

The Effect of Profitability and Liquidity on Firm Value: Capital Structure as a Mediating Variable

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Abstract: *The purpose of this study is to investigate the influence of profitability and liquidity on firm value, considering the role of capital structure as a mediating variable in pharmaceutical companies listed on the Indonesia Stock Exchange. The research is quantitative and uses data from pharmaceutical companies listed on the Indonesia Stock Exchange from 2016 to 2021. The findings reveal that profitability positively impacts capital structure and firm value, while liquidity negatively affects them. However, capital structure does not mediate the effect of profitability and liquidity on firm value.*

Keywords: Profitability, Liquidity, Capital Structure, Firm Value, Mediation, Pharmaceuticals.

1. Introduction

The condition of the Covid-19 pandemic has encouraged the pharmaceutical industry to be involved and play a direct role in preparing products for public consumption, especially when the Indonesian government is aggressively launching and hastening vaccinations for the public. Pharmaceutical companies certainly reap high profits from this situation. However, as the Covid-19 outbreak began to decline, the demand for medicines from pharmaceutical companies decreased. Of course, with this decline, pharmaceutical companies must improve their performance so as not to experience a decrease in revenue in the following year. One of the performance that must be improved by the company is the value of the company.

The firm value is the same as the share price, the higher the share value, the better the company value. [1] If the value of the company grows from year to year, then an investor will not hesitate to invest in the company. To be able to calculate the company's valuation value, you can use Price to Book Value (PBV).

Firm value can be influenced by many factors including; profitability, liquidity and capital structure. Profitability is a factor that deserves full attention and is an indicator in measuring financial performance and evaluating companies. Without making a profit, it is certain that it will be very difficult for companies to get capital from outside parties. Profitability in this study is measured by Return On Assets (ROA). According [2] the liquidity ratio reflects the company's capacity to fulfill short-term debt. Liquidity in this study is measured by the Current Ratio (CR). The capital structure is very important for the company, because good or bad capital structure will have a direct effect on the company's financial position. [3] In this study, the capital structure is proxied by the Debt to Equity Ratio.

The researcher wants to convey some of the results of previous studies that are relevant to the research that will be carried out. Research conducted by [4] states that; 1) Profitability and liquidity have a negative and insignificant

effect on firm value. 2) Capital structure has a positive and insignificant effect on firm value. 3) Profitability has a positive and significant effect on capital structure. 4) Liquidity has a positive and insignificant effect on capital structure. 5) Profitability has a direct, insignificant effect on firm value but when mediated by capital structure has a significant effect on firm value, 6) Liquidity has a direct, insignificant effect on firm value and when mediated by capital structure has an insignificant effect significant to firm value.

Meanwhile, in [1] stated that; 1) Profitability has a significant positive effect on firm value, 2) Profitability has a significant positive effect on capital structure, 3) Capital structure has a significant positive effect on firm value and 4) Profitability has a significant positive effect on firm value with capital structure being the intervening variable. Based on the phenomena that have been described and also some of the results of previous studies, the researcher has an interest in re-examining the influence between variables by conducting research on different objects according to the discussion raised in order to obtain an overall picture and point of view.

2. Literature Review

The following will describe related theories to support the disclosure of results in this study.

2.1 Agency Theory

Agency theory exists to explain that the issuer's holder is the principal, while the management of the issuer or individual who carries out the company's activities is an agent. The principal as the holder of capital has the authority to enter the internal information of the issuer while the agent in the operational practice of the issuer has complete and comprehensive information about the operation and performance of the issuer. [5]

2.2 Firm Value

Firm value is a form of conformity with the value of each share sold on the capital market. From there you will see the total value of assets owned by a company. If the assets are large, the company value obtained will also be higher. [6] The value of the company is measured by Price to Book Value (PBV), which is to measure whether the price of the shares being traded is above or below the book value of the shares.

2.3 Capital Structure

Capital structure, namely the comparison between external capital in the form of debt and own. The capital structure in this study is measured by the debt to equity ratio (DER). According to [7] DER is a comparison between total (debt) to shareholder equity owned by the company.

2.4 Profitability

The profitability ratio is the main indicator of all financial statements because the main objective of an entity is the result of its business activities. Profit is the end result of management policies and decisions. In this study, profitability is measured by return on assets (ROA). ROA measures the ability of the company as a whole to make a profit with the total assets available to the company.

2.5 Liquidity

According to [8] liquidity is the company's ability to meet debts that have a maturity period of less than one year on time. Liquidity in this study is measured by the current ratio (CR). CR is a ratio that measures a company's ability to pay its short-term debts with its current assets. If the short-term debt is small, the company's chances of obtaining profits at the end of the year are even greater.

3. Methodology

This type of research is quantitative. The analytical method used, namely; descriptive statistics, classical assumption test and then hypothesis testing. 11 companies are defined as population. The sample selection technique used purposive sampling in order to obtain 7 companies that met the criteria with a total sample of 42 data, the result of multiplying 7 companies with 6 years of observation (2016-2021). The scope of the research is the Pharmaceuticals Sub Sector Companies which are listed on the Indonesia Stock Exchange. The software used to process the data is E-Views 12.

4. Result

After going through quite a long data processing stage, starting from; descriptive statistical analysis, classical assumption test, multiple linear regression test, hypothesis test, Sobel test and determination test. Then obtained some results that will be explained in the form of recapitulation.

Table 1: Recapitulation of Test Results

Variable	β	Sig.	α	Result
ROA \rightarrow DER	0,562	0,031	0,05	Positive Significant
CR \rightarrow DER	-0,053	0,036	0,05	Negative Significant
ROA \rightarrow PBV	10,399	0,001	0,05	Positive Significant
CR \rightarrow PBV	-0,623	0,036	0,05	Negative Significant
DER \rightarrow PBV	-8,470	0,000	0,05	Negative Significant
ROA \rightarrow DER \rightarrow PBV	1	0,075	0,05	DER is unable to mediate
CR \rightarrow DER \rightarrow PBV	-0,5275	0,278	0,05	DER is unable to mediate

5. Discussion

In this section, an in-depth discussion of the results of data processing and its relation to theory will be carried out.

5.1 Effect of Profitability (ROA) on Capital Structure (DER)

Based on table 1, the sig value is 0.031 or < 0.05 with a positive β gain (0.562). Thus explaining that profitability has a significant positive effect on capital structure. Companies that want to expand require a lot of funds to encourage increased profits in the future. This result is consistent with the trade off theory that companies that earn large amounts of profit will use it as an external funding source to benefit from tax savings. [9]

5.2 Effect of Liquidity (CR) on Capital Structure (DER)

Based on table 1, the sig value is 0.036 or < 0.05 with a negative β gain (-0.053). Thus explaining that liquidity has a significant negative effect on capital structure. The higher the liquidity, the level of the company's capital structure will decrease. That is, if a company has high liquidity, it means it has the ability to pay short-term debt, so it tends to reduce total debt, which in turn will reduce the capital structure.

5.3 Effect of Profitability (ROA) on Firm Value (PBV)

Based on table 1, the sig value is 0.001 or < 0.05 with a positive β gain (10.399). Thus explaining that profitability has a significant positive effect on firm value. Companies that have high profitability and succeed in recording increasing profits will show that the company has good performance, so that it will create a positive response to shareholders (stakeholders) and make the company's stock price increase.

5.4 Effect of Liquidity (CR) on Firm Value (PBV)

Based on table 1, the sig value is 0.036 or < 0.05 with a negative β gain (-0.623). Thus explaining that liquidity has a significant negative effect on firm value. A high level of liquidity can reduce the value of the company. This is because if the high level of liquidity makes the company allocate more funds to pay off short-term obligations so that the returns or dividends to be paid to shareholders are lower, this will be responded negatively by investors and can reduce the value of the company.

5.5 Effect of Capital Structure (DER) on Firm Value (PBV)

Based on table 1, the sig value is 0.000 or < 0.05 with a negative β gain (-8.470). Thus explaining that the capital structure has a significant negative effect on firm value. A debt to equity ratio that is too high indicates that the company's performance is poor because debt is higher than equity. This shows that the company depends on external parties (creditors), the higher the risk of the company. This makes investors reluctant to invest because of the risk of default and lowers company value due to low demand for company shares.

5.6 Effect of Profitability (ROA) on Firm Value (PBV) with Capital Structure (DER) as A Mediating Variable

Based on table 1, the sig value is 0.075 or > 0.05 . Thus explaining that the capital structure is not able to mediate the effect of profitability on firm value. This is because companies use more external funding in the form of debt than their own capital. The higher the debt level, the greater the interest expense, which means reducing profits and affecting investors' interest in investing in the company due to poor financial performance and increasing financial risk.

5.7 Effect of Liquidity (CR) on Firm Value (PBV) with Capital Structure (DER) as A Mediating Variable

Based on table 1, the sig value is 0.278 or > 0.05 . Thus explaining that the capital structure is not able to mediate the effect of liquidity on firm value. The capital structure of the company only makes a small contribution in influencing the value of the company, thus making the size of the company's debt use not too much attention by investors, because investors see more how the company uses existing funds optimally in achieving added value to the company's value. Investors also look at other factors that can affect the value of the company.

6. Conclusion

Based on the results of the research and discussion that has been done, the following conclusions can be drawn: Profitability (ROA) has a significant positive effect on capital structure (DER) and firm value (PBV), Liquidity (CR) has a significant negative effect on capital structure (DER), Liquidity (CR) and capital structure (DER) have a significant

negative effect on firm value (PBV). Capital structure (DER) is unable to mediate the effect of profitability (ROA) and liquidity (CR) on firm value (PBV).

7. Future Scope

Based on the analysis of the research results, there are several recommendations that can be used as suggestions for future research, namely; expected to be able to test the effect of other financial ratios that have not been explored in this study. While recommendations that can be used as suggestions for investors, namely; pay attention to the percentage of CR, ROA and DER before investing because these values can show the company's financial position which can affect the value of the company.

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