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The Effect of Profitability and Capital Structure on Company Value: An Empirical Study of LQ 45 Companies Listed on the Indonesia Stock Exchange (2019-2023)

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A B S T R A C T
This inquiry interrogates the mechanistic influence of operational profitability and capital structure architecture on the enterprise valuation of premier LQ45 corporations listed on the Indonesia Stock Exchange (IDX) across the 2019–2023 temporal horizon. Operating within a quantitative paradigm supported by descriptive and associative analytical designs, the empirical framework evaluates a refined sample of 20 corporate entities chosen via non-probability purposive filtering from a total baseline population of 45 enterprises. Utilizing longitudinal panel regression analysis on secondary metrics, the empirical outputs demonstrate that both earning capacity and financial leverage structure exert positive and statistically significant ramifications on market valuation, functioning both discretely and in tandem. Furthermore, the calculated coefficient of determination (R^2) reveals that these dual independent predictors absorb the predominant variance within corporate enterprise value, while the remaining unexplained residual is governed by unobserved exogenous variables.

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INTRODUCTION

Rapid macroeconomic transformations and heightened global market convergence continue to intensify inter-corporate rivalry, obligating business entities to continually recalibrate their competitive advantages to preserve long-term viability. Within this volatile economic landscape, modern corporate governance transcends mere short-term profit extraction, shifting focus toward sustained enterprise value maximization, organizational longevity, and market share expansion. Capitalizing on these ambitious trajectories demands substantial financial capital, thereby necessitating prudent investment paradigms and strategic financing choices mediated across corporate executives, equity investors, and credit underwriters.

Enterprise value encapsulates the collective perception of the investing public regarding a firm's operational trajectory and future cash-flow prospects (Hery, 2017). A preeminent operational metric used to quantify this market sentiment is the Price to Book Value (PBV) metric, representing the comparative ratio between prevailing equity share prices and underlying net book valuation. This balance denotes the premium or discount at which capital markets value corporate net assets. Elevated PBV metrics signify robust market confidence regarding leadership's asset allocation efficiency and capacity to generate sustainable economic rents (Septiani, 2022). Consequently, superior enterprise valuation reinforces shareholder wealth accumulation and reflects an enterprise's structural capability to produce incremental value for its capital providers.

Figure 1. Mean Market Valuation (PBV) Trajectory of LQ45 Listed Entities (2019–2023)

(Source: Secondary financial data processed, 2025)

As illustrated in Figure 1, the mean market valuation across benchmark LQ45 firms exhibited noticeable volatility over the 2019–2023 observation period. Between 2019 and 2020, PBV experienced a sharp contraction of 5.01 units, driven primarily by the macroeconomic shocks of the COVID-19 pandemic, which severely impaired operational profitability and induced widespread capital instability. Conversely, the 2020–2021 window recorded a modest recovery of 0.39 units as economic activity rebounded and corporate financial statements stabilized. Nevertheless, during 2021–2022, PBV underwent a subtle downward correction of 0.04 units, triggered by escalating debt service obligations and sub-optimal leverage configurations. Finally, the 2022–2023 period yielded a minor uptick of 0.01 units as broader market conditions normalized, debt structures were recalibrated, and baseline profitability was sustained.

Market valuation fluctuations represent an inherent feature of equity markets. However, prolonged structural contractions in firm valuation erode investor confidence and damage corporate creditworthiness. Preserving market confidence is paramount, as equity dividends remain directly tied to net earnings generation. A concurrent decline in equity prices and circulating share volume indicates diminishing market confidence, sparking skepticism among capital allocators regarding the wisdom of retaining or expanding their equity exposure.

Earning capacity stands as a fundamental determinant of enterprise value, as it quantifies an entity's operational capability to convert allocated resources into net economic yields. This financial dimension is typically evaluated via operating margins, net income, return on invested capital, and return on equity. According to Diyah (2022), firms that consistently demonstrate superior earnings performance generate favorable market signals, stimulating equity demand and driving enterprise valuation upward. Thus, sustained profitability serves as an essential analytical heuristic for market participants evaluating corporate growth trajectories.

Concurrently, capital structure configuration acts as a pivotal driver of enterprise value by defining the balance between borrowed debt obligations and owner-contributed equity. Strategic financing decisions dictate the capital cost baseline for corporate expansion and operational maintenance. Establishing an optimal debt-to-equity ratio optimizes equity valuations by balancing tax-shield benefits against financial distress risks, whereas excessive leverage exposure risks undermining corporate market value (Ardiansah & Idayati, 2024).

This study addresses the empirical interplay between operational profitability and capital structure within LQ45 listed entities on the Indonesia Stock Exchange across the 2019–2023 period, evaluating both their isolated and combined influences on firm valuation. The underlying theoretical framework posits that asset earning power acts as an internal indicator of operational health, while capital structure configuration shapes external investor perceptions of financial risk and return. Accordingly, three core hypotheses are formulated:

- H1: Operational profitability exerts a statistically significant partial effect on enterprise value.
- H2: Capital structure architecture exerts a statistically significant partial effect on enterprise value.
- H3: Operational profitability and capital structure architecture simultaneously exert a statistically significant joint effect on enterprise value.

The primary objective focuses on empirically quantifying these financial dynamics within the specified 2019–2023 timeframe. Theoretically, this research enriches corporate finance literature by validating valuation models within an emerging market context. Practically, these empirical insights provide corporate leaders with actionable guidelines for optimizing financial leverage and asset efficiency, while simultaneously offering institutional investors robust criteria for fundamental equity analysis.

LITERATURE REVIEW

To construct a rigorous theoretical base for evaluating the impact of earning power and capital leverage on enterprise value, this inquiry synthesizes five theoretical foundations in corporate finance: Signaling Theory, Trade-Off Theory, Pecking Order Theory, Agency Theory, and the Modigliani-Miller Theorem.

1. Signaling Theory

Formulated by Spence (1973) and introduced to corporate financial analysis by Brigham and Houston (2019), Signaling Theory posits an inherent information asymmetry between corporate insiders and external capital providers. To bridge this information gap, executive leadership emits informative "signals" through audited financial disclosures, particularly regarding operating margins and dividend distributions. High operating earnings signal operational strength and future cash-flow expansion. Consequently, capital markets react positively by increasing demand for the firm's equity, driving up market prices and enhancing enterprise value.

2. Trade-Off Theory

The Trade-Off Theory of capital structure, advanced by Myers (1984), asserts that an enterprise identifies its optimal leverage threshold by balancing the tax benefits of debt against its associated financial liabilities. While debt interest payments offer valuable corporate tax shields, excessive borrowing heightens bankruptcy risks and agency costs. Under this paradigm, management aims for an optimal leverage ratio where the marginal present value of tax savings equals the incremental cost of financial distress, thereby maximizing overall enterprise valuation.

3. Pecking Order Theory

Pioneered by Myers and Majluf (1984), the Pecking Order Theory contends that corporate managers follow a hierarchy of financial choices driven by the costs of information asymmetry. Firms prioritize internal funding sources (retained earnings) first, as they carry no issuance costs or negative market signals. When external financing is required, management prefers straight debt over new equity, since issuing equity can signal that existing shares are overvalued, triggering adverse market reactions. This theory underscores how capital structure configurations reflect historical profitability and internal cash generation capacity.

4. Agency Theory

Agency Theory, conceptualized by Jensen and Meckling (1976), examines the conflict of interest arising between principals (equity holders) and agents (corporate management), as well as between shareholders and debt holders. Because managers may prioritize personal utility over firm value maximization, monitoring frameworks and capital commitments are necessary. Debt service obligations act as an effective disciplinary mechanism, restricting discretionary cash flows and aligning managerial focus with shareholder wealth creation, ultimately elevating corporate value.

5. Modigliani-Miller Theory (Capital Structure & Enterprise Valuation)

Grounded in the works of Modigliani and Miller (1963) incorporating corporate taxation, this theory establishes that in tax-bearing economies, a leveraged enterprise achieves a higher total market valuation than an unleveraged counterpart due to the tax deductibility of interest expenses. The resulting tax shield lowers the weighted average cost of capital (WACC) and increases overall enterprise value. This structural model provides the theoretical basis for assessing how capital ratios (e.g., Debt to Equity Ratio) systematically influence market valuation metrics (e.g., Price to Book Value).

RESEARCH METHODOLOGY

To evaluate how operational earning power—proxied by Return on Assets (ROA)—and capital structure configuration—measured via the Debt to Equity Ratio (DER)—influence enterprise valuation—represented by Price to Book Value (PBV)—this study deploys a quantitative framework incorporating descriptive and associative analytical designs. The investigation examines constituent firms of the LQ45 index listed on the Indonesia Stock Exchange (IDX) across the 2019–2023 observation period.

The dataset comprises secondary panel data combining cross-sectional corporate entities with annual time-series observations. These metrics were gathered from audited financial reports retrieved from the official IDX database (www.idx.co.id).

Sampling Strategy and Selection Benchmarks

The initial target population consisted of all 45 companies listed on the LQ45 index from 2019 through 2023. A non-probability purposive sampling scheme was applied using the following selection criteria:

1. Uninterrupted inclusion within the benchmark LQ45 index across 2019–2023.
2. Financial statements denominated in Indonesian Rupiah (IDR).
3. Zero trading suspensions or delisting procedures during the 5-year observation window.
4. Continuous operational profitability with no reported net losses over the study period.
5. Uninterrupted submission of required annual financial disclosures throughout 2019–2023.
6. Availability of complete financial data necessary for variable calculations.

Applying these selection criteria resulted in a final sample of 20 companies, detailed in Table 1.

Table 1. Final Research Sample Entities

No.	Ticker	Company Name
1	ACES	Ace Hardware Indonesia Tbk
2	ANTM	Aneka Tambang Tbk
3	BBCA	Bank Central Asia Tbk
4	BBRI	Bank Rakyat Indonesia (Persero) Tbk
5	BBTN	Bank Tabungan Negara (Persero) Tbk
6	BSDE	Bumi Serpong Damai Tbk
7	BTPS	Bank BTPN Syariah Tbk
8	CPIN	Charoen Pokphand Indonesia Tbk
9	ERAA	Erajaya Swasembada Tbk
10	EXCL	XL Axiata Tbk
11	ICBP	Indofood CBP Sukses Makmur Tbk
12	INDF	Indofood Sukses Makmur Tbk
13	INKP	Indah Kiat Pulp & Paper Tbk
14	JPFA	Japfa Comfeed Indonesia Tbk
15	KLBF	Kalbe Farma Tbk
16	MNCN	Media Nusantara Citra Tbk
17	PWON	Pakuwon Jati Tbk
18	SMGR	Semen Indonesia (Persero) Tbk
19	TLKM	Telkom Indonesia (Persero) Tbk

No.	Ticker	Company Name
20	TOWR	Sarana Menara Nusantara Tbk

RESULTS AND DISCUSSION

Descriptive Statistical Diagnostics

Table 2. Descriptive Statistical Summary

Metric	X1 (ROA)	X2 (DER)	Y (PBV)
Mean	0.085531	0.731790	0.123944
Median	0.916538	0.558731	0.073765
Maximum	0.957830	2.621594	1.378742
Minimum	0.031230	0.088160	0.010951
Std. Dev.	0.165446	0.527127	0.189046

(Source: Secondary financial data processed via EViews 13, 2025)

The descriptive statistical outputs in Table 2 show that the operational profitability variable (X_1) yielded a sample mean of 0.085531 (8.55%) with a standard deviation of 0.165446, reflecting noticeable dispersion across sampled firms. BBNI recorded the peak profitability metric of 1.368340 in 2019, whereas EXCL recorded the minimum value of 0.010519 in 2019 due to compressed operational margins. ERAA registered a median profitability level of 0.060613 in 2022, representing moderate earning efficiency.

The mean capital structure metric (X_2) stood at 0.731790, indicating that the majority of sampled entities favored equity financing over external debt. EXCL recorded the maximum leverage ratio of 2.621594 in 2021 due to heavy debt utilization, whereas MNCN recorded the minimum value of 0.088160 in 2023, reflecting a reliance on internal equity. The standard deviation of 0.527127 underscores notable variation in financing strategies across the sample.

The mean enterprise valuation (Y) stood at 0.123944, reflecting a modest average market premium, accompanied by a standard deviation of 0.189046. BTPS achieved the highest valuation metric of 1.378742, demonstrating strong market performance. Conversely, KLBF recorded the lowest valuation metric of 0.010951 in 2023, while MNCN represented the median benchmark with a PBV of 0.073765 in 2023.

Classical Assumption Diagnostics

- Normality Diagnostic: The Jarque-Bera (JB) statistical procedure produced a probability value of 0.154414 ($p > 0.05$), confirming that the residual terms within the panel model conform to a normal distribution.
- Heteroscedasticity Diagnostic: As detailed in Table 3, the Likelihood Ratio (LR) test for homoscedasticity yielded a statistical value of 6.772601 with

an associated probability of 0.9974 ($p > 0.05$). This confirms the absence of heteroscedasticity.

- Multicollinearity Diagnostic: Multicollinearity testing revealed Tolerance values exceeding 0.10 and Variance Inflation Factors (VIF) well below the 10.0 threshold (Correlation X_1--$X_2 = -0.114863$), confirming the absence of collinearity between independent variables.
- Autocorrelation Diagnostic: The estimated Durbin-Watson statistic reached 1.659245. Falling cleanly within the acceptable 1.50–2.50 range, this confirms the absence of first-order serial autocorrelation.

Hypothesis Diagnostic Procedures

Table 4. Partial Regression Coefficients (t-Test)

Variable	Coefficient	Std. Error	t-Statistic	p-Value
Constant (C)	-1.485591	0.354803	-4.187090	0.0001
X_1 (ROA)	0.318372	0.097788	3.255751	0.0016
X_2 (DER)	0.354062	0.174208	2.032415	0.0448

(Source: Secondary financial data processed via EViews 13, 2025)

- Partial Significance (t-Test):
  - Profitability (X_1): The regression coefficient for ROA reached 0.318372 with a calculated t-statistic of 3.255751 ($p = 0.0016 < 0.05$). This supports H1, confirming that operational profitability exerts a statistically significant positive effect on firm valuation.
  - Capital Structure (X_2): The coefficient for DER reached 0.354062 with a t-statistic of 2.032415 ($p = 0.0448 < 0.05$). This supports H2, demonstrating that capital structure leverage exerts a statistically significant positive effect on market valuation.
- Simultaneous Model Fit (F-Test): Joint hypothesis testing produced an empirical F-statistic of 7.157538 with an associated p-value of 0.000000 ($p < 0.05$). This confirms H3, establishing that operational profitability and capital structure jointly exert a statistically significant influence on enterprise valuation.
- Coefficient of Determination (R^2): The empirical model yielded an R-squared value of 0.658357 (Adjusted $R^2 = 0.566376$). This indicates that 65.84% of the variance in enterprise valuation across LQ45 firms is explained by profitability and capital structure, while the remaining 34.16% is governed by external variables omitted from the model.

DISCUSSION

The Influence of Operational Profitability on Enterprise Valuation

The partial regression analysis confirms that operational profitability (ROA) exerts a statistically significant positive influence on enterprise value ($\beta = 0.318372, p = 0.0016$). Substantively, superior asset management efficiency directly elevates market sentiment and investor confidence, as consistent

earnings capacity signals financial strength. This outcome aligns with prior empirical literature, including studies by Perianti et al. (2023), Kurniawan et al. (2022), Pratami & Jamil (2020), Aprilianingsih et al. (2023), Fuhrotun (2022), Setiawati (2020), Saridewi et al. (2020), Iman et al. (2022), and Apriliani et al. (2020), which similarly established that earning power serves as a primary driver of market valuation.

The Influence of Capital Structure on Enterprise Valuation

The partial regression output demonstrates that capital structure configuration (DER) maintains a statistically significant positive effect on enterprise value ($\beta = 0.354062, p = 0.0448$). This indicates that employing external debt within manageable limits enhances equity returns and provides positive market signals regarding corporate operational leverage and expansion potential. These findings corroborate prior studies by Lisdawati (2023), Athira (2021), Setyarini et al. (2022), Lestiyadi & Ghazali (2023), Nurmala et al. (2023), Fadmala et al. (2023), and Pebriawan et al. (2021), which affirmed the positive contribution of strategic debt deployment to firm valuation.

The Combined Influence of Profitability and Capital Structure

Simultaneous testing demonstrates that operational profitability and capital structure jointly dictate enterprise value among LQ45 listed entities on the Indonesia Stock Exchange ($F = 7.157538, p = 0.000000$). This combined relationship supports empirical observations documented by Nurmala et al. (2023), Rahmadani et al. (2022), Muliana & Astuti (2021), Pebriawan et al. (2021), Putri et al. (2021), and Pebriyani & Subardjo (2020), who confirmed that operational performance metrics and capital leverage choices together serve as key determinants of corporate market valuation.

CONCLUSION

This empirical investigation demonstrates that operational profitability (ROA) and capital structure configuration (DER) serve as crucial positive drivers of enterprise value (PBV), demonstrating both partial and joint statistical significance among LQ45 firms listed on the Indonesia Stock Exchange over the 2019–2023 period. Consequently, an enterprise's ability to maintain high earning efficiency while balancing an optimal debt-to-equity ratio directly enhances market perception and drives favorable investor valuations.

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