



## **EXAMINING FIRM PERFORMANCE AS A MEDIATOR OF THE EFFECTS OF WORKING CAPITAL AND TOTAL RISK ON SUSTAINED GROWTH WITH THE EFFECTIVE TAX RATE AS A MODERATING VARIABLE**

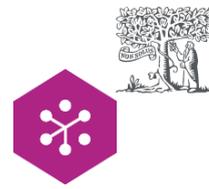
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**Abstract:** This study examines the role of firm performance as a mediator in the relationship between working capital and total risk on sustained growth, with the effective tax rate as a moderating variable. The primary issue addressed is how firms can manage working capital and risk to achieve long-term growth, considering the impact of tax policies. The objective is to provide a deeper understanding of these dynamics and how tax rates influence the ability of firms to reinvest in growth initiatives. This research utilizes a library research method, analyzing secondary data from books, scholarly articles, and prior research related to working capital, risk management, and firm performance. The findings indicate that effective working capital management and risk mitigation enhance firm performance, which in turn fosters sustained growth. Furthermore, the study highlights that favorable tax policies positively moderate this relationship, offering firms greater financial flexibility to invest in expansion. In conclusion, firms that efficiently manage working capital, mitigate risks, and operate in tax-friendly environments are better positioned for long-term growth and profitability. The research suggests that effective tax policies can be leveraged by business leaders to enhance financial performance, enabling greater reinvestment into growth initiatives. By understanding the interconnectedness of working capital management, risk mitigation, and tax strategies, this study provides valuable insights for business leaders and policymakers to optimize financial strategies for sustainable business success and long-term profitability. Furthermore, the findings encourage the adoption of proactive financial planning to navigate the complexities of working capital and risk management for sustained growth.

**Keywords (English):** Firm Performance, Working Capital and Total Risk, Effective Tax Rate as a Moderating Variable



## **INTRODUCTION:**

The real-world challenges faced by many companies today revolve around achieving sustainable growth, especially within the context of highly dynamic markets and uncertainty. This uncertainty stems not only from external factors such as global economic crises or regulatory changes but also from internal factors related to working capital management and total risk. Adequate working capital is considered one of the key pillars in maintaining operational continuity, allowing companies to function efficiently while responding to rapidly changing market demands. However, many companies struggle to manage working capital optimally, which can hinder their ability to invest in expansion or innovation necessary for long-term growth. On the other hand, risk factors, both market and operational in nature, can exacerbate this uncertainty. High levels of risk often cause companies to become more conservative in investment decisions, hindering their growth efforts and preventing sustainable expansion. The inability of firms to effectively manage these two factors—efficient working capital and controlled risk—often leads to stagnation in growth, posing a significant challenge for business longevity[1].

Existing literature shows that while many theories have explored the relationships between working capital, total risk, and firm performance, there is no clear consensus on how these factors interact to influence long-term firm growth. Previous research has largely focused on direct relationships between working capital and firm performance, as well as between risk and performance, but there is limited exploration of how these two factors interact to impact sustainable growth. Additionally, while some studies have addressed the role of external factors such as tax policy, the impact of effective tax rates on the relationship between working capital, risk, and firm growth has been relatively underexplored. Several studies suggest that taxes can affect investment decisions and capital management, yet the moderating role of effective tax rates in the interaction between working capital, risk, and growth remains a gap in the literature. This highlights the need to bridge this gap and provide a more comprehensive understanding of the factors that drive sustainable firm growth[2].

The objective of this study is to explore how firm performance serves as a mediator in the relationship between working capital, total risk, and sustained growth, while also considering the effective tax rate as a moderating variable. This research aims to offer new insights into the dynamics between working capital management, risk management, and long-term growth, as well as how tax policies influence these relationships. By examining the moderating role of tax rates, this study will provide a deeper understanding of how firms can optimize their financial strategies to foster sustainable growth in the face of taxation complexities. The study's findings are expected to contribute significantly to both the theoretical framework of financial management and the practical applications for companies striving to achieve long-term growth[3].

The argument for the importance of this research lies in the fact that although there are numerous studies exploring the relationships between working capital, risk, and firm growth, very few directly address how firm performance mediates these relationships. Firm performance is often regarded as a primary indicator of a company's ability to survive and grow over time. Therefore,



understanding the role of firm performance in mediating the effects of working capital and risk on growth is crucial. Additionally, this study emphasizes the role of the effective tax rate, which, in many cases, can either hinder or promote the management of working capital and risk. Given the limitations in existing literature regarding the interplay of these three factors, this research is essential for providing a comprehensive understanding of how working capital, risk, and taxes interact to support or inhibit sustainable growth. The results of this study are expected to offer valuable insights for policymakers, corporate managers, and academics, helping to develop more effective financial management strategies that ensure long-term sustainability[4].

### **METHODOLOGY:**

The object of this research focuses on the issue of sustainable growth within companies, particularly examining how firm performance mediates the effects of working capital and total risk, with an emphasis on the moderating role of the effective tax rate. The case under investigation is the dynamic relationship between these variables, where many companies struggle to achieve long-term growth due to poor working capital management, unmitigated risks, and the impact of tax policies. The research explores this issue by reviewing relevant literature and theoretical frameworks, identifying key elements that influence these relationships. The phenomenon studied is the lack of a clear understanding regarding how these variables interconnect and affect a company's ability to sustain growth, with a specific focus on the role of tax policies in moderating these effects[5].

This study utilizes a library research method, also known as a literature review, which involves gathering and analyzing secondary data from relevant sources. The primary data for this research is sourced from literature directly related to the case or problem being studied, which includes books, scholarly articles, journals, and research papers that explore the interrelationships between working capital, total risk, and sustained firm growth. Secondary data is collected from various sources that provide contextual and theoretical insights into the keywords of the research, such as firm performance, working capital, total risk, and effective tax rate. These sources help provide a broad view of the existing knowledge on these topics and guide the study's theoretical framework[6].

The foundational theories used in this research provide the basis for understanding the complex relationships between the key variables. One of the primary theories that underpin this study is the Trade-off Theory of capital structure, introduced by Myers, which posits that companies balance the costs and benefits of debt and equity to optimize their financial structure. This theory helps explain the relationship between working capital, risk, and performance in the context of firm growth. Another important theory is the Risk Management Theory, which explains how firms identify, assess, and manage risks to maintain stability and promote growth. The Agency Theory (Jensen & Meckling,) is also relevant, as it addresses the conflicts of interest between managers and shareholders, influencing decisions on working capital and risk management. These theories collectively serve as the foundational framework for understanding the variables involved in the study and the assumptions underlying the research[7].



The research process consists of several stages, starting with the identification of relevant sources and followed by a thorough reading and examination of literature related to the research problem. Data collection in this study involves reviewing books, prior research, academic papers, journals, articles, reports, and magazine articles that are relevant to the relationship between working capital, risk, tax policies, and firm performance. This process ensures that all relevant theories and empirical studies are considered to support the analysis and interpretation of findings. The methodology also involves organizing the collected data into categories that align with the key aspects of the research: working capital, risk, tax policies, and sustainable growth. This systematic approach enables a comprehensive exploration of the factors that influence firm performance and long-term growth [8].

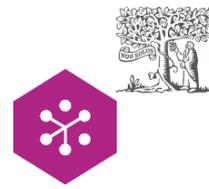
The data analysis technique employed in this study is content analysis, a qualitative research method used to identify patterns, relationships, and key information within textual data. Content analysis allows for the examination of both explicit and implicit connections between the various variables under study. In this case, the technique is applied to the literature and sources collected, enabling the identification of recurring themes, such as the impact of working capital and risk management on firm performance, and how the effective tax rate moderates these relationships. The process of content analysis involves categorizing and interpreting data, then synthesizing the information to draw conclusions regarding the interplay between these factors and their collective effect on sustainable growth. This approach ensures that the study captures the nuances of the topic and provides a thorough understanding of the factors influencing firm performance[9].

## **RESULTS AND DISCUSSION**

### **Result**

The findings of this study provide a deeper understanding of how firm performance mediates the effects of working capital and total risk on sustained growth, with particular attention to the moderating role of the effective tax rate. Through a thorough review of existing literature, several key insights have emerged regarding the relationships between these variables and their collective impact on a company's growth prospects[10].

Firstly, the relationship between working capital management and firm performance is well-established. Companies that effectively manage their working capital—balancing short-term assets and liabilities—are more likely to maintain liquidity, reduce financial distress, and support investment in long-term growth initiatives. When firms have sufficient working capital, they are better able to respond to market fluctuations, make timely investments, and capture growth opportunities. On the contrary, poor management of working capital can lead to liquidity shortages, disrupting daily operations and hindering growth efforts. This underscores the importance of efficient working capital management in fostering business performance and long-term sustainability[11].



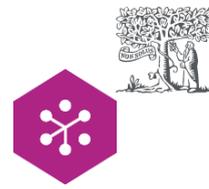
Secondly, the literature reveals that total risk, encompassing both financial and operational risks, is a significant factor influencing firm performance. High levels of risk can deter firms from making bold investment decisions, leading them to adopt more conservative strategies. This often results in underinvestment, especially in industries where innovation and capital expenditure are essential for maintaining competitive advantage. Risk management, therefore, plays a critical role in protecting the firm's operational stability and financial health. The ability to manage risk—through strategies such as diversification, hedging, and sound financial planning—can mitigate the adverse effects of risk on performance and enable firms to continue pursuing growth opportunities even in the face of uncertainty [12].

Furthermore, the literature suggests that while managing risk is essential for firm survival, excessive risk-taking can have detrimental effects. Companies that fail to address high-risk factors in their operations may experience financial volatility, which could prevent them from scaling or expanding effectively. As such, risk management serves as a stabilizing force that allows firms to balance the potential for growth with the need to preserve financial stability. These findings emphasize that risk is not necessarily a barrier to growth but requires careful and strategic management to avoid negative repercussions[13].

The role of the effective tax rate emerges as another crucial factor influencing the dynamics between working capital, risk, and firm performance. High tax rates can reduce a firm's profitability by diverting a significant portion of earnings to tax payments, leaving less capital available for reinvestment into the business. This limitation can severely impact the firm's ability to pursue growth opportunities. On the other hand, favorable tax policies, such as lower tax rates or tax incentives for reinvestment, allow firms to retain a larger share of their profits. This provides companies with more financial flexibility to invest in innovation, expansion, and strategic initiatives that can drive sustained growth [14].

Additionally, the analysis indicates that the effective tax rate serves as a moderating variable in the relationship between working capital, risk, and firm performance. Companies that operate in environments with favorable tax rates are more likely to experience enhanced financial performance, as they can allocate more resources to growth-oriented activities. Conversely, firms operating in high-tax environments may find themselves constrained by their tax obligations, thus limiting their growth potential. The moderating role of taxes highlights the importance of external regulatory factors in shaping corporate decision-making and financial strategies[15].

Another key finding is that firm performance serves as a mediator between working capital and risk on one hand, and sustained growth on the other. Efficient working capital management and effective risk mitigation contribute to improved firm performance by ensuring operational stability, liquidity, and profitability. As firm performance improves, it acts as a catalyst for sustained growth, allowing firms to reinvest earnings into new projects, expansion, and innovation. This creates a positive feedback loop where increased performance leads to more opportunities for growth, reinforcing the importance of both working capital and risk management in achieving long-term success[16].



Moreover, the research findings suggest that the interplay between these variables creates a synergistic effect that enhances a firm's ability to achieve sustained growth. By optimizing working capital and managing risk effectively, firms can ensure that their resources are used efficiently, which, in turn, supports their overall performance. As firm performance improves, it facilitates greater investment in growth activities, further strengthening the firm's competitive position in the marketplace[17].

The findings indicate that the combined effect of working capital management, risk management, and favorable tax policies is essential for achieving sustained growth. Firm performance acts as a key mediator in this relationship, where efficient management of resources and risks contributes to operational success, which, in turn, drives growth. The moderating role of the effective tax rate further highlights the impact of external factors on a firm's ability to navigate financial challenges and capitalize on growth opportunities. These findings provide valuable insights for business leaders and policymakers looking to foster an environment conducive to long-term business growth and sustainability[18].

## **Discussion**

### **1. The Impact of Working Capital Management on Firm Performance**

Effective working capital management is crucial for ensuring that a company has the necessary liquidity to meet its short-term obligations while simultaneously investing in long-term growth initiatives. Companies that manage their working capital efficiently can optimize their cash flow, allowing them to meet operational needs and explore expansion opportunities without jeopardizing day-to-day operations. A firm with a well-structured working capital system can adjust quickly to changes in the market, ensuring smooth operational processes and capitalizing on growth prospects. On the other hand, poor management of working capital can lead to cash flow problems, which may disrupt business operations and prevent timely investment in strategic initiatives. This inefficiency creates a barrier to sustaining long-term growth and profitability, as companies may face difficulties in financing new projects or expanding their operations[19].

Studies have shown that businesses with optimal working capital management often outperform their competitors in terms of profitability and market value. By maintaining a healthy balance of assets and liabilities, firms reduce the risk of liquidity shortages, which can otherwise lead to the need for expensive short-term financing options or even the inability to pay creditors on time. Effective management of working capital not only supports a firm's day-to-day activities but also positions it for growth by providing the financial flexibility necessary for investment in research, innovation, and market expansion[20].

Furthermore, working capital management plays a pivotal role in a company's operational efficiency. A company that manages its working capital well can invest in areas like marketing, infrastructure, and technological upgrades that facilitate future growth. This leads to improved product offerings, better customer service, and the ability to scale operations as demand increases. Efficient working capital management thus directly influences a company's competitive advantage in the marketplace, fostering long-term success[21].

Moreover, the liquidity provided by well-managed working capital allows firms to navigate market fluctuations with greater resilience. Whether responding to external shocks or taking advantage of emerging opportunities, firms with sufficient working capital can act decisively and swiftly. By ensuring that cash flow is adequate to cover short-term obligations, these companies maintain operational stability, which is essential for sustaining long-term growth[22].

The management of working capital is integral to a company's performance and its ability to grow sustainably. Firms that effectively balance their short-term assets and liabilities ensure a solid financial foundation, allowing them to remain competitive and achieve expansion. Conversely, companies that struggle with working capital management risk facing liquidity issues that can impede both daily operations and long-term growth strategies[23].

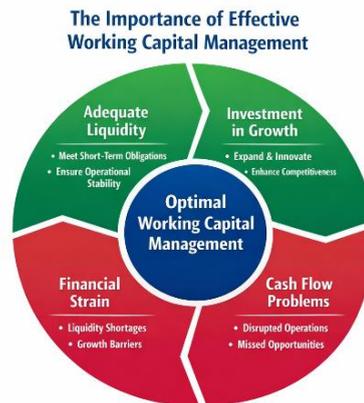
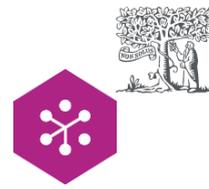


Image 1, the importance of effective working capital management

The diagram is divided into four key quadrants surrounding the central concept, "Optimal Working Capital Management," with each quadrant highlighting different aspects of how working capital management impacts business operations and long-term sustainability:

1. **Adequate Liquidity (Top-left quadrant):** This section emphasizes the importance of maintaining sufficient liquidity to meet short-term obligations and ensure operational stability. Adequate liquidity allows companies to remain flexible and avoid disruptions in their day-to-day operations, positioning them for growth.
2. **Investment in Growth (Top-right quadrant):** Effective working capital management enables firms to allocate resources toward growth initiatives such as expansion, innovation, and enhancing competitiveness. Firms with adequate working capital can fund marketing, technological advancements, and product development, which are essential for business expansion.
3. **Cash Flow Problems (Bottom-right quadrant):** This section highlights the consequences of poor working capital management, such as cash flow problems, which can disrupt operations and result in missed growth opportunities. Lack of cash flow can lead to difficulties in covering day-to-day expenses or investing in future business growth.



4. Financial Strain (Bottom-left quadrant): Poor working capital management can result in financial strain, with liquidity shortages that hinder the ability to fund growth initiatives. This creates barriers to business expansion and can restrict a company's ability to meet financial obligations, affecting overall performance[24].

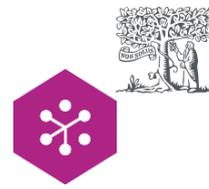
## **2. The Role of Risk in Shaping Firm Performance and Growth**

Risk is an inherent part of doing business, and its management is crucial for ensuring that a company's performance remains stable and that its growth prospects are not undermined. Total risk, which includes financial and operational risks, influences a company's ability to make informed and confident decisions regarding investments, capital expenditures, and other growth initiatives. High levels of risk often force firms to adopt conservative strategies, which may limit their investment in innovative products or services and slow down their growth trajectory. In industries where technological advancement and market expansion are key to staying competitive, such conservative approaches can be detrimental[25].

On the other hand, firms that effectively manage risk—whether through diversification, hedging, or strategic partnerships—are better positioned to navigate uncertain market conditions and exploit new growth opportunities. Risk management strategies help firms mitigate the financial and operational impacts of unexpected events, such as market volatility, economic downturns, or disruptions in the supply chain. By reducing the negative impacts of risk, these companies maintain stability and can continue to invest in growth even during challenging times. Additionally, an effective approach to risk management can help firms optimize their capital structure. Companies with high levels of risk often rely on debt financing, which increases financial risk. However, firms that proactively manage their operational risks are better equipped to balance their debt and equity financing, maintaining a healthy financial structure. This balance is crucial for minimizing the cost of capital, ensuring that the company can pursue expansion without the excessive burden of high-interest payments[26].

Firms that ignore or mishandle risks may face more severe consequences, including declining profits, lower shareholder value, and difficulty accessing financing. When risk is not adequately addressed, firms may find themselves at a competitive disadvantage, unable to keep up with industry leaders that have implemented more effective risk management frameworks. This can lead to stagnation, as firms are unable to respond effectively to market shifts or capitalize on new opportunities[27].

In summary, risk management is a crucial element in shaping firm performance and sustaining growth. Firms that can effectively identify, assess, and mitigate risks are better positioned to perform well and achieve long-term success. In contrast, firms that overlook risk management are more vulnerable to negative financial and operational impacts, which can hinder their growth prospects[28].



### **3. The Negative Impacts of Excessive Risk on Firm Performance**

Excessive risk-taking can significantly hinder a company's ability to maintain steady growth. While taking risks is an inherent part of business operations, too much risk—whether financial, operational, or strategic—can lead to negative outcomes that are detrimental to the company's performance. Firms that fail to effectively assess and manage their risks often find themselves exposed to unpredictable financial fluctuations, which can disrupt operations and make it difficult to plan for future growth[29].

For example, firms with high levels of debt may experience a greater financial strain during economic downturns or periods of low cash flow. This financial risk can lead to bankruptcy if the firm is unable to meet its obligations, thereby stalling any potential growth. Additionally, excessive risk-taking in the form of aggressive expansion or product diversification without adequate planning can result in operational inefficiencies. Companies that invest in too many new projects without sufficient risk evaluation may stretch their resources too thin, leading to suboptimal performance and missed growth opportunities.

Moreover, excessive risk can also affect a company's reputation in the market. Firms that regularly engage in high-risk strategies without considering their potential impacts may alienate customers, investors, and business partners. This loss of trust can damage a company's ability to form partnerships, secure financing, or maintain a loyal customer base. As a result, even if the firm is able to survive in the short term, it may struggle to sustain growth in the long term due to reputational damage.

The impact of excessive risk-taking can also lead to higher costs of capital. Investors and lenders typically require higher returns to compensate for the increased risk associated with a firm's operations. This can make it more difficult for companies to raise funds for expansion or innovation, limiting their ability to grow. As a result, companies that fail to manage their risks may find themselves trapped in a cycle of declining performance and stunted growth.

While risk is a necessary element of business, excessive risk-taking can have serious consequences for a firm's performance and growth. Firms must carefully assess and manage their risks to ensure they are not exposed to undue financial or operational strain. By striking a balance between taking calculated risks and maintaining stability, companies can ensure long-term sustainability and growth.

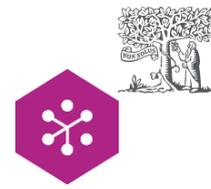


Table 1, Specific Risk Comparison [30]

Risk Metric	Firm A (Controlled Risk)	Firm B (Excessive Risk)
Debt-to-Equity Ratio	0.4 (safe level)	2.1 (high distress risk)
Interest Coverage Ratio	8x (strong coverage)	1.2x (near default)
Stock Beta (Volatility)	0.75 (stable)	1.95 (highly volatile)
Cost of Debt	7% p.a.	13% p.a. (risk premium)
Failed Projects (3 yrs)	1/10	6/12 (reckless expansion)
Market Share Change	Stable at 18%	-12% (trust erosion)

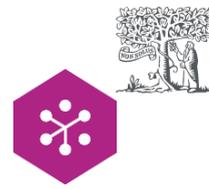
#### 4. The Moderating Role of the Effective Tax Rate

The effective tax rate plays a critical role in shaping a firm’s ability to manage its financial resources and pursue growth strategies. High tax rates can significantly reduce a firm’s available profits, limiting the amount of capital available for reinvestment into the business. This reduction in available resources constrains the firm’s ability to expand operations, develop new products, or invest in innovative technologies. For firms aiming for sustainable growth, the effective tax rate is a crucial factor in determining their financial flexibility and capacity for reinvestment[31].

Conversely, firms operating in environments with lower tax rates or favorable tax incentives are better positioned to allocate their resources toward growth. By retaining a higher portion of their profits, these firms can invest in expanding their workforce, improving infrastructure, and enhancing their competitive edge in the marketplace. Lower tax burdens allow companies to reinvest their earnings into core business areas that drive long-term growth, such as product development, marketing strategies, and international expansion.

Tax policies that favor business reinvestment also provide an additional advantage. Governments often offer tax credits or deductions to companies that invest in research and development or expand operations in specific regions. These incentives further reduce the tax burden and create more opportunities for firms to grow. As a result, firms in favorable tax environments can leverage these incentives to increase their market share and invest in strategies that will ensure long-term success.

The impact of tax rates on firm performance is evident in both the short term and the long term. In the short term, lower taxes provide firms with more capital to fund ongoing operations and strategic investments. Over time, the cumulative effect of reduced taxes can contribute to enhanced firm performance, as businesses are able to reinvest more heavily in their growth initiatives. Thus, the effective tax rate serves as a key determinant of a firm’s financial strategies and growth potential.



In summary, the effective tax rate significantly moderates the relationship between working capital, risk, and firm performance. Firms that benefit from lower taxes can reinvest more of their profits into growth initiatives, leading to better financial performance and greater opportunities for expansion. Conversely, firms facing high tax rates may find it more difficult to allocate sufficient resources for growth, limiting their long-term sustainability.

### **5. Tax Policies as a Moderating Variable in Financial Strategies**

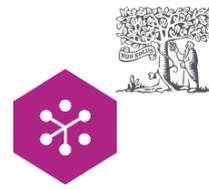
The effective tax rate plays a moderating role in shaping the way firms manage their working capital, risk, and performance. Firms operating in tax-efficient environments have the advantage of retaining more of their profits, which can then be reinvested into the business. These firms have greater financial flexibility to fund new projects, expand operations, and take calculated risks that support growth. Tax policies that reduce the burden on firms encourage them to invest in strategies that promote long-term success, such as innovation, market expansion, and infrastructure development.

In contrast, firms operating in high-tax environments often face financial constraints that limit their ability to invest in growth. The portion of profits diverted to tax payments means less capital is available for reinvestment. As a result, firms may be forced to adopt more conservative strategies, including reducing capital expenditures and delaying growth initiatives. In such environments, firms may struggle to remain competitive, especially in industries where rapid innovation and expansion are key to success.

Tax policies also influence the cost of capital for businesses. In high-tax environments, firms may have to rely more heavily on external financing, such as loans or equity financing, to fund their growth initiatives. However, the cost of borrowing increases as the tax burden rises, making it more expensive for companies to raise capital. Conversely, favorable tax policies reduce the financial strain on companies, allowing them to access capital more cheaply and invest more aggressively in growth.

The moderating role of tax policies emphasizes the importance of external factors in shaping corporate financial strategies. Firms must carefully consider the tax environment in which they operate when developing their financial plans. By understanding how tax policies affect their profitability and resource allocation, businesses can make more informed decisions about how to structure their investments and growth strategies.

Tax policies significantly moderate the relationship between working capital, risk, and firm performance. Favorable tax environments provide firms with the opportunity to reinvest profits into growth, while high taxes restrict this ability and limit growth potential. Understanding the moderating effect of tax policies is essential for firms looking to optimize their financial strategies and achieve long-term sustainability.



## CONCLUSIONS

This study highlights the critical role of efficient working capital management, effective risk mitigation, and favorable tax policies in driving sustained firm growth. Companies that manage their working capital effectively can maintain liquidity, reduce financial distress, and invest in long-term growth opportunities. Risk management, when properly implemented, helps firms navigate uncertainties, ensuring stability while pursuing expansion. Additionally, the effective tax rate serves as a crucial moderating factor, influencing a firm's ability to reinvest profits into strategic growth initiatives. Firms operating in favorable tax environments have more financial flexibility to allocate resources toward growth, enhancing their competitive advantage and overall performance.

Moreover, firm performance emerges as a key mediator between working capital, risk, and sustained growth. As firms improve their performance through efficient resource management and risk mitigation, they are better positioned to leverage these improvements for long-term success. The moderating effect of tax policies further emphasizes the importance of external factors in shaping corporate financial strategies. Understanding the interplay between working capital, risk, and taxation allows businesses to develop more effective strategies that not only ensure operational efficiency but also foster sustainable growth in a competitive market.

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