ATESTASI: JURNAL ILMIAH AKUNTANSI
Vol 7, Issue 1, (2024), 763 - 776

The Effect of Profitability and Liquidity on Firm Value with Capital Structure as a Moderating Variable

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Received: January, 07, 2024 **Revised:** March, 28, 2024 **Accepted:** March, 31, 2024

Abstract

This study aims to analyze the effect of profitability and liquidity on firm value with capital structure as a moderating variable in companies in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange during the 2018–2022 period. The research methods used are descriptive and verification quantitative methods. Descriptive methods are used to describe firm value, profitability, liquidity, and capital structure. In contrast, verification methods are used to test the effect of independent variables on the dependent variable and the moderating role of capital structure. Data collection is done using secondary data from the company's published financial statements. The results showed that profitability and liquidity positively and significantly influence firm value. High profitability indicates good economic performance and provides a positive signal to investors. In contrast, high liquidity suggests the company's ability to meet short-term obligations and reduce the risk of bankruptcy. In addition, capital structure is found to function as a moderating variable that can strengthen or weaken the effect of profitability and liquidity on firm value. A balanced capital structure between debt and equity can maximize the benefits of profitability and liquidity, while an unbalanced capital structure can reduce these positive effects. This study implies that company management in the apparel and luxury goods subsector needs to optimize profitability and liquidity and manage the capital structure wisely to increase firm value. The findings also support signal, pecking order, and trade-off theories, which emphasize the importance of effective financial management and optimal capital structure. This study contributes to the financial management and corporate strategy literature and offers practical insights for corporate managers and investors in economic decision-making.

Keywords: Profitability, Liquidity, Firm Value, Capital Structure.

DOI : https://doi.org/10.57178/atestasi.v7i1.940
p-ISSN : 2621-1963
e-ISSN : 2621-1505

Introduction

In a competitive business environment, firm value is often used to indicate success, reflecting operational performance and investor perceptions of the firm's prospects (Brigham & Houston, 2022; Ross et al., 2020). Profitability and liquidity are two critical factors influencing firm value; profitability reflects a firm's ability to generate profits, while liquidity indicates the ability to meet short-term obligations (Fama & French, 2015; Damodaran, 2018).

However, the relationship between these two factors and firm value is only sometimes direct, as it can be moderated by capital, the combination of debt and equity used to fund the firm's operations (Modigliani & Miller, 1958; Jensen, 1986). In the apparel and luxury goods subsector on the Indonesia Stock Exchange, capital structure influences how profitability and liquidity affect firm value, especially in changing fashion trends and consumer expectations (Johnson et al., 2019; Kapferer, 2012).

In recent years, global economic uncertainty triggered by factors such as the COVID-19 pandemic, exchange rate fluctuations, and changes in international trade policies has increased the relevance of firm value studies, especially in the apparel and luxury goods subsectors. Companies with high profitability and good liquidity tend to be more stable and better able to weather the crisis, which can increase firm value (Baker et al., 2020; Alfaro et al., 2020). However, the apparel and luxury goods subsector face unique challenges, such as rapid changes in fashion trends and changes in consumer behavior, which make it essential to effectively manage capital structure to maintain stability and increase firm value in uncertain economic situations (Bhattacharya et al., 2021; McKinsey & Company, 2020).

Although there are many studies on the impact of profitability and liquidity on firm value, there is still a significant research gap in understanding the role of capital structure as a moderating variable, especially in the apparel and luxury goods subsector (Chowdhury & Chowdhury, 2010; Myers, 1984). Previous research tends to focus on the broader industry without specifically examining this subsector, which has unique characteristics and faces high market volatility (Ding et al., 2021). This suggests further research to explore the dynamic interactions between profitability, liquidity, and capital structure in a subsector-specific context and how these factors affect firm value together.

The novelty of this study lies in its specific focus on the apparel and luxury goods subsector, which has rarely been studied in the context of the influence of profitability, liquidity, and capital structure on firm value. By highlighting the important role of capital structure as a moderating variable, this study offers a new perspective that can help firms formulate more effective and adaptive financial strategies. The practical implications of our findings can equip practitioners and academics with actionable knowledge, contributing to the development of theories and practices that are more relevant to dynamic market conditions.

Literature Review

Firm value, profitability, liquidity, and capital structure are three main variables often used to analyze companies' financial health and performance. These three variables not only determine a company's internal financial strategy but also influence external perceptions, especially from investors. Understanding how these three variables interact with each other and affect firm value is essential in today's highly competitive and dynamic market context.

Profitability

Profitability is often defined as a company's ability to generate profits from its operational activities, and it is one of the leading indicators used to assess a company's financial performance (Brigham & Houston, 2022). This indicator illustrates the operational efficiency and effectiveness of management in managing assets and shows the company's long-term growth prospects, which are highly considered by investors (Ross et al., 2020).

According to Fama and French (2015), companies with high levels of profitability usually have higher company values because they are considered more stable and have strong growth potential. The study by Damodaran (2018) also emphasizes the importance of profitability as one of the main determinants of firm value, with significant effects in various industry sectors. Recent research emphasizes the relevance of profitability in the context of global economic uncertainty. For example, Zeng et al. (2021) found that firms with solid profitability can better survive during periods of economic crisis, as seen during the COVID-19 pandemic, as they have sufficient cash reserves and stable cash flows. Research by Li et al. (2022) also supports this finding by showing that high profitability improves firms' access to external capital, as financial institutions are more likely to provide credit to firms with good profit performance. In addition, a study by Johnson and Lee (2023) indicated that consistent and high profitability can reduce a firm's cost of capital due to lower default risk, thereby increasing overall firm value. Research by Chen et al. (2023) confirms that firms with high profitability tend to make more aggressive investments in innovation, which, in turn, increases the competitiveness and market value of the firm. This finding aligns with Jensen's (1986) view of agency cost theory, where more profitable firms can minimize conflicts of interest between management and shareholders through higher dividend payments. Furthermore, research by Garcia and Martinez (2020) shows that sustained profitability allows firms to invest in long-term growth strategies, such as product development and market expansion, which increase investors' perceptions of firm value. Thus, recent literature reaffirms the central role of profitability in determining firm value and optimal financial strategies across industries (Fama & French, 2015; Damodaran, 2018).

Liquidity

Liquidity measures a company's ability to meet its short-term obligations, and it has become one of the leading indicators in assessing a company's financial health, especially during periods of high economic uncertainty (Megginson et al., 2021). High liquidity indicates the company's ability to pay short-term debt and reflects financial flexibility that can help companies cope with economic uncertainty (Hovakimian et al., 2022). Recent research by Chen and Wang (2022) shows that firms with solid liquidity have better resilience during the economic crisis, as seen during the COVID-19 pandemic. They found that these firms can maintain operational stability by utilizing their liquid assets to cover temporary losses and maintain operations (Chen & Wang, 2022). This study supports previous findings by Harris and Raviv (1991), which suggest that liquidity plays a vital role in mitigating bankruptcy risk, especially in sectors that face high volatility. Research by Liu et al. (2023) found that adequate liquidity allows firms to make better strategic decisions during economic instability, such as expanding product lines or entering new markets. This is in line with the liquidity adjustment theory, which states that companies with adequate liquidity can be more flexible in their financial strategies, taking advantage of existing opportunities for growth (Opler et al., 2021). Furthermore, a study by Kim and Lee (2021) shows that high liquidity can reduce a firm's cost of capital, as investors and creditors see these firms as less risky investments. Research by Rajan and Zingales (2020) also emphasizes that high liquidity can be an essential buffer during financial crises, helping firms survive unexpected market shocks. Recent literature confirms that strong liquidity is essential for short-term survival and long-term growth

strategies (Fazzari et al., 2022; Myers & Majluf, 1984).

Capital structure

Capital structure, which includes the combination of debt and equity to fund a firm's operations, is essential in determining firm value. The capital structure theory proposed by Modigliani and Miller (1958) states that capital structure does not affect firm value under perfect market conditions. However, this theory was further criticized by considering fundamental factors such as taxes, bankruptcy costs, and agency issues, which influence how capital structure affects firm value (Jensen & Meckling, 1976). More recent research has deepened this understanding by showing that there is an optimal level of leverage that can maximize the positive influence of profitability and liquidity on firm value. The study by Margaritis and Psillaki (2010) supports this concept by finding that a capital structure that is too aggressive or too conservative can affect financial performance and, ultimately, firm value.

Research by Morellec et al. (2019) found that firms with a balanced capital structure tend to be better able to deal with market volatility, which positively impacts firm value during periods of economic uncertainty. This study is in line with the findings of DeAngelo and Roll (2020), which show that bankruptcy costs and other financial costs can affect capital structure decisions, thus affecting firm value. Kim et al. (2021) also found that firms with a more conservative capital structure have a greater capacity to withstand volatile market conditions, strengthening the argument that there is an optimal level of debt and equity usage. Research by Flannery and Rangan (2022) shows that industry dynamics and fiscal policy also play an essential role in determining the optimal capital structure for firms, suggesting that one size does not fit all. Meanwhile, a study by Lemmon and Zender (2020) identified that firms with a more flexible capital structure have a greater chance of adapting to market changes, ultimately increasing firm value. Another study by Bhamra et al. (2021) stated that an optimal capital structure strategy can help companies minimize the cost of capital while maximizing operational efficiency. In addition, a recent study by Korteweg and Strebulaev (2022) shows that a more dynamic approach to capital structure management can benefit the company in the long run, especially in the face of the global economic crisis. This supports the pecking order theory, which proposes that firms are more likely to choose internal financing before considering external debt and equity options (Myers & Majluf, 1984). Overall, recent literature suggests that a deeper understanding of capital structure and its influencing factors is crucial for firms to optimize their value in uncertain markets (DeAngelo & Roll, 2020; Flannery & Rangan, 2022; Korteweg & Strebulaev, 2022).

Hypothesis Development

Profitability, measured through metrics such as Return on Assets (ROA) and Return on Equity (ROE), has a positive influence on firm value as it reflects the efficiency of asset management and the ability to generate profits (Brigham & Houston, 2022). Studies by Fama and French (2015) show that companies with high profitability tend to have higher values, as investors see them as stable and potentially growing. High profitability also sends a positive signal to investors regarding future growth potential by signaling theory (Ross et al., 2020). In addition, Damodaran's (2018) research confirms that profitability is a crucial determinant of firm value across industries, while other studies show that consistent profitability reduces the

cost of capital due to lower perceived risk (Nissim & Penman, 2001). Recent research by Chen and Zhang (2020) and Al-Hadi et al. (2020) underscores the importance of profitability in enhancing firm value through adaptability to market changes and investment strategies. The resource and capability theory (Barney, 1991) is also relevant, as high profitability indicates effective resource management, increasing the attractiveness of the firm. However, the impact of profitability on firm value may be moderated by capital structure, as shown in Margaritis and Psillaki's (2010) study, which suggests that an optimal capital structure is required to maximize the effect of profitability on firm value.

H_1: *Profitability influences firm value*

The second hypothesis (H2) states that liquidity affects firm value, supported by liquidity adjustment theory, which emphasizes the importance of maintaining high liquidity for financial flexibility in the face of economic uncertainty and taking advantage of growth opportunities (Chen & Wang, 2022). Research by Hovakimian et al. (2022) shows that firms with good liquidity are better able to survive economic shocks and have a lower risk of bankruptcy, increasing firm value. Recent research reinforces this view by showing that high liquidity can serve as a buffer during periods of uncertainty, allowing firms to avoid bankruptcy and maintain operations (Liu et al., 2023; Fazzari et al., 2022). The pecking order theory by Myers and Majluf (1984) suggests that firms with high liquidity are more likely to use internal funds, reducing the cost of capital and increasing firm value. The study by Kim and Lee (2021) confirms that high liquidity reduces the firm's cost of capital, increasing the market's positive perception of firm value. Another study by Rajan and Zingales (2020) supports the view that high liquidity allows firms to optimize their capital structure, strengthening the positive relationship between liquidity and firm value. Therefore, recent literature and financial theory suggest that liquidity is essential to increasing firm value through financial risk management, operational efficiency, and greater financial flexibility.

H_2: *Liquidity influences firm value*

The third hypothesis (H3) examines the moderating role of capital structure in the relationship between profitability and firm value, which suggests that capital structure may influence the extent to which profitability contributes to firm value. Based on trade-off theory, there is an optimal level of debt that maximizes tax benefits while minimizing bankruptcy risk (Modigliani & Miller, 1958; Jensen & Meckling, 1976). Research by Margaritis and Psillaki (2010) found that firms with a balanced capital structure can better utilize high profitability to increase firm value, while an overly aggressive or conservative capital structure can reduce this positive effect. This is supported by DeAngelo and Roll's (2020) study, which shows that capital structure can moderate the relationship between profitability and firm value through its effect on investors' perception of financial stability. Agency theory is also relevant, stating that debt can serve as a control mechanism for management, but too much debt increases bankruptcy risk and reduces firm value (Myers, 2001). Research by Flannery and Rangan (2022) and Rajan and Zingales (2020) supports the view that an optimal capital structure allows firms to maximize profitability benefits to firm value. In contrast, a non-optimal capital

structure can reduce these benefits, emphasizing the importance of flexible and adaptive capital structure management to increase firm value.

H_3: *Capital structure can moderate the influence of profitability on firm value*

The fourth hypothesis (H4) states that capital structure moderates the effect of liquidity on firm value, based on the pecking order theory, which suggests that firms with high liquidity are more likely to use internal funds before turning to external financing (Myers & Majluf, 1984). Research by Rajan and Zingales (2020) shows that companies with high liquidity and a conservative capital structure have higher value because they can better manage market risk and uncertainty. A flexible capital structure allows firms to utilize their liquidity more effectively, strengthening the positive relationship between liquidity and firm value (Korteweg & Strebulaev, 2022). In addition, Chen and Mahajan's (2010) study demonstrated that a conservative capital structure can increase firm value by lowering bankruptcy risk and other financial costs. Another study by Kim et al. (2021) supports that a flexible capital structure allows optimal adjustment to market conditions, maximizing the benefits of liquidity to firm value. Signaling theory (Ross, 1977) also supports this hypothesis, where a balanced capital structure and high liquidity send positive signals about the firm's stability to the market. Overall, recent research suggests that capital structure plays a vital role in moderating the effect of liquidity on firm value, supporting the hypothesis that effective management of capital structure and liquidity can increase firm value.

H_4: *Capital structure can moderate the effect of liquidity on firm value*

Research Design and Method

Object of Study

In this study, the research object used is firm value as the dependent variable, measured using price to book value (PBV). Return on assets (ROA), a measure of profitability, and the current ratio (CR), a measure of liquidity, are the independent variables in this study. In addition, capital structure, measured by debt-to-equity ratio (DER), is used as a moderating variable. The subjects of this research are companies in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange in the 2018–2022 period.

Research Method and Design

The methods used in this research are descriptive and verification methods. The descriptive method describes the company value, profitability, liquidity, and capital structure of companies in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange during 2018–2022. Furthermore, the verification method is used to determine the effect of profitability and liquidity on firm value with capital structure as a moderating variable, which will be tested through hypotheses. This research is quantitative and causal to prove the effect of profitability and liquidity on firm value with capital structure as a moderating variable in companies in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange during 2018–2022.

Data Collection

The data used in this study comes from secondary data from the Indonesia Stock Exchange and each company's official website. The data collection technique aims to obtain information through reports and data that can support research. The data collection method used is the documentation method, where the data comes from the company's financial statements published on the official website of each company and the Indonesia Stock Exchange.

Population and Sample Drawing Technique

The population in this study consisted of 22 companies in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange during the 2018–2022 period. The sampling technique used is purposive sampling, namely with consideration based on research objectives so that several research criteria are used, as follows:

Table 1. Research Sample

No	Criteria	Total
1	Clothing and luxury goods subsector companies listed on the Indonesia Stock Exchange for the 2018-2022 period.	22
2	Clothing and luxury goods subsector companies listed on the Indonesia Stock Exchange for the 2018-2022 period.	(3)
3	Companies that experienced suspension during the 2018-2 022 period.	(3)
4	Companies that have outlier data.	(3)
Total Samples		13

Based on the purposive sampling technique results, the samples used in this study met the criteria, namely 13 companies in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange for the period 2018-2022.

Hypothesis Testing

Before testing the hypothesis, a classic assumption test will be carried out to assess the feasibility of the research model. This classic assumption test consists of linearity, multicollinearity, autocorrelation, and heteroscedasticity tests. After the model meets the criteria of the classical assumption test, proceed with the model selection test to determine the best model to be used in this study. This test includes the Chow test to determine the best model between the expected effect (CEM) and fixed effect (FEM) models, the Hausman test to determine the best model between fixed effect (FEM) and random effect (REM), and the Lagrange Multiplier test to determine the best model between the random effect (REM) and common effect (CEM) models. After the best regression model is selected, hypothesis testing is carried out with the F test to determine whether the independent variables in the model can explain the dependent variable and the t-test to determine the effect of the independent variable on the dependent variable based on the regression coefficient.

Research Conceptual Framework

The signal theory put forth by Brigham and Houston (2011) defines a signal as a

company's action to inform investors of management's expectations for the company's future performance. This signal contains information investors need, namely complete, precise, and accurate information, which will be considered when making investment decisions. One of the pieces of information investors need is about the company's value. A high company value will be captured as a positive signal that shows the company's good condition and prospects in the future. Therefore, a high company value reflects investor confidence in the company because it can manage its resources for shareholders' (investors') welfare. There are three ratios used to measure firm value, namely Price to Book Value (PBV), Price to Earnings Ratio (PER), and Tobin's Q. The ratio used in this study is Price to Book Value (PBV) because PBV is often used as an indicator to measure firm value in previous studies by comparing stock prices and book value.

Fahmi (2018) emphasizes that a company's financial performance reflects its financial stability, business health, and growth potential. Financial ratios indicate that this performance significantly impacts the company's value (Ardimas & Wadoyo, 2014). These financial ratios serve as a tool for management to demonstrate their success in effectively managing assets and capital to maximize firm value. The study focuses on profitability and liquidity ratios as critical indicators influencing firm value. The current ratio (CR), which also varies and rises, serves as a proxy for liquidity, and the author finds issues with profitability and liquidity. This is in line with research by Zulfa & Azhar (2022), which claims that profitability and liquidity impact firm value. Profitability describes how efficient a manager is in making decisions to profit from sales and investment activities (Kasmir, 2019). In this study, the profitability ratio is the return on assets (ROA) because it can be used to measure the company's ability to generate net income based on its assets (Saputra, 2022). This means that the higher the ROA value, the higher the profit generated from the assets owned, which will impact investor confidence. High profits will reflect a high rate of return, so investors will be interested in investing in the company. Based on signal theory, high profitability will give a positive signal to investors so that the company value increases. Conversely, low profitability will give a negative signal, causing the company's value to decrease.

As Irham Fahmi (2017) points out, liquidity is the company's ability to meet its short-term debt obligations within a specified time. The current ratio (CR) is used in this study as a measure of liquidity. This ratio is chosen because it effectively describes the company's ability to meet short-term debt with assets expected to become cash in the same period (Mamduh, 2016: 75). High liquidity, according to signal theory, sends a positive signal to investors, thereby increasing the company's value. However, excessive liquidity can also send a negative signal, indicating that the company is not using its assets efficiently to generate profits. Therefore, maintaining a balance between sufficient liquidity and efficient asset use is crucial for maximizing firm value.

There are differences in research results from previous researchers regarding the effect of profitability and liquidity on firm value, which encourages researchers to include situational factors, namely moderating variables. The debt-to-equity ratio (DER), a proxy for capital structure, is the moderating variable in this study used to strengthen or weaken the impact of profitability and liquidity on firm value. According to Komarudin and Tabroni (2019), capital structure refers to the total debt or capital used by the company to fulfill its operational activities and assets. Capital structure is used as a moderating variable because

many previous studies that examine the effect of profitability and liquidity on firm value use capital structure as a moderating variable, and there are empirical gaps in the results of their research.

Results and Discussion

Result

The F-test is used to determine the significance of regression with a significance value of 0.05 or 5%. That is, if the prob (F-statistic) value is <0.05, then profitability and liquidity have a significance level to the regression on firm value. Table 2 shows that the prob (F-statistic) value is 0.000000 <0.05, which means H0 is rejected, and Ha is accepted. This shows that profitability and liquidity are significant to the company's value. As a result, the research can continue by using the t-test to assess the significance of the regression coefficient.

Table 2 Regression Significance Test Results (F Test)

R-squared	0.650969	Mean dependent var	0.482413
Adjusted R-squared	0.621390	SD dependent var	1.824351
SE of regression	1.122547	Sum squared resident	74.34661
F-statistic	22.00784	Durbin-Watson stat	1.900376
Prob(F-statistic)	0.000000		

A t-test is used to determine how meaningful the relationship between profitability and liquidity is to the value of a business using the regression coefficient and a significance level of 0.05 (five percent). Table 3 shows that the probability value of profitability is 0.0014 ≤ 0.05, and the probability value of liquidity is 0.0013 ≤ 0.05, which means H0 is rejected, and Ha is accepted. Thus, it can be concluded that profitability and liquidity significantly positively affect firm value.

Table 3. Regression Coefficient Significance Test Results (t Test)

Variables	Coefficient	Std. Error	t-Statistics	Prob.
C	-0.039795	0.391252	-0.101712	0.9193
X1	0.050569	0.015029	3.364708	0.0014
X2	0.453707	0.133837	3.390008	0.0013
Z	1.165992	0.141395	8.246318	0.0000
X1Z	-0.033963	0.008965	-3.788353	0.0004
X2Z	-0.510719	0.113350	-4.505693	0.0000

From the table 4, the regression model formed is as follows:

$$Y = -0.039795 + 0.050569X1 + 0.453707X2 + 1.165992Z - 0.033963X1Z - 0.510719X2Z + e$$

The coefficient of -0.039795 indicates that when all independent variables (X1, X2, Z, X1Z, X2Z) are zero, the firm value is estimated at -0.039795. However, this value is not statistically significant because its probability value (0.9193) is far above 0.05. This means

that the constant has no significant effect on firm value. The coefficient for profitability (X1) is 0.050569 with a t-statistic value of 3.364708 and a probability of 0.0014. Since this probability value is smaller than 0.05, profitability positively and significantly affects firm value. This means that an increase in company profitability tends to increase firm value. The coefficient of liquidity (X2) is 0.453707, with a t-statistic value of 3.390008 and a probability of 0.0013. The probability value smaller than 0.05 indicates that liquidity also has a positive and significant effect on firm value. This means that companies with higher liquidity tend to have higher firm value. The coefficient for capital structure (Z) is 1.165992 with a t-statistic value of 8.246318 and a probability of 0.0000. This value is highly significant (probability <0.05), indicating that capital structure has a highly significant favorable influence on firm value. A more robust capital structure tends to increase firm value significantly.

Interaction of Profitability and Capital Structure (X1Z): The interaction coefficient between profitability and capital structure (X1Z) is -0.033963 with a t-statistic value of -3.788353 and a probability of 0.0004. The probability smaller than 0.05 indicates that this interaction significantly negatively affects firm value. This means that although profitability and capital structure each positively influence firm value, their combination reduces firm value. The interaction coefficient between liquidity and capital structure (X2Z) is -0.510719 with a t-statistic of -4.505693 and a probability of 0.0000. Since the probability is minimal (less than 0.05), this interaction significantly negatively affects firm value. This indicates that when liquidity and capital structure are considered together, their combined effect decreases firm value.

The regression results show that profitability, liquidity, and capital structure each have a positive and significant influence on firm value. However, the interaction between profitability and capital structure, as well as the interaction between liquidity and capital structure, show a significant negative effect. This highlights the responsibility of managing these interactions, as they can have detrimental effects if not handled properly.

Discussion

This study found that profitability, as measured by Return on Assets (ROA), has a positive and significant effect on firm value. This is to signal theory, which states that high profitability positively signals investors about the company's financial performance and growth prospects (Ross, 1977). When companies show high profitability, investors tend to believe more that the company can generate sustainable profits, which ultimately increases the value of the company (Brigham & Houston, 2019). This research is consistent with previous research by Dewi (2024), Zulfa & Azhar (2022), and Wijaya & Pancawati (2019), who also found that profitability has a positive influence on firm value. Liquidity, as measured by the Current Ratio (CR), is also found to positively and significantly influence firm value. This finding underscores the stability and confidence that high liquidity brings, as companies with ample liquidity are considered more financially stable and better equipped to meet their short-term obligations. This reduces the risk of bankruptcy and instills confidence in investors (Chen & Mahajan, 2010). The study aligns with the findings of Rizkika et al. (2022) and Mahanani & Kartika (2022), who also found that high liquidity increases firm value.

The Debt-to-Equity Ratio (DER), which measures capital structure, is a moderating variable in this study. The results showed that capital structure can strengthen or weaken the

effect of profitability and liquidity on firm value. A balanced capital structure between debt and equity allows the firm to utilize liquidity and profitability to increase firm value optimally. According to research findings (Myers & Majluf, 1984; Jensen, 1986), a capital structure that is too aggressive or conservative can reduce the positive effect.

The location of this research in the apparel and luxury goods subsector on the Indonesia Stock Exchange has some unique characteristics that affect the research results. This sector is susceptible to economic and market changes because fashion trends, consumer preferences, and global economic conditions significantly impact it (Smith & Chen, 2020). High profitability provides a tremendous competitive advantage for companies in this sector, allowing them to invest in product innovation, marketing, and market expansion. High liquidity is also essential, as it helps firms deal with economic uncertainty and stabilize their operations during market downturns (Almeida et al., 2004).

In this context, capital structure plays a pivotal role in determining how firms utilize their liquidity and profitability. A balanced capital structure allows firms to take the necessary risks for growth without compromising their financial stability. Conversely, a capital structure that is overly dependent on debt can increase interest costs and bankruptcy risk, potentially reducing the value of the firm even with high profitability (Modigliani & Miller, 1958). This underscores the importance of strategic financial decisions in maximizing firm value.

The findings of this study are consistent with several relevant financial theories. According to Ross's (1977) signaling theory, businesses with strong financial performance—such as high profitability and liquidity—will communicate favorably with the market. Investors who receive this signal tend to value the company higher, increasing the market value of the company. Additionally, this finding is consistent with Myers and Majluf's (1984) pecking order theory, which contends that firms are more likely to use internal financing than external financing, particularly in high liquidity conditions. An optimal capital structure will facilitate greater use of internal funds and minimize the cost of capital, contributing to increased firm value.

The trade-off theory is also relevant in this context, as it states that there is an optimal level of debt usage that maximizes the tax benefits of debt while minimizing the risk of bankruptcy (Modigliani & Miller, 1958). The results show that capital structure can moderate the effect of profitability and liquidity on firm value, supporting the idea that firms should seek an optimal balance in their capital structure to maximize firm value.

Several earlier studies demonstrating a favorable relationship between profitability, liquidity, and firm value support this study. For example, research by Cahyono et al. (2019) shows that high profitability increases firm value by increasing investor confidence in the company's prospects. Similarly, research by Indira and Wany (2021) found that high liquidity is associated with higher firm value, indicating that firms can meet their short-term obligations. However, some studies still need to support these findings fully. For example, Rizkika and Seputra (2022) found that profitability negatively influences firm value, which may be due to differences in measurement methods or different market conditions. Similar to this, some studies—such as the one by Sagita et al. (2023)—showed that liquidity has no appreciable impact on firm value, which might be due to variations in the context of the industry or the location of the research. This study also finds that capital structure can moderate the effect of profitability and liquidity on firm value. This is consistent with research

by Korteweg and Strebulaev (2022), which shows that a flexible capital structure allows firms to better utilize their liquidity and profitability advantages. This study is also supported by research by Jensen (1986), which states that capital structure can be used as a control mechanism to reduce agency problems and increase firm value.

Conclusions

This study highlights the importance of profitability, liquidity, and capital structure in determining firm value in the apparel and luxury goods subsector listed on the Indonesia Stock Exchange from 2018-2022. The main findings show that profitability and liquidity positively and significantly influence firm value. At the same time, capital structure acts as a moderating variable that can strengthen or weaken the effect. Higher profitability provides a positive signal to investors about the company's financial performance, while high liquidity signals the company's financial stability and ability to meet short-term obligations. However, an unbalanced capital structure can reduce the positive effect of profitability and liquidity on firm value.

The practical implication of this finding is that managers of companies in the apparel and luxury goods subsector should pay attention to the balance between profitability, liquidity, and capital structure to maximize firm value. Effective management of these three factors can increase investor confidence and reduce the risk of bankruptcy. From a theoretical perspective, this study strengthens signal theory, pecking order theory, and trade-off theory, all of which emphasize the importance of optimal capital structure and the use of internal resources in increasing firm value. The findings contribute to the literature on financial management and corporate strategy, particularly in emerging markets such as Indonesia.

However, this study has some limitations that should be considered. First, this study is limited to Indonesia's apparel and luxury goods subsector, so the results may only partially apply to other industries or locations. Secondly, this study only uses data for 2018–2022, which may not cover long-term market dynamics. For future research, it is recommended to expand the scope of the study by including more subsectors or different geographical locations, as well as considering a more extended period to get a more comprehensive picture of the factors that affect firm value. Future research can also consider additional variables such as product innovation or marketing strategy to see how these factors affect firm value in a broader context.

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