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Capital Structure And Firm Value: The Mediating Role Of Profitability

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Abstract: *The property and real estate sector is one of the important sectors that contribute to the Indonesian economy, but in the 2021–2024 period, this sector experienced a decline in company value as reflected in market performance. This problem prompted this study, which aims to analyze the effect of capital structure on company value and examine the role of profitability as a mediating variable in property and real estate sector companies listed on the Indonesia Stock Exchange for the 2020–2024 period. This study uses a quantitative approach with the Partial Least Square-Structural Equation Modeling (PLS-SEM) method and the sample was determined through a purposive sampling technique on companies that meet the research criteria. The results of the study indicate that capital structure has a significant negative effect on company value and profitability, while profitability has a significant positive effect on company value and is proven to mediate the effect of capital structure on company value; this finding supports the Trade-off Theory regarding the importance of balance in the use of debt, but also shows limitations in the application of Signaling Theory in the property sector. This study concludes that excessive use of debt can reduce profitability and company value, so companies need to establish an optimal capital structure to maintain financial performance and increase investor confidence.*

Keywords*: Capital Structure, Profitability, Company Value, Trade-Off Theory, Signaling Theory*

INTRODUCTION

The capital market is one of the main pillars of the modern economy, functioning as an effective mechanism for companies to obtain long-term funding from the investing public (Dewi & Vijaya, 2018). Through this mechanism, companies can issue financial instruments such as stocks and bonds to finance their operations, expansion, or strategic project development. On the other hand, the capital market provides dynamic investment opportunities for investors to earn returns that align with their risk profiles and financial objectives (Handini & Astawinetu, 2020).

Without the existence of the capital market, public access to investment instruments would be very limited, constrained only to placing funds in banking institutions or real assets such as property and land. These instruments generally have low liquidity and offer limited flexibility in

portfolio diversification. The presence of the capital market opens a broader space for investors to allocate capital more flexibly and based on risk considerations (Handini & Astawinetu, 2020).

Firm value is one of the key indicators monitored by investors to assess a company's financial health and future prospects in the capital market (Saputra et al., 2023). Firm value reflects the market's perception of the company's fundamentals and growth potential, and it represents the level of shareholder wealth. In practice, firm value is often proxied by the Price-to-Book Value (PBV) ratio, which compares the market price of a stock to its book value per share (Khotimah et al., 2022).

Empirical facts show that the property and real estate sector listed on the Indonesia Stock Exchange has experienced significant valuation pressure during the 2020–2024 period. In 2024, most companies in this sector recorded PBV values below the sectoral average, indicating undervaluation. This downward trend in firm value has persisted consistently over the past five years, raising fundamental questions regarding the factors contributing to declining valuations, especially in a capital-intensive sector.

One theoretical factor believed to influence firm value is capital structure, as explained in the Trade-off Theory by (Kraus & Litzenberger 1973). This theory argues that companies must find an optimal balance between the tax benefits of debt and the bankruptcy risks arising from excessive leverage. The proportional use of debt is expected to increase firm value; however, if poorly managed, it may undermine investor confidence (Fahri et al., 2022).

Nevertheless, previous research shows inconsistencies in the relationship between capital structure and firm value. (Syafitri & Oktavianna 2024) found that capital structure has a significant positive effect on firm value in the property and real estate sector. In contrast, (Wardoyo & Fauziah 2024) concluded that capital structure does not have a significant effect, and that profitability is instead the primary determinant of firm value. Profitability reflects a company's efficiency in generating profits from its assets (Kalbuana et al., 2021).

Based on Signalling Theory proposed by (Spence,1973), an aggressive capital structure characterized by a high debt ratio may send negative signals to the market, as it increases fixed obligations in the form of interest and principal payments. These obligations eventually put pressure on net income and reduce profitability, which in turn lowers firm value. The decline in

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earnings due to interest expenses directly decreases Return on Assets (ROA), which is a commonly used proxy for profitability (Vidyasari et al., 2021).

Based on these findings, there is strong indication that profitability is not only influenced by capital structure but also consistently affects firm value. This opens the possibility that profitability serves as an intervening variable in the relationship between capital structure and firm value. However, only a limited number of studies have explicitly examined this mechanism, particularly within Indonesia's property and real estate sector.

METHOD

This study employs a quantitative research method with a correlational research design. Quantitative research is a method used to analyze the relationship between variables based on numerical data and statistical testing. It is conducted systematically to examine a phenomenon by collecting measurable data through statistical, mathematical, or computational techniques. Correlational research is a type of study aimed at identifying the existence of a relationship or association between two or more variables without manipulating them, and it focuses on determining the extent and strength of the correlation among the variables examined to test this relationship, the study proposes the following hypotheses.

RESULTS AND DISCUSSION

This study uses panel data from 17 property and real estate companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period, resulting in a total of 85 observations. Data analysis was performed using SmartPLS 4.0 software for PLS-SEM modeling.

Variabel	Minimum	Maximum	Mean	Std. Deviation
DER (X)	0.002	3.359	0.68	0.665
PBV (Y)	0.000	5.751	0.99	1.077
ROA (Z)	0.000	0.2	0.042	0.038

Tabel 1. *Descriptive Statistics Analysis*

For the DER variable, the average value of 0.680 is below the optimal threshold of 0.9, indicating that, collectively, the companies tend to be conservative in their use of debt. The

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standard deviation of 0.665 reflects considerable variation, largely due to outliers such as URBN (3.359). For the PBV variable, the average value of 0.990 shows that, in general, the companies remain slightly undervalued. The relatively high standard deviation of 1.077 indicates substantial disparities in valuation across firms, with some being extremely undervalued (such as URBN) and others highly overvalued (such as MKPI). For the ROA variable, the average value of 0.042 is far below the optimal level of 0.30, indicating low efficiency in asset utilization.

R-Square Test

The R-square test is used to measure how much variance in the dependent variable can be explained by the independent variables in the model.

Path	F-Square
X → Y	0.031
X → Z	0.215
Z → Y	0.052

Table 2. *R-Square Test Results*

An R^2 value of 0.124 for PBV indicates that capital structure is able to explain 12.4% of the variation in firm value, while the remaining 87.6% is influenced by other factors outside the model. For ROA, an R^2 value of 0.177 indicates that capital structure explains 17.7% of the variation in profitability. Although the values are relatively low, they are still acceptable in financial research because firm value and profitability are typically influenced by many external factors.

F-Square Test (Effect Size)

The Effect Size (f^2) test is used to assess the substantive magnitude of the influence of the independent variable on the dependent variable.

Path	Original Sample (O)	T Statistics	P Values
X → Y	-0.181	2.669	0.004

X → Z	-0.421	8.719	0.000
Z → Y	0.235	2.373	0.009

Table 3. *F-Square Test*

An f^2 value of 0.031 for the path X → Y indicates a small effect size, although still meaningful because it is above the 0.02 threshold. For the path X → Z, the f^2 value of 0.215 indicates a medium effect size, almost reaching a large category, suggesting that capital structure contributes significantly to profitability. For the path Z → Y, the f^2 value of 0.052 indicates a small but still relevant effect size. Overall, capital structure has the strongest substantive influence on profitability, which aligns with the theory that higher debt increases interest expenses and reduces earnings.

Path Coefficient Test

The path coefficient test is used to examine the strength, direction, and significance of the direct relationships among variables.

Path	Original Sample (O)	T Statistics	P Values
X → Y	-0.181	2.669	0.004
X → Z	-0.421	8.719	0.000
Z → Y	0.235	2.373	0.009

Table 4. *Path Coefficient and Significance Results*

The path coefficient X → Y of -0.181 indicates a negative and significant influence of capital structure on firm value, with a p-value of 0.004 (<0.05). The path coefficient X → Z of -0.421 indicates a negative and highly significant influence on profitability, with a p-value of 0.000. The path coefficient Z → Y of 0.235 shows a positive and significant influence of profitability on firm value, with a p-value of 0.009. All paths are significant at $\alpha = 5\%$, confirming that capital structure reduces profitability, and profitability increases firm value. Therefore, capital structure indirectly decreases firm value through profitability.

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Specific Indirect Effect Test

The Specific Indirect Effect test is used to examine the indirect influence of capital structure on firm value through profitability.

Path	Original Sample (O)	T Statistics	P Values
X → Z → Y	-0.099	2.253	0.012

Table 5. *Specific Indirect Effect Results*

A p-value of 0.012 indicates that the indirect effect is significant because it is below 0.05. The Original Sample value of -0.099 shows that profitability mediates the relationship between capital structure and firm value. The VAF value is calculated at 35%, meaning that 35% of the total effect of capital structure on firm value is explained through profitability. This percentage falls under the category of partial mediation, confirming that profitability acts as a significant intervening variable in the relationship between capital structure and firm value.

CONCLUSION

Based on the results of the research and discussion conducted in accordance with the objectives and hypotheses using PLS-SEM analysis, it can be concluded that capital structure has a negative and significant effect on firm value in property and real estate companies listed on the Indonesia Stock Exchange (IDX) for the period 2020–2024. A higher debt-to-equity ratio leads to a lower market valuation, as investors perceive firms with excessive leverage to be riskier. Capital structure also has a negative and significant effect on profitability, indicating that an increase in debt directly suppresses net income due to the higher interest burden. Profitability has a positive and significant effect on firm value, meaning that companies capable of generating earnings efficiently tend to be valued higher by the market. Furthermore, profitability is proven to mediate the effect of capital structure on firm value, with a mediation contribution of 35%, indicating that most of the decline in firm value associated with higher leverage occurs through a reduction in profitability.

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