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# ANALYSIS OF THE EFFECT OF CAPITAL STRUCTURE AS AN INTERVENING BETWEEN PROFITABILITY, OPERATING LEVERAGE, LIQUIDITY ON PRICE BOOK VALUE

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## ABSTRACT

*The aim of this study is to analyze the impact of capital structure as an intervening variable between profitability, operating leverage, liquidity, and price-book value. Inferential statistical analysis was performed using Path Analysis with SEM-PLS analysis tool. The study found that profitability has a significant and positive effect on firm value. However, operating leverage and liquidity have no significant and negative impact on firm value. Furthermore, profitability and operating leverage variables have a significant and negative effect on capital structure. However, liquidity has no significant and negative impact on capital structure. The study also found that capital structure has no significant and negative impact on firm value. Finally, capital structure cannot act as an intervening variable between profitability, operating leverage, liquidity, and firm value. The study's novelty lies in using capital structure as an intervening variable in the context of real estate sector companies. The study suggests that investors conduct fundamental analysis, especially analyzing the company's financial ratios, before investing in certain industry stocks to assess the company's financial performance. The study's limitations include the need for further research by adding other variables or indicators. Additionally, researchers should consider selecting different industrial sectors to be studied.*

**Keywords:** *Capital Structure; Profitability; Operating Leverage; Liquidity*

## INTRODUCTION

The business world is rapidly growing and becoming increasingly competitive. To sustain operations and ensure growth, companies require capital, which is one of the necessary factors, in addition to resources, materials, and other supporting elements. When making decisions on expenditure, managers must carefully consider the nature and cost of the funding source selected because each source of funds has financial consequences that are not the same. Companies require capital, particularly when they intend to expand, and they must determine how much capital is necessary to finance their business.

Capital markets in Indonesia are essential to companies because they can attract investors by issuing their shares on the stock exchange, generating funds that can be used for operational activities while simultaneously increasing the company's value (Sudiani & Darmayanti, 2016). Financial ratio analysis is a commonly used method to analyze financial statements, which allows companies to compare one account with another and assess their financial performance (Rahmatullah, 2019). According to Brigham & Houston (2018), financial performance impacts the firm's value and capital structure. A good financial

performance can increase the firm's value. In this study, the capital structure is used as a variable that intervenes in firm value, according to Fama & French (1998), who suggest that financial management functions are necessary to optimize firm value.

Increasing company value is one of the steps to maximize shareholder value (Brigham & Gapenski, 1996). Shareholder prosperity follows the high or increasing company value, and the company's value reflects what price investors are willing to pay for a company (Wijaya & Sedana, 2015). The company's value is determined by the capital structure because it is the company's funding resource. The ideal proportion between debt and private equity reflects the company's capital structure. Therefore, the capital structure is used as a mediating variable in this study.

Previous research by Meidiawati & Mildawati (2016) and Rahayu (2021) showed that the capital structure has a significant effect on firm value (Meidiawati & Mildawati, 2016; Rahayu, 2021). However, Frederica (2019) and Widnyana et al. (2021) found that capital structure has no significant effect on firm value (Frederica, 2019; Widnyana et al., 2021). This discrepancy creates a research gap in the relationship between capital

structure and firm value, contradicting Modigliani & Miller (1958) who argued that firm value is determined by capital structure.

Capital structure is influenced by various factors, including profitability and liquidity (Besley & Brigham, 2008). Some studies such as Hauteas (2019), Kyissima et al. (2020), and Musabbihan & Purnawati (2018) found that profitability has a significant effect on capital structure (Hauteas, 2019; Kyissima et al., 2020; Musabbihan & Purnawati, 2018), while Andika & Sedana (2019) and Jayanty et al. (2021) found no impact (Andika & Sedana, 2019; Jayanty et al., 2021). On the other hand, Liang & Natsir (2019) and Pacheco & Tavares (2017) discovered that liquidity has a negative effect on capital structure (Liang & Natsir, 2019; Pacheco & Tavares, 2017), while Maisal Riga Mikrawardhana (2015) and Suherman & Mardiyati (2019) support the trade-off theory, where liquidity has a positive effect on capital structure (Maisal Riga Mikrawardhana, 2015; Suherman & Mardiyati, 2019).

The study aims to contribute to the understanding of the relationship between profitability, operating leverage, liquidity, and price-book value with capital structure as the intervening variable. By examining the impact of capital structure on the relationship between these variables, the study seeks to provide insights into how firms can optimize their capital structure to enhance their value. Through this research, it is hoped that a better understanding of the factors that affect capital structure and firm value can be gained, which could help firms make informed decisions about their financing and investment strategies.

## LITERATURE REVIEW

The Trade-off Theory, as proposed by Kraus & Litzenberger (1973), emphasizes the balance between the benefits of using debt through tax shields and the costs incurred by the use of debt as a means to build firm value. This hypothesis explains that the higher a company's financing relies on obligations, the more significant the risk they face in financial distress because they pay excessive interest to debtholders annually, given the uncertain profitability conditions. In line with the compromise hypothesis articulated by Myers (2001), companies will incur debt up to a certain level where the cost of shielding from additional obligations equals the cost of financial distress (Shahar et al., 2015). The cost of financial distress encompasses bankruptcy costs and the costs a company incurs due to a decline in confidence. As demonstrated by Brigham & Houston (2021), the

compromise hypothesis is the point at which companies trade-off subsidized benefits through obligations. This hypothesis elucidates the relationship between costs, liquidity risk, and the utilization of obligations brought about by the capital structure choices made by companies.

Additionally, the Pecking Order Theory can explain why companies with significant profits tend to have lower levels of debt. This lower debt level is not because these companies have a lower objective debt level, but rather because they don't need to bother with external financing. The undeniable benefits make their internal assets sufficient to address investment issues. According to Wibowo (2016), the Pecking Order Theory categorizes sources of corporate financing into two main groups: internal subsidy sources, such as retained earnings, and external subsidy sources through the issuance of new securities. This theory is supported by two crucial premises, as emphasized by Myers and Majluf. First, corporate managers tend to prefer utilizing internal sources of financing, such as accumulated earnings, over seeking financial support from external parties. They lean more towards relying on existing internal resources. Second, corporate managers will act with the aim of maximizing returns for investors who have invested in the company. In other words, they will prioritize the interests of existing shareholders. In the context of the Pecking Order Theory, companies will follow this priority sequence in selecting sources of financing, giving higher importance to the use of internal resources before considering external funding, always mindful of the interests of existing investors in the company.

Signal theory highlights the significance of information released by a company on investment decisions outside of the company. This theory suggests that management always discloses information desired by investors, especially if it is good news. Information about the company serves as a signal for investors in investment decisions. This signaling theory suggests that information about the company is a signal for investors in investment decisions, and these signals can be in the form of financial or non-financial information indicating that the company is better than other companies. Signaling theory aims to boost a company's value when selling shares. Quality companies intentionally send signals to the market to help differentiate themselves from lower quality ones. According to Megginson, for the signal to be effective, it must be responded to by the market and perceived as good, and it should not be easily imitated by poor-quality companies.

### Profitability

Profitability is a crucial factor related to the results obtained by a company through its activities (Pertwi et al., 2016). The profitability ratio describes the effectiveness of a company's management. A higher profitability is desirable for a company, as it leads to increased prosperity for its shareholders or owners (Wahyudi et al., 2016).

### Operating Leverage

Operating leverage measures the amount of fixed costs used by a company. The higher the fixed costs, the higher the operating leverage, and the greater the sensitivity of net income to changes in sales. High operating leverage can significantly amplify a company's profits with even a small increase in sales

### Liquidity

According to Hery (2015), liquidity ratio shows the company's ability to fulfill its short-term debt obligations. In other words, the liquidity ratio measures how willing the company is to pay short-term debt that will mature.

### Price Book Value

Price Book Value (PBV) is a company valuation ratio. According to (Brigham & Houston, 2018), PBV is a market value/book value ratio that describes the financial market's assessment of the company's management and organization. For investors, this can be used as a selling point for a company as an operating business. The company's value will give a positive signal in the eyes of investors to invest in a company.

### Capital Structure

The optimal capital structure is a situation where the company can optimally utilize a combination of debt and equity (Angeliend, 2012). If the company can utilize debt and equity, it means that the company has good performance, which can trigger shareholders or investors to be interested in investing in the company. A capital structure that has a good value can minimize the cost in the operation of a company, balance risk and capital optimally, and thus maximize the price or value of a share. For investors, assessing the performance of a company is good to see from the share price. By knowing the share price, it can be seen the value of the capital structure because the capital structure is related to the value or share price of a company.

### Effect of Profitability on Capital Structure

When a company earns a high level of profit, it has a larger internal funding source. This affects the company's funding decisions or capital structure. Such companies tend to use their own capital, such as retained earnings from profits generated by the company, to finance their business activities such as product development and investments, rather than using external funds or debt from outside parties. This results in lower debt levels and minimizes the risk of bankruptcy and high capital/debt costs (Andanika & Ismawati, 2017).

According to the Capital Structure theory (Weston, 1991), companies with a high rate of return on investment use relatively small debt because they can finance most of their internal funding with their high retained earnings. Similarly, the pecking order theory suggests that companies with high levels of profit have larger internal funding sources and tend to use smaller amounts of debt to finance their investments, preferring external funding only as a last resort (Hasni, 2013).

### Effect of Operating Leverage on Capital Structure

Operating leverage is the degree to which fixed costs are used in a company. A higher degree of fixed costs results in higher operating leverage and greater sensitivity of net income to changes in sales. Companies with high operating leverage will experience a larger percentage increase in profit if there is even a slight increase in sales. Conversely, companies with low operating leverage will experience a smaller percentage increase in profit with an increase in sales. Several studies have confirmed that operating leverage has a positive effect on capital structure (Liestyasih & Yadnya, 2015)(Alamsah, 2021). However, this finding contradicts the results of other research studies (Mardiansyah, 2013) which found that operating leverage has a negative effect on capital structure.

### Effect of Liquidity on Capital Structure

A study conducted by Mikrawardhana et al. (2015) on the effect of profitability and liquidity on capital structure found that liquidity has a significant impact on capital structure. This result is supported by research conducted by Bhawa (2015), which states that the greater the liquidity, the greater the capital structure, and the smaller the liquidity, the smaller the capital structure. The higher a company's ability to meet its short-term obligations, the more liquid it is, which increases

creditors' trust and makes it easier for the company to obtain long-term debt.

### Effect of Profitability on Price Book Value

Profitability is an important factor that impacts a company's performance and its ability to generate sales. A significant increase in profit reflects positively on the company, while a drastic decrease can have a negative effect. The value of a company is closely linked to the rate of profit it generates, as investors in the capital market view profitable companies more favorably. In line with the Signaling theory, a company's management signals its profitability to potential investors, which in turn affects investment decisions. A study by Wulandari (2013) found a significant positive effect of profitability on firm value.

### Effect of Operating Leverage on Price Book Value

A company's capacity to make changes that can increase net benefits from fixed income helps to increase its profits. This is consistent with the Pecking Order theory, which suggests that companies with sufficient internal funds should avoid taking on additional debt from external financial supporters to fund operational activities. Wulandari (2013) also found a significant influence of operating leverage on capital structure, which in turn affects the value of the firm.

### Effect of Liquidity on Price Book Value

Liquidity refers to a company's ability to meet its immediate financial obligations. According to Raharjaputra (2009), liquidity is positively related to firm value, with higher liquidity resulting in a higher firm value. Conversely, lower liquidity leads to a lower firm value (Citra et al., 2021). A company's high cash capability enhances its short-term liability capability, which has a positive impact on firm value.

### Effect of Capital Structure on Price Book Value

The Modigliani-Miller (MM) theory suggests that increasing debt can increase the value of a firm if it has not reached its optimal point. This is supported by the Trade-off theory, which explains that using debt can reduce a company's tax burden and agency costs (Brigham & Houston, 2018). As according to the MM theory, the increase in firm value due to an increase in the amount of debt (below the optimal point) is caused by the management's use of the debt for business

expansion. This results in a positive impact on firm value.

### Effect of Capital Structure mediates the Profitability variable on Price Book Value

Financial ratios provide valuable insight into a company's performance, with profitability being a key indicator of its ability to generate profits using available resources (Rachmawati & Pinem, 2015). Maintaining high profitability is crucial for a company's long-term survival, as it allows the company to secure its continuity without relying on additional debt funding, thereby increasing its value (Hermuningsih, 2012). Effective capital structure management is also critical to a company's financial position and value, as it determines the mix of funding sources from internal and external sources that can maximize share prices (Nisasmara & Musdholifah, 2016).

### Effect of Capital Structure mediates the Operating Leverage variable on Price Book Value

Operating leverage has two sides: it can significantly boost a company's profits, or it can lead to heavy losses. High operating leverage can produce a substantial increase in EBIT with a slight rise in sales, while low operating leverage can result in an unbalanced decline in EBIT (Lukman, 2013). In line with signaling theory, operating leverage can act as a signal to shareholders to evaluate a company's prospects. The Debt to Equity Ratio (DER) is a common measure of capital structure that depicts the funding sources used by a company. Brigham & Houston (2018) suggest that companies with assets that can be used as collateral tend to rely on more debt financing.

### Effect of Capital Structure mediates the Liquidity variable on Price Book Value

Liquidity reflects a company's ability to meet its short-term financial obligations quickly. A high level of liquidity means that a company has adequate assets to fund its activities without raising liabilities, resulting in lower interest costs and higher benefits. Kusna & Setijani (2018) assert that capital structure can mediate the impact of liquidity on firm value. According to signaling theory, increasing the amount of debt can signal to the market that the company is on a growth trajectory, leading to an increase in its value. Therefore, increasing current debt can enhance a company's value.



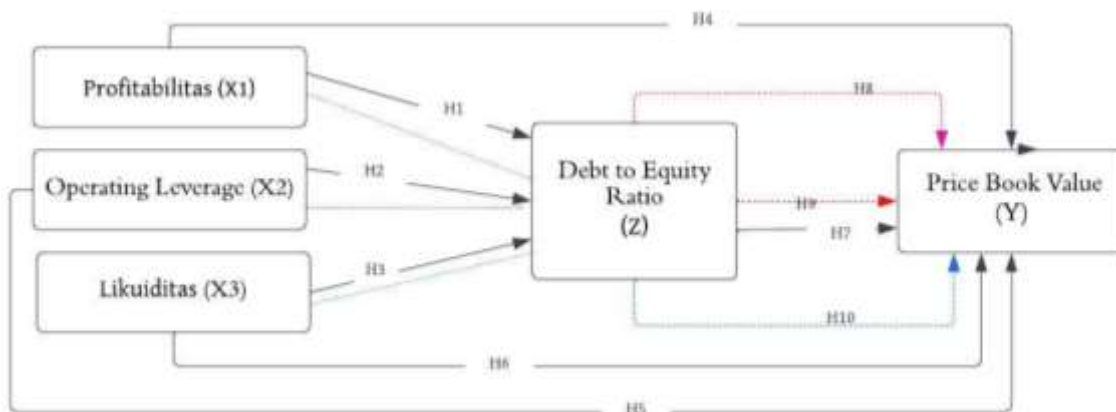


Figure 1. Conceptual framework

Hypothesis:

H1: Profitability has a positive and significant effect on capital structure.

H2: Operating leverage has a positive and significant effect on capital structure.

H3: Liquidity has a positive and significant effect on capital structure.

H4: Profitability has a positive and significant effect on price book value.

H5: Operating leverage has a positive and significant effect on price book value.

H6: Liquidity has a positive and significant effect on price book value.

H7: Capital structure has a positive and significant effect on price book value.

H8: Capital structure mediates the effect of profitability on price book value.

H9: Capital structure mediates the effect of operating leverage on price book value.

H10: Capital structure mediates the effect of liquidity on price book value.

## RESEARCH METHODS

The research conducted was quantitative in nature and employed a descriptive approach. Data were collected from the financial statements of food and beverage sub-sector companies listed on the Indonesia Stock Exchange (IDX) during the period of 2018-2020. Purposive sampling technique was used to select the sample, which included companies that met the following criteria: (1) listed as Property & Real Estate companies on the IDX during the 2018-2020 period, (2) listed as Property & Real Estate Sub-Sector Service Industry Companies on the IDX during the 2018-2020 period continuously, (3) regularly published financial reports for the 2018-2020 period, and (4) did not incur losses during the 2018-2020 period. The data collected for analysis included annual reports, financial reports, and company sustainability reports. Statistical analysis in this study was conducted using a variance-based model, employing the Partial Least Square (PLS) method for path analysis.

Table 1. Company Sample

Stock code	Company name
ADHI	Adhi Karya (Persero) Tbk.
ARMY	Armidian Karyatama Tbk.
BCIP	Bumi Citra Permai Tbk.
BSDE	Bumi Serpong Damai Tbk.
CTRA	Ciputra Development Tbk.
DILD	Intiland Development Tbk
DMAS	Puradelta Lestari Tbk
DUTI	Duta Pertiwi Tbk
GPRA	Perdana Gapuraprima Tbk
JRPT	Jaya Real Property Tbk
KIJA	Kawasan Industri Jababeka Tbk
MKPI	Metropolitan Kentjana Tbk
MTLA	Metropolitan Land Tbk
PLIN	Plaza Indonesia Realty Tbk
PPRO	PP Properti Tbk.
PUPD	Pudjiadi Prestige Tbk
PWON	Pakuwon Jati Tbk
RDTX	Roda Vivatex Tbk
SMDM	Suryamas Dutamakmur Tbk.
SMRA	Summarecon Agung Tbk

**Independent Variable**

Independent variables are variables that explain or influence other variables. This study uses 3 independent variables namely Profitability, Operating Leverage, and Liquidity.

**Profitability**

Profitability in this study is calculated using Return On Assets and Return On Equity.

**Return on Assets (ROA)**

$$ROE = \frac{\text{Profit after tax}}{\text{Total assets}} \times 100\%$$

**Return on Equity (ROE)**

$$ROE = \frac{\text{Profit after tax}}{\text{Total equity}} \times 100\%$$

**Operating Leverage**

$$DOL = \frac{\% \text{ Change in EBIT}}{\% \text{ Change in Sales}}$$

**Liquidity**

Liquidity in this study is calculated using the Current Ratio and Quick Ratio.

1) Current Ratio

$$CR = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100\%$$

2) Quick Ratio

$$QR = \frac{(\text{current assets} - \text{stock})}{\text{current liabilities}} \times 100\%$$

**Dependent Variable**

The dependent variable is the variable that is explained or influenced by the independent variable Price Book Value.

**Price Book Value**

$$PBV = \frac{\text{Market price per share}}{\text{Book value per share}}$$

**Intervening Variables**

Intervening variables refer to variables that have the potential to impact the relationship between the independent variable and the dependent variable indirectly, but cannot be observed or measured. These variables lie between the independent and dependent variables, causing the independent variable to not directly influence the occurrence or change of the dependent variable.

**Capital Structure**

$$\text{Debt to equity ratio} = \frac{\text{Total Debt}}{\text{Total Equity}} \times 100\%$$

## RESULTS AND DISCUSSION

### Validity and Reliability Test

Table 2. Construct Reliability and Validity

Indicator	Cronbach's Alpha	rho_A	Composite Reliability	AVE
Profitability	0.980	1,006	0.990	0.980
Operating Leverage	1,000	1,000	1,000	1,000
Liquidity	0.820	0.889	0.915	0.884
Price Book Value	1,000	1,000	1,000	1,000
Capital Structure	1,000	1,000	1,000	1,000

Table 2 shows the construct reliability and validity test results. The AVE output for each latent variable is greater than 0.5, indicating that all the latent variables are valid. In addition to the validity test, a reliability test was also conducted to evaluate the internal consistency of the measuring instrument. The reliability test was based on the Cronbach's alpha value and Composite Reliability value. For a construct to be deemed reliable, the Cronbach's alpha value should be > 0.6 and the Composite Reliability value should be > 0.7 (Jogiyanto & Abdillah, 2015). The table above shows that all the variables met the reliability requirements, with Cronbach's alpha value > 0.6 and Composite Reliability value > 0.7. This

indicates that each variable was consistent and reliable as a measuring instrument for the research.

### R-Square

To evaluate the inner model, one can examine the R Square ( $R^2$ ) value, which serves as a test of the goodness of fit for each variable in the structural model and their predictive power. As noted by Jogiyanto & Abdillah (2015), the  $R^2$  value measures the extent to which changes in the independent variable affect the dependent variable. A higher  $R^2$  value indicates a more accurate prediction model for the proposed research model.

Table 3. The coefficient of determination (R-Square)

	R Square	R Square Adjusted
Price Book Value	0.231	0.175
Capital Structure	0.466	0.437

The variable for firm value has an  $R^2$  value of 0.231, or 23.1%, indicating that the company's value can be attributed to 23.1% of the profitability ratio, operating leverage, and liquidity studied. The remaining 76.9% of the company's value can be explained by other variables not considered in the analysis. On the other hand, the Capital Structure variable has an  $R^2$  value of 0.466, or 46.6%, indicating that 46.6% of the company's value can be accounted for by the profitability ratio, operating leverage, and liquidity studied. The remaining 53.4% of the company's value is

attributable to other variables that were not examined.

### Q-square Predictive Relevance

The Q-Square Predictive Relevance is a measure of the goodness of the model, as evaluated in Table 4 through the Construct Crossvalidated Communality. The  $Q^2$  value for variable y (firm value) and variable Z (Capital Structure) is 1,000, indicating that the  $Q^2$  value is greater than 0. This suggests that the research model utilized is reliable and effective.

Table 4. Q-Square values

Indicator	SSO	SSE	$Q^2(=1-SSE/SSO)$
Profitability	120.000	31.721	0.736
Operating Leverage	60.000		1.000
Liquidity	120.000	69.217	0.423
Price Book Value	60.000		1.000
Capital Structure	60.000		1.000



### Hypothesis Test Results

The hypothesis test results comprise of two types of analyses in this study. Firstly, path coefficients are utilized to determine the significance of the relationship between variables. Secondly, specific indirect effects are conducted to observe the mediating effect of variable Z.

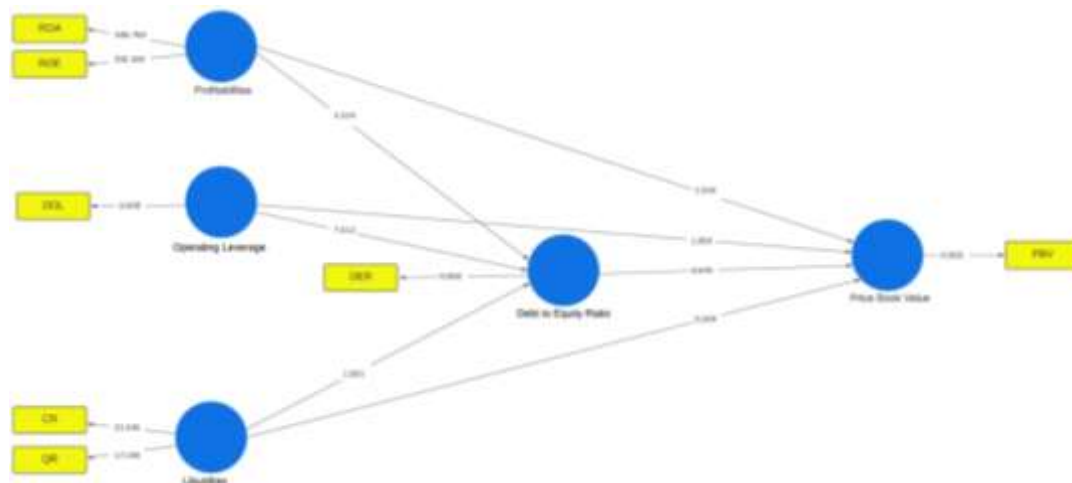


Figure 2. Path Analysis Results

Table 5. Path coefficient values

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Q Statistics ( O /STD EV)	P Values
Profitability ->Capital Structure	-0.221	-0.222	0.069	3,224	<b>0.001</b>
Operating Leverage ->Capital Structure	-0.545	-0.538	0.072	7,512	<b>0.000</b>
Liquidity ->Capital Structure	-0.146	-0.154	0.081	1,801	0.072
Profitability -> Price Book Value	0.462	0.478	0.182	2,545	<b>0.011</b>
Operating Leverage -> Price Book Value	-0.192	-0.181	0.182	1,056	0.292
Liquidity ->Capital Structure	-0.034	-0.033	0.125	0.269	0.788
Capital Structure -> Price Book Value	0.141	-0.129	0.218	0.645	0.519
Profitability ->Capital Structure -> Price Book Value*	0.031	0.028	0.052	0.594	0.553
Operating Leverage ->Capital Structure -> Price Book Value	0.077	0.068	0.118	0.650	0.516
Liquidity ->Capital Structure -> Price Book Value	0.021	0.015	0.040	0.512	0.609

The results of the path coefficient values analysis indicate that the profitability variable shows a statistically significant positive influence, as evidenced by the t-statistic values exceeding the critical t-table values and p-values below the significance level, supporting H1. Conversely, the operational leverage variable does not demonstrate a significant influence, with t-statistic values lower than the critical t-table values and p-values above the significance level, leading to the rejection of

H2. Similarly, the liquidity variable also fails to exert a significant influence, as the t-statistic values are below the critical t-table values, and the p-values exceed the significance level, resulting in the rejection of H3.

Furthermore, the profitability variable continues to exhibit a significant negative influence, further supporting H4. In contrast, the operational leverage variable reveals a significant negative influence as well, confirming H5.

However, the liquidity variable still does not show a significant influence, leading to the rejection of H6. The analysis of the capital structure variable also does not yield a significant influence, resulting in the rejection of H7. Furthermore, when considering the mediating effects of the capital structure, none of these variables exhibit a significant influence on firm value, as indicated by the t-statistic values below the critical t-table values and p-values exceeding the significance level, leading to the rejection of H8, H9, and H10. In summary, this study finds significant support for the positive influence of profitability and the negative influence of operational leverage on the outcome variable, while other variables and their mediating effects do not reach statistical significance.

### Effect of Profitability on Capital Structure

Research conducted by Kamela et al. (2023), Rahmawati and Sapari (2021), and Sari (2021) have shown that profitability has a significant positive effect on capital structure (Kamela et al., 2023; Rahmawati & Sapari, 2021; Sari, 2021). This means that a low profitability value would result in an increase in capital structure. In this case, a company would use its retained earnings as company capital to balance its activities and increase the value of the capital structure. These findings suggest that profitability is an important factor that affects a company's capital structure.

However, Ekinanda et al. (2021) and Septiani and Suaryana (2018) found no significant effect of profitability on capital structure (Ekinanda et al., 2021; Septiani & Suaryana, 2018). This may be due to the recent recessionary period in the property and real estate sub-sector, where companies have faced decreasing sales and lower profits. As a result, profitability may not have a significant impact on capital structure during this period.

### Effect of Operating Leverage on Capital Structure

The study found no significant influence of operating leverage on capital structure. The results indicate that operating leverage has a positive but insignificant effect on capital structure. When a company generates high operating expenses, it requires more funds to finance its operations. These funds may be obtained from external sources, such as debt. However, this finding contradicts the pecking order theory, which suggests that companies would prefer to use internal funds to finance their activities. High

levels of operating leverage also indicate that a company has high fixed costs.

### Liquidity Effect on Capital Structure

In this study, the results regarding the effect of liquidity on capital structure are contradictory to previous research conducted by Liang & Natsir (2019) and Pacheco & Tavares (2017), which demonstrated a negative and significant relationship between liquidity and capital structure (Liang & Natsir, 2019; Pacheco & Tavares, 2017). However, by adopting the pecking order theory, companies with high levels of liquidity are viewed as being financially strong enough to fund their obligations using current assets, and therefore may not need to rely on external funding sources such as debt. This is consistent with the findings of Maisal Riga Mikrawardhana (2015) and Suherman & Mardiyati (2019), who found a positive and significant relationship between liquidity and capital structure (Maisal Riga Mikrawardhana, 2015; Suherman & Mardiyati, 2019).

A high level of liquidity indicates that a company has the ability to pay its current debt obligations on time with current assets, without interrupting the company's operational activities. This reflects one of the applications of signaling theory, whereby a company signals to investors that it is financially stable and capable of meeting its financial obligations, making it an attractive option for investment.

### Effect of Profitability on Price Book Value

The better a company's performance, the greater its profitability ratio. This indicates an increase in management's ability to generate net income, making it essential for investors to pay attention to management's share price management. The results of this study are consistent with signaling theory, which suggests that higher profitability reflects effective asset management, signaling to investors that the company is a worthwhile investment. Profitability performance is a reference for investors to predict future profitability and the potential for good dividends. As investors invest more in the company, its stock price increases, boosting the company's value. The findings of this study are consistent with previous research (Damayanti & Nugroho, 2023; Fitri & Sabana, 2023; Pioh et al., 2018), which found that profitability has a significant positive effect on price book value.

## 8 Effect of Operating Leverage on Price Book Value

The study's results show that the operating leverage variable does not have a significant negative effect on firm value, indicating that changes in a company's operating leverage do not significantly impact its value. The higher the Degree of Operating Leverage (DOL), the lower the company value and vice versa. These findings align with research conducted by Osazuwa & Che-Ahmad (2016), which found that leverage does not significantly affect firm value, but contradict research conducted by Rustam (2013), which found that leverage has a significant effect on firm value. The significant and positive influence of operating leverage on firm value indicates that the higher a company's operating leverage, the higher its firm value, and vice versa. This aligns with the signaling theory, which suggests that information presented as an announcement is perceived as a signal by investors in their investment decision-making. If this information is positive, the market will react to the announcement, leading to changes in stock trading volume. Operating leverage operates in two ways, as it can amplify a company's profits or magnify its losses. If a company has high operating leverage, even a slight increase in sales can lead to a significant percentage increase in EBIT. Conversely, if a company has low operating leverage, it can cause a disproportional decrease in EBIT. Furthermore, Hanafi (2004) in (Persada & Ariyani, 2019) defines operating leverage as the extent to which fixed operating costs are used. The level of operating leverage or degree of operating leverage (DOL) is the percentage change in operating income (EBIT) resulting from a one percent change in output (sales).

According to the Trade-off Theory, companies aim to strike a balance between the benefits of using debt (leverage) to enhance firm value and the costs associated with that debt. In this context, research results showing that changes in operating leverage do not significantly impact firm value can be explained by the company's failure to achieve an optimal balance between debt and equity. It is possible that the company had already reached what was considered an optimal level of leverage, or perhaps the company's management prefers to utilize internal sources of funds rather than external borrowing.

On the other hand, the Pecking Order Theory states that companies tend to prefer internal sources of funds (such as retained earnings) before seeking external funds because external funds are generally more expensive and involve transaction

costs. This research's findings also support the Pecking Order Theory as they demonstrate that companies do not rely on increasing operating leverage as their first choice to finance their operations or alter their capital structure. Instead, they may opt to use internal sources of funds or consider other alternatives that align better with their financial strategy.

Overall, this research suggests that companies may be more inclined to follow the Pecking Order Theory rather than the Trade-off Theory in their financial decision-making, focusing on the use of internal sources of funds and avoiding an increase in operating leverage as the primary means to influence firm value.

## Effect of Liquidity on Price Book Value

The study's results do not support the hypothesis that higher company liquidity translates to higher price book value. This contradicts signaling theory, which suggests that companies with high liquidity can balance capital sourced from investments with current assets to generate profits, signaling to investors that the company is worth investing in. However, this study found that some companies may not optimally utilize their current assets, reducing their ability to earn profits. These results align with previous research by Ambarwati et al. (2015) and Pitoyo and Lestari (2018), which found that liquidity has no effect on profitability (Ambarwati et al., 2015; Pitoyo & Lestari, 2018).

From the perspective of different financial theories, we can better understand why the study's findings challenge the common belief that having more cash on hand leads to a higher company value. Looking through the lens of the Trade-off Theory, which suggests that companies need to balance the benefits of liquidity with its costs, the study's results suggest that some companies might be overly cautious in holding excess cash. While liquidity is essential for financial stability, it can also mean missed opportunities for profitable investments. In this light, not using cash reserves to boost the company's value may indicate a need for a more careful trade-off between liquidity and investment opportunities.

Meanwhile, the Pecking Order Theory proposes that companies prefer internal sources of funding, like their own profits, over external ones. In this context, the study's findings could imply that companies prioritize cash for day-to-day needs or as a safety net rather than using it to invest in projects that could increase their book value. This perspective underscores the idea that companies may have a hierarchy of financial choices, and

liquidity is allocated for reasons other than signaling their worth to investors.

Lastly, from the Signal Theory perspective, financial decisions, including cash management, are seen as a way to communicate information to investors. If companies are not using their cash to enhance their book value, it might suggest uncertainty about whether this is an effective signal for attracting investors. Alternatively, they might be relying on other methods to convey their attractiveness as an investment opportunity.

### Effect of Capital Structure on Price Book Value

The study's results do not support the hypothesis that decreasing a company's capital structure increases its firm value. This contradicts Pecking Order Theory, which suggests that companies prefer using internal funds over debt to avoid debt interest and increase their value. The study found that capital structure has a small contribution to firm value and is not a major concern for investors. Investors focus on how the company utilizes its existing funds optimally to achieve added value for the firm. Other factors may also influence firm value. These results align with previous research by Chasanah (2018) and Parhusip et al. (2016), which found that capital structure has no effect on firm value (Chasanah, 2018; Parhusip et al., 2016).

From the perspective of the Trade-off Theory, the research indicates that a company's capital structure has a positive influence, aligning with this theory. According to the Trade-off Theory, companies strive to find a balance between interest costs and tax benefits by using a mix of debt and equity. An increase in the capital structure will raise interest expenses but also reduce the taxes to be paid. However, this positive impact is not significant, possibly because companies have already approached or reached the optimal point in achieving this balance.

Secondly, in the context of the Pecking Order Theory, research results showing a positive yet not significant influence of the capital structure on firm value can also be explained. According to the Pecking Order Theory, companies tend to use internal sources of funds first, followed by debt, and lastly equity to finance their projects. In this situation, even if a company decides to increase the use of debt, its impact on firm value might not be significant because debt is used as the last option after internal sources of funds have been depleted.

From the Signal Theory perspective, a company's decision to increase its capital structure might be viewed as a signal to the market that the

company has profitable projects and is confident in its ability to generate cash flows to repay the debt. However, due to its insignificant influence on firm value, this signal might not be as strong or may be distorted by other factors affecting firm value. Thus, this research indicates that factors outside of the capital structure also have a significant influence on firm value, which should be considered in financial decision-making.

### Effect of Capital Structure mediates the Profitability variable on Price Book Value

The research findings suggest that the effect of capital structure mediates the profitability variable on Price Book Value, which is consistent with previous research conducted (Asih, 2017; Hanif et al., 2020; Hermuningsih, 2012; Musabbihan & Purnawati, 2018; Purnomo & Erawati, 2019; Wulandari, 2013). The lack of a direct effect of profitability on capital structure suggests that capital structure cannot mediate the relationship between profitability and firm value.

Investors often consider the price of a stock as a key factor in determining the value of a company. Hence, it is important for companies to instill confidence in the sales market, which not only helps in their present operations but also shapes their future expectations. In particular, the growth in profitability of a company, as measured by its net profit, can lead to an increase in its stock prices. This positive impact can, in turn, enhance the value of the company, which affects the capital structure.

Meidiawati & Mildawati (2016) explain that the capital structure reflects a company's use of debt to achieve equality in costs, thereby enabling potential investors to understand the difference between risk and profit. Understanding the capital structure of a company is crucial for investors to make informed investment decisions.

From the perspective of the Trade-off Theory, the results that indicate that profitability does not have a significant and positive influence on firm value with capital structure as a mediating variable suggest that the company has not yet reached an optimal point in the use of debt and equity. This theory argues that companies strive to find a balance between the tax benefits of debt and the additional financial costs associated with debt. These results may suggest that the company's profitability is not sufficiently large to offset the interest costs that the company would have to pay if it were to use more debt.

Secondly, from the perspective of the Pecking Order Theory, these results can be interpreted as an indication that the company is



more inclined to use internal sources of funding rather than external ones. The Pecking Order Theory states that companies prefer to use internal sources of funding, such as retained earnings, rather than borrowing or issuing new shares, unless there are no other options. Therefore, these results may indicate that the company prefers to use its generated earnings for investments rather than relying on external debt.

On the other hand, in the signaling theory, companies use various signals or signs to communicate information to shareholders and external parties about the company's condition and prospects. Profitability is often considered one of the crucial signals that can influence shareholders' and investors' perceptions of the firm's value. However, in the context of this research, the significance test results show that although profitability may play a role as a signal, it is not reflected in a significant influence on firm value when capital structure becomes a mediating factor. This indicates that other factors or variables may have a stronger influence on firm value within the framework of this study. In practical terms, these findings may have implications for company managers and shareholders. Company managers may need to consider factors other than profitability and capital structure when seeking to enhance firm value. Shareholders and investors also need to be aware that profitability alone may not be sufficient to predict changes in firm value in this situation, so they should consider other factors that may have a more significant impact on firm value.

### **Effect of Capital Structure mediates the Operating Leverage variable on Price Book Value**

The results of the significance test indicate that the operating leverage variable does not have a significant and positive effect on firm value, with capital structure as a mediating variable. These findings are consistent with previous research conducted by Wulandari (2013b), which also concludes that capital structure cannot mediate the relationship between operating leverage and firm value.

Investors tend to focus more on a company's performance in generating profits from changes in sales volume, rather than the capital structure used by the company. However, the positive influence of high profits suggests that companies with good performance in utilizing all of their capital can easily attract funding from external sources. This is reflected in the upward

trend of the company's profits, indicating an increase in the value of the company.

To further enhance the company's value, it may issue debt to increase investor confidence in its performance, which is demonstrated by rising profits. Additionally, companies with high profits may benefit from tax savings by using debt. Therefore, it can be concluded that capital structure plays a mediating role in the relationship between operating leverage and firm value.

According to the Trade-off Theory, companies strive to strike a balance between the financial costs associated with debt and the tax benefits of debt. The results that indicate that the operating leverage variable does not have a significant and positive influence on firm value can be explained by the argument that the company may have already reached an optimal point in the use of debt to maximize firm value, so increasing operating leverage no longer provides significant benefits.

Meanwhile, the Pecking Order Theory suggests that companies prefer to use internal sources of funding before seeking external financing. The results of this study may indicate that the company tends to use internal sources of funding or equity capital, which is safer, rather than further investing in additional debt to increase operating leverage, especially if the capital structure is already relatively balanced.

Furthermore, the Signal Theory states that a company's capital structure decisions can be used as a signal to investors and the market regarding the company's condition. In this context, the research results that show operating leverage is not significant and positive can be interpreted as a signal that the company does not view operational improvement as a critical factor in enhancing firm value. This can influence investor and market perceptions of the company, so the company may prefer to use other sources of funding or send positive signals through other more relevant factors.

### **Effect of Capital Structure mediates the Liquidity variable on Price Book Value**

The effect of capital structure on mediating the relationship between liquidity and price book value was investigated in this study. Interestingly, the findings contradict previous research conducted by Maria and Widjaja (2023) and Thaib and Dewantoro (2017), who proposed that capital structure acts as a mediator for liquidity on firm value due to the influence of liquidity on capital structure (Maria & Widjaja, 2023; Thaib & Dewantoro, 2017). However, the data processing



in this current study suggests that there is no direct effect of liquidity on firm value, and hence, the relationship is mediated by capital structure. Capital structure was found to have a strong influence on firm value, making it a good mediator.

In Property & Real Estate companies, capital structure contributes little to the influence of firm value. As a result, investors are more concerned with how the company uses its existing funds optimally to add value to the firm. Investors also take into account other factors that can affect firm value, so the level of debt used by the company is not a major concern. Therefore, it can be concluded that the capital structure variable is unable to mediate the relationship between liquidity and price book value.

From the perspective of the Trade-off Theory, the results of this research can be explained by the existence of a trade-off between the benefits and costs of using liquidity. In this theory, companies must strike a balance between the benefits of liquidity that enhance operational flexibility and the additional costs that arise from reduced leverage. In this case, the research findings indicate that the benefits of liquidity are not significant enough to offset the additional costs that may arise from using liquidity to influence the capital structure.

Secondly, from the perspective of the Pecking Order Theory, this finding can be explained by considering that companies tend to avoid using internal liquidity (such as cash and short-term loans) for financing investment projects unless they do not have adequate access to the capital markets or long-term debt. In this theory, companies would prefer to use long-term debt as the primary source of financing because it is the first choice in the Pecking Order hierarchy. The research results that show liquidity does not have a positive influence on firm value may suggest that companies prefer to avoid using internal liquidity and rely more on external sources of financing, such as long-term debt.

Thirdly, from the perspective of Signal Theory, the research results can be interpreted as a signal that the company may not have sufficiently strong or credible information to convince investors that the use of liquidity will enhance firm value. In this theory, companies use the capital structure as a signal to investors about the quality of their investments. If the company does not use its liquidity to influence the capital structure, it may indicate that they lack sufficient confidence in the prospects of their investment projects or do not want to expose themselves too much to financial

risk. As a result, investors may doubt the value of the company and therefore not respond positively to the liquidity variable.

## CONCLUSION

The results of the study show that profitability has a significant and positive impact on firm value, but has a significant and negative impact on capital structure. On the other hand, operating leverage has no significant and positive impact on firm value, but has a significant and negative impact on capital structure. Liquidity does not have a significant and positive impact on firm value or capital structure. Moreover, the study found that capital structure does not have a significant influence on firm value, and an increase in capital structure tends to be accompanied by a decrease in firm value.

It is important for management to make appropriate decisions in order to benefit shareholders, such as selecting profitable investments and using an optimal amount of debt. It is also important to balance the interests of shareholders and bondholders when making financial decisions, as decisions that prioritize one group over the other can be risky for the company. The decision to issue bonds and increase debt should be made carefully, as it can potentially lower the price of bonds and negatively affect the company. In summary, this study highlights the importance of considering multiple factors when making financial decisions, and the potential impact these decisions can have on both the short-term and long-term value of the company.

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