

## How Do Financials Fundamentals Shape Firm? Evidence on the Mediating Role of Profitability

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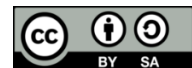
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### ABSTRACT

This study examines the influence of capital structure, sales growth, and firm size on firm value, with profitability acting as a mediating variable. The empirical analysis is conducted on firms operating in the metals and related sub-sectors listed on the Indonesia Stock Exchange (IDX) over the period 2011–2021, with a sample comprising only firms with complete financial disclosures. Utilizing a causal-comparative research design, the study seeks to identify and generalize the structural relationships among key financial variables. The study considers capital structure, sales growth, and firm size as independent variables, with firm value serving as the dependent variable and profitability (as measured by Return on Assets) functioning as a mediating construct. A quota sampling technique was employed to select 14 firms from the metals and related sub-sectors listed on the Indonesia Stock Exchange (IDX), based on data completeness and sectoral relevance. The analytical framework incorporates descriptive statistics, classical assumption testing, model fit evaluation, multiple linear regression analysis, and hypothesis testing to examine the proposed relationships. The empirical results indicate that capital structure has a positive and statistically significant effect on firm value. Conversely, sales growth exhibits a negative but statistically insignificant relationship with firm value, while firm size demonstrates a significant negative impact. Profitability shows a positive and significant influence on firm value. Further analysis reveals that capital structure negatively affects profitability, although the effect is not statistically significant. Sales growth has a positive and significant impact on profitability, whereas firm size is positively related to profitability, albeit insignificantly. Mediation testing confirms that profitability does not mediate the relationship between capital structure and firm value; however, it significantly mediates the effects of both sales growth and firm size on firm value.

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## 1. INTRODUCTION

Maximizing shareholder wealth by increasing firm value represents the core objective of corporate existence [1]. As noted by [2], firm value represents the outcome of managerial performance across multiple dimensions, including net cash flows derived from investment decisions, the firm's growth trajectory, and capital cost management. The market price of a firm's shares serves as a primary indicator of firm value; a rising share price implies enhanced investor returns and affirms the firm's commitment to shareholder wealth maximization [3].

Firm value is a critical indicator of corporate performance, as a higher firm value is typically associated with greater shareholder wealth (Brigham & Houston, 2011). A strong firm value also reflects stability and enhances the company's reputation, thereby increasing investor confidence and interest. According to [4], firm value encompasses the market value of both equity and debt, and is often linked to the level of return on investment provided to shareholders. One commonly used metric to assess firm value is the Price to Book Value (PBV) ratio, which compares a company's market price per share to its book value.

The composition of a firm's capital structure plays a critical role in shaping its financial resilience and strategic adaptability. According to [5], firms with suboptimal capital structures—particularly those characterized by excessive debt—are more susceptible to financial strain, largely driven by increased interest expenses and tax liabilities. While debt financing can potentially enhance firm value through the benefits of financial leverage, its effectiveness is contingent upon the firm's growth potential and operational scale. Consequently, capital structure decisions must be carefully optimized to support sustainable value creation and reinforce the firm's competitive positioning. Furthermore, capital structure reflects the effectiveness of managerial decision-making in balancing financial risk and return, particularly in the context of

minimizing the weighted average cost of capital and maximizing shareholder wealth. A commonly employed indicator of capital structure is the Debt-to-Equity Ratio (DER), which measures the proportion of debt relative to equity financing

Firm performance reflects the degree to which an organization attains its strategic goals, particularly in terms of profit generation as a key driver of firm value [6]. Profitability plays a pivotal role in influencing investor sentiment; firms demonstrating strong profitability are generally perceived as more favorable in the capital markets, thereby enhancing their potential for higher valuation. Return on Assets (ROA)—calculated as net income divided by total assets—is widely recognized as a standard measure of profitability, capturing a firm's efficiency in utilizing its asset base to generate earnings.

Sales represent a fundamental metric in assessing a firm's profitability and are widely recognized as a key indicator of operational performance [7]. According to [8], sales performance holds strategic importance, as increased sales typically require proportional asset expansion to sustain growth. In addition to reflecting a firm's market expansion capability, sales growth plays a crucial role in shaping working capital management, enabling firms to project future profitability based on revenue trends. Sales growth is typically measured as the percentage change in sales between two periods, calculated by comparing the increase in sales to the prior period's sales volume.

Firm size is recognized as a significant factor that may influence firm value. Larger firms typically enjoy easier access to both internal and external sources of financing due to their established scale and market presence. According to [9], firm size affects managerial choices regarding accounting policies, where larger firms are more inclined to adopt income-deferment strategies. This tendency is based on the assumption that large corporations are more exposed to political scrutiny and wealth transfers, particularly through taxation and regulatory pressures. The natural logarithm of

total assets (Ln Total Assets) is frequently employed as a proxy for firm size, representing the scale of economic resources managed by the firm [10].

On the Indonesia Stock Exchange (IDX), manufacturing firms are classified into three principal sectors: the Basic and Chemical Industry, the Miscellaneous Industry, and the Consumer Goods Industry. Among these, the Basic and Chemical Industry sector encompasses firms engaged in the production of primary materials that serve as essential inputs for a wide range of everyday applications. This sector is further subdivided into several subsectors, including cement; ceramics, porcelain, and glassware; metals and related products; chemical manufacturing; plastics and packaging; animal feed; wood and processed timber; as well as pulp and paper production.

This study focuses on publicly listed companies within the metals and related products sub-sector of the Indonesia Stock Exchange, which recorded year-on-year growth in 2018, reflecting a generally positive developmental trajectory. Nevertheless, the sub-sector's performance in terms of Price to Book Value (PBV) exhibited a fluctuating yet relatively stable pattern over time. Despite such variability, a comparative analysis with 2015 data reveals a declining trend in PBV across the observed period.

The decline in firm value is observable through decreasing share prices in the capital market, which often reflects waning investor confidence across multiple sectors, as well as a downturn in the manufacturing index—factors that collectively contribute to broader economic weakening. Enhancing profitability is essential for improving firm value, as it serves as an indicator of solid financial performance and can stimulate investor interest, thereby supporting share price appreciation. In addition to profitability, firm value is also influenced by other critical financial determinants such as capital structure and sales growth.

Capital structure theory examines a firm's financing strategy in balancing the

proportion of debt and equity to maximize firm value [11]. Consistent with the trade-off theory, a higher Debt-to-Equity Ratio (DER) can lead to an increase in Price-to-Book Value (PBV), as long as leverage remains within its optimal range. From the signaling theory perspective, an improvement in Return on Assets (ROA) is interpreted by investors as a positive signal of financial health, thereby increasing share prices and enhancing firm value. On the other hand, trade-off theory posits that profitability is influenced by capital structure decisions, where increased debt usage may generate tax benefits and reduce agency costs, ultimately resulting in higher net income.

This study aims to examine the effects of capital structure, sales growth, and firm size on firm value, as well as their respective impacts on profitability. The findings are expected to contribute meaningful insights and serve as a comparative reference for future empirical research in related or broader contexts

## 2. LITERATURE REVIEW

### 2.1 *Signalling Theory*

Signaling Theory, initially introduced by [12], posits that information asymmetry between parties can be mitigated when the information holder (the sender) conveys relevant signals intended to influence the perceptions and subsequent behavior of the information receiver. The theory was further developed by [13], who argued that corporate executives possess superior information about their firms and are thus motivated to disclose such information to potential investors in an effort to enhance the firm's stock price [14].

Signaling theory emphasizes the importance of information signals that investor consider when deciding whether to invest in a particular company. Fundamentally, the theory is closely associated with information availability. It asserts that firms are obligated to disclose financial information to external stakeholders in a manner that is relevant,

accurate, complete, and timely. Such disclosures, typically in the form of financial statements, serve as analytical tools that inform investment decisions by providing insight into a firm's past, present, and anticipated future financial performance [15].

Based on this theoretical framework, internal management issues financial statements to convey positive signals about the firm's performance with the intention of attracting potential investors. Financial statement analysis, particularly through financial ratios—such as liquidity, solvency, profitability, activity, and market ratios—enables investors to assess the firm's overall financial health. If the analysis reveals strong financial performance, investor interest is likely to increase, thereby driving up the firm's stock price in the capital market.

## 2.2 Capital Structure Decisions and Their Effect on Market-Based Firm Valuation

The Trade-Off Theory of capital structure emphasizes the need to balance the benefits and costs associated with the use of debt. As long as the benefits—such as tax shields—outweigh the associated costs, firms may increase their leverage. However, when the costs, including financial distress and agency costs, exceed the benefits, further use of debt is no longer advisable. The theory predicts a **positive relationship** between capital structure and firm value, assuming that the tax advantages of debt still outweigh its drawbacks. In essence, debt utilization can enhance firm value, but only up to an optimal point; beyond that threshold, additional debt may actually diminish firm value [16]. Based on this theoretical foundation, the hypothesis proposed in this study is as follows:

H1 : Capital structure has a positive effect on firm value.

## 2.3 Does Sales Growth Enhance Firm Value? An Empirical Study

Sales growth sends a positive signal to investors, indicating strong future prospects for the company, which can ultimately enhance firm value. According to [17], firms with high sales growth are perceived as being better prepared to compete and are likely to experience an increase in market share, which directly contributes to higher firm value. This perspective is supported by [18], who found that sales growth has a significant positive effect on firm value. The relationship between sales growth and firm value is aligned with the principles of Signaling Theory, which posits that observable performance indicators convey relevant information to the market.

H2: Sales growth has a positive effect on firm value.

## 2.4 Does Firm Size Influence Market-Based Firm Value? An Empirical Study

In this study, firm size refers to the magnitude of a company as reflected in its total assets. Larger firms tend to attract greater investor attention due to their perceived operational stability and maturity. This stability often translates into higher investor confidence and demand for the company's shares, which may subsequently lead to an increase in the firm's stock price. Investors generally hold high expectations for larger firms, particularly in terms of dividend distribution. As stock demand rises, market prices respond accordingly, resulting in a higher Price-to-Book Value (PBV), thereby enhancing firm value.

Larger firms also exhibit stronger signals of long-term viability, making them more appealing to investors. From the perspective of Signaling Theory, firm size acts as a positive signal to investors and creditors, indicating lower risk and stronger financial capacity. Large firms are typically better positioned to access capital markets, demonstrating greater flexibility and financial strength—factors

that suggest a more favorable outlook for future growth.

H3: Firm size has a positive effect on firm value.

## 2.5 *The Relationship Between Profitability and Market-Based Firm Value*

To maximize firm value, management must leverage the company's strengths and address its weaknesses. Financial statement analysis plays a critical role in this process by comparing a firm's performance with industry peers and evaluating trends over time. Such analysis helps management identify areas for improvement and implement strategies to enhance overall performance [19].

Profitability ratios serve as indicators of a firm's ability to generate earnings. In this study, profitability is measured using Return on Equity (ROE), a key metric for shareholders, as it reflects the return generated by management on the capital invested by the company's owners. Higher profitability typically leads to increased firm value, as strong earnings signal positive future prospects. This, in turn, attracts investors and boosts demand for the firm's stock, contributing to a higher market valuation [20], [21]. The relationship between profitability and firm value is further supported by Signaling Theory, which suggests that higher profit margins convey favorable information to the market.

H4: Profitability has a positive effect on firm value.

## 2.6 *Does Capital Structure Influence Corporate Profitability?*

When a firm's **return on assets (ROA)** exceeds its **cost of debt**, the use of financial leverage can enhance **return on equity (ROE)**, resulting in greater shareholder gains than would be possible without leverage. Under such conditions, debt financing becomes advantageous, as the income generated from borrowed capital surpasses the interest expenses incurred, thereby benefiting equity holders. The relationship between **capital**

**structure and profitability** is supported by the **Trade-Off Theory**, which posits that firms aim to balance the tax advantages of debt against the potential costs of financial distress.

Empirical findings by [22] suggest that a higher proportion of debt in the capital structure is associated with an increase in return on equity, indicating improved profitability. This finding is consistent with the results of [23], who also observed a positive correlation between leverage and profitability.

H5: Capital structure has a positive effect on profitability.

## 2.7 *Does Sales Growth Improve Profitability?*

An increase in sales growth indicates strong future prospects, which can positively influence a firm's profitability. Conversely, low sales levels may adversely affect earnings, resulting in a decline in overall revenue. Higher sales enable firms to better absorb production costs, thereby improving profit margins. This positive association is supported by the findings of [24] as well as [25], who concluded that sales growth has a significant and positive impact on profitability. The relationship between sales growth and profitability is further explained by Signaling **Theory**, which posits that strong financial indicator—such as increasing sales—serve as positive signals to the market.

H5: Sales growth has a positive effect on profitability.

## 2.8 *The Effect of Firm Size on Profitability*

Large firms typically possess extensive resources and engage in broad operational activities, which directly reflects their potential to generate higher levels of profit. According to [26], a company's assets are utilized to support its operational activities with the ultimate goal of generating profit; thus, the more effectively these assets are employed, the greater the profit that can be realized. This notion is consistent with the findings of [25] and [27], who concluded that firm

size has a positive influence on profitability. The relationship between firm size and profitability is also supported by Signaling Theory, which suggests that larger firms convey stronger signals of stability and performance, thereby enhancing investor confidence.

H7: Firm size has a positive effect on profitability

## 2.9 Does Profitability Mediate the Relationship Between Capital Structure and Firm Value?

The Trade-Off Theory suggests that when a firm's capital structure is below its optimal level, additional debt can lead to an increase in firm value. Appropriately managing debt can enhance profitability more effectively than relying solely on equity. Meanwhile, Signaling Theory posits that debt usage serves as a positive signal to investors, indicating strong performance and promising future prospects. Consequently, debt financing can contribute to higher firm value, especially as increasing profitability attracts investor confidence and leads to higher stock prices.

This perspective is supported by [28], who found that capital structure positively influences firm value through profitability. Thus, profitability functions as a mediating variable in the relationship between capital structure and firm value. H8: Profitability mediates the relationship between capital structure and firm value.

## 2.10 Does Profitability Mediate the Relationship Between Sales Growth and Firm Value?

An increase in a company's sales can lead to higher profitability. Firms experiencing strong sales growth often report greater profits, which reflect solid operational performance. This, in turn, enhances investor confidence, potentially boosting the firm's stock price and, consequently, its overall firm value. This relationship is supported by [29], who

found that sales growth positively influences firm value through profitability. Furthermore, this mediating relationship is consistent with **Signaling Theory**, which suggests that increased profits signal favorable future prospects to investors, encouraging investment and driving up firm valuation.

H9: Profitability mediates the relationship between sales growth and firm value.

## 2.11 Does profitability mediate the relationship between firm size and firm value?

Large firms typically demonstrate strong business development, operational stability, and promising future prospects. These characteristics tend to attract investors, as such firms are perceived to be more capable of expanding market share, competing effectively, and meeting product demand—factors that contribute to higher profitability. As company profits increase, so does firm value, driven by a convincing business outlook and an upward trend in stock prices.

Investors often associate firm size with asset magnitude, which reinforces trust and facilitates access to external financing. According to [30], total assets are a reliable indicator of firm size. The trust garnered by large firms allows them to secure external funding for operational activities. When managed efficiently, this funding can enhance profitability. In turn, increased profitability tends to elevate firm value.

This indirect relationship, wherein profitability mediates the link between firm size and firm value, aligns with the principles of Signaling Theory, which holds that profitability in larger firms serves as a credible signal of financial soundness and future performance potential

H10: Profitability serves as an intermediary factor linking firm size to firm value

### 2.12 Theoretical Framework

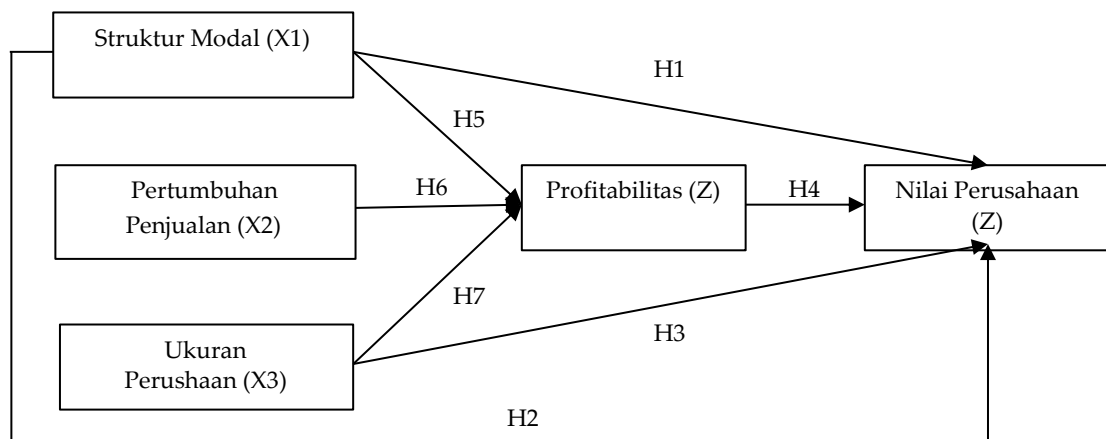


Figure 1. Theoretical Framework

## 3. METHODS

This study focuses on manufacturing firms listed on the Indonesia Stock Exchange (IDX), particularly those within the Basic Industry and Chemical sector, including the metals and related products sub-sector. The analysis utilizes secondary data derived from company financial statements covering the period from 2011 to 2021, obtained as of July 2022. The research adopts a causal-explanatory approach aimed at identifying and describing cause-and-effect relationships among variables, consistent with the framework proposed by [31]. Aligned with the underlying hypotheses, the study examines five key variables: capital structure, sales growth, firm size, firm value, and profitability.

This study utilizes a quota sampling technique, in which the sample size is determined by the researcher based on predefined criteria. One of the strengths of this approach is its practicality, as eligible samples are identified in advance. The sample includes firms from the Basic Industry and Chemical sector, specifically those within the Metals and Related Products sub-sector listed on the Indonesia Stock Exchange (IDX) during the 2011–2021 period. Only companies with complete financial data—covering the Debt-to-Equity Ratio (DER), Sales Growth, Firm Size (proxied by the natural logarithm of Total

Assets), Price-to-Book Value (PBV), and Return on Assets (ROA)—were selected. A total of 14 companies met the inclusion criteria.

The study employs three independent variables: Debt-to-Equity Ratio (DER), Sales Growth, and Firm Size. DER reflects the firm's capital structure by measuring the proportion of debt to equity. Sales Growth represents the firm's capacity to increase its revenue over time. Firm Size, a proxy for the scale of operations, is measured using the natural logarithm of total assets reported at the end of the fiscal year.

The dependent variable in this study is firm value, which reflects the outcome influenced by variations in the independent variables. It is operationalized using the Price-to-Book Value (PBV) ratio, a metric derived by comparing a firm's market price per share to its book value per share. PBV serves as an indicator of market perception regarding the firm's intrinsic value relative to its accounting value.

An intervening variable is a conceptual construct that explains the indirect relationship between independent and dependent variables, often capturing mechanisms that are not directly observable [32]. In this study, Return on Assets (ROA) is employed as the intervening variable. ROA, calculated as net income divided by total assets, is a fundamental measure of a firm's

efficiency in utilizing its assets to generate earnings.

The research relies on secondary data, obtained from financial reports of companies in the Basic Industry and Chemical sector, specifically the Metals and Related Products sub-sector, listed on the Indonesia Stock Exchange (IDX) over the period 2011 to 2021.

#### 4. RESULTS AND DISCUSSION

##### 4.1 *Evaluating the Link Between Capital Structure and the Market Value of Firms*

The regression analysis shows that the t-statistic (4.996) surpasses the critical value (1.65723) at a significance level of 0.000, indicating a robust relationship. This empirical evidence supports the Trade-Off Theory's premise that debt financing may lead to higher firm valuation when the tax shield on interest payments exceeds the potential downsides of financial instability and agency-related inefficiencies. The results suggest that increasing the proportion of debt in the capital structure can raise firm value, although this effect holds true only up to an optimal leverage level [16].

These results are consistent with prior empirical studies by [33] and [34], which confirmed that capital structure has a positive and significant association with firm value. Their findings underscore the strategic importance of leverage in increasing market-based performance measures, suggesting that higher reliance on debt financing is correlated with greater firm valuation.

##### 4.2 *Sales Growth as a Determinant of Corporate Value*

Contrary to the proposed hypothesis, the analysis reveals that sales growth does not significantly impact firm value and, in fact, displays a negative association, suggesting that revenue expansion alone may not directly translate into increased firm valuation. Although the t-statistic is positive ( $t = 3.909 > t\text{-critical} = 1.65723$ ), the associated p-value exceeds the 0.05 significance level, indicating that the effect is not

statistically meaningful. This outcome is inconsistent with **b** which asserts that strong sales performance should act as a positive indicator of a firm's future growth potential and thus attract investor interest.

In theory, as [17] suggests, firms demonstrating robust sales growth are typically perceived as competitive and capable of expanding market share—factors expected to contribute to increased firm value. However, the current findings do not support this theoretical expectation.

These results align with previous empirical research by [35]–[37], which also reported that sales growth has a negative and statistically insignificant relationship with firm value. This may be attributed to operational inefficiencies, such as poor cost control or limited capacity to convert sales into sustainable profitability, thereby diminishing the potential for value creation despite revenue increases.

##### 4.3 *Exploring the Link Between Firm Size and Corporate Valuation*

Contrary to the initial hypothesis, the empirical evidence demonstrates that larger firm size is significantly and negatively related to firm value, suggesting that expansion in scale does not necessarily enhance market perception. The regression output reveals a negative t-statistic ( $t = -2.005$ ), which is lower than the critical value (1.65723), with a p-value of 0.047, confirming statistical significance at the 5% level. These results suggest that increases in firm size may not contribute positively to firm value and could, in fact, be detrimental under certain conditions.

This finding contradicts the expectations of Signaling Theory, which asserts that firm size conveys a favorable signal to investors and creditors, implying greater financial stability and reduced risk exposure. In theory, larger firms are typically seen as having better access to capital markets, enhanced



financing flexibility, and stronger growth potential [38]. However, the present results imply that the advantages of size may be offset by inefficiencies, diseconomies of scale, or managerial complexity, leading to adverse valuation effects.

These results are in line with prior empirical studies conducted by [36], [39], all of which report that firm size has either a negative or statistically insignificant effect on firm value. The evidence collectively points to the possibility that beyond a certain threshold, increases in firm size may not necessarily lead to improved market performance, potentially due to diminishing marginal returns and operational inefficiencies in larger-scale firms.

#### 4.4 *Evaluating the Role of Profitability in Enhancing Firm Value*

The results provide robust empirical support for the hypothesis that higher levels of profitability are positively associated with firm value, indicating that profitability is a key driver of firm valuation. The regression analysis produces a t-statistic of 5.906, which surpasses the critical value (1.65723) and is associated with a significance level of 0.000, affirming the strength and reliability of this relationship.

The results align with the core tenets of Signaling Theory, wherein high levels of profitability are interpreted by investors as credible indicators of the firm's sound financial standing and promising future outlook. As firms report stronger profits, investor confidence typically increases, leading to greater demand for their equity. This heightened demand tends to elevate share prices, ultimately enhancing firm value [21].

Furthermore, the findings are corroborated by prior research, including studies by [40]–[42], all of which documented a positive and significant **relationship** between profitability and firm value. These studies collectively

emphasize that firms demonstrating strong profitability are generally perceived as more attractive investment opportunities, thereby contributing to improved market valuation.

#### 4.5 *The Influence of Financing Decisions on Profitability Performance*

Empirical evidence reveals a non-significant negative relationship between capital structure and profitability, undermining the theoretical expectation that higher leverage contributes to improved financial performance. The regression output shows a negative t-statistic ( $t = -1.711$ ) that falls below the critical value (1.65723), accompanied by a p-value of 0.090, which exceeds the 5% significance level. These findings suggest that greater reliance on debt financing does not contribute meaningfully to profitability in the firms analyzed.

The result deviates from the predictions of the Trade-Off Theory, which suggests that an optimal capital structure is achieved by weighing the tax shields from debt against the potential costs arising from agency problems and financial distress. Ideally, optimal leverage should yield returns greater than the associated interest burden. However, the present evidence fails to confirm this theoretical proposition, implying that in practice, excessive debt usage may reduce profitability due to inefficiencies, interest burdens, or operational constraints.

The findings are partially aligned with prior research by [28], [35], which reported a significant relationship between capital structure and profitability. However, this study's results are more consistent with [43], who found a significant negative effect of capital structure on profitability. These contrasting outcomes indicate that the impact of leverage on firm performance may be contingent upon firm-specific dynamics, industry context, and the scale of debt utilization.

#### 4.6 *The Influence of Revenue Expansion on Firm Profitability*

The analysis reveals a statistically significant and positive relationship between sales growth and profitability, lending support to the proposition that improved sales performance enhances the firm's earning capacity. The regression analysis reveals a t-statistic of 3.909, which exceeds the critical value of 1.65723, accompanied by a p-value of 0.000, confirming the robustness and statistical significance of the relationship.

These findings align with the core assumptions of Signaling Theory, which posits that rising sales figures serve as a positive indicator of operational strength and future growth potential, thus reinforcing investor confidence. Higher sales volumes are generally associated with economies of scale, allowing firms to better absorb fixed costs and enhance operating margins, ultimately leading to higher levels of profitability. In contrast, limited or negative sales growth may constrain a firm's ability to generate earnings and impair financial sustainability.

This empirical evidence is consistent with the work of [44], [45], whose studies also identified a positive and statistically significant correlation between sales growth and profitability. These empirical results reinforce the notion that revenue expansion is a fundamental contributor to financial stability and operational excellence.

#### 4.7 *Exploring the Effect of Organizational Scale on Profit Performance*

The empirical findings reveal that firm size exerts a positive yet statistically insignificant influence on profitability. While the regression analysis produces a positive t-statistic ( $t = 1.922 > t\text{-table} = 1.65723$ ), the associated p-value of 0.057 exceeds the conventional 5% significance level, indicating that the effect, although directionally aligned with the hypothesis, lacks sufficient statistical support.

Despite the absence of statistical significance, the findings are theoretically consistent with Signaling Theory, which posits that larger firms tend to possess greater resources, economies of scale, and operational advantages, all of which enhance their capacity to generate profits. As noted by [26], firm assets play a pivotal role in supporting core operational activities, and firms that can optimize asset utilization are more likely to realize improved financial outcomes.

These results are broadly in line with earlier studies, such as [46], which identified a positive and significant relationship between firm size and profitability. Their findings underscore the view that larger firms are better equipped to leverage fixed costs and operational efficiencies, thereby improving profitability performance over time.

#### 4.8 *Exploring the Mediating Effect of Profitability on the Nexus Between Capital Structure and Firm Value*

The path analysis results suggest that profitability does not function as a statistically significant mediating variable in the relationship between capital structure and firm value. Moreover, the inclusion of profitability in the model as an intervening variable further weakens the direct influence of capital structure on firm value. Additionally, the Sobel test confirms the insignificance of the indirect effect, thereby reinforcing the conclusion that the mediating role is not supported empirically.

This finding aligns with the notion that excessive leverage may undermine profitability, primarily due to the increased financial burden and decreased efficiency in managing returns. As a result, higher debt levels fail to translate into enhanced firm value through the profitability channel.

These results are consistent with the empirical evidence presented by [33], [35], [47], all of whom report similar conclusions regarding the non-significant

mediating role of profitability in the capital structure–firm value nexus. This suggests that while capital structure may influence firm value, its indirect effect through profitability remains negligible within the observed context.

#### **4.9 Assessing Profitability's Mediating Effect in the Nexus Between Revenue Growth and Firm Value**

The path analysis results demonstrate that profitability exerts a meaningful mediating effect in the linkage between sales growth and firm value. The inclusion of profitability as an intermediary enhances the indirect pathway from sales growth to firm value, although the direct relationship between the two remains statistically non-significant. The Sobel test confirms the significance of this indirect path, indicating that sales growth contributes to higher firm value primarily through its positive impact on profitability.

This finding suggests that sales growth alone does not directly elevate firm value, but it facilitates profit generation, which subsequently enhances the firm's market valuation. Increased sales growth translates into improved profitability, thereby strengthening firm value.

Moreover, these results align with prior empirical evidence provided by [34], [48], both of which support the mediating effect of profitability in the causal relationship between sales growth and firm value. Thus, the study confirms that profitability serves as a key transmission mechanism through which revenue expansion contributes to firm valuation.

#### **4.10 Assessing the Mediating Impact of Profitability on the Relationship Between Organizational Size and Firm Value**

The path analysis results demonstrate that profitability acts as a significant mediator in the relationship between firm size and firm value. The inclusion of profitability in the model

amplifies the influence of firm size on firm value, as reflected by the strengthened regression coefficient. The Sobel test validates the statistical significance of this mediating effect, indicating that firm size contributes indirectly to firm value through its impact on profitability.

While the direct relationship between firm size and firm value is found to be statistically insignificant, the indirect pathway via profitability reveals a more substantial effect. These findings suggest that firm size alone does not inherently enhance firm valuation, but rather facilitates greater access to financial resources and operational efficiency, both of which improve the firm's ability to generate profit [30]. Enhanced profitability, in turn, positively influences firm value.

This outcome supports earlier empirical investigations, including those conducted by [49], which also confirmed that profitability mediates the relationship between firm size and firm value. Therefore, the study provides robust support for the notion that firm size contributes to firm value indirectly through profitability.

## **5. CONCLUSION**

This study, conducted on companies in the metals and related products sub-sector listed on the Indonesia Stock Exchange (IDX) during the 2011–2021 period, provides empirical insights into the effects of capital structure, sales growth, and firm size on firm value, with profitability serving as an intervening variable. The findings reveal that capital structure, proxied by the Debt-to-Equity Ratio (DER), has a positive and statistically significant influence on firm value (measured by Price-to-Book Value/PBV), indicating that greater financial leverage can enhance firm valuation. Conversely, sales growth (SG) exhibits a negative and statistically insignificant direct effect, suggesting that variations in revenue

performance alone may not meaningfully impact investor assessments of firm value.

Furthermore, the analysis shows that **firm size**, measured by the natural logarithm of total assets (LnTA), has a negative and significant direct effect on firm value, implying that larger firm scale does not necessarily correlate with higher market valuation. In contrast, profitability, represented by Return on Assets (ROA), demonstrates a positive and significant effect on firm value, reinforcing its critical role in value creation and investor confidence.

In the assessment of indirect effects, capital structure exerts a negative and insignificant impact on profitability, indicating that increasing leverage does not directly contribute to earnings generation. Meanwhile, sales growth positively and significantly influences profitability, suggesting that increased revenue is effectively translated into higher profits. **Firm size**, while positively associated with profitability, shows an insignificant statistical relationship.

Mediation analysis confirms that profitability does not mediate the relationship between capital structure and firm value, likely due to the absence of a significant link between DER and ROA. However, profitability does function as a significant mediator in the relationship between both sales growth and firm size on firm value. This is evidenced by the insignificant direct effects of SG and LnTA on firm value, and the significant indirect effects transmitted through profitability.

Taken together, these results underscore the importance of profitability as a central mechanism through which operational and structural variables influence firm valuation. The findings contribute to the broader literature by highlighting the

complex pathways through which internal financial decisions and performance indicators shape market-based outcomes.

## ACKNOWLEDGEMENTS

In light of the study's findings, the following recommendations are put forward:

1. For Investors and Prospective Investors are advised to conduct a comprehensive evaluation of financial statements before making investment decisions. Relying solely on indicators such as sales volume or firm size has the potential to distort a comprehensive analysis of the company's performance trajectory. Therefore, it is essential to analyze various financial dimensions to ensure a more accurate evaluation of both the firm's present efficiency and its future trajectory, which can serve as a more reliable basis for investment decision-making.
2. For Future Researchers Future research is encouraged to expand beyond the commonly studied variables of capital structure, sales growth, firm size, profitability, and firm value. Exploring alternative and less conventional variables may yield more innovative insights and contribute to the enrichment of the financial literature. Moreover, researchers are encouraged to employ alternative mediating variables that may better explain the connection between sales growth dynamics and the firm's market value.

What is more, increasing the sample size and data coverage in future studies is recommended to enhance the robustness and generalizability of the research findings.

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