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# Effect of Profitability Mediation on Solvency, Liquidity and Activity Ratios on Company Value in IPO Companies in Indonesia

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**ABSTRACT**

The high opportunity to attract investors to IPO companies in Indonesia requires companies to be able to carry out efficiency and effectiveness in their operational activities. This paper aims to review the performance of IPO companies in Indonesia by examining the relationship between solvency, liquidity, activity and profitability of companies to the achievement of company value. This study uses secondary data through the analysis of annual financial statements for the period 2018 – 2023. The performance of IPO companies is measured by looking at the movement of stock values within five years since going public on the Indonesia Stock Exchange The analysis method used is descriptive statistics with classical assumption tests. The findings of the study show that profitability has an important role as a mediator of solvency to the value of the company and simultaneously solvency, liquidity and activities affect the value of the company by being mediated by profitability. The results of the study also show that solvency, liquidity and activities have no direct effect on profitability or company value. This condition occurs because IPO companies prioritize the determination and implementation of strategic policies over existing regulations. Potential investors can benefit from these findings in an effort to consider investment decisions and determine the high or low value to invest in IPO companies in Indonesia. To the researcher's knowledge, this study provides new insights into the performance of IPO companies in Indonesia, the relationship between asset turnover and the value of the company's shares, which is mediated by the company's ability to generate profits from its capital.

**Keywords:** Capital Structure, Liquidity, Activities, Profitability, Company Value.

## INTRODUCTION

Every year, the number of companies listed on the Indonesia Stock Exchange increases. In 2023, the number of companies offering on the Indonesia Stock Exchange (IDX) will reach 79 companies with a total fund of Rp.54.14 trillion. To date, 903 companies have conducted IPOs (Initial Public Offerings). With the development of the stock market, investors must pay attention to the financial condition of IPO companies to avoid future losses. They should also look at whether the IPO company has set up the allocation of funds correctly.

The initial public offering of a company's shares is closed to the public known as an IPO. When equity, debt, or securities are offered for the first time, an IPO is considered to go public (Tajuddin et al., 2023);(Mehmood et al., 2022). Expectations of potential investors are rising due to the company's poor IPO performance in the short term(Bhatia, S. and Singh, 2013);(Mayur, M. and Mittal, 2014);(Dhamija, S. and Arora, 2017);(Mangala & Dhanda, 2019). Investors expect their money to generate value greater than the value at the time of investment. As a result, it is important to conduct a thorough analysis of the IPO company. The company was established to earn more money from shareholders. If the company's value is as high as possible, shareholders will get greater profits (Husnan & Pudjiantuti, 2015). Investors receive signals from businesses that help improve their prestige and reputation in the market by using information asymmetry (Habib & Hossain, 2013). They provide certain information to show that they excel at attracting investments and improving their favorable reputation (Verrecchia, 1983). Management must take advantage of their strengths and minimize their weaknesses to increase the value of the Company (E. F. Brigham & Houston, 2011).

Signal theory is the background for companies that become issuers in presenting information (Wolk et al., 2001). Reporting is carried out by managers who have confidence in the quality of the Company, considering the costs that will be incurred

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to signal higher to companies that have poor quality (Scott-Phillips et al., 2009). Signals given by good quality companies are considered good news, while signals given by poor quality companies are considered bad news (Kurniati, 2019). Managers signal because there is information that only the company knows, and believes that the information is relevant and useful to disclose. The disclosure of information is carried out because external parties do not know the Company's performance and capabilities. This disclosure aims to convince external parties about the performance or capabilities of companies that are different from the conditions of other companies in the same industry.

To maintain its survival, a company must be able to create a market value (company) with a high selling value, because it can determine and measure the success of the company. The higher the company's value, the higher the level of investor confidence will increase. The value of the company shows the good performance of a company and shareholders will give a good assessment of the company's management (E. . . Brigham & Houston, 2013). The market assessment of a business is recognized as the real value of the company's price in the market from the owner's point of view (Tarus et al., 2014). The market value of a business can be measured by the total value of the company's shares in the financial market, so that in an efficient market, every increase in the company's shares indicates an increase in its value and vice versa, the decrease in price indicates a decrease in the value of the company (Mohammad et al., 2023).

Companies with high corporate values will provide signals for different corporate financial policies compared to companies with low values. This signal is a costly process in the form of deadweight costing that aims to convince investors of the company's value. A good signal is a signal that cannot be imitated by other companies.

A company's performance is an indicator of business success and provides investors with information about its overall health (10). Most of the existing research argues that company performance is the main determinant of market value, both in individuals and the level of economic prosperity of the country (Mehari & Aemiro, 2013);(Tran et al., 2021). Entrepreneurs must understand and monitor their performance and the factors that affect growth and profitability, which can be an important element to understand the company's competitive resources and the sources of implementing entrepreneurial strategies (Abdallah, 2017); (Bryła, P. (Ed.), 2017); (Wach et al., 2016); (Cassia & Colombelli, 2010); (Gao et al., 2010); (Richard et al., 2009).

Financial analysis shows the difference in performance between companies in the same industry and the company's current financial position or trends. The study helps management identify weaknesses and find solutions to minimize or even eliminate them. Before making a long-term investment, investors should analyze the profitability, future prospects and investment risks of the IPO company. In practical terms, financial ratios provide valuable information that improves the ability to assess the financial situation of a company (Alesh, Alarusi, 2020). In analyzing certain indicators are needed to carry out financial analysis. The measurement of indicators that are generally carried out is the ratio of financial statement analysis. There are five types of financial ratio analysis that are often used, namely liquidity ratio, asset management, debt management, profitability and market value (E. . . Brigham & Houston, 2013);(Hery, 2016)(Hery, 2016). .

Expenditure on company capital is something important in increasing the value of the company, because all types of investments made by the company will give a positive signal to the growth and income of the company which has an impact on increasing the stock price where the stock price is an indicator of the company's value (Putri & Setiawan, 2019). The three main decisions made by the company's financial manager, namely: investment decision, financing decision and working capital decision (Zutter, 2019).

Decisions on capital structure are essential for any business organization. In the company's business activities, it is the task of management in making decisions on a good capital structure so that the company's value can be maximized. Analysis in maximizing the value of a company is not an easy job because it involves selecting a good and balanced type of debt and capital allocation by considering the costs and benefits that will be obtained. The capital structure aims to integrate permanent sources of funds that the company further uses in a way that is expected to maximize the value of the company (Fahmi, 2016). Funding decisions will have an impact on capital costs, allowing companies to improve their performance (Myers & Majluf, 1984);(Abdullah & Tursoy, 2019). It is predictable that the capital structure is cosmic in choice and varies by country (Mathur et al., 2021). A good capital structure can be reflected in whether or not the company effectively uses funds for operational activities in obtaining profits and paying costs arising from these funding activities, so that the company's ability to maximize profits can be achieved and will increase the stock price and attract investors to invest.

An increase in the capital structure ratio reduces the profitability and value of the company (Nguyen & Nguyen, 2020). According to theoretical models, the relationship between capital structure and firm value is still unclear (Miglo, 2016). Some of the studies that link the influence of capital structure on company value include (Aggarwal1 & Padhan, 2017) ; (Matias & Serrasqueiro, 2017) ; (Modigliani & Miller, 1958); and (Widya & Nugrahani, 2018). And empirical studies

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provide mixed evidence as confirmed in the meta-analysis, finding 63 studies with positive impacts, 117 studies with negative effects and 65 studies with insignificant effects (Dao & Ta, 2020).
Another factor that greatly affects market value is the level of liquidity of the company represented in monetary resources that allow the business to meet its short-term and long-term commitments (Mohammad Alladwan et al, 2023). Companies with high levels of liquidity will have a better chance of getting various supports from many parties, ranging from financial institutions, creditors, and suppliers.
By expanding market share and maximizing the use of the company's assets, it can increase sales which will have a positive impact on the company's value (Gunawan, 2016). The level of effectiveness and efficiency of a company's performance is generally measured by the activity ratio. If the activity is too low then sales will be low and the expected profit will not be achieved. Balanced profit and sales results explain how management successfully manages its assets (Rinnaya et al., 2016). Companies with a broad asset base are good indicators of a company's financial health and are expected to be more stable, efficient, and profitable, it also helps to increase investor confidence, which can positively affect the company's value (Panda et al., 2023). The size of a company is a scale that can be calculated by the level of total assets and total sales. Larger companies will have an advantage in the source of funds obtained to finance their investments in obtaining profits. The size of a company can be used as one of the financial characteristics of a company. Generally, large companies that are already stable will find it easier to obtain funding in the capital market than small companies.
Profitability is a very important factor in determining the capital structure, if the company's profitability is high, the company will use less debt for operations in its company's funding needs. Profitability indicates the operational and financial efficiency of the company (Panda et al., 2023). The profitability ratio is the end result of various policies and decisions taken by a company (Rahayu et al., 2019) . Profitability which has a positive effect on the company's value shows that the higher the profit, the higher the company's value (Mardiyati et al., 2012).

The purpose of the study is to analyze the impact of solvency, liquidity, and company size activities on company value by considering the mediating effect of profitability on IPO companies published in Indonesia from 2018 to 2023. The number of closed companies that publish on the IDX is an attraction for investors who want to develop their businesses. The originality of this study is the use of research subjects in the form of IPO companies in Indonesia for the 2018-2023 period and there are still limited studies that test the relationship between the ratio of measured activities and total assets to the value of companies. With the conduct of this research, it is hoped that research findings can be produced describing the performance of IPO companies in Indonesia. This research is compiled into five parts. Part 1 introduces research. Part 2 outlines the literature review and hypothesis development. Part 3 shows the research methodology. Part 4 details the results of data analysis and part 5 is the conclusion.

## METHODS

This study uses a purposive sampling method on IPO companies published on the Indonesia Stock Exchange from 2018 to 2023 with a population of 34 companies so that the total sample is 204 data. The independent variables in this study consist of Capital Structure (DER), Current Ratio (CR) and Total Asset Turnover Ratio (TATO) and the dependent variable is the value of the company using Price Book Value (PBV), while the mediating variable uses profitability in this case is Return On Equity (ROE).
The data analysis in this study is descriptive statistics. Descriptive statistics are statistics that are used for the purpose of analyzing information by descriptively or explaining the information that has been collected as it is (Sugiyono, 2017). Descriptive statistics are used to explain and convey explanations about the distribution of variables in research. The operationalization variables of this study use five financial ratio formulas.

**Table 2. Variable Operationalization**

| Variable | Definition | Source |
|---|---|---|
| Debt to Total Equity Ratio | Total debt to total equity | (Alarussi, A.S. and Shamki, 2016) |
| Curent Ratio | Current assets against current liabilities | (Alarussi & Alhaderi, 2018) |

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|---|---|---|
| Total Asset Turnover Ratio | Total sales to Total assets | (Gitman, 2015); (Alarussi & Alhaderi, 2018) (Yasser et al., 2011) |
| Return on Equity Ratio | Net Profit to Total Equity | |
| Price to Book Value | Market price of stocks against the value of book price stocks | (Bradshaw, M.T. et al., 2013) |

The data analysis method uses the EVIEWS application program, by conducting a classical assumption test consisting of normality, multicollinearity, heteroskedasus, and autocorrelation tests as well as chow tests, housman tests, and langrage multiplier tests to select test models. To see the influence / relationship between independent variables and dependent variables, a linear regression test of the least square panel was carried out with the following equation model:

$$Y = \beta\ 0 + \beta 1\ DER + \beta 2\ CR + \beta 3\ TATO + \beta 4\ ROA + \beta 5\ PBV + e$$

Hypothesis testing is carried out partially using the individual parameter significance test / T. Coefficient determination ($R^2$) is a value that explains how far the capability of the dependent variable is independent and the value of the determination coefficient ($R^2$) switches between 0 to 1, which means that when the value of the determination coefficient ($R^2$) is more similar to 1, the bond between the independent variable and the dependent variable will be stronger (Purnomo, 2016). So if the value of the determination coefficient ($R^2$) resembles 0 more, then all the bonds of independent variables with dependent variables will become weaker.

## RESULTS

### *1.1. Descriptive Statistics*

The data testing on this research sample of energy sector companies was met in its entirety for the classical assumption test. With the test model carried out:

Regression for Y:
$Y= \beta 1DER+ \beta 2CR+ \beta 3TATO+\varepsilon PBV$

Regression for Z:
$Z=\alpha 1DER+\alpha 2CR+\alpha 3TATO+\varepsilon ROE$

Regression for Y Through Z:
$Y=\beta 1DER+\beta 2CR+\beta 3TATO+\gamma ROE+\varepsilon PBV$

The test results showed that the data was normally distributed with a significance value above 0.05, which was 0.316543 for the dependent variable (PBV), 0.453262 for the mediating variable (ROE) and 0.360624 for the dependent variable through the mediation variable. The multicollinearity test on the three models did not show multicollinearity with the results of VIF < 10 as shown in the table below:

**Table 3. Summary of Multicollinearity Test Results**

| Influence | VIF | Result |
|---|---|---|
| DER, CR, TATTOO against ROE | X1=1.024827<br>X2 = 1.020192<br>X3 = 1.008447 | No Multicollinearity, VIF <10 |
| DER, CR, TATTOO against PBV | X1 = 1.024827 | No Multicollinearity, VIF <10 |

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| | | |
|---|---|---|
| | X2 = 1.020192<br>X3 = 1.008447 | |
| DER, CR, TATTOO through ROE, against PBV | Z = 1.009549<br>X1 = 1.027576<br>X2 = 1.025523<br>X3 = 1.010332 | No Multicollinearity, VIF <10 |

The heteroscedasticity test showed that the probability of Chi-Square was greater than 0.05 so that the tested data did not contain heteroscedasticity for the dependent variable (PBV) showing a Chi-Square of 0.3065, for the Chi-Square mediating variable (ROE) of 0.9740 and for the dependent variable (PBV) through the CH-Square mediated variable (ROE) of 0.3154. And the autocorrelation test on the three models showed a VIF value below 3 of 2.210657 for the dependent variable (PBV), 2.029661 for the mediating variable (ROE) and 2.191634 for the dependent variable (PBV) through the mediated variable (ROE).

### *1.2. Data Analysis Results*

For the model test carried out with the Chow, Housman and Langrange Multiplier tests, a model test was formed on the dependent variable (PBV) using FEM, on the mediated variable (ROE) using CEM and on the dependent through mediation using REM, with the test results showing the following data:

| Path | Coeeficient | Std. Error | t-statistic | Prob | R-Squared | Prob (F-Statistic) |
|---|---|---|---|---|---|---|
| X1-> Y | 0.088384 | 0.053586 | 1.649402 | 0.1009 | 0.524844 | 0.000000 |
| X2-> Y | -0.007684 | 0.012766 | -0.601870 | 0.5481 | | |
| X3-> Y | -0.389443 | 0.258317 | -1.507617 | 0.1335 | | |
| X1-> Z | -0.032622 | 0.044545 | -0.732352 | 0.4648 | 0.009459 | 0.592247 |
| X2-> Z | -0.009341 | 0.009137 | -1.022334 | 0.3079 | | |
| X3->Z | 0.043875 | 0.071753 | 0.611469 | 0.5416 | | |
| X1-Z->Y | 0.142048 | 0.050117 | 2.834334 | 0.0051 | 0.055749 | 0.021740 |
| X2-Z->Y | -0.009441 | 0.011476 | -0.822660 | 0.4117 | | |
| X3-Z->Y | -0.047733 | 0.134678 | -0.354425 | 0.7234 | | |
| Z->Y | 0.132334 | 0.075470 | 1.753464 | 0.0811 | | |

The results of the independent variable test (DER, CR, TATO) on the dependent variable (PBV) above, that DER has a coefficient: 0.088 with a probability of 0.1009 > 0.05 indicating a positive and insignificant relationship, for CR has a coefficient of –0.0077 with a probability of 0.5481 > 0.05 indicates a negative relationship and has an insignificant influence while for TATO has a coefficient of -0.389443 with a probability of 0.1335 > 0.05 indicates a negative and insignificant relationship Significant.

The results of the independent variable (DER, CR, TATO) on the mediating variable (ROE) above showed a small coefficient (positive or negative) with p>0.05, this illustrates that there is no significant relationship between the dependent variable (DER, CR, TATO) and Z (ROE). And the results of the DER, CR. TATO on PBV through ROE shows that the independent variable (DER) against the dependent variable (PBV) through mediation (ROE) has a coefficient of 0.142048 (positive) with a probability of 0.0051 <0.05 that there is an interaction between DER and ROE that has a significant influence on PBV.

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The independent variable (CR) to the dependent variable (PBV) through mediation (ROE) has a coefficient of -0.009441 (negative) with a probability of 0.4117 > 0.05 that there is no significant interaction between CR and ROE on PBV. And for the independent variable (TATO) to the dependent variable (PBV) through mediation (ROE) has a coefficient of -0.047733 (negative) with a probability of 0.7234 > 0.05 that there is no significant interaction between TATO and ROE on PBV.

Based on the table of model test results above, the regression equation of panel data for the results of this study is as follows:

Regression for Y (DER):

Y= 0.956053 + 0.088384DER - 0.007684CR - 0.389443 TATO

Regression for Z (ROE):

Z= -2.026197 - 0.03262DER -0.009341CR + 0.043875TATO

Regression for Y (DER) Through Z (ROE):

Y= 0.838849 + 0.142048DER - 0.009441CR - 0.047733TATO +0.132334PBV

Based on the test results of table 3 above, for the first test model, the dependent variable (DER, CR, TATO) against the dependent variable (PBV) showed R2 = 0.5248 which explained that 52.48% of the variation in PBV could be explained by DER, CR and TATO and the probability of F-statistic of 0.00000 indicates that this model is significant overall. The test model of the two independent variables (DER, CR, TATO) against the mediating variable (ROE) showed R2=0.0095 explaining that only 0.95% of the variation in ROE could be explained by DER, CR, and very low TATO with a probability of F-statistic 0.5922 > 0.05 indicating that this model was overall insignificant. For the third test model, the independent variable (DER, CR, TATO) against the dependent variable (PBV) through the mdesizedization variable (ROE) showed R2=0.0557 which explained that 5.57% of the variation in PBV could be explained by the interaction, with a probability of F-statistic 0.0217 < 0.05 indicating a significant model at a confidence level of 95%.

### *1.3. Hypothesis Discussion*

First, this study rejects the first hypothesis that the debt equity ratio (DER) affects the price book value (PBV). This is generally the case when companies in IPOs tend to increase equity capital through the issuance of new shares and this can lower the DER (as equity increases), even if the debt remains the same. This condition makes DER less relevant in determining the PBV value at the initial stage.
Second, this study rejects the second hypothesis that the current ratio (CR) has an effect on the price book value (PBV). This happens because the stock price of IPO companies is often initially influenced by market sentiment, prospective valuations, and interest from institutional investors, which are not directly related to the company's liquidity.
Third, this study rejects the third hypothesis that total asset turnover (TATO) has an effect on price book value (PBV). IPO companies generally have an asset structure that is not yet stable and are in the early stages of growth or expansion, so their asset structure may not reflect normal operations. Newly purchased large assets (such as property or equipment) to support growth can lower the TATO, but investors are more concerned with the ability of these assets to generate value in the future.
Fourth, this study rejects the fourth hypothesis that the debt equity ratio (DER) has an effect on return on equity (ROE). In IPO companies, net profit is often low or even negative because the company is in the stage of massive expansion or investment. Under these conditions, the relationship between DER and ROE becomes weak or irrelevant.
Fifth, this study rejects the fifth hypothesis that the current ratio (CR) has an effect on return on equity (ROE). At the IPO stage, companies usually acquire fresh funds that increase current assets (such as cash) and equity at the same time. This increase can make CR look high without operational efficiency or profitability, so that the impact on ROE is minimal.
Sixth, this study rejects the sixth hypothesis that total asset turnover (TATO) has an effect on return on equity (ROE). Companies that have just IPOs generally get fresh funds that increase total assets (especially cash and cash equivalents), and this can reduce TATO mechanically without reflecting the operational performance in the early stages of the IPO.
Seventh, this study accepts the seventh hypothesis that the debt equity ratio (DER) affects the price book value (PBV) by mediating by return on equity (ROE). Companies that have just IPOs often use fresh funds from equity and reduce reliance on debt and balance their capital structure to demonstrate good financial risk management in the eyes of investors. An optimal capital structure allows companies to use leverage to increase net income (profitability), which ultimately boosts

ROE. And ROE is an important measure that investors use to evaluate a company's ability to generate profits from equity which will eventually be reflected in the market valuation (PBV).
Eighth, this study rejects the eighth hypothesis that the current ratio (CR) affects the price book value (PBV) by being mediated by return on equity (ROE). Companies that have just IPOs often have a significantly changed financial structure, especially from equity fund injections. This causes the company's current assets to increase where IPO funds enter the company's treasury and can make CR temporarily high. However, this increase in CR does not always reflect the company's operational performance or ability to generate profits, so it does not affect ROE and PBV.
Ninth, this study rejects the ninth hypothesis that total asset turnover (TATO) affects price book value (PBV) mediated by return on equity (ROE). Companies that have just IPOs often have a significantly changed financial structure, especially from equity fund injections. This causes the company's current assets to increase where IPO funds enter the company's treasury and can make CR temporarily high. However, this increase in CR does not always reflect the company's operational performance or ability to generate profits, so it does not affect ROE and PBV.
Tenth, this study accepts the tenth hypothesis that debt equity ratio, current ratio and total asset turnover (TATO) affect price book value (PBV) mediated by return on equity (ROE). Effective use of debt can increase net profit if the company succeeds in generating a return higher than the cost of debt. In IPO companies, sufficient liquidity will signal that the company can meet its short-term obligations, thereby reducing risk and increasing the potential for operational sustainability thereby creating financial stability and increasing ROE. High efficiency in asset management (TATO) can increase ROE, because efficiency in asset use means that the company is able to generate more profits with less capital. And investors tend to judge companies with high ROE to be more profitable and more efficient in managing capital.

## CONCLUSION

Based on the hypothesis testing, it can be concluded that the capital structure affects the company's value (PBV) by being mediated by return on equity. And capital structure (DER), current ratio (CR) and total asset turnover (TATO) have a simultaneous effect on the company's value (PBV) mediated by return on equity. (ROE). And this study shows that for IPO companies on the Indonesia Stock Exchange for the period 2018 – 2023, there is no direct relationship between capital structure, liquidity and activities both on profitability and company value.

The limitations in this study, the population used is only limited to IPO companies from 2018 to 2023 with all existing sub-sectors. This study has not compared the measurement of other variables and the use of mediation and other moderation variables related to the growth of IPO companies so that it is expected to see a positive and significant direction for IPO companies.

The research can provide an overview for investors in assessing and analyzing IPO companies in Indonesia. Where the assessment taken can use other variables to provide a more concrete analysis of the development of IPO companies in Indonesia.

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