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Factors Affecting Firm Value Through Profitability As A Mediation Variable

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ABSTRACT
This study examines the impact of Capital Structure, Firm Size, and Increase in sales on Firm wealth in manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2020, with Ability to generate income as an intervening variable. A total of 72 companies were included as a sample in this investigation. The result of this research are capital structure affect firm wealth positively significant, firm size affect firm wealth negatively insignificant, increase in sales affect firm wealth negatively significant, capital structure affect ability to generate effect on ability to generate income, increase in sales affect ability to generate income positively significant, ability to generate income affect firm wealth positively significant, ability to generate income is unable to mediate effect of capital structure and increase in sales on firm wealth, and ability to generate income is able to mediate effect of firm size on firm wealth.

Keywords: *Capital structure, firm size, increase in sales, firm wealth, ability to generate income*

1. INTRODUCTION

As we all know, the economic climate has evolved rapidly in recent years, especially in terms of the pandemic of Coronavirus Disease 2019 (COVID-19). Changes in Indonesia's economic climate might result in an increase or decrease in people's well-being. Furthermore, economic changes force companies to adapt when confronted with major issues in order to meet their targets. One technique for achieving the company's goals is to maximize the firm wealth [1]. An investor's assessment of a company's management's ability to handle the company's resources, which is commonly tied to stock prices [2], determines its worth. Maximizing a company's worth is critical, and it is every business's management goal [3]. This is because raising a firm wealth also increases its shareholders' wealth. Investing in companies with a high company value will pique investors' interest.

Several factors determine the company value, the first is the capital structure. Capital structure describes as a huge sum of money that is tied in the long term [4]. These funds will be used as a source of finance in the future to meet the company's operational requirements [5]. Firm size, which is a representation of a company's size as measured by total sales, average sales, and total assets, influences its value. Because large firms often require substantially extra finances to support their operational activities, one possibility is to employ foreign capital, the larger the company, the more likely it is to use foreign capital [6]. Another aspect that influences the firm wealth is the increase in sales. Increase in sales is linked to the company's earnings [7], with higher increase in sales implying larger profits distributed to shareholders. Ability to generate income is the final aspect that influences the company value. High ability to generate income indicates that the firm has a good prospect, and investors are likely to respond favorably to the signal, boosting the firm wealth. Low ability to generate income, on the other hand, implies that the company is in difficulty [8].

Based on the explanation above, this research aims to answer the questions (1) Does capital structure affect firm wealth?; (2) Does firm size affect firm wealth?; (3) Does increase in sales affect firm wealth?; (4) Does capital structure affect ability to generate income?; (5) Does firm size affect

ability to generate income?; (6) Does increase in sales affect ability to generate income?; (7) Does ability to generate income affect firm wealth?; (8) Does capital structure affect firm wealth through ability to generate income?; (9) Does firm size affect firm wealth through ability to generate income?; and (10) Does increase in sales affect firm wealth through ability to generate income?

1.1. Theories

1.1.1. Agency Theory

This theory describes link between the capital owner (principal) and the management (agent) [9]. The agency theory explains the distribution between the management function performed by managers and the ownership function performed by shareholders, which leads to knowledge asymmetry and, in turn, agency challenges [10]. According to agency theory, shareholders assign authority to management, and management is responsible for the authority given by maximizing shareholder welfare [11].

1.1.2. Trade-Off Theory

Is a theory that has relation with capital structure in which organizations are believed to trade earnings and losses from debt usage [12]. The usage of debt may be increased if the benefits achieved are greater, as effective debt can raise the company's worth.

1.1.3. Signalling Theory

Signal theory, is a theory that explains why individuals and entities have differential access to information [13]. This theory also explains how the company's management tries to minimize information asymmetry by sending a signal to investors [14].

1.1.4. Firm Wealth

Firm wealth is a situation that a company has reached and displays an image of public trust that began when the company was established and continues to this day [15].

1.1.5. Capital Structure

Capital structure, a company’s financial proportion of its capital is described [5].

1.1.6. Firm Size

Firm size is a metric that may be used to categorize a company's size based on total assets, log size, stock market value, and other factors [16].

1.1.7. Increase in Sales

Increase in sales may be used to analyze a company's capacity to sustain its market position as well as overall economic development [17].

1.1.8. Ability to Generate Income

Ability to generate income refers to a company's ability to make money and can be used to evaluate management effectiveness [18].

1.2. Our Contribution

The author hopes that this study will be valuable to others in the future. For first off, the findings of this study should support businesses in reviewing, enhancing, and maximizing their management system. As an outcome, the organization fulfils its goal of maximizing the firm wealth. Second, for investors, this study is anticipated to help them in studying and evaluating an organization, allowing them to make better better investment decisions. Finally, advanced researchers are likely to use the findings of this study as a reference material when doing future research. Furthermore, this study is intended to contribute to and increase knowledge, particularly in the discipline of accounting. The researchers are expected to benefit from this study. This research, on the other hand, is intended to give insight and information about the firm wealth, which is impacted by four variables: capital structure, firm size, and increase in sales, with ability to generate income acting as a mediating component.

1.3. Paper Structure

The remaining part of the paper is laid out in the following order. The descriptive statistics test, path analysis test, measurement model test, structural model test, path coefficient test, and mediation analysis test are all presented in the second section. The methodology used in this study is discussed in the third section. In Section 4, the outcome of the path coefficient test and mediation analysis test are presented. Section 5 brings the research to a conclusion and offers out a research plan for the future.

2. BACKGROUND

2.1. Descriptive Statistics Test

The descriptive statistics test involves numerical computations to analyze the characteristics of the general research outcomes summary of all the data used in this research. Descriptive statistics tests provide a summary or explanation of the variable data with the objective of presenting an overview of the distribution and behavior of the sample data [19]. It is to give an overview of the sample data's distribution and behavior.

2.2. Path-Analysis Test

When the independent variable influences the dependent variable, the path analysis test can be performed to identify the extent of the relationship [20].

2.3. Measurement Model Test (Outer Model)

2.3.1. Validity Test

As part of this test, the convergent and discriminant validity values are assessed. Convergent validity is measured using a loading factor, which can be used to show the link between indicators and latent variables. The requirement for the outside loading limit is more than 0.50 [21]. The convergent validity value can be strengthened by using the Average Variance Extracted (AVE) value [21]. To be declared as an appropriate indication and proven valid, the AVE value must be more than 0.50.

Based on empirical studies, discriminant validity indicates a level at which a construct separates itself from other constructs. Discriminant validity can be measured using the Heterotrait-Monotrait Ratio (HTMT), Fornell-Lacker, and cross loading [22]. Fornell-Lacker is calculated by comparing the square roots of AVE, with each construct's square root of AVE having to be bigger than the correlation with other constructs. Cross loading with related variables must be higher than cross loading with unrelated variables [22].

2.3.2. Reliability Test

The composite reliability and Cronbach's alpha values are evaluated as part of the reliability test. Composite reliability is a metric for assessing the consistency of several indicators in a single variable. The composite reliability value must be larger than 0.70 [21] to state that a variable has a suitable level of reliability for research to be conducted. Cronbach's alpha is a value that can be utilized to improve the reliability test. Cronbach's alpha must be larger than 0.70 to indicate a high level of reliability in a variable [22].

2.4. Structural Model Test (Inner Model)

2.4.1. Multicollinearity Test

The Variance Inflation Factor (VIF) value can be used to detect if a regression model is multicollinear. If the VIF number is less than 5, there is no concern about multicollinearity [22].

2.4.2. R-Square Test

To measure how well the independent variable can explain or describe the dependent variable, the R-square test is utilized. The optimal R-square value is in the middle of 0 and 1. The model is said to be good if it is close to 1 [21].

2.4.3. F-Square Test

The effect size test is designed to measure the independent variable's relative impact on the dependent variable. If the F-Square value is less than 0.02 [22], the independent variable has no relative impact on the dependent variable. A slight, moderate, or substantial effect is indicated by F-Square values of 0.02, 0.15, and 0.35, respectively.

2.5. Path-Coefficient Test

The path coefficient value may be used to do direct effect testing. The goal of this test is to see if the research's independent factors have a direct impact on the dependent variable. When the T statistic value more than 1.96, then independent variable have a significant influence on the dependent variable [22]. The effect is also considered significant if the P values are smaller than 0.05. The independent variable has the same effect on the dependent variable whether the original sample value is positive. Meanwhile, if the original sample value is negative, the independent variable's effect on the dependent variable is not the same.

2.6. Mediation Analysis Test

To check if the mediating variable can mediate the independent variable's impact on the dependent variable, T statistics and P values can be employed. If the T statistic value is larger than 1.96 and the P value is less than 0.05, the mediating variable is said to be able to mediate the influence of the independent variable on the dependent variable [22].

3. METHODS

The method used in this research is a quantitative descriptive research design. The research used non-probability sampling with a purposive sampling approach to choose samples. The population in this study are manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2018-2020. A total of 72 companies were chosen as samples in this study. Smart Partial Least Square (Smart PLS) 3.3.3 is used to process the data obtained.

4. FINDINGS AND DISCUSSIONS

Based on the Table 1, the t-statistics and p-values of the capital structure to firm wealth were 2.907 and 0.004, with the original sample value 0.245. As a result of the findings, the capital structure affect firm wealth positively significant. The key to increasing productivity and enhancing a company's performance is to improve its capital structure. The increase in total debt can occur because the company's management uses the debt to expand market share. With an increase in total debt which is still below the optimal point, it can cause an increase in company value.

The t-statistics and p-values of firm size to firm wealth are 1.146 and 0.252, with the original sample value -0.074. As a result, the test findings reveal that the firm size affect firm wealth negatively insignificant. Investors do not give the size of a company much consideration when making investment decisions. Investors prefer companies that make profits since their goal in investing is to make as much money as possible.

The t-statistics and p-values of increase in sales to firm wealth are 2.247 and 0.025, with the original sample value -0.114. So increase in sales affect firm wealth negatively significant. High sales do not always imply that a company is a wise investment. As a result, investors do not have trust in a company's management because an increase in sales does not always imply an increase in profit.

The t-statistics and p-values of the capital structure on ability to generate income are 0.876 and 0.381, with the original sample value -0.076. So the results is capital structure affect ability to generate income negatively insignificant. Debt will indeed reduce tax costs, but companies with high levels of debt usually have a high risk of bankruptcy as well. This is because with the addition of debt in capital structure, the increase in interest will be greater than the tax savings. The company will be encouraged to pay off its debts as a result of this predicament.

The t-statistics and p-values of firm size on ability to generate income are 4.384 and 0.000, with the original sample value -0.265. The results indicate that the size of a firm affect ability to generate income negatively significant. The scale of a large corporation is believed to be insufficient to ensure that the company's ability to generate income would be great. This is because usually large-scale companies are hesitant to make an additional investment in expansion-related activities. The company will prefer to pay off its debt obligations first before expanding that can bring profits in the future.

The t-statistics and p-values of increase in sales on ability to generate income are 2.393 and 0.017, with the original sample value 0.127. So, the increase in sales affect ability to generate income positively significant. Higher increase in sales can indicate that the performance of a company is good. Companies with good performance indirectly market their products well too. So that it certainly encourages an increase in profits earned by a company.

The t-statistics and p-values of ability to generate income to firm wealth are 3.958 and 0.000, with the original sample value 0.528 means that ability to generate income and firm wealth have a unidirectional relationship. So, the ability to generate income affect firm wealth positively significant. An increase in ability to generate income illustrates an increase in profits obtained by the company. This situation can indicate that the prospects of a company are good. This will attract the attention of investors to invest and there will rise in interest in company stock. As a result of the increased demand in company stock, the stock price rises and also increasing the company value.

Table 1 Result of Path Coefficent Test

	Original Sample	*Sample Mean*	*Standard Deviation*	*T Statistics*	*P Values*
CS -> FV	0.245	0.255	0.084	2.907	0.004
CS -> P	-0.076	-0.086	0.086	0.876	0.381
FS -> FV	-0.074	-0.059	0.064	1.146	0.252
FS -> P	-0.265	-0.277	0.060	4.384	0.000
P -> FV	0.528	0.559	0.133	3.958	0.000
SG -> FV	-0.114	-0.127	0.051	2.247	0.025
SG -> P	0.127	0.138	0.053	2.393	0.017

Table 2 Result of Mediation Analysis Test

	Original Sample	*Sample Mean*	*Standard Deviation*	*T Statistics*	*P Values*
FS -> P -> FV	-0.140	-0.160	0.065	2.167	0.031
CS -> P -> FV	-0.040	-0.052	0.055	0.729	0.466
SG -> P -> FV	0.067	0.080	0.041	1.622	0.105

Based on Table 2, the t-statistics and p-values of the capital structure to firm wealth through ability to generate income are 0.729 and 0.466, respectively. As a result of the analysis, ability to generate income is unable to mediate the impact of capital structure on firm wealth. Lower ability to generate income will arise from a company's capital structure containing a substantial quantity of debt. This will also have an effect on the company's bankruptcy. As profits fall and the risk of bankruptcy rises, investors will become less interested in investing. This condition will result in a drop in stock prices, which will be followed by a drop in the firm wealth.

The t-statistics and p-values of firm size to firm wealth through ability to generate income are 2.167 and 0.031. As a result of the findings, ability to generate income appears to be able to mediate the effect of firm size on firm wealth. A huge company's size can indicate a good company's future possibilities. Large organizations also have the advantage of being able to get additional cash to help increase their ability to generate income. A company with strong ability to generate income will result in an increase in earnings per share. As a result, it attracts investor’s attention, which might lead to a rise in the firm wealth.

The t-statistics and p-values from increase in sales to firm wealth through ability to generate income are 1.622 and 0.105. So the test results show ability to generate income is not able to mediate the effect of increase in sales on firm wealth. Increase in sales doesn’t always follow by increase in profit. This circumstance sends a negative message to investors. As a result, investors are less willing to buy the company's stock, and the stock price falls. As a result, the firm wealth plummets.

5. CONCLUSIONS

Capital structure affect firm wealth positively significant, firm size affect firm wealth negatively insignificant, increase in sales affect firm wealth negatively significant, capital structure affect ability to generate income negatively insignificant, firm size affect ability to generate income negatively significant, increase in sales affect ability to generate income positively significant, ability to generate income affect firm wealth positively significant, ability to generate income is unable to mediate the effect of capital structure and increase in sales on firm wealth, and ability to generate income is able to mediate the effect of firm size on firm wealth.

The first limitation is this research only uses 3 independent variables, which is capital structure, firm size, and increase in sales and 1 mediating variable, which is ability to generate income, so it does not explain other influence variables not tested in this study. Furthermore, the sample analyzed only includes manufacturing companies that are consistently listed on the Indonesia Stock Exchange (IDX), therefore it does not represent the firm wealth of other businesses. Finally, the research period employed was only 2018-2020, therefore it solely depicts the condition during that time frame.

According on the existing limitations, for future research are recommended to add independent variables or other mediating variables, expand the sector of the company that is the research sample, and increase the research period.

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