

# Bank Soundness and Firm Value under the RGEC Framework

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## ABSTRACT

Bank soundness is integral to firm value, reflecting a bank's financial stability, risk management capacity, and profitability. This study investigates the association between bank soundness and firm value using the RGEC framework—comprising risk profile, good corporate governance, earnings, and capital—over the period 2011–2022. The analysis draws on 47 annual reports sourced from Refinitiv Eikon. Firm value is modeled as a function of the RGEC components, with revenue and total assets included as control variables. Grounded in signaling theory, the study employs multiple linear regression to examine the relationship. The findings reveal that good corporate governance, earnings, and capital are positively associated with firm value, whereas the risk profile exhibits a negative association. These results suggest that stronger governance, profitability, and capital adequacy, alongside lower risk exposure, enhance a bank's long-term value by signalling resilience and operational soundness.

**Keywords:** Risk Profile, Good Corporate Governance, Earnings, Capital, Firm Value

## *Bank Soundness and Firm Value under the RGEC Framework*

### ABSTRAK

Kesehatan perbankan merupakan bagian integral dari nilai perusahaan, yang mencerminkan stabilitas keuangan bank, kapasitas manajemen risiko, dan profitabilitas. Studi ini meneliti hubungan antara kesehatan perbankan dan nilai perusahaan menggunakan kerangka kerja RGEC—yang terdiri dari profil risiko, tata kelola perusahaan yang baik, pendapatan, dan modal—selama periode 2011–2022. Analisis ini didasarkan pada 47 laporan tahunan yang bersumber dari Refinitiv Eikon. Nilai perusahaan dimodelkan sebagai fungsi dari komponen RGEC, dengan pendapatan dan total aset dimasukkan sebagai variabel kontrol. Berdasarkan teori sinyal, studi ini menggunakan regresi linier berganda untuk menguji hubungan tersebut. Temuan menunjukkan bahwa tata kelola perusahaan yang baik, pendapatan, dan modal berhubungan positif dengan nilai perusahaan, sedangkan profil risiko menunjukkan hubungan negatif. Hasil ini menunjukkan bahwa tata kelola yang lebih kuat, profitabilitas, dan kecukupan modal, bersamaan dengan paparan risiko yang lebih rendah, meningkatkan nilai jangka panjang bank dengan memberi sinyal ketahanan dan kesehatan operasional.

**Kata Kunci:** Profil Risiko, Good Corporate Governance, Pendapatan, Modal, Nilai Perusahaan

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## INTRODUCTION

The banking sector plays a strategic role in supporting economic growth. As financial intermediaries between surplus and deficit units, banks contribute significantly to improving societal welfare (Riani, 2018). In line with this function, Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector in Indonesia reinforces the role of banks in mobilising public funds and redistributing them through credit or financing to enhance societal well-being. Given this role, bank soundness is critical for ensuring financial system stability and maintaining public confidence (Nurjanah et al. 2017).

Bank soundness is a key indicator of institutional performance and long-term viability. Its evaluation is important not only for regulators but also for investors, shareholders, and broader stakeholders. Banks with strong financial health tend to attract investor interest and are more likely to achieve higher market valuations (Maheswari & Suryanawa, 2016). Conversely, financial distress can lead to declining stock performance and eroded investor confidence.

In the banking context, firm value is often proxied by Tobin's Q, which reflects market perceptions of intrinsic value based on the ratio of market capitalisation to the book value of equity. Given the central role of banks in allocating financial resources, analysing the determinants of firm value provides insights into the factors that influence investor behaviour and support financial system stability. A deeper understanding of these determinants can inform regulatory bodies such as Bank Indonesia in designing more effective policies, while also guiding investment decisions. In Indonesia, where the banking sector contributes approximately 20–30% of GDP, high firm value is indicative of operational efficiency and resilience to external shocks, including pandemics and macroeconomic volatility (Maheswari & Suryanawa, 2016).

Volatility in banking stock prices during the COVID-19 pandemic illustrates the sensitivity of firm value to macroeconomic conditions and investor sentiment. The pandemic served as a natural experiment to test bank resilience, as measured by the RGEC framework (Risk Profile, Good Corporate Governance, Earnings, and Capital). At the onset of the crisis in 2020, the banking sector index on the Indonesia Stock Exchange declined sharply, driven by heightened credit risk, deteriorating asset quality, weakened intermediation, and broader economic uncertainty. This decline reflected investor concerns about the sector's ability to maintain stability. For instance, several major banks recorded stock price corrections exceeding 30% in the first quarter of 2020.

Over time, banks with lower risk exposure, stronger governance, sustained profitability, and adequate capital showed faster recovery. This aligns with signalling theory, wherein RGEC components serve as signals of soundness that influence market perceptions. Banks that demonstrated effective risk management and capital strength were rewarded with improved valuations, in some cases surpassing pre-pandemic levels.

These observations suggest that bank soundness, as measured through the RGEC framework, not only fulfills regulatory functions but also plays a substantive role in shaping firm value via investor perceptions. The pandemic thus highlights the importance of RGEC in assessing a bank's ability to navigate uncertainty.

To strengthen the assessment of bank soundness, Bank Indonesia adopted the

RGEC framework, which replaced the earlier CAMELS system. By incorporating risk-based metrics and governance indicators, RGEC provides a more comprehensive approach to evaluating bank performance (Bank Indonesia Regulation No. 13/1/PBI/2011). Accordingly, this study employs the RGEC framework to measure bank soundness.

Although several prior studies have examined the relationship between RGEC components and firm value, important gaps remain. First, many studies (Apriyanti *et al.*, 2023; Lestari & Wirakusuma, 2018; Prabawati *et al.*, 2021; Wulandari & Mertha, 2017) have analysed the direct effect of RGEC variables without accounting for control variables such as revenue and total assets, which may moderate these relationships. Second, most studies are limited to observation periods that predate significant external shocks, such as the COVID-19 pandemic or regulatory changes post-2018, thereby limiting their applicability to current conditions. Third, there has been limited empirical research that integrates all four RGEC components with relevant controls in a unified model within the post-implementation context of RGEC in Indonesia. Addressing these gaps is essential for a more comprehensive understanding of the determinants of firm value.

In light of this, a renewed investigation into the drivers of banking firm value amid global economic disruption is warranted. By extending the observation period and incorporating control variables, this study aims to offer actionable insights for policymakers seeking to refine regulatory frameworks and for practitioners aiming to enhance risk management. It also contributes to the academic literature by offering updated empirical evidence on the relationship between bank soundness and firm value.

This study investigates the relationship between the four RGEC components—Risk Profile, Good Corporate Governance, Earnings, and Capital—and the firm value of Indonesian banks over the 2011–2022 period. The analysis incorporates revenue and total assets as control variables, enabling the study to account for operational scale and profitability effects. Specifically, the study aims to identify how each component contributes to firm value and whether these relationships are moderated by firm-specific characteristics.

Revenue is included as a control variable given its role as a proxy for profitability, which may shape investor expectations. Total assets are used to represent firm size, which may influence the strength of the relationship between soundness indicators and firm value through scale-related efficiencies. Previous studies, including Prabawati *et al.* (2021) and Apriyanti *et al.* (2023), did not incorporate these controls, potentially limiting the explanatory power of their findings.

Within the RGEC framework, the risk profile reflects a bank's exposure to credit, market, and operational risks. From a theoretical perspective, signalling theory posits that higher risk levels serve as negative signals to the market, potentially diminishing investor confidence. Empirical studies consistently report a negative association between risk profile and firm value. This finding is supported by Prabawati *et al.* (2021), Apriyanti *et al.* (2023), and Linda *et al.* (2021), who demonstrate that elevated credit risk undermines market perception. Similarly, Wulandari and Mertha (2017) and Lestari and Wirakusuma (2018) report that increased risk exposure is generally associated with lower firm value.

H<sub>1</sub>: The risk profile is negatively associated with firm value.

Good corporate governance serves as both an internal and external control mechanism aimed at ensuring accountability, transparency, and managerial effectiveness. Within the framework of signalling theory, strong governance practices signal that a bank is managed in a transparent and accountable manner, with an orientation toward long-term sustainability. Effective governance mitigates agency conflicts, enhances the credibility of financial reporting, and strengthens risk management, thereby providing a positive signal to the market. As a result, investor confidence improves, contributing to higher firm valuation. Empirical evidence supports this relationship. Wulandari and Mertha (2017) and Lestari and Wirakusuma (2018) find that governance quality positively affects firm value, while Apriyanti *et al.* (2023), Bagh *et al.* (2025), Kyere and Ausloos (2021), Prabawati *et al.* (2021), and Zahwa *et al.* (2023) report that strong governance improves market perceptions and reinforces a firm's competitive positioning.

H<sub>2</sub>: Good corporate governance is positively associated with firm value.

Earnings are among the most closely monitored financial indicators in capital markets. From a signalling perspective, higher earnings reflect managerial competence, sound operational performance, and favourable growth prospects. Such signals are typically interpreted by investors as evidence of financial strength, often resulting in increased share demand and elevated firm valuation. The literature consistently demonstrates a positive relationship between earnings and firm value. Irma *et al.* (2016) identify earnings as a credible market signal, while Lestari and Wirakusuma (2018), Linawati *et al.* (2022), Prakarsa *et al.* (2020) and Wulandari and Mertha (2017) find that higher earnings are positively associated with investor valuation.

H<sub>3</sub>: Earnings are positively associated with firm value.

Capital reflects a bank's capacity to absorb losses and maintain operational continuity during periods of financial stress. Within both banking and signalling theory, higher levels of capital convey resilience, prudence, and long-term viability. Investors tend to interpret a strong capital position as a positive signal of a bank's ability to withstand economic shocks, preserve stability, and ensure sustainable growth. Several studies confirm this relationship. Apriyanti *et al.* (2023) and Prabawati *et al.* (2021) show that greater capital buffers increase investor confidence. Similarly, Prakarsa *et al.* (2020) find that capital adequacy enhances market trust and improves firm valuation, while El-Sood (2016), Bui *et al.* (2023), and Marsella and Pangestuti (2023) report that capital strength is significantly and positively associated with firm value.

H<sub>4</sub>: Capital is positively associated with firm value.

## RESEARCH METHODS

This study adopts a quantitative approach with a causal-associative design to examine the relationship between bank soundness and firm value. The empirical analysis focuses on banking institutions listed on the Indonesia Stock Exchange over the period 2011–2022. Firm value serves as the dependent variable, analysed in relation to four dimensions of bank soundness as defined by the RGEC framework: risk profile, good corporate governance, earnings, and capital.

The sample comprises a subset of listed banking firms selected using purposive sampling to ensure the availability and completeness of relevant data throughout the observation period. The final dataset consists of 472 firm-year observations.

**Table 1. Sample Selection Criteria**

No	Criteria	Company	Total
1	Banking companies listed on the Indonesia Stock Exchange during the observation period	49 x 12	588
2	Banking companies listed on the Indonesia Stock Exchange that did not publish annual reports during the observation period	0	0
3	Banking companies that were delisted during the observation period	2 x 12	-24
4	Banking companies that did not publish stock price data during the observation period	89	-89
5	Banking companies that experienced losses	3	-3
Sample			472

Source: Research Data, 2025

The study utilises quantitative data sourced from Refinitiv Eikon. All data were collected through the documentation method, ensuring consistency and traceability across the sample period.

Firm value represents the market's assessment of a company's financial condition and future prospects, reflecting the perceptions of investors, customers, and other stakeholders (Mulyati *et al.*, 2024). In this study, firm value is measured using the Tobin's Q ratio, which is widely used in empirical research to capture the relationship between market valuation and the underlying book value of assets. Tobin's Q offers a more comprehensive perspective by incorporating both financial and non-financial factors associated with corporate performance (Wulandari & Mertha, 2017). The ratio is computed using the following formula:

$$\text{Tobin's Q} = \frac{\text{MVE} + \text{Debt}}{\text{Total Assets}} \dots\dots\dots(1)$$

Risk profile refers to the level of credit risk borne by a bank, particularly related to the bank's ability to manage non-performing loans. This study focuses on credit risk. In accordance with Circular Letter of the Financial Services Authority (OJK) No. 14/SEOJK.03/2017, credit risk can be measured using the Non-Performing Loan (NPL) ratio, calculated as follows:

$$\text{NPL} = \frac{\text{Non-Performing Loans}}{\text{Total Loans}} \times 100\% \dots\dots\dots(2)$$

Good corporate governance (GCG) reflects a set of principles adopted by firms to optimise firm value, enhance performance, support long-term sustainability, and reinforce stakeholder confidence. In this study, GCG is measured using a self-assessment framework in accordance with Bank Indonesia Circular Letter No. 15/15/DPNP of 2013, which mandates that banks independently evaluate the implementation of corporate governance practices. The assessment encompasses multiple dimensions of governance quality, as outlined in Table 2.



**Table 2. Good Corporate Governance Assessment Aspects**

No.	Assessed Aspects
1	Implementation of the Duties and Responsibilities of the Board of Commissioners
2	Implementation of the Duties and Responsibilities of the Board of Directors
3	Completeness and Implementation of Committee Duties
4	Handling of Conflicts of Interest
5	Implementation of the Compliance Function
6	Implementation of the Internal Audit Function
7	Implementation of the External Audit Function
8	Implementation of Risk Management and Internal Control
9	Provision of Funds to Related Parties and Large Debtors (Large Exposures)
10	Transparency of the Bank's Financial and Non-Financial Conditions, GCG Implementation Reports, and Internal Reports
11	Bank Strategic Plan

Source: Bank Indonesia Circular Letter No. 15/15/DPNP dated 29 April 2013

Earnings represent an approach used to assess a bank's ability to generate profits by comparing income with assets or capital over a specific period (Melinda & Sibarani, 2021). According to the Financial Services Authority (OJK) Circular Letter No. 14/SEOJK.03/2017, earnings can be measured using the Return on Assets (ROA) ratio, calculated as follows:

$$ROA = \frac{\text{Profit Before Tax}}{\text{Total Assets}} \times 100\% \dots\dots\dots(3)$$

Capital refers to the resources provided and allocated to a company or organization as a foundation for carrying out its operations (Huu Vu & Thanh Ngo, 2023). Based on the Financial Services Authority (OJK) Circular Letter No. 14/SEOJK.03/2017, capital can be measured using the Capital Adequacy Ratio (CAR), calculated as follows:

$$CAR = \frac{\text{Capital}}{\text{Risk-Weighted Assets}} \times 100\% \dots\dots\dots(4)$$

The data analysis techniques employed in this study include descriptive analysis, classical assumption tests, multiple linear regression analysis, and hypothesis testing. The multiple linear regression model used in this study is specified as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \dots\dots\dots(5)$$

Where:

- Y = Firm Value
- $\alpha$  = Constant
- $\beta_1, \beta_2, \beta_3, \beta_4$  = Coefficients of the Independent Variables
- $X_1$  = Risk Profile
- $X_2$  = Good Corporate Governance
- $X_3$  = Earnings
- $X_4$  = Capital
- $\varepsilon$  = Error

## RESULTS AND DISCUSSION

Descriptive statistics are used to summarize the characteristics of the research sample, as indicated by the minimum, maximum, mean, and standard deviation.

**Table 3. Descriptive Statistics Results**

Variabel	N	Mean	Std. Dev.	Min	Max
Firm Value	472	1.581	0.640	0.995	6.408
Risk Profile	472	3.137	2.470	0	22.27
GCG	472	2.032	0.532	1.000	4.000
Earnings	472	0.340	2.830	-15.830	2.230
Capital	472	26.441	28.486	8.02	390.500
Revenue	472	1.150	0.060	0.985	1.274
Total Assets	472	1.238	0.043	1.127	1.331

Source: Research Data, 2025

The minimum observed firm value in the banking sector is 0.995, while the maximum is 6.408. The average firm value is 1.581, suggesting that the sector overall retains scope for performance improvement. Understanding the determinants of firm value—measured through the RGEC framework (Risk Profile, Good Corporate Governance, Earnings, and Capital)—can support the development of strategic initiatives to enhance competitiveness and strengthen investor confidence. The standard deviation of firm value is 0.640, which is lower than the mean, indicating a relatively consistent distribution across the sample.

For the risk profile variable, the minimum value is 0—recorded by ARTO, BACA, BANK, and NOBU—indicating full repayment compliance and high asset quality. The maximum risk profile value is 22.27, observed at BEKS. The mean value of 3.137 suggests that, in general, banks maintain sound loan portfolios with limited repayment issues. The standard deviation of 2.470, which is below the mean, reflects moderate variability and consistency in risk exposure across banks.

The good corporate governance (GCG) score ranges from a minimum of 1.000 to a maximum of 4.000. A score of 1.000 indicates the absence of a self-assessment, whereas the maximum reflects full compliance with governance principles. The average GCG score is 2.034, suggesting that most institutions adhere to basic governance standards. The standard deviation of 0.532, being lower than the mean, points to relatively stable governance practices across the sample.

Earnings exhibit greater variability. The minimum value, -15.830, recorded by AGRO, indicates inefficiencies in asset utilisation, while the maximum value of 8.963, reported by BTPS, reflects strong profitability. The average earnings value is 0.340, implying that banks, on average, achieve modest returns. However, the standard deviation of 2.830, which exceeds the mean, reveals substantial dispersion and performance heterogeneity within the sector.

Capital levels range from 8.02 (BEKS) to 390.500 (BANK), highlighting a wide gap in loss-absorption capacity. The minimum value signals limited capital buffers and elevated risk exposure, while the maximum suggests robust financial resilience. The average capital value is 26.441, with a standard deviation of 28.486, indicating considerable variability in capital adequacy among banks.

Revenue ranges from -0.0985 (equivalent to IDR 15.73 billion, recorded

by ARTO) to 1.274 (equivalent to IDR 147.77 trillion, recorded by BBRI). A negative revenue value suggests the inability to cover operational costs, potentially due to inefficiencies or adverse market conditions. The average revenue value is 1.150, indicating that most banks generate sufficient income to cover expenses and achieve profitability. The standard deviation of 0.060, which is well below the mean, suggests a tight distribution across observations.

Total assets range from 1.127 (IDR 664.67 trillion, recorded by ARTO) to 1.331 (IDR 1,992.54 trillion, recorded by BMRI). The lower bound reflects limited operational scale and risk-bearing capacity, while the upper bound indicates a significant asset base and systemic importance. The mean value of 1.238 suggests that most institutions operate with adequate asset capacity. The standard deviation is 0.043, reflecting relatively low variation in total asset size among the sampled banks.

To assess the strength and direction of the relationships between variables, a Pearson correlation analysis is conducted. The results indicate a positive and statistically significant correlation between firm value and capital at the 0.05 level. Conversely, firm value is negatively associated with the risk profile. Significant positive relationships are also observed between firm value and both revenue and total assets, suggesting that these variables tend to move in the same direction. In contrast, a higher risk profile is associated with lower firm value, consistent with theoretical expectations.

To evaluate potential multicollinearity among the independent variables, variance inflation factor (VIF) diagnostics are applied. A VIF value exceeding 10 or a tolerance value below 0.1 would indicate multicollinearity. In this study, none of the VIF values surpass the threshold, confirming that the regression model is not affected by multicollinearity.

To examine the effect of the independent variables on firm value, multiple linear regression analysis is employed. This approach enables the assessment of the individual and combined contributions of RGEC components, while accounting for control variables.

**Table 4. Results of Multiple Linear Regression Analysis**

F-statistic	: 15.01			
F-significance	: 0.000			
R-squared	: 0.162			
Adj R-squared	: 0.151			
	<b>Coef.</b>	<b>Std. err.</b>	<b>T</b>	<b>P&gt;  t </b>
Risk Profile	-0.019	0.129	-1.46	0.014
GCG	0.072	0.065	1.11	0.026
Earnings	0.006	0.106	0.56	0.044
Capital	0.008	0.011	8.23	0.000
Revenue	1.265	1.693	0.75	0.048
Total Assets	2.461	2.298	1.07	0.028
_cons	2.866	1.242	2.31	0.021

Source: Research Data, 2025

Based on the results of the multiple linear regression analysis, the regression equation in this study can be formulated as follows:

$$Y = 2.866 - 0.019X_1 + 0.072X_2 + 0.006X_3 + 0.008X_4 + 1.265X_5 + 2.461X_6 + \dots \quad (6)$$

The regression results show a constant value of 2.866, indicating that when



all independent variables—risk profile, good corporate governance, earnings, capital, revenue, and total assets—are held at zero, the baseline firm value is 2.866. Each independent variable exhibits a positive or negative association with firm value, consistent with theoretical expectations.

The risk profile has a negative regression coefficient ( $-0.019$ ), suggesting an inverse relationship with firm value. This implies that higher risk exposure reduces firm value, consistent with signalling theory, which posits that elevated risk is perceived negatively by investors. Good corporate governance is positively associated with firm value, as indicated by a coefficient of  $0.072$ , reflecting the market's favourable response to enhanced transparency and accountability. Earnings also show a positive coefficient ( $0.006$ ), suggesting that improved profitability strengthens market valuation. Capital is positively related to firm value, with a coefficient of  $0.008$ , consistent with the interpretation that stronger capital buffers increase financial resilience and investor confidence. Similarly, revenue and total assets have positive coefficients of  $1.265$  and  $2.461$ , respectively, indicating that higher income generation and greater asset capacity are associated with higher firm value.

The explanatory power of the model is assessed through the coefficient of determination (R-squared). The R-squared value of  $0.162$ , as presented in Figure 1, indicates that approximately  $16.2\%$  of the variation in firm value is explained by the independent variables included in the model—namely, risk profile, good corporate governance, earnings, capital, revenue, and total assets. The remaining  $83.8\%$  of variation is attributed to other factors not captured by this specification.

The joint significance of the model is evaluated using the F-test. This test examines whether the independent and control variables collectively have a statistically significant relationship with firm value. The F-statistic yields a p-value of  $0.00$ , which is below the  $0.05$  threshold, indicating that the model is statistically significant at the  $5\%$  level. Accordingly, the variables included in the model—both explanatory and control—jointly explain a significant proportion of the variation in firm value.

To assess the individual contribution of each independent variable, a t-test is conducted. As shown in Table 4, risk profile is negatively associated with firm value ( $t = -1.46$ ;  $p = 0.014$ ), consistent with the hypothesis that increased risk reduces market valuation. Good corporate governance is positively associated with firm value ( $t = 1.11$ ;  $p = 0.026$ ), indicating that stronger governance contributes to higher valuation. Earnings also exhibit a positive relationship ( $t = 0.56$ ;  $p = 0.044$ ), suggesting that profitability positively influences investor perception. Capital has a strong and statistically significant positive relationship with firm value ( $t = 8.23$ ;  $p = 0.000$ ), reinforcing the importance of capital adequacy. The control variables also yield significant results: revenue is positively related to firm value ( $t = 0.75$ ;  $p = 0.045$ ), as is total assets ( $t = 1.07$ ;  $p = 0.028$ ), suggesting that larger and more profitable firms tend to be valued more highly by the market.

## CONCLUSION

The results confirm that the risk profile is negatively associated with firm value, highlighting the importance of effective risk management in promoting financial stability and mitigating investor concerns. Conversely, good corporate governance exhibits a positive association with firm value, suggesting that the

adoption of robust governance practices enhances transparency, reduces agency costs, and strengthens market confidence. Earnings are also positively related to firm value, indicating that profitability serves as a credible signal of managerial efficiency and operational performance. Strong earnings performance may increase investor demand, leading to upward pressure on share prices and improved firm valuation. Capital is positively associated with firm value as well, reflecting the market's favourable perception of firms with strong capital positions. Higher capital levels are indicative of greater financial resilience and the capacity to absorb losses, supporting long-term growth and strategic flexibility.

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