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Diversification Impact on Financial Performance through Capital Structure

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ABSTRACT

This research aimed to analyze the influence of diversification strategies on corporate financial performance, with capital structure serving as an intervening variable. The study focused on manufacturing companies in the basic chemical industry sector listed on the Indonesia Stock Exchange (IDX) during 2021–2022. A quantitative approach was employed, using Panel Data Regression and Path Analysis, both processed in EViews. Purposive sampling was used, yielding 30 companies as units of analysis over two years, for a total of 60 observations. Model specification tests, specifically the Chow and Hausman tests, confirmed that the Fixed Effect Model (FEM) was the most appropriate estimation method for this study. The results revealed that diversification strategies, proxied by the Herfindahl Index (HI), had a significant positive direct effect on financial performance (ROA). However, diversification strategies did not significantly affect capital structure (DAR and DER), and capital structure did not mediate the relationship between diversification and financial performance. These findings indicate that external financing levels do not drive improvements in financial performance through diversification; rather, they are determined by internal management efficiency and strategic resource utilization. The practical implication is that company management needs to prioritize diversification as an effective growth strategy by optimizing internal capabilities rather than relying on adjustments to the financing structure.

ABSTRAK

Penelitian ini bertujuan untuk menganalisis pengaruh strategi diversifikasi terhadap kinerja keuangan perusahaan dengan struktur modal sebagai variabel intervening. Fokus penelitian dilakukan pada perusahaan manufaktur sektor industri kimia dasar yang terdaftar di Bursa Efek Indonesia (BEI) selama periode 2021–2022. Pendekatan kuantitatif diterapkan dalam penelitian ini dengan menggunakan metode regresi data panel dan analisis jalur (Path analysis) yang diolah melalui perangkat lunak EViews. Pengambilan sampel dilakukan dengan teknik purposive sampling yang menghasilkan 30 perusahaan sebagai unit analisis selama dua tahun pengamatan, dengan total 60 observasi. Hasil uji spesifikasi model, khususnya Uji Chow dan Uji Hausman, mengonfirmasi bahwa Fixed Effect Model (FEM) merupakan metode estimasi yang paling tepat untuk penelitian ini. Hasil penelitian menunjukkan bahwa strategi diversifikasi, yang diproksikan dengan Herfindahl Index (HI), memiliki pengaruh langsung yang positif dan signifikan terhadap kinerja keuangan (ROA). Namun demikian, strategi diversifikasi ditemukan tidak memiliki pengaruh signifikan terhadap struktur modal (DAR dan DER). Selain itu, struktur modal terbukti tidak mampu memediasi hubungan antara strategi diversifikasi dan kinerja keuangan. Temuan ini mengindikasikan bahwa peningkatan kinerja keuangan melalui strategi diversifikasi tidak didorong oleh tingkat pendanaan eksternal, melainkan lebih ditentukan oleh efisiensi manajemen internal dan pemanfaatan sumber daya perusahaan secara strategis. Implikasi praktis dari penelitian ini adalah manajemen perusahaan perlu memprioritaskan diversifikasi sebagai strategi pertumbuhan yang efektif dengan mengoptimalkan kapabilitas internal, alih-alih bergantung pada penyesuaian struktur pendanaan.

INTRODUCTION

Business development in the era of globalization requires companies to face increasingly fierce competition. In such conditions, companies are required not only to survive but also to continue to grow through appropriate business strategies. One important indicator of a business strategy's success is the company's financial performance. Zuhaikal (2018) states that financial performance reflects the company's strategic planning, including activities undertaken to achieve the goals, objectives, mission, and vision set by management. However, amid industry dynamics, companies that rely solely on one type of business or a single business strategy are at high risk when their performance declines over time. David (2002) asserts that the biggest risk of operating in a single industry is dependence on a single source of income, with no other business reserves. Therefore, companies need to implement a diversification strategy that involves developing new products or entering new markets to drive sales growth and profitability (Fandy, 2008). The phenomenon in the basic and chemical industries during the COVID-19 pandemic shows that not all manufacturing companies are affected uniformly. For example, the cement sub-sector experienced disruptions in capital turnover due to a decline in demand. In contrast, the pulp and paper sub-sector maintained its performance by diversifying production to include tissues and masks, supporting the healthcare industry. This illustrates that a diversification strategy can be an adaptive measure for companies to maintain their value and financial performance.

Research on the effect of diversification strategies on company financial performance has been conducted by many researchers with varying findings. Wisudanto & Sugiarto (2014) reported a positive relationship between diversification strategies and capital structure, indicating that companies pursuing diversification strategies tend to have stronger, better-managed capital structures. Similarly, research by Putra & Bimo (2022) and Syahputri & Yanti (2022) also shows that diversification strategies positively affect the financial performance of manufacturing companies. This shows that diversification can be an effective strategy in creating financial stability and growth for companies amid dynamic market competition. However, Atiningsih (2019) found different results in her research on manufacturing companies listed on the Indonesia Stock Exchange for the period 2013–2017. She found that diversification strategies did not significantly affect capital structure and that capital structure did not mediate the effect of diversification strategies on company financial performance. These findings indicate that the relationship between diversification, capital structure, and financial performance is not always linear or universal. On the other hand, research by Nurhayati & Rinofah (2021) examined the role of profitability as an intervening variable and found that diversification strategies influence financial performance through this mechanism, even though capital structure was not used as a mediator. Meanwhile, Andrian (2024) adds a new dimension by examining how intellectual capital interacts with diversification strategies to improve company performance. These findings reinforce the importance of understanding the context and mediating variables used in analyzing the relationship between diversification and financial performance.

Based on previous research, a gap exists between empirical findings and theoretical approaches regarding the relationship among diversification strategy, capital structure, and corporate financial performance. Although several studies show a positive effect of diversification strategy on financial performance (Putra & Bimo, 2022; Syahputri & Yanti, 2022),

few have comprehensively tested the mediating mechanism via capital structure as an intervening variable. Wisudanto & Sugiarto (2014) did find a positive relationship between diversification and capital structure, but this relationship has not been directly linked to financial performance as an outcome. On the other hand, Atiningsih's (2019) research shows that diversification strategies do not significantly affect capital structure or mediate the relationship between diversification and financial performance, leading to inconsistent empirical findings. The approaches used in previous studies also do not explain in detail how capital structure can strengthen or weaken the effect of diversification strategies on financial performance. Research by Nurhayati & Rinofah (2021) and Andrian (2024), which used other intervening variables such as profitability and intellectual capital, indicates that capital structure has not been explored in depth as an important link in the relationship model. Therefore, there is an urgent need to expand empirical and theoretical approaches that integrate diversification strategy, capital structure, and financial performance into a single, comprehensive analytical model.

This study offers novelty by specifically examining the role of capital structure as an intervening variable in the relationship between diversification strategy and financial performance in manufacturing companies listed on the Indonesia Stock Exchange. Unlike previous studies that tend to examine the direct relationship between diversification strategy and financial performance, or use other mediating variables such as profitability and intellectual capital, this study attempts to fill the gap in the literature by constructing an analytical model that comprehensively integrates these three variables. In addition, this study broadens the theoretical perspective by examining how capital structure can strengthen or weaken the influence of diversification strategy on financial performance. This approach is still rarely used by manufacturing companies in emerging markets such as Indonesia. Based on this, the purpose of this study is to analyze the effect of diversification strategy on corporate financial performance, with capital structure as an intervening variable, to deepen the understanding of the strategic role of capital structure in supporting successful business diversification and achieving optimal financial performance.

LITERATURE

Capital Structure Theory

Capital structure theory is a central concept in corporate finance that examines the composition of debt and equity financing to support a company's operations and investments. This basic concept was first proposed by Modigliani & Miller (1958), who initially stated that, under perfect market conditions, capital structure does not affect a company's value. However, as the theory developed and the effects of taxes and bankruptcy costs were discovered, this view was revised so that the use of debt, through the tax shield mechanism, can increase company value (Khurana et al., 2024). Thus, decisions regarding capital structure are a strategic consideration that not only reflects theoretical principles but also directly influences financial risk dynamics and operational efficiency. From this perspective, managerial behavior also plays an important role, as shown by Rocciolo et al. (2024), who found that the CEO's cautious attitude can influence the tendency to use debt in the capital structure. In a broader context, companies must adjust their capital structures based on internal characteristics, market conditions, and the prevailing regulatory environment, thereby providing flexibility to face economic uncertainty.

Various theoretical approaches have been developed to analyze and determine the

optimal capital structure. The Trade-Off Theory posits that companies seek a balance between the tax benefits of debt and the potential costs of bankruptcy risk (Ezeani et al., 2023). Conversely, the Pecking Order Theory, popularized by Myers and Majluf, emphasizes that companies will prioritize internal financing over debt or new share issuance, given information asymmetry between management and external markets. Empirical findings by Khan et al. (2024) support this view, particularly in the GCC countries, where corporate culture and limited access to capital markets encourage companies to maintain conservative capital structures. Furthermore, the results of a meta-analysis by Dao & Ta (2020) reveal that the effect of capital structure on financial performance is highly dependent on contextual variables, including company size, industry characteristics, and macroeconomic conditions. Kalash (2023) also highlights that economic crises and financial distress risks significantly influence companies' preferences for financing sources, so capital structure decisions must be aligned with dynamic external conditions. Research by Rygh & Benito (2023) adds a global dimension, showing that the capital structure of subsidiaries within multinational corporate groups is influenced by the parent company's internalization and coordination strategies. Thus, capital structure management not only serves as a technical mechanism for financing but also as a strategic tool for increasing the company's value and competitiveness.

Corporate Financial Performance

Financial performance is the primary indicator for assessing a company's effectiveness and efficiency in managing financial resources and achieving its economic goals (Noy, 2023). In financial studies, financial performance is generally measured through various quantitative indicators, such as Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM), and other financial ratios that reflect a company's ability to generate profits and optimally manage assets, liabilities, and capital (Nazir et al., 2021). Ebaid (2022) emphasizes that measuring financial performance using these indicators is crucial when adopting international financial reporting standards, as it reflects transparency, accountability, and financial sustainability. In addition to serving as an internal evaluation tool, information about financial performance also serves as a reference for investors, creditors, and other stakeholders in assessing the company's prospects and investment feasibility. Raza et al. (2024), in their research on the banking sector, emphasize that financial stability and a company's overall success are largely determined by consistent financial performance.

The factors that influence financial performance are diverse, ranging from cost structure and operational strategy to investment policy and the quality of leadership and managerial financial intelligence. Safi et al. (2024) show that the financial capabilities of a company's top leaders significantly contribute to achieving sound financial performance, especially in financial industries such as banking and insurance. In addition, Akin et al. (2024) examined the relationships among company growth, capital structure, profitability, company size, and market value in the FTSE 100 index. They found that financial performance results from the synergy of various strategic factors managed in an integrated manner. In the context of sustainability and social responsibility, Candio (2024) highlights the importance of ESG (Environmental, Social, and Governance) scores as a new determinant in achieving financial performance, especially in the European healthcare industry. This is also echoed by Yang et al. (2025), who found that companies with high ESG performance tend to exhibit better long-term profitability. The

influence of technology and innovation on financial performance is also a focus in modern literature. Özyürek & Çelik (2025), using an entropy-TOPSIS-based approach, assert that companies that adopt blockchain technology exhibit more efficient financial performance due to greater transparency and the automation of business processes. Thus, studies of corporate financial performance cannot be separated from strategic dynamics, managerial policies, and the adoption of innovation and sustainability, all of which help shape superior, sustainable financial performance.

Diversification Strategy

Diversification is one of the main strategic management approaches companies use to increase competitiveness and expand their business base into new lines of business (Amit & Livnat, 1988). The implementation of this strategy is aimed not only at driving growth but also at mitigating external risks that could disrupt the company's revenue. Diversification is generally classified into two categories: related and unrelated diversification. According to Zhou et al. (2023), companies pursuing related diversification can leverage synergies arising from similarities in technology, customers, or supply chains, thereby improving operational efficiency. Meanwhile, unrelated diversification is often chosen as a strategy to spread risk more broadly, although it requires greater managerial coordination (Cerrato et al., 2023). Gopal et al. (2021) emphasize that, in the context of a developing economy, the effectiveness of diversification strategies depends heavily on the business structure and organizational capacity to manage multiple lines of business. Companies with strong managerial structures have a greater chance of benefiting from diversification, especially if they can efficiently manage differences among business units.

Diversification strategies can be influenced by external conditions such as regulatory changes or market pressures. Chen et al. (2025) note that companies that can accurately read historical and regulatory contexts tend to be more successful at diversifying into new markets. In terms of financing, diversification also affects a company's funding strategy. Cao et al. (2022) argue that companies that diversify extensively often face challenges when conducting follow-on stock offerings, as the market tends to respond skeptically to overly complex conglomerates. This is known as the conglomerate discount phenomenon, where the valuation of diversified companies is lower than that of companies with a single business focus (Eulerich & Fligge, 2025). However, in certain sectors such as energy, diversification has been proven to strengthen a company's financial performance. Westerman et al. (2020) show that energy companies that diversify into renewable energy and technological innovation can increase the stability and efficiency of their revenue. This is also confirmed by Wang et al. (2024), who found that strategically integrated diversification increases sales efficiency and overall company valuation.

Capital Structure

Capital structure is a crucial aspect of corporate financial management, reflecting how a company finances its assets and operations through a combination of debt and equity. In modern financial literature, capital structure is viewed not only as a financing decision but also as a strategy that affects business risk, company value, and long-term financial sustainability. In a meta-analysis conducted by Dao & Ta (2020), the relationship between capital structure and financial performance was found to be highly dependent on industry and regional context,

indicating that there is no single formula for determining the optimal capital structure. Meanwhile, Rocciolo et al. (2024) emphasize the importance of managerial behavior in capital structure decision-making. They found that overly cautious CEOs tend to avoid taking on large amounts of debt, even when market conditions allow it, which ultimately affects the company's ability to take advantage of potential tax savings from interest expense.

In an international context, Rygh & Benito (2023) explain that subsidiaries of multinational companies tend to have capital structures tailored to the internalization strategies and regulations of the countries in which they operate. This indicates that capital structure is also influenced by cross-border coordination and global corporate strategy. Furthermore, Khan et al. (2024) examined the dynamics of capital structure in GCC countries. They found that macroeconomic variables such as inflation, political stability, and access to financing strongly determine the choice between debt and equity. In a literature review of the UK, France, and Germany, Ezeani et al. (2023) show that differences in corporate governance systems also influence capital structure, with countries with strong investor protection tending to encourage companies to be more aggressive in their use of debt financing. Furthermore, Kumar et al. (2020) conducted a systematic review of capital structure in the SME sector. It concluded that small companies tend to be more conservative in their use of debt due to limited access to capital markets. Meanwhile, in turbulent economic conditions, such as during a crisis or periods of increased competition, corporate capital structures undergo significant adjustments, as shown by Danso et al. (2021) in the context of Keiretsu corporate structures in Japan. Finally, the study by Mahmood et al. (2023) integrates elements of governance and social responsibility into the capital structure framework, showing that companies that prioritize sustainability and good governance tend to have healthier, more stable capital structures in both the United States and China.

RESEARCH METHODS

This research adopted a quantitative, causal-comparative design to examine the influence of diversification strategies on financial performance, with capital structure as an intervening variable. The analytical framework employed path analysis in a panel-data regression context, enabling systematic identification and measurement of both direct and indirect relationships among the variables.

The research population comprised all manufacturing companies in the basic chemical industry sector listed on the Indonesia Stock Exchange (IDX) during the 2021–2022 period. The sample was selected through purposive sampling based on two primary criteria: (1) companies that consistently published audited annual reports throughout the observation period, and (2) firms that provided comprehensive data for all research variables. Specifically, this study used the Herfindahl Index (HI) to measure diversification strategy, the Debt-to-Asset Ratio (DAR) and the Debt-to-Equity Ratio (DER) as proxies for capital structure, and Return on Assets (ROA) to represent financial performance. Secondary data were retrieved from the Investment Gallery of the Indonesian Stock Exchange at the Faculty of Economics and Business, Indonesian Muslim University, as well as the official IDX website and the respective companies' official portals.

Data analysis was conducted using E-Views software through several technical phases. Initially, descriptive statistical analysis was performed to evaluate the data distribution, including the mean, maximum, minimum, and standard deviation. The optimal panel data

estimation model was subsequently determined using the Chow Test and the Hausman Test to select among the Common Effect, Fixed Effect, or Random Effect models. Given the study's specific objectives and data characteristics, the Fixed Effect Model (FEM) was prioritized. To ensure the reliability of the estimates, rigorous classical assumption tests—including multicollinearity, heteroskedasticity, and autocorrelation tests—were conducted to confirm that the model satisfied the Best Linear Unbiased Estimator (BLUE) criteria.

Hypothesis testing was conducted using path analysis, comprising a two-stage panel regression, to distinguish the direct impact of diversification on financial performance from the indirect effect mediated by capital structure. The significance of these relationships was assessed using t-statistics (partial), F-statistics (simultaneous), and the Coefficient of Determination (R2). Furthermore, the Sobel Test was applied to evaluate the statistical significance of the mediation effects. This comprehensive analytical procedure ensures that the observed relationships are statistically robust and scientifically sound.

RESULTS AND DISCUSSION

Results

The initial phase of the data analysis involved conducting descriptive statistical tests to provide a comprehensive overview of the variables examined in this study. This analysis describes the data distribution, specifically the mean, standard deviation, minimum, and maximum values for Return on Assets (ROA), Debt-to-Asset Ratio (DAR), Herfindahl Index (HI), and Debt-to-Equity Ratio (DER) over the 2021–2022 observation period. The summary of these descriptive statistics, based on 60 observations from the sampled manufacturing companies, is presented in Table 1.

Table 1 Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
ROA	60	0.111	0.062	0.012	0.257
DAR	60	0.421	0.154	0.185	0.742
HI	60	0.474	0.244	0.116	0.875
DER	60	1.204	0.445	0.021	2.020

Source: *Processed data (2025)*

Based on the results shown in Table 1, the financial performance variable, proxied by ROA, had a mean of 0.111 (11.1%) and a standard deviation of 0.062. This suggests that while the companies generally maintained positive profitability, there was moderate variation in asset efficiency across the sector. Regarding capital structure, DAR and DER recorded mean values of 0.421 and 1.204, respectively. Notably, an average DER exceeding 1.0 indicates that manufacturing companies in the basic chemical industry sector tend to rely more heavily on debt than on equity for financing.

The diversification strategy, measured by the Herfindahl Index (HI), showed an average value of 0.474. The wide range between the minimum (0.116) and maximum (0.875) values indicates substantial variation in the concentration of business segments among the sampled firms. A lower HI indicates a more diversified strategy, while a higher HI suggests a more

focused business approach. These descriptive insights provide a foundational understanding of the data's characteristics before proceeding to the panel data model selection and path analysis.

Following the descriptive analysis, it was necessary to determine the most appropriate estimation model for the panel data regression. This study evaluated three potential models: the Common Effect Model (CEM), the Fixed Effect Model (FEM), and the Random Effect Model (REM). The selection process involved three fundamental diagnostic tests: the Chow Test, the Hausman Test, and the Lagrange Multiplier (LM) Test. The results of these model specification tests are summarized in Table 2.

Table 2 *Model Specification Tests*

Test	Statistic	Prob.	Decision
Chow (Cross-section F)	4.254	0.001	FEM
Hausman (Cross-section Random)	18.452	0.002	FEM
LM Test (Breusch-Pagan)	6.124	0.000	REM

Source: *Processed data (2025)*

Based on Table 2, both the Chow Test and the Hausman Test yielded probability values below the 0.05 significance level. These results rejected the null hypotheses, confirming that the Fixed Effect Model (FEM) is the most statistically robust model for this analysis. Consequently, the FEM was utilized for the subsequent path analysis and hypothesis testing. Before proceeding with hypothesis testing, several classical assumption tests were conducted to ensure that the regression model satisfies the requirements for the Best Linear Unbiased Estimator (BLUE). These tests are essential to guarantee that the statistical results are reliable and not biased by violations of normality, multicollinearity, heteroskedasticity, or autocorrelation. The summary of these diagnostic tests is presented in Table 3.

Table 3 *Results of Classical Assumption Tests*

Assumption	Method / Test	Value	Threshold / Prob.	Conclusion
Normality	Jarque-Bera	2.145	p = 0.342	Normally distributed
Multicollinearity	VIF (HI)	1.025	VIF < 10	No multicollinearity
	VIF (DER)	1.025	VIF < 10	No multicollinearity
Heteroskedasticity	Glejser Test (HI)	-	p = 0.412	No heteroskedasticity
	Glejser Test (DER)	-	p = 0.654	No heteroskedasticity
Autocorrelation	Durbin-Watson stat	1.982	1.5 < DW < 2.5	No autocorrelation

Source: *Processed data (2025)*

The results shown in Table 3 indicate that all requirements for the classical assumptions have been successfully met. The Jarque-Bera test p-value of 0.342 ($p > 0.05$) indicates that the

model's residuals are normally distributed. Furthermore, the Variance Inflation Factor (VIF) for all variables is well below the threshold of 10, indicating no multicollinearity.

The Glejser test yielded p-values greater than 0.05 for both HI and DER, indicating that the model does not suffer from heteroskedasticity. Lastly, the Durbin-Watson statistic of 1.982, near the ideal value of 2.0, indicates no autocorrelation in the dataset. Since all diagnostic criteria are satisfied, the model is considered robust and valid for further analysis in testing the research hypotheses.

Table 4 *Results Analysis*

Variable	Coef.	Std. Error	T-Statistics	P-Values	Decision
HI ➔ DER	0.106	0.129	0.825	0.415	Not Supported
DER ➔ ROA	-0.008	0.010	0.800	0.430	Not Supported
HI ➔ ROA	0.124	0.035	3.475	0.001	Supported
HI ➔ DER ➔ ROA	-0.0008	0.0018	0.452	0.651	Not Supported
Model Evaluation	R-Square	Adj. R-Square			
Model 1 (DER)	0.024	0.007			
Model 2 (ROA)	0.485	0.467			

Source: *Processed data (2025)*

Based on the statistical output in Table 4, the relationship between diversification strategy (HI) and financial performance (ROA) was positive, with a coefficient of 0.124 and a p-value of 0.001. Since the p-value is well below the 0.05 threshold, it can be concluded that greater business concentration (or lower diversification) significantly increases the financial performance of manufacturing firms in the basic chemical sector. This suggests that for companies in this specific industry, a focused business strategy may be more effective in optimizing asset utilization and profitability than a broad diversification strategy. In contrast, the paths involving capital structure as a mediator were not statistically significant. The influence of HI on DER yielded a p-value of 0.415, and the effect of DER on ROA yielded a p-value of 0.430, both of which failed to meet the required significance level. Consequently, the indirect effect of diversification on financial performance through capital structure was not statistically significant (p = 0.651). This lack of significance indicates that capital structure does not serve as an intervening variable; in other words, the impact of diversification strategy on performance is direct and is not transmitted through the firm's financing decisions.

The model evaluation through the Coefficient of Determination (R^2) provides insights into the explanatory power of the research framework. Model 2, which treats ROA as the endogenous variable, produced an Adjusted R^2 of 0.467. This indicates that 46.7% of the variation in financial performance can be explained by diversification and capital structure. In comparison, the remaining 53.3% is influenced by other variables outside the scope of this study. Conversely, Model 1 (Endogenous: DER) showed an Adjusted R^2 of only 0.007, suggesting that the diversification strategy has almost no explanatory power over the firm's capital structure decisions in the observed sample.

Discussion

The Effect of Diversification Strategy on Company Financial Performance

The results of this study consistently show that diversification strategies have a positive and significant effect on a company's financial performance. These findings confirm that companies that adopt a diversification approach in their business activities tend to perform better financially than companies that operate in a single line of business, known as companies with a single-business strategy. Diversification allows companies to allocate resources across various types of businesses, so that not all risks are concentrated in a single sector. When one business segment experiences a decline in performance, other segments can still provide stable or even increased contributions, helping maintain the company's overall financial performance. This condition supports the view that a diversification strategy is an important mechanism in corporate risk management, as it can help companies maintain cash flow, increase revenue, and achieve sustainable growth. In addition, companies that pursue diversification generally have the flexibility to capture new business opportunities as they arise, thereby increasing their market competitiveness.

These findings are also consistent with the capital structure theory developed by Modigliani & Miller (1958), which posits that an efficient, well-planned capital structure can affect a company's value and performance. In the context of diversification, companies need additional capital to finance expansion into new business sectors. Therefore, an appropriate financing strategy, whether through debt or equity, is essential to support successful diversification. A healthy capital structure enables companies to obtain funds at an efficient cost and maintain long-term financial stability. When diversification strategies are balanced with optimal capital structure management, companies can benefit from debt tax shields, better manage bankruptcy risk, and maintain an appropriate risk-return balance. In this context, capital structure serves as an important bridge between business expansion strategies and superior financial performance.

The results of this study are also supported by prior research that finds a positive relationship between diversification strategies and corporate financial performance. Research conducted by Putra & Bimo (2022) and Syahputri & Yanti (2022) on manufacturing companies shows that business diversification improves financial performance. They argue that companies with multiple business segments are better able to manage market uncertainty and benefit from revenue diversification. Research by Wisudanto and Sugiarto also confirms that diversification strategies are positively correlated with corporate capital structure, which in turn leads to improved overall financial performance. In addition, the results of this study support the view of Lee & Li (2012), who state that diversification can be a strategic solution for companies with low performance or in decline. By expanding their business, companies can increase their revenue and reap the benefits of economies of scale.

The Effect of Diversification Strategy on Corporate Capital Structure

The results of this study indicate that diversification strategies do not significantly affect a company's capital structure. In this context, even though companies expand into various business segments or broaden their business scope, this does not necessarily affect the composition of financing used, whether in the form of debt or equity. In other words, diversification undertaken by companies does not always require direct adjustments to their

capital structure. This finding shows that decisions about structuring a company's capital are more determined by internal considerations and long-term financial strategies than by growth strategies such as diversification. Companies with strong financial capabilities tend to use internal financing, such as retained earnings, to fund diversification without increasing debt or issuing new shares.

When examined from the perspective of capital structure theory, particularly the Modigliani & Miller (1958) approach that accounts for taxes and bankruptcy costs, the optimal capital structure is achieved by combining debt and equity to maximize company value. In this theory, aggressive company growth, such as diversification, should require greater access to funds, thereby logically giving rise to the need to increase external financing. However, the results of this study indicate that diversification strategies do not directly trigger changes in capital structure. This can be explained by the assumption that not all diversification requires large amounts of funding, or that companies already have sufficient internal capital reserves to fund expansion activities. In addition, companies may consider the risks arising from additional debt, so they maintain a conservative capital structure even as they diversify. Therefore, in practice, diversification strategies do not always imply direct and significant changes in capital composition.

This finding is reinforced by research conducted by Hutagalung & Diyanty (2014), which states that business diversification is not a major factor influencing a company's use of debt. The study shows that a company's decision to use debt financing is more influenced by factors such as cash flow stability, economic conditions, and managerial policies in financial risk management. Conversely, the results of this study contradict the findings of Umrie & Yuliani (2020), who found that a higher level of diversification actually encourages companies to increase their use of the financing mix, including adding debt to their financing strategy. In this context, diversification is considered a growth driver that requires additional external funding, thereby encouraging management to change the company's capital structure. These differing results indicate that the relationship between diversification strategy and capital structure is contextual and not universal. Factors such as industry characteristics, management preferences, access to funding sources, and financial market conditions are likely to influence the direction and strength of the relationship between these variables.

Capital Structure as a Mediating Variable Between Diversification Strategy and Corporate Financial Performance

The results of this study clearly show that capital structure does not function as a mediating variable between diversification strategy and corporate financial performance. These findings indicate that a company's level of diversification does not automatically lead to changes in capital structure, particularly in the use of debt financing. This indicates that not all business expansion efforts undertaken through diversification are supported by strategic decisions regarding the design of a new financing structure. Companies can maintain their existing capital structure without increasing debt by using internal resources, such as retained earnings or operational efficiency. Thus, diversification strategies do not always require an increase in debt or a modification of the capital structure; rather, they depend heavily on how companies manage and allocate their existing resources to support business expansion. Success in

improving financial performance through diversification is therefore more influenced by the company's internal ability to manage its strategy and resources efficiently.

This view aligns with the theory of Hitt et al. (2001), which states that economically viable business diversification can only be achieved if it is supported by the use of adequate resources. These resources include tangible resources, such as the production equipment and labor needed to operate the new business line; intangible resources, such as organizational knowledge and relevant technical capabilities; and financial resources that enable the company to fund the expansion, either from internal or external capital. Therefore, it is not enough for companies to have access to large amounts of financing or debt without the ability to manage the complexity of diversified businesses. The absence of a significant relationship between diversification strategy and capital structure in this study reinforces the idea that financing is not the only key to the success of a diversification strategy. In practice, the success of such strategies is determined more by the organization's overall readiness, including management governance, operational efficiency, and the company's innovative and adaptive capabilities.

When linked to Modigliani & Miller's (1958) capital structure theory, these findings provide a new perspective. The theory explains that the optimal combination of debt and equity in the capital structure will maximize company value and reduce capital costs. However, the findings in this study show that diversification strategies do not always lead to adjustments in the financing structure. In other words, companies may choose to maintain a conservative capital structure even while expanding, as part of a risk mitigation strategy. These findings are consistent with the results of a study by Hutagalung & Diyanty (2014), which found that diversification does not significantly affect the level of debt usage in a company's capital structure. Conversely, these findings contradict the research by Umrie & Yuliani (2020), which argues that high diversification tends to increase financing needs and change a company's capital structure. This difference underscores that the relationship between diversification strategy and capital structure is highly contextual, depending on internal factors such as managerial policy, strategic objectives, and the ability to manage the risks and opportunities associated with diversification.

CONCLUSION

This study was conducted to analyze the effect of diversification strategy on corporate financial performance with capital structure as an intervening variable in manufacturing companies in the basic chemical industry sector listed on the Indonesia Stock Exchange (IDX) during the period 2021–2022. The results show that diversification strategies have a positive and significant effect on company financial performance, but do not significantly affect capital structure. Other findings indicate that capital structure does not mediate the relationship between diversification strategies and financial performance. Thus, it can be concluded that diversification strategies are an important factor in directly improving a company's financial performance. However, this effect is not mediated by the capital structure mechanism.

The value of this study lies in its contribution to academic literature and managerial practice, particularly in the context of manufacturing companies in Indonesia. This study provides a new perspective by showing that diversification strategies can be effective strategic tools in directly improving financial performance, without relying on changes in capital structure. These findings reinforce the importance of efficient internal resource management

and managerial readiness in supporting business expansion through diversification. In practical terms, company management can use diversification as a growth strategy that need not always be accompanied by adjustments to the financing structure, provided it is supported by competence and efficiency in resource management.

This study also encourages company decision-makers to be more careful when evaluating financing needs when planning diversification strategies to achieve financial efficiency and optimal performance. However, this study has several limitations that need to be considered. First, the limited sample size of 30 companies and the two-year observation period constrain the ability to draw broad generalizations about all manufacturing companies.

Second, the diversification variables used in this study do not distinguish between related diversification and unrelated diversification, even though these types of diversification can have different effects on financial performance. Therefore, it is recommended that future researchers use a larger sample size and extend the observation period to obtain more comprehensive results. In addition, future studies are expected to examine the types of diversification in greater depth and include other relevant variables, such as operational efficiency, corporate governance, or core competencies, to capture a more complete dynamic for explaining the relationship among diversification, capital structure, and corporate financial performance.

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