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# The Effect of Profitability, Firm Size and Capital Structure on Firm Value

**Irma Sukamdi**[1*]
[1]Univeristas Terbuka, Indonesia, email: irma.sukamdi@gmail.com

*Corresponding author: Irma Sukamdi

**Abstract**: Company value is an important thing that investors must know. Company value provides a separate view for investors on the ability of a company in an effort to provide maximum benefits to investors. Company values are subject to change at any time. The value of the company can be influenced by internal as well as external factors. This study aims to determine profitability, company size and capital structure to company value. For future research, this study will be useful to examine the influence between variables. The *research library* method, sourced from *Mendeley*, *Google Scholar*, and other academic *online* media is used to discuss how variables influence. The results of this literature review article are as follows: 1) profitability affects the value of the company; 2) the size of the company affects the value of the company; and 3) capital structure affects the value of the company.

**Keywords:** Company Value, Profitability, Company Size and Capital Structure

## INTRODUCTION

No investor wants to incur losses in investing. For investors, getting maximum profit from a company is a must. Because the investor's goal is to earn and increase his income. Investors will make investment decisions in companies that are considered capable of providing high investment returns. Company value is one of the considerations of investors in determining investment choices. Company value is seen as a picture of the overall condition of the company. Company value as a company's performance will be seen from the stock price as an impact on demand and supply in the capital market which reflects a good company assessment in the eyes of the public (Harmono, 2011).

Generating optimal profitability is the goal of all companies. The ability of a company to optimize its profits is a benchmark for the success of company performance. Investors assume companies with high profitability will provide high returns as well. Profitability is a company's effort to generate profits by using all existing capabilities and resources such as sales activities, cash, capital, number of employees, number of branches and so on (Harahap, 2015). In other words, the company will optimize what it has to generate maximum profits. All resources owned will be managed as well as possible to realize maximum profits. Doing efficiency and working effectively will be one of the company's strategies to increase its profits.

Another factor that can affect the value of a company is the size of the company. The size or size of the company can be assessed from various aspects such as total assets, total sales and market capitalization (Nurminda, 2017). The level of investor confidence will be higher in companies that have a large size. Larger companies are believed to be able to provide investors with higher returns. The size of the company will also determine the decision in obtaining the company's funding source. Funding can be obtained from internal or external sources. For large companies, it will certainly be easy to get external sources of financing. With this convenience, external financing will provide benefits in the form of interest expenses that can be used as a profit deduction so as to minimize income tax that must be paid by the company.

Another factor that affects the value of an enterprise is the capital structure. The company's capital structure is a comparison between long-term debt and the capital owned by the company. The capital structure will show the composition of the company's funding sources. Capital structure is very important for the company and affects the risks that the company will face and will also relate to the return on investment expected by shareholders or investors (Brigham and Houston, 2011).

Putri Zafirah Nabila Amro and Nur Fadjrih Asyik (2021) in their research stated the results that profitability and capital structure affect company value. While the size of the company has no effect on the company. In contrast to research conducted by Lasmanita Rajaguguk, Valencia Ariesta, Yunus Pakpahan (2019) which obtained profitability results, company size, and debt policies affect company value.

Supporting articles will be used by students and writers to assist them in conducting their research. Relevant articles will strengthen the theory under study, to see the relationship or influence between variables and build a research framework. This article discusses the effect of profitability, company size, and capital structure on company value which is a literature review study in the field of Financial Management.

## LITERATURE REVIEW

### Company Value

Company value is the price investors are willing to pay if the company is to be sold (Sartono, 2014). Investors will be willing to buy a company at a certain price level if the company has a high value and is believed to provide a high rate of return in the future. High company value will make the market trust the company's performance for now and in the future (Achmad and Amanah, 2014). Thus it is important for the company to create a good view of performance in the eyes of investors. If the value of a company increases, the welfare of shareholders will also increase (Pangestuti &; Tindangen, 2020).

For a company that issues its shares on the stock market, the value of the company can be reflected in the share price. The higher the value of the shares, it can be interpreted that the higher the value of the company. One measurement that can be used to measure stock price performance is to use *Price to Book Value* (PBV). PVB is a ratio used to measure the performance of a stock's market price compared to its book value. There is a relationship between market price and book value per share (Tandellin, 2001). The formation of stock market prices can come from the perception of the market itself. The better the market perception of the company, the more investors will be interested in investing. The amount of demand for company shares will automatically increase the stock price beyond its book value.

### Profitability

Obtaining prosperity from investments made is the main goal of investors. Investors will choose to invest in companies that have high returns. Profitability is the ability of a company to generate profits during a certain period (Munawir, 2004). Profit is one of the good signals for investors. Investors will have a good view of companies that have positive returns. Investors are of the view that companies with positive returns are able to provide a good return on investment. Profitability is a description and performance of management in managing the company (Petrolina and Mukhlasin, 2003) in Hermuningsih (2013). Thus it can be said that the company is managed well if it can generate profits and provide prosperity for investors. Profitability is the profit generated in a certain accounting period obtained from the company's effectiveness in managing assets and capital (Husnan, 2021) All resources owned in a given year will be managed and utilized effectively and efficiently. The company ensures that every step and effort made will bring it closer to the main goal, which is to make a profit. The company's ability to generate profits can be measured from profit *margins*, return on *assets and return on equity* (Amro and Asyik, 2021).

**Company Size**

Company size is a scale that measures the size of a company in various ways, including total assets, log size, stock market value, and others (Husnan &; Pudjiastuti, 2018). The company's total assets, sales, or capital can be used to calculate the size of the company (Husna and Satria 2019). Companies with large total assets are considered capable of providing better profits compared to companies with small total assets. With greater total assets, the company is more flexible in managing its assets. This is expected to be able to provide maximum returns for the company so that in the end it will increase the number of assets from year to year and further increase the size of the company. Meanwhile, companies with large total sales will increase the company's chances of getting large profits. Large sales will certainly require large resources as well. The amount of resources needed can provide opportunities for companies to obtain resources at a cheaper value. Thus the opportunity to get profits will be greater so that it will form a good perception in the eyes of investors which will then ultimately increase the value of the company. Similarly, the large capital owned by the company. The large capital owned by the company will make it easier for the company to carry out its operational activities such as obtaining raw materials in large quantities so as to reduce costs and maximize company profits.

**Capital Structure**

The capital structure will compare debt with the company's own capital. Corporate debt consists of short-term debt and long-term debt. While the company's capital comes from retained earnings and belongs to the company. Decision making regarding the company's capital structure is important because it will be one of the considerations for investors in investing. Companies that have a portion of debt use more than capital, are seen by investors as companies that have high risk. Capital structure describes the proportion of debt used to finance investments, so investors can determine the balance between risk and the rate of return on their investments (Putri, 2020). Theoptimal capital structure is a mixed percentage of preferred stock, debt and common equity that maximizes the intrinsic value of the stock (Brigham &; Houston, 2019). The measurement of the capital structure to be used is the debt *equity ratio* (DER). This ratio compares the amount of debt with the amount of equity so that it will be seen whether a company will approach bankruptcy or the company can develop well.

## RESEARCH METHOD

Descriptive Qualitative and library research review, sourced from *Google Scholar*, *Mendeley* and other online academic applications were used in this study. In qualitative research, literature review should be used consistently with methodological assumptions. This means that it should be used inductively so that it does not direct the questions asked by the researcher. One of the main reasons for conducting qualitative research is because the research is exploratory, (Ali &; Limakrisna, 2013).

## FINDINGS AND DISCUSSION

Based on relevant theoretical studies and previous research, the discussion of *this literature* review article is a review of relevant **articles**, followed by a study of the influence between variables and continued by making a conceptual thinking research plan:

### Review Relevant Articles

Review relevant articles as a basis for establishing research hypotheses by explaining the results of previous research, explaining similarities with research plans and differences in research plans with previous authors.

**Table 1: Review of relevant articles**

| Do not | Author (Year) | Previous Research Results | Similarities with this article | Differences with this article | Hipoteis |
|---|---|---|---|---|---|
| 1 | Putri Zafirah, Nabila Amro and Nur Fadjrih Asyik (2021) | Profitability and capital structure affect the value of the company. While the size of the company has no effect on the company | Profitability and capital structure affect the value of the company. | The size of the company affects the value of the company | H1 |
| 2 | Nanang, Ari Utomo and Nisa, Novia Avien Christy (2017) | Capital structure and company size have a negative and significant effect on company value, while profitability has a positive and significant effect on company value | Profitability affects the value of the enterprise | Capital structure and company size affect the value of the company | H1 |
| 3 | Lasmanita Rajaguguk, Valencia Ariesta, Yunus Pakpahan (2019) | Profitability, company size, and debt policy have a significant influence on a company's value. While investment decisions have no effect on company value | Profitability &; Company Size Affects Company Value | Not researching the effect of investment decisions on company value | H1 |
| 4 | Jove Vernando and Teguh Erawati (2020) | Company size and capital structure have a positive and significant effect on company value, company size has a positive and significant effect on capital structure and company size has a significant positive effect on company value with capital structure as an intervening variable | The size of the company affects the value of the company | The size of the company has a positive and significant influence on the capital structure | H2 |
| 5 | Dimas, Wahyu Prasetyo and Aditya Hermawan (2023) | The size of the company affects the value of the company, but profitability and capital structure have no effect on the value of the company | the size of the company affects the value of the enterprise, | Profitability and capital structure affect the value of the company | H2 |
| 6 | Dina Shafarina Dwiastuti | Taken together, company size, debt policy, and profitability have a significant | Profitability &; Company Size Affects Company | Debt policy affects the value of the company | H2 |

| | | | | | |
|---|---|---|---|---|---|
| | dan Vaya Juliana Dillak (2019) | influence on a company's value. While partially, the size of the company, and debt policy do not have a significant effect on the value of the company. However, profitability has a significant influence on the value of the company | Value | | |
| 7 | Afifa Lutfita and Nurjanti Takarini (2021) | Profitability and capital structure positively affect the value of the company. While the size of the company negatively affects the value of the company | Profitability and capital structure positively affect the value of the enterprise | The size of the company affects the value of the company | H3 |
| 8 | Clarissa Mercyana, hamidah and Destria Kurnianti (2022) | The capital structure and profitability of the company do not have a significant effect on the value of the company. | Equally test profitability and capital structure against company value | Capital structure affects the value of the company | H3 |
| 9 | Inngi Rovita Dewi, Siti Ragil handayani, Nila Firdausi Nuzula (2014) | Capital structure affects the value of the company | Capital structure affects the value of the company | In addition to capital structure, the study also examined the effect of profitability and company size | H3 |

**Analysis of the Influence between Variables**

**The effect of profitability on the value of the company.**

Profit is one of the main pieces of information investors look at. Investors assess companies with profits that always grow from year to year will provide a good future for their investment returns. Profitability will shape the perception of investors that the company has been successfully managed well and is expected to provide maximum returns for investors. This of course will make many investors interested in investing in a company. The high interest of investors due to a profitable company will increase the demand for company shares which results in high stock prices. Stock price is one of the indicators of a company's value. The higher the company's stock price, the higher the company's value.

Thus, profitability affects company value, this is in line with research conducted by: Putri Zafirah Nabila Amro and Nur Fadjrih Asyik (2021), Nanang Ari Utomo and Nisa Novia Avien Christy (2017), and Lasmanita Rajaguguk, Valencia Ariesta, Yunus Pakpahan (2019)

**The effect of company size on company value.**

The size of the company can be seen from the total assets owned. The larger the total assets of the company, the larger the size of the company. Large companies can easily meet their funding needs both internally and externally. In the eyes of investors, large companies are considered capable of growing and providing a good future for their investment results. They believe that large companies are better able to survive dynamic business situations and are better managed. With this valuation, the size of the company affects the value of the company. Large companies will have positive value for investors so that they can increase investor interest which leads to an increase in company value which is reflected in high stock prices. Company size affects company value, this is in line with research conducted by: Jove Vernando and Teguh Erawati (2020), Dimas Wahyu Prasetyo and Aditya Hermawan (2023) and Lasmanita Rajaguguk, Valencia Ariesta, Yunus Pakpahan (2019)

**The effect of capital structure on the value of the company.**

Capital structure is a decision in determining how much debt or capital is used in financing an enterprise. The capital structure must be able to provide more benefits than the risks that will be faced by the company. Companies with more external funding sources than internal funding sources will signal that the company is at high risk. Conversely, if internal funding is more dominant, then the company will lose the opportunity to take advantage of tax advantages. Thus, the company needs to manage an optimal capital structure so that it can provide optimal results for the company. An optimal capital structure will certainly provide profitable results for the company so that it will get a good assessment from investors which will result in high company value as seen in the high price of the company's shares. Capital structure affects company value according to research conducted by Dimas Wahyu Prasetyo and Aditya Hermawan (2023) and Clarissa M. ercyana, hamidah and Destria Kurnianti (2022)

**Conceptual framework of research**

Based on the problem formulation, theoretical studies, relevant previous research and discussion of the influence between variables, the framework of thinking in this article is as follows.

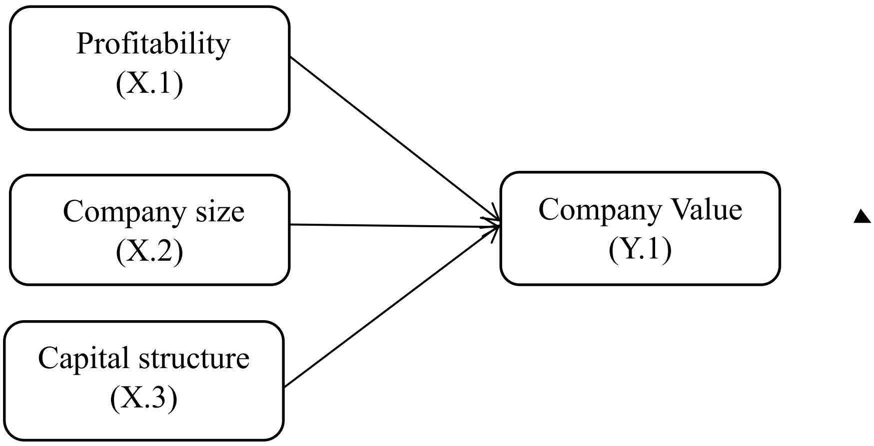


**Figure 1: Conceptual Framework**

Based on the description of the conceptual framework above, then: profitability, company size, and capital structure affect the value of the company. There are many other variables that can affect a company's value aside from profitability, company size and capital structure. Other variables that can affect a company include:

1) *Earnings per share* (Nur kholis, Eka Dewi, Hestin, 2018)
2) Dividend policy (Yulianti &; Widyasasi, 2020)
3) Asset structure (Meiriska Febrianti, 2012)

## CONCLUSION AND SUGGESTION

**Conclusion**

Based on the theory, relevant articles and discussion, the conclusions that can be drawn from this literature review article are as follows: Profitability affects the value of the enterprise. The size of the company affects the value of the company. Capital structure affects the value of the company.

**Suggestion**

Based on the conclusions above, the advice for the next author is that there are other factors that affect the value of the company, in addition to profitability, company size, and capital structure. More studies are needed to find these other factors. Other factors that affect a company's value aside from the three variables examined in this aricle such as *earnings per share*, dividend policy and asset structure.

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