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Do Capital Structure and Liquidity Increasing Value of The Firm? A Mediating Role of Profitability

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Abstract—The aim of this study is to determine how profitability mediating the effects of the capital structure and company liquidity to company value. This research is conducted at the telecommunications sub-sector company on the Indonesia Stock Exchange (2015-2018). The population in this study are food and beverage companies in Indonesia Stock Exchange. Sample was conducted by purposive sampling method and then the number of samples is 12 companies. The research data is secondary data obtained from the website of the Indonesia Stock Exchange and the Indonesian Capital Market Directory from 2014 until 2017. Data analysis by path analysis technique. The results of this study that can be concluded are (1) the capital structure has negative insignificant impact on profitability, (2) the company liquidity has negative significant impact on profitability, (3) the capital structure has negative significant impact on value of the firm, (4) the company liquidity has negative insignificant impact on value of the firm, (5) the profitability had positive and significant impact on value of the firm, (6) profitability is able to mediate the effect of capital structure on value of the firm significantly, (7) the profitability is able to mediate the effect of company liquidity on value of the firm significantly.

Keywords: Capital structure; liquidity; profitability; value of the firm

INTRODUCTION

The value of the firm determines the selling price when the company is sold to prospective investor. However, for the public company, value can be reflected through stock prices. A value of the firm has a positive relationship with stock prices. The higher the stock price will result in higher value of the firm. Higher stock prices will make investors' profits higher as well. This is based on the idea that the higher the stock price purchased by investors, the investor will not only get dividends from the company but investors will also get capital gains if they sell the shares they have. Increasing stock demand is an attraction for investors because it indicates the value of the company will also increase. Market confidence in the company will increase if the company value is high. The market will also believe in the company's prospects in the coming year (Wiagustini, 2014).

There are many factors that influence the value of the firm including capital structure, company liquidity, profitability, and company growth. Based on the capital structure theory, if the capital structure position is above the optimal capital structure target, then any increase in debt will reduce the value of the company. The essence of the trade-off theory in capital structure is to balance the benefits and sacrifices that arise as a result of using debt. As far as greater benefits arise, additional debt is still allowed. If the sacrifices incurred are greater then, additional debt is not allowed. The trade-off theory predicts a positive relationship between capital structure and company value with the assumption that tax benefits are still greater than the costs of financial pressure and agency costs.

Therefore, it can be seen that the use of debt will increase the value of the company but only to a certain point. After that point, the use of debt actually decreases the value of the company (P. Y. S. Dewi, Yuniarta, & Atmadja, 2014).

The company liquidity is the level of a company's ability to pay short-term and timely obligations. A company that have high liquidity ratios certainly have good prospects going forward because investors have a perception that the company has good performance. It can increase stock prices which means increasing the value of the company as well. Many studies have been conducted on the effect of company liquidity on value of the firm. (Rompas, 2013) found that company liquidity has a significant effect on value of the firm. (Putra & Lestari, 2016) recorded that company liquidity has a positive effect on value of the firm. In contrast to (Mahendra Dj, Artini, & Suarjaya, 2012) a company liquidity has a positive and insignificant effect on value of the firm. (Nurhayati, 2013) found that the company liquidity with the current ratio indicator does not have a significant effect on value of the firm. In (Sudiani & Darmayanti, 2016) found that the company liquidity has a negative effect on firm value.

Profitability is the net result of policies and decisions that have been chosen by the management of a company. When the capital structure and company liquidity have a positive effect on value of the firm, profitability is thought to be a mediator for the effect of capital structure and liquidity on the value of the company that was already positive to be more positive after profitability as a mediating variable. (Hamidy, Wiksuana, & Artini, 2015) and (Andrian, 2012) found that profitability is able to mediate the effect of capital structure on value of the firm. (Putra & Wiagustini, 2013) in their research also found that profitability is able to mediate the effect of company liquidity on value of the firm. High profitability shows the company's performance is higher so that it can be a positive signal for investors to buy company shares. When demand for shares increases while the availability of fixed shares indirectly increases the value of the company.

Based on the results of previous studies that have different conclusions, thus it motivates the writers to investigate capital structure and liquidity that increase value of the firm with a profitability as a mediating variable.

CONCEPT AND HYPOTHESIS

Value of The Firm

Value of the firm can be reflected through stock prices. This value is determined by supply and demand that work together on the market, where buyers and sellers negotiate acceptable prices for these assets. Company value can reflect the present value of the expected income in the future and reflect that the value of the company is the impact of the decisions taken by financial managers on the company's stock price (Prasetyo, Zahroh, & Azizah, 2013).

Company value can be measured by the price to book value (PBV) indicator. The ratio of stock prices to the book value of the company or price to book value, shows the level of ability of the company to create relative value to the amount of capital invested. A high PBV reflects a high share price compared to the value of a share. The higher the stock price indicates the company is more successful in creating value for shareholders. The success of the company creating this value certainly gives hope to shareholders in the form of greater profits. In simple terms, price to book value (PBV) is a market ratio used to measure the performance of stock market prices on its book value (Kusumajaya, 2011).

Profitability

Profitability is the level of a company's ability to generate profits for investors. Profitability is interpreted as an indicator in assessing the financial condition and performance of a company. A high level of profitability shows that the company has a good performance so that the company can provide a high level of investment return to investors, so this will lead to positive sentiment from investors who can increase stock prices. If the company's ability to generate profits increases, then the share price will also increase. Increasing stock prices in the market means increasing the value of the company in the eyes of investors (Husnan & Pudjiastuti, 2012).

Based on signal theory, companies can send signals to investors through disclosure of company-owned information to reduce uncertainty about future company prospects and to increase company value. The prospect of a company can be observed from its level of profitability, high profitability illustrates the prospect of increasing profitability or profit in financial statements will increase the company's prospects in the future so that this will be considered a positive signal by investors (Rizqia, Aisjah, & Sumiati, 2013). Investors will respond to these positive signals through increasing demand for company shares which will have an impact on increasing stock prices and value of the firm.

Capital Structure

Capital structure decisions are important because the company's profitability is directly affected by the decision. The selection and use of capital are one of the key elements of a company's financial strategy (Velnampy & Niresh, 2012). Addition of debt in the capital structure will increase the profitability of the company because interest payments on debt are tax deductible (Astuti, Retnowati, & Rosyid, 2015).

In (Velnampy & Niresh, 2012) research states that there is a positive relationship between DER and ROE. The greater the use of debt in the capital structure, the greater the rate of return on equity in the profitability of a company (Chisti, Ali, & Sangmi, 2013) and (Danis, Rettl, & Whited, 2014) in his research stated that the capital structure has a positive relationship to profitability. (Gupta & Vishnoi, 2015) also state that the capital structure has a significant effect on profitability.

The use of long-term debt that is more than equity capital in financing operations can produce positive company value (Ogbulu & Emeni, 2012). The trade-off theory explains that if the position of the capital structure is below the optimal point, any additional debt will increase the value of the company. Conversely, if each position of the capital structure is above the optimal point, any additional debt will reduce the value of the company. The trade-off theory predicts the existence of a positive relationship to the value of the company assuming that the optimal capital structure target point has not been achieved (Dewi & Wirajaya, 2013).

(Chaidir, 2015) obtained the results of the study that the capital structure with a debt to equity ratio (DER) indicator had a significant positive effect on firm value with the price to book value (PBV) indicator. (Prasetia, Tommy, & Saerang, 2014) states that the capital structure has a positive and insignificant influence on firm value. (Dewi et al., 2014) states that the capital structure has a significant positive effect on value of the firm. (Riaz & Qasim, 2016) and (Winarto, 2015) state that capital structure has a positive influence on firm value. Based on the theory and the results of previous research, a hypothesis can be formulated:

H1: Capital structure has a positive and significant effect on profitability

H2: Capital structure has a positive and significant effect on value of the firm

Company Liquidity

(Gitman, Zutter, Elali, & Roubaie, 2013) states that company liquidity is measured based on its ability to meet its short-term obligations when due. Liquidity as a measure of how much the company's ability to meet cash needs to pay short-term obligations and to finance operations on a daily basis as working capital. Liquidity can be proxied by the current ratio. The high current ratio value of a company will provide good prospects for the company going forward. The company will gain the trust of creditors. Creditors will not hesitate in lending their funds that are used by companies to increase capital, which will benefit the company. (Ehiedu, 2014) in his research found that there was a significant positive relationship between liquidity and profitability. (Meidiyustiani, 2016) also found that liquidity had a significant positive effect on profitability.

(Sartono, 2014) states that liquidity is the company's ability to fulfill short-term financial obligations on time. High liquidity shows the company's high ability to pay current debt from current assets owned by the company. Companies that have high levels of liquidity are certainly considered to have good prospects by investors, investors perceive companies to have good performance so that investor demand for shares will increase. Increasing demand for shares will result in the company's value also. (Rompas, 2013) found that liquidity has a positive effect on firm value. (Putra & Lestari, 2016) also found that liquidity has a positive and significant effect on firm value. Based on the theory and results of previous research, a hypothesis can be formulated for the effect of liquidity on firm value:

H3: Company Liquidity has a significant effect on profitability

H4: Company Liquidity has significant effect on value of the firm

There is another correlation between profitability and value of the firm. (A. S. M. Dewi & Wirajaya, 2013) obtained the results of research that profitability has a positive effect on firm value. (Riaz & Qasim, 2016) and (Winarto, 2015) state that profitability has a positive effect on firm value. (Hargiansyah, 2015) obtained the results of profitability having a positive and significant effect on the value of the firm. Likewise, according to (Ayem & Nugroho, 2016) states that profitability has a significant positive effect on firm value. The results of a similar study were also found by (Sucuahi & Cambarihan, 2016). Based on the theory and the results of previous research, a hypothesis can be formulated:

H5: Profitability has a significant effect on value of the firm

The mediating role of profitability

The existence of profitability as a mediator of the relationship between capital structure and company value will make the positive results become more positive. High profitability shows high company performance so that it becomes a positive signal for investors. (Hamidy et al., 2015) also found that profitability was able to mediate the effect of capital structure on firm value.

(Putra & Wiagustini, 2013) in their research also found that profitability is able to mediate the effect of liquidity on firm value. (Al-Fizah, 2016) shows that profitability is able to mediate the effect of capital structure on value of the firm. Based on the theory and the results of previous research, a hypothesis can be formulated.

H6: The effect of capital structure on value of the firm is mediated by Profitability

H7: The effect of firm's liquidity on value of the firm is mediated by Profitability.

METHOD

This research is conducted at the telecommunications sub-sector company on the Indonesia Stock Exchange (2015-2018). The population in this research is food and beverage companies in Indonesia Stock Exchange. The sample consists of 12 companies. This study uses data collection methods in the form of non-participant observation methods. In this method, data can be obtained by observing, recording, studying the books, journals, theses descriptions and accessing the Indonesian Stock Exchange (idx) (www.idx.co.id). The data analysis technique used is path analysis.

RESULT AND DISCUSSION

Based on the sequence of analysis has been carried out, the result of this study described in this following.

Capital structure has a negative and not significant effect on profitability. This means that increased use of debt can reduce profitability in food and beverage sub-sector companies on the Indonesia Stock Exchange. This is because the company uses too much debt in its operational activities, so the profits obtained are used to cover debt and interest expenses. The results of this study are supported by research from (Rosyadah, 2013) showing that the capital structure (DER) has a negative and significant effect on profitability (ROA).

Liquidity has a significant negative effect on profitability. This means that the increase in the current ratio does not necessarily increase profitability in the food and beverage sub-sector of the Indonesia Stock Exchange.

The results of the study that support the results of this study include (Mahendra Dj et al., 2012) states that liquidity has no significant effect on firm value. (Nurhayati, 2013) states that liquidity with the current ratio indicator does not have a significant effect on value of the firm.

Capital structure has no significant effect on firm value. This means that the capital structure variable has a positive but not significant effect on firm value, where increased use of debt can increase profitability, but the increase is not significant in the food and beverage sub- sector companies on the Indonesia Stock Exchange. The results of this study are supported by research from (Kodongo, Mokoaleli-Mokoteli, & Maina, 2014) states that the capital structure does not affect the value of the company. (Mandalika, 2016) states that capital structure does not have a significant relationship with value of the firm.

Liquidity has a negative and not significant

effect on firm value. This means that the liquidity variable has a negative and not significant effect on firm value, where the increase in the current ratio cannot increase the value of the company in the food and beverage sub-sector of the Indonesia Stock Exchange. The results of this study are supported by the results of a study from (Mahendra Dj et al., 2012) states that liquidity has no significant effect on firm value. (Nurhayati, 2013) states that liquidity with the current ratio indicator does not have a significant effect on value of the firm.

Profitability has a positive and significant

effect on firm value. This means that the increase in return on equity can increase the value of the company in the food and beverage sub-sector of the Indonesia Stock Exchange. The results of this study are in line with the research conducted by (Dewi & Wirajaya, 2013; Hermuningsih, 2013; Paminto, Setyadi, & Sinaga, 2016; Riaz & Qasim, 2016; Sudiani & Darmayanti, 2016; Winarto, 2015) stated that profitability has a significant positive effect on value of the firm.

The effect of capital structure through mediating profitability has a positive effect on firm value. These results indicate that the profitability variable significantly mediates the effect of capital structure on firm value. This means that the use of debt accompanied by increased return on equity can increase the value of the company in the food and beverage sub-sector companies on the Indonesia Stock Exchange. The results of this study are in line with the research conducted by (Hamidy et al., 2015) and (Andrian, 2012) found that profitability is able to mediate the effect of capital structure on value of the firm.

The effect of liquidity through mediating profitability has a positive effect on firm value. These results indicate that the profitability variable significantly mediates the influence of liquidity on firm value. This means that the increase in the current ratio along with the increase in return on equity can increase the value of the company in the food and beverage sub-sector of the Indonesia Stock Exchange. The found of this research are in line with the research conducted by (Putra & Wiagustini, 2013) found that profitability is able to mediate the effect of liquidity on value of the firm.

CONCLUSIONS

The conclusion that can be drawn about the profitability in mediating the effects of the capital structure and company liquidity to company value are:

Capital structure has no significant negative effect on profitability. Increased use of debt cannot increase profitability in the company.

Liquidity has a significant negative effect on profitability. The increase in the current ratio does not necessarily increase the profitability of the company.

Capital structure has no significant effect on firm value. Increased use of debt cannot significantly increase profitability for the company.

Liquidity has a negative and not significant effect on firm value. The increase in the current ratio cannot increase the value of the company.

Profitability has a positive and partially significant effect on firm value. Increasing return on equity can increase the value of the company.

Profitability significantly mediates the effect of capital structure on firm value. Increasing the use of debt and increasing return on equity can increase the value of the company

Profitability significantly mediates the effect of liquidity on firm value. Increasing the current ratio and increasing return on equity can increase the value of the company.

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Appendix

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95,0% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
	(Constant)	2,904	,739		3,928	,000	1,413	4,396		
1	DER	-,500	,295	-,400	-1,695	,097	-1,094	,095	,375	2,670
	CR	-,744	,334	-,526	-2,229	,031	-1,417	-,071	,375	2,670

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95,0% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
	(Constant)	8,088	3,779		2,140	,038	,471	15,705		
1	DER	-4,738	2,245	-,263	-2,111	,040	-9,262	-,215	,481	2,080
	CR	-,018	,009	-,219	-1,932	,060	-,037	,001	,584	1,713
	ROE	,284	,032	,874	8,905	,000	,220	,348	,777	1,286

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
	(Constant)	1.732	1.909		.907	.369
1	DER	-2.104	1.799	-.117	-1.170	.248
	ROE	.277	.033	.850	8.495	.000

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
	(Constant)	1.185	2.035		.582	.563
1	CR	-.006	.008	-.068	-.741	.462
	ROE	.256	.030	.783	8.571	.000