS, 2024

The information presented describes the results of factor analysis conducted to examine the relationship between several variables measured in a study. The variables observed consisted of revenue diversification, external risks, financial performance, stock price. Each of these variables has several indicators that are used to measure or represent certain aspects of that variable. Given loadings indicate how strong the relationship between each indicator and its associated variables is. Composite reliability is a measure of the combined reliability of the indicators in a variable, while Average Variance Extracted (AVE) measures how well the indicators represent that variable. Cross loading indicates whether certain indicators have a significant correlation with other variables, which may indicate a problem in construct validity. By examining this information, researchers can evaluate the reliability and validity of the measurement instruments used in the study.

Hypothesis Test

After ensuring that the measurement model of the construct is reliable and valid, then hypothesis testing is carried out. Hypothesis testing in this study is carried out on a structural model or inner model which shows a direct or indirect relationship between exogenous and endogenous latent variables. Hypothesis testing is based on the significance value of the path coefficient after resampling or bootstrapping 5,000 times. The statistical test used is the t test with a confidence level of 95% or a significance level of 5%. The hypothesis is accepted if the t value is more than the t-table value for the two-tailed test, namely 1,96. The results of boostraping procedur as shown in Table 2.

Direct Effect: Direct effects refer to the influence or relationship between one variable and another without any intermediate variables. In this case, the information provides details about the direct effects between variables, including the original sample size, T statistics, P values, and whether the effects are significant.

1. The effect of income diversification on financial performance has a weight value of -0.121, indicating a negative impact; however, it is not statistically significant (p = 0.100). This suggests that while increased income diversification appears to slightly decrease financial performance, this effect does not reach statistical significance, meaning it may not be a reliable predictor in this context.
2. The effect of income diversification on stock prices has a weight value of 0.327, indicating a positive and statistically significant impact (p = 0.001). This result implies that income diversification contributes positively to stock prices, with diversified revenue sources likely increasing investor confidence, thereby driving stock prices higher
3. The effect of external risk on financial performance has a weight value of 0.061, indicating a positive influence; however, it is not statistically significant (p = 0.263). This suggests that external risk has a slight positive effect on financial performance, though this relationship lacks statistical significance and may not be a dependable influence on financial outcomes in this case.
4. The effect of external risk on stock prices has a weight value of -0.107, indicating a negative but statistically insignificant impact (p = 0.129). This finding suggests that while external risk might exert downward pressure on stock prices, the relationship is not strong enough to be deemed statistically significant, indicating a lack of a robust influence in this study's context.
5. The effect of financial performance on stock prices has a weight value of 0.449, showing a positive and statistically significant impact (p = 0.001). This indicates that improved financial performance has a strong positive influence on stock prices, suggesting that companies with better financial results tend to see an increase in stock value, reflecting investor confidence in the company's growth and stability.

Indirect Effect: Indirect effects involve the influence of one variable on another variable through an intermediary or mediating variable. The information provided for indirect effects includes the original sample size, T statistics, P values, and explanations about the significance of the indirect effects.

1. The effect of income diversification on stock prices through financial performance has a weight of -0.054, indicating a negative but statistically insignificant impact (p = 0.211). This suggests that income diversification, through its influence on financial performance, has a negative but non-significant effect on stock prices.
2. The effect of external risk on stock prices through financial performance has a weight of 0.147, indicating a positive and statistically significant impact (p = 0.014). This indicates that external risk, through its impact on financial performance, has a significant positive effect on stock prices.

Table 2: Bootstraping Results

The Value of Influence Between Variables	Original Sample	T Statistics	Information
The effect of income diversification on financial performance	-0.121	0.100	Negative impact; not statistically significant
The effect of income diversification on stock prices	0.327	0.001	Positive impact; statistically significant
The effect of external risk on financial performance	0.061	0.263	Positive impact; not statistically significant
The effect of external risk on stock prices	-0.107	0.129	Negative impact; not statistically significant
The effect of financial performance on stock prices	0.449	0.001	Positive impact; statistically significant
The Value of Influence Between Variables	**Original Sample**	**T Statistics**	**Information**
The effect of income diversification on stock prices through financial performance	-0.054	0.211	Negative impact; not statistically significant
The effect of external risk on stock prices through financial performance	0.147	0.014	Positive impact; statistically significant

Source: Calculated using SmartPLS, 2024

Discussion

Income diversification does not have a statistically significant impact on the financial performance of banking companies listed on the Indonesia Stock Exchange (IDX). This is indicated by the T-statistics and p-value, which exceed the threshold for significance, suggesting that variations in income diversification do not have a meaningful effect on financial performance. This may be due to several key factors that more dominantly influence bank performance than income diversification strategies.

Firstly, banking income in Indonesia is still primarily driven by interest income, whereas non-interest income, which is a part of income diversification, has not grown large enough to significantly impact total income and financial performance. As shown in the data, although non-interest income has remained stable over the past five years, its contribution to total income remains relatively small compared to interest income. Meanwhile, factors such as interest rates, inflation, and regulatory policy fluctuations play a larger role in influencing bank profitability and operational efficiency. This indicates that external economic factors have a more substantial impact on bank financial performance than efforts to diversify income sources.

Secondly, financial performance indicators like Return on Equity (ROE), BOPO (Operational Expenses to Operating Income), Capital Adequacy Ratio (CAR), and Loan to Deposit Ratio (LDR) are complex and influenced by various factors beyond income diversification. For example, a bank's ROE can be affected by its capital structure and operational efficiency, which are not directly related to non-interest income. BOPO, reflecting operational efficiency, tends to be more impacted by operational costs such as loan management and non-performing loans, rather than income diversification. This suggests that while income diversification can offer stability, its direct impact on financial performance is not always visible in the short term.

These findings align with the study by Turiastini & Darmayanti (2017), which found that income diversification does not significantly impact the financial performance of companies in the industrial sector on the IDX. A key reason for this is that income diversification often requires initial investments and time to yield results, which may weigh on short-term financial performance. Additionally, income diversification strategies are not always successful, as they depend on how well banks manage risks and align their diversification strategies with market conditions.

Research by Brahmana et al. (2018), Gurbuz et al. (2013), and Ismail et al. (2020) indicates that income diversification, when implemented effectively, has the potential to positively impact financial performance. They emphasize that banks that successfully diversify their income into non-interest sectors can enjoy reduced risk and increased financial stability, especially when facing economic uncertainty. This is supported by Smith & Johnson (2020), who found that banks capable of implementing diversification strategies effectively tend to achieve higher Return on Assets (ROA) and ROE compared to banks that diversify less.

Li & Wang (2018) also confirm that income diversification can contribute to improving financial performance in the long term, particularly through increases in Net Interest Margin (NIM), ROE, and Return on Investment (ROI). This suggests that the positive effects of income diversification are more apparent in the long run, as banks need time to build the infrastructure and resources required to manage multiple income sources.

Kumar et al. (2019) found that banks successful in developing non-interest sectors tend to have lower credit and market risks. This underscores that income diversification, besides offering financial benefits, can also help reduce the bank's exposure to external risks such as interest rate and exchange rate fluctuations, which frequently impact overall bank profitability.

This study shows that income diversification has not yet had a significant impact on the financial performance of Indonesian banking companies in the short term. However, this result does not diminish the importance of diversification strategies in the long term. Effective implementation, a deep understanding of the market, and strong risk management capabilities remain essential to optimizing the influence of income diversification on future banking financial performance. Furthermore, in an increasingly dynamic and uncertain market, diversification remains a vital strategy to enhance the resilience and stability of the banking sector.

Income diversification has a significant impact on the stock prices of banking companies listed on the Indonesia Stock Exchange (IDX). This finding indicates that variations in income diversification play a crucial role in influencing stock price fluctuations. Statistically, the significance of this effect strengthens the argument that revenue from various sources, such as interest income from loans and non-interest income, can directly affect stock price movements. The success of income diversification by banks boosts positive market sentiment, which is reflected in higher stock prices.

A more concrete explanation of this result can be seen from several factors. First, income diversification, which involves expanding revenue sources to non-interest products like financial services, insurance, and asset management, contributes significantly to overall financial performance. This creates growth expectations in the stock market, especially when diversification successfully increases the company's profits. As a result, investors respond positively to prospects for more sustainable growth, ultimately contributing to rising stock prices. Favorable market conditions and conducive regulatory policies further strengthen the impact of income diversification on stock prices.

Second, in the context of the stock market, macroeconomic factors such as interest rate fluctuations, inflation, and exchange rates often directly affect stock prices. However, income diversification allows banks to be more resilient to market volatility and economic uncertainty, which in turn builds investor confidence. Banks that can reduce reliance on a single income source demonstrate better risk management capabilities, attracting investors' interest. Therefore, these findings can be seen as a reflection of a successful income diversification strategy that enhances market confidence, particularly in navigating dynamic economic conditions.

Income diversification also plays a key role in creating stability for banking companies. As noted by Yustyarani & Yuliana (2020) and Natalia et al. (2016), income diversification significantly impacts stock prices, especially when diversification strategies are effectively implemented. Research by Jiang & Han (2018) supports this finding, showing that income diversification positively affects long-term stock price movements by enhancing profitability and reducing risk.

Simetris & Darmawan (2019) emphasize that income diversification has a significant positive effect on firm value. This suggests that banks that successfully diversify their income sources can increase their firm value, as reflected in rising stock prices. On the other hand, Suharno (2016) found that income diversification does not always have a significant impact on stock prices. This result may be explained by contextual variables such as unfavorable economic conditions or ineffective diversification strategies.

Another study by Wijaya & Sari (2015) also mentions that income diversification can significantly impact profitability and risk. In this case, income diversification not only boosts revenue but also reduces business risks associated with reliance on a single revenue source, such as loan interest. This demonstrates that income diversification is not only important for enhancing financial stability but also offers long-term benefits in increasing stock value in the capital market.

The findings of this study are consistent with previous empirical research showing that income diversification has a positive and significant impact on stock prices, although the effect may vary depending on market conditions and the strategies applied by each bank. Considering the current economic context, where global economic uncertainty and market volatility pose major challenges, income diversification becomes an essential strategy for banks to maintain stability and increase company value. Proper implementation of this strategy can enhance investor confidence, ultimately driving stock price increases on the Indonesia Stock Exchange.

External risk, although it affects the financial performance of banking companies listed on the Indonesia Stock Exchange (IDX), does not demonstrate the statistical significance required to be considered a significant influence on financial performance. This means that while external risks such as inflation, interest rates, and exchange rates impact bank operations, their effect is not strong enough in this study's context to be regarded as a significant factor. This study suggests that these external factors interact in complex ways with financial performance, and other factors not analyzed in this research may play a more dominant role in determining bank performance outcomes.

A concrete explanation of this result can be viewed from several perspectives. First, external risk indicators like inflation, interest rates, and exchange rates are often influenced by other complex macroeconomic variables and interact non-linearly with financial performance indicators. For instance, inflation can impact banks' operational costs, but its effect is often offset by monetary policies implemented by the government or central bank. Similarly, exchange rates and interest rates can affect banking investment portfolios, but these influences are not always immediately visible in financial performance, depending on the mitigation strategies employed by banks.

Second, the timeframe and parameters used in this study are insufficient to capture the broader impact of external risks. Changes in external conditions, such as government policies, geopolitical situations, or global market shifts, require longer observation periods to significantly impact banking financial performance. These findings also reflect that the relationship between external risk and financial performance is dynamic and requires further research to explore other variables that could serve as moderators or mediators in this relationship.

Empirical studies supporting these findings come from previous research. For example, Rosyidi's (2020) study shows that external risk has a positive but not significant impact on the financial performance of construction companies. This is similar to findings in banking research, where external risk is not strong enough to directly affect financial outcomes. Research by Khurram et al. (2018) and Ashenafi et al. (2013) suggests that external risks, including political and macroeconomic risks, can affect financial performance, but the results often depend on how a company or bank manages these risks.

The study by Sari & Wijaya (2019) also found that political risk has a significant effect on financial performance, measured by the Return on Assets (ROA). However, this is more relevant for banks operating in environments with high political instability, whereas Indonesian banks generally have better protection against political risk. Kurniawan & Setiawan (2018) found that macroeconomic risks, such as inflation and interest rates, significantly impact financial performance, emphasizing the importance of macroeconomic variables in determining banking performance. However, as seen in this study, these influences may not be significantly apparent over shorter timeframes or under certain parameters.

Additionally, research by Pratiwi & Suryanto (2017) states that political risk can significantly impact financial performance, measured by Return on Investment (ROI), indicating that global political events or policy changes can create uncertainties affecting company finances. Although this study does not find statistically significant effects, the complexity of external risk remains an essential factor to consider in bank risk management.

To address external risks, banks need to develop more comprehensive risk management strategies, including the use of derivative financial instruments and portfolio diversification. Additionally, having adequate capital resilience and effective liquidity management is crucial in handling fluctuations caused by external factors. In an increasingly uncertain global economic environment, such as geopolitical instability or pandemics, banks must continuously monitor external conditions and adapt swiftly to maintain their financial stability.

Although the results of this study do not show the required statistical significance, this finding does not diminish the importance of external risks as factors that must be well managed. In increasingly dynamic and complex markets, a bank's ability to identify, measure, and manage external risks remains a crucial component in maintaining stability and sound financial performance. Therefore, further research is needed with a longer timeframe and additional variables to capture the more accurate impact of external risks on banking financial performance.

External risk, while influencing the stock prices of banking companies on the Indonesia Stock Exchange (IDX), does not show sufficient statistical significance to be considered a direct factor affecting stock prices. This insignificance implies that variations in external risk are not strong enough to affect overall stock price movements, particularly within the timeframe and parameters used in this study. Therefore, interpretations regarding the influence of external risk on stock prices should be approached cautiously, taking into account the existing statistical uncertainty.

A deeper explanation of this result can be linked to the complexity of the relationship between external risk and stock prices. Indicators of external risk, such as inflation, exchange rates, and interest rates, tend to have an indirect impact on stock prices. Other factors, such as a company's operational performance, regulatory policies, and general market conditions, often play a more dominant role in influencing investor perceptions of bank stock prices. Stock prices on the IDX are also affected by daily volatility and market dynamics driven by global market sentiment, macroeconomic factors, or political events. Thus, external risk has only a moderate, indirect effect on short-term stock price movements.

In the banking context, the impact of external risk on stock prices can also vary depending on the mitigation strategies adopted by companies. As Mariana (2015) points out, although changes in the external environment put negative pressure on stock prices in the property and real estate sectors, the influence is not statistically significant because companies can manage these risks through portfolio diversification and effective risk management strategies. This is relevant to the banking sector, where banks can manage external risks, such as interest rate and exchange rate fluctuations, with hedging and asset diversification strategies.

Empirical studies also support this finding. Research by Istanti (2022), Nugroho et al. (2020), and Paragina & Leon (2020) indicates that external risks, such as economic uncertainty and changes in global policies, can affect stock prices. In more volatile markets, the influence of external risk tends to be more significant. Al-Mohana & Al-Khazali (2017) show that political risk has a significant impact on stock prices in Arab stock markets, especially since political instability increases investor uncertainty and reduces market confidence. Sari & Wijaya (2019) found that political risk can significantly affect financial performance, which ultimately influences stock prices. This research suggests that political and regulatory instability can reduce business activity and increase operational costs, which is reflected in stock price valuations.

Research by Chen, Chen, & Ku (2016) also highlights that geopolitical risk significantly affects stock prices in global markets. Geopolitical events can heighten investor uncertainty and trigger stock sell-offs, which can lead to a drop in stock prices. This impact reflects market sensitivity to external events, as investors often tend to sell shares during periods of significant political or economic uncertainty.

Although this study did not find a significant impact of external risk on banking stock prices in Indonesia, it is important to consider that this result is related to the specific timeframe and parameters used. Macroeconomic variables, such as inflation and exchange rates, have complex effects on the banking sector, but their influence is more noticeable over the long term or under more unstable economic conditions. Therefore, to better understand the impact of external risk on banking stock prices, more comprehensive analysis is needed, involving additional variables and a broader observation period.

The financial performance of banking companies listed on the Indonesia Stock Exchange (IDX) has a significant impact on stock prices. This finding indicates that variations in financial performance can directly affect stock price movements, making it an essential indicator in assessing the health and prospects of banking companies. In other words, positive financial performance—such as increased net income, strong capital adequacy ratios, and operational efficiency—tends to attract investor interest and influence the stock price valuation of banking companies. However, the interpretation of these results should be approached cautiously, considering the impact of external factors such as market conditions and monetary policies that may moderate this relationship.

Specifically, the impact of financial performance on stock prices can be explained through several key indicators. Net income, for instance, is often viewed by investors as a positive signal of company profitability, and increases in net income can provide an upward push on stock prices. Similarly, net interest margin is an essential aspect in the banking sector as it reflects the difference between interest income received from loans and interest expenses on deposits. A healthy interest margin indicates effective management of net interest income and can support stock price increases.

The capital adequacy ratio (CAR) also plays an important role in attracting investor interest, as it reflects a bank's ability to bear risk and indicates financial stability, which is crucial to investors. Investors are generally attracted to banking companies with strong CAR, as it provides a financial reserve that can be used in uncertain economic conditions. Operational efficiency, measured through the operating expense to operating income ratio (BOPO), is also a significant consideration. A low BOPO indicates management efficiency in controlling costs, ultimately enhancing the company's competitiveness in the market and supporting stock price movement.

Empirical research supports this finding. Brastama et al. (2020), Dinu & Bunea (2022), and Hac et al. (2021) show that financial performance significantly influences stock prices, indicating that financial performance indicators are directly linked to market valuation of banking companies. Tanjungsari (2018) also reveals that financial performance simultaneously has a significant effect on stock prices, emphasizing the importance of financial performance evaluation in understanding stock price fluctuations.

Research by Aspriyadi (2020) reinforces this finding by showing that return on assets (ROA), return on equity (ROE), and earnings per share (EPS) have significant effects on stock prices, while other indicators like the current ratio and debt-to-equity ratio do not significantly influence stock prices. This result suggests that profitability and earnings per share are stronger indicators in affecting stock price valuation than liquidity or capital structure indicators. Similar findings were presented by Rusdiyanto, Soetedjo, Susetyorini, & Wibowo (2018), who found that financial ratios like ROA and EPS have a significant impact on stock prices, while ratios such as capital adequacy ratio, non-performing loans, loan-to-deposit ratio, net interest margin, and BOPO do not have a significant influence.

Additional indicators such as asset growth and dividend policy also play important roles in attracting investor interest, particularly for those seeking stable income from their investments. Consistent asset growth and a steady dividend policy increase investor confidence, creating potential for stock price appreciation. On the other hand, external factors such as global economic conditions, interest rate changes, and geopolitical risks can moderate the impact of financial performance on stock prices. For instance, in uncertain economic situations or amidst high interest rate fluctuations, the positive impact of financial performance on stock prices may not be as strong as in stable economic conditions.

This study shows a significant relationship between financial performance and stock prices; however, it is essential to understand that external factors can also moderate this relationship. Investors are advised to conduct a more holistic analysis, considering both the company's internal factors and the overall economic environment. In the context of dynamic financial markets, monitoring financial performance alongside attention to external changes will help investors make more informed and strategic decisions regarding the valuation and prospects of banking stocks on the IDX.

The income diversification of banking companies has an indirect effect on stock prices through financial performance, though its statistical significance is low. This finding suggests that variations in income diversification indirectly influence stock prices through financial performance, but the effect is not strong enough to be statistically significant. In the context of banking on the Indonesia Stock Exchange, this highlights the importance of understanding indirect factors, where income diversification has the potential to positively impact stock prices through improved financial performance.

Several concrete reasons may explain this indirect relationship. First, income diversification, which includes both interest income from loans and non-interest income, creates a more stable revenue composition. This stability can, in turn, influence financial performance indicators such as BOPO (Operating Expenses to Operating Income), CAR (Capital Adequacy Ratio), LDR (Loan to Deposit Ratio), and ROE (Return on Equity). For instance, effective income diversification can enhance operational efficiency, evident from a reduced BOPO ratio. CAR and LDR can also reflect better management of revenue structure, indicating sufficient capital and liquidity resilience to support sustainable growth. Therefore, these financial performance indicators can act as a mediating mechanism in the influence of income diversification on stock prices, although this effect is not statistically strong within the study's timeframe.

Income diversification in the banking sector can enhance revenue stability by reducing reliance on a single income type or specific financial product. Through diversification, banks can manage credit risk and strengthen their loan portfolio, especially when facing market fluctuations or economic recession risks. This portfolio diversification not only creates stability in financial performance but also generates a positive perception among investors, ultimately increasing the stock prices of banks. This stability is particularly relevant in the current dynamic economic environment, where global economic fluctuations, such as economic crises or political uncertainty, can affect the market.

Empirical studies support these findings. Yustyarani & Yuliana (2020) found that income diversification has a negative and insignificant effect on stock prices through financial performance, indicating that even though banking companies diversify, the impact on stock prices is not yet significant. Quyen et al. (2021) affirm that the effect of diversification on financial performance is also mediated by variables such as bank size, ownership structure, and financial crises. This shows that under certain conditions, like crises or changes in corporate structure, income diversification can play a more significant role in determining company performance and value.

Suleiman & Gunu (2020) state that income diversification positively affects financial performance, but its impact on stock prices becomes more apparent over the long term after the company has achieved performance stability. Another study by Simetris & Darmawan (2019) indicates that income diversification has a partially significant effect on firm value. On the other hand, Sari & Wijaya (2015) show that income diversification can positively influence profitability but carries risk in facing market volatility, highlighting the challenges in achieving optimal diversification.

The study by Kurniawan & Setiawan (2018) shows that external risks, such as macroeconomic risk, significantly impact financial performance. This is relevant to income diversification, which is essentially a strategy to address macroeconomic, market, or industry risks that may affect financial stability. Effective risk management through diversification can help banking companies achieve more stable performance, which is expected to be reflected in the company's stock value.

These findings confirm that income diversification can influence stock prices of banking companies through improved financial performance. However, this relationship is complex and may be influenced by many other indirect factors, such as risk management strategies and external market conditions. Therefore, to holistically understand the impact of income diversification on company value, a more comprehensive analysis of financial statements, diversification strategies, and banking risk management policies is essential in navigating uncertainties in the stock market.

External risk has an indirect impact on the stock prices of banking companies on the Indonesia Stock Exchange (IDX) through financial performance, with relevant statistical significance. This finding confirms that variations in external risks, such as inflation, exchange rates, and interest rates, can significantly affect stock prices indirectly through financial performance. This implies that external conditions influence the financial outcomes of banking companies, which in turn affect market perceptions of stock prices. In today’s economic context, where external risks are increasingly dynamic and complex, these results highlight the importance of a comprehensive understanding of the role of external factors in banking financial analysis.

Several concrete reasons underlie this relationship. First, external risk indicators like interest rates and exchange rates often indirectly influence banking financial performance. For example, changes in exchange rates can impact the value of assets and liabilities for banks with global exposure, while fluctuations in interest rates can affect net interest margins and alter banks’ income structures. Global economic instability or uncertain fiscal policies can add pressure to banks’ financial performance, leading to changes in stock prices.

This research aligns with empirical views on the complex relationship between external risk, financial performance, and stock prices. Hartuti et al. (2022) emphasized the importance of solvency stability in attracting investors, where an increase in solvency ratios can positively impact a company’s stock prices. Nugraha & Artini (2022) highlighted the importance of Return on Assets (ROA), Current Ratio, and Debt to Equity Ratio in stock price determination, indicating that stock market investors closely consider financial performance as a primary basis for evaluating a company’s stock value.

Al-Mohana & Al-Khazali (2017) found that political risk significantly affects stock prices in Arab stock markets. Their findings indicate that political instability increases market uncertainty, impacting investor confidence and ultimately influencing stock prices. Sari & Wijaya (2019) found that political risk significantly affects financial performance, showing that political instability can disrupt business operations and increase company operational costs, eventually impacting investor perceptions of stock value. Additionally, Chen, Chen, & Ku (2016) found that geopolitical risk significantly affects stock prices in global markets, reflecting the fear and uncertainty that influence investment decisions.

These findings suggest that banks with strong risk management strategies are more resilient against external pressures. Effective risk management, through portfolio diversification or other mitigation strategies, enables banks to maintain financial stability and reduce negative impacts on stock prices. Conversely, banks less capable of managing external risks may experience financial instability that impacts their stock prices.

By understanding that external risks affect banking financial performance and, indirectly, stock prices, investors can make more informed decisions. This study underscores the need for an analysis that includes external factors and financial performance to understand the dynamics of bank stock prices on the IDX, enabling investors and analysts to monitor external risks that may affect the stability of a company's financial performance and more accurately determine stock price prospects.

V. CONCLUSION, LIMITATION AND FUTURE RESEARCH

Based on the analysis and discussion, several conclusions can be drawn. Firstly, income diversification has a direct impact on the financial performance of banking companies, though it is statistically insignificant, indicating that variations in income diversification do not significantly affect financial performance. However, income diversification does show a statistically significant direct effect on stock prices, meaning that diversified revenue sources influence stock prices on the Indonesia Stock Exchange within the study's timeframe. External risk, while having a direct influence on financial performance, does not reach the statistical significance required to be considered impactful on financial performance within the same parameters. Similarly, the direct effect of external risk on stock prices is negative but statistically insignificant, highlighting that variations in external risk do not have a strong effect on stock prices in this context. Conversely, financial performance has a statistically significant and positive impact on stock prices, indicating that variations in financial performance influence stock prices on the Indonesia Stock Exchange. Additionally, there is an indirect effect of income diversification on stock prices through financial performance; however, this impact lacks statistical significance, emphasizing the need to understand indirect factors between income diversification, financial performance, and stock market value. Finally, external risk has a statistically significant positive indirect effect on stock prices via financial performance, suggesting that variations in external risk impact stock prices indirectly by influencing financial performance.

Based on these conclusions, several recommendations are proposed. Although the impact of income diversification on financial performance is insignificant, banking companies should still consider the potential influence of income diversification on their financial outcomes. Regular evaluation of income composition can help identify opportunities for adjustments or improvements. Given that income diversification has a significant effect on stock prices, it is essential that banking companies ensure their diversification policies align with long-term goals and sustainability. Effectively communicating these strategies and their impact to shareholders can help manage expectations. External risks, though having an insignificant direct impact on financial performance, should still be a focus in risk management. Banking companies need to build resilience against external factors such as inflation, exchange rates, and interest rates. Additionally, companies should remain mindful of potential external risks on stock prices, as evaluating and mitigating these risks is crucial to minimizing any adverse impacts on stock value.

Since financial performance has a significant positive impact on stock prices, companies should emphasize strengthening their financial fundamentals. Strategies aimed at balancing performance growth with shareholder confidence can enhance corporate value. Banking management should also recognize the importance of indirect factors linking income diversification, financial performance, and stock prices. Integrating diversification policies with financial performance strategies can positively affect the company's market value. Furthermore, understanding the indirect effect of external risk on stock prices through financial performance requires a holistic approach, and companies should consistently monitor and evaluate these complex interrelations to optimize market value and shareholder confidence.

To improve transparency, banking companies on the Indonesia Stock Exchange could enhance disclosures related to income diversification and external risk management. Providing clear and detailed information on income composition, diversification strategies, and risk management measures can help improve shareholder understanding, reduce uncertainty, and foster greater trust. Future research could explore moderating or altering factors between income diversification, external risk, financial performance, and stock prices, including macroeconomic conditions and banking regulations. A more in-depth analysis of these factors could offer better insight into the context in which these relationships form, leading to findings that are more relevant for corporate policies and sector regulation.

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