

Profitability Pays Idle Liquidity Does Not: Financial Fundamentals and Firm Value in Indonesian Manufacturing

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DOI: <https://doi.org/10.61656/sbamr.v8i3.196>.

ABSTRACT:

Purpose: This study examines whether liquidity (current ratio), profitability (return on assets), firm size, and leverage (debt-to-equity ratio) affect the firm value of manufacturing companies listed on the Indonesia Stock Exchange, using signalling theory as the main lens.

Methodology: The study adopts a quantitative explanatory design using secondary data from the published financial statements of manufacturing companies listed on the Indonesia Stock Exchange for the 2018 financial year. Firm value is proxied by the price-to-book value ratio, and the hypotheses are tested with multiple linear regression analysis using the t-test, while the F-test is used to assess model fit.

Findings: The current ratio has a negative and significant effect on firm value, whereas return on assets and firm size have positive and significant effects. The debt-to-equity ratio has a negative but insignificant effect. The model fit test confirms that the regression model is appropriate, and the results indicate that investors reward profitable and large firms but discount excessive idle liquidity.

Implications: Managers should channel excess current assets into productive, profit-generating investments and communicate profitability credibly to the market, while investors may rely more on profitability and size signals than on leverage when assessing the price-to-book value of manufacturing firms.

Originality: The study integrates signalling, agency, and capital-structure perspectives to explain the effects of four fundamental ratios on the market valuation of manufacturing firms in an emerging market, and reconciles its results with both international and Indonesian evidence.

Keywords: firm value, price-to-book value, current ratio, return on assets, firm size, debt-to-equity ratio, signalling theory.

JEL Classification: G32, G12, L25

Article info: Received: 10 July 2026; Published: 30 September 2026

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Recommended citation:

Hapuk, C. K., Nany, M., & Nainggolan, I. (2026). Profitability Pays Idle Liquidity Does Not: Financial Fundamentals and Firm Value in Indonesian Manufacturing, *Sustainable Business Accounting and Management Review (SBAMR)*, 8(3), 142-152.

1. INTRODUCTION

Maximising firm value is widely regarded as the primary objective of a company because firm value reflects the wealth of its shareholders. For a listed company, firm value is mirrored in its share price, whereas for an unlisted company it is realised only when the company is sold and depends on its assets, prospects, business risk, and operating environment (Mardiyati et al., 2012). Capital-market research commonly captures firm value through market-based ratios that compare the market valuation of a company with the book value of its assets or equity, such as Tobin's q and the price-to-book value (PBV) ratio (Chung & Pruitt, 1994; Fama & French, 1992; Lang & Stulz, 1994). A PBV above one

indicates that the market values the company at more than the capital invested by its owners, signalling confidence in the firm's performance and growth prospects (Penman, 1996).

Because outside investors know less than managers about a firm's true prospects, they rely on observable information to form their valuations. Signalling theory explains that managers can reduce this information asymmetry by sending credible signals through published financial information, and that investors respond to such signals in pricing the firm's shares (Spence, 1973; Connelly et al., 2011). Information asymmetry is particularly pronounced in emerging markets such as Indonesia, where ownership is often concentrated and investor protection is weaker, so that fundamental financial ratios become important cues for valuation (Claessens et al., 2002; Ararat et al., 2021). Liquidity, profitability, firm size, and leverage are four fundamental characteristics that investors routinely use to judge the prospects and risks of manufacturing companies.

Empirical evidence on how these characteristics affect firm value, however, remains inconclusive. Liquidity may increase firm value by reducing the risk of financial distress, but excessive liquid assets may also signal idle resources and agency problems (Opler et al., 1999; Wang, 2002). Indonesian studies report that the current ratio has a significant effect on firm value (R. et al., 2018; Utami & Welas, 2019), a negative effect only before the COVID-19 pandemic (Ambarwati et al., 2021), or no significant effect (Annisa & Chabachib, 2017; Salainti, 2019). Profitability is generally associated with higher valuation (Dang et al., 2019; Husna & Satria, 2019), although some studies find no effect (Ambarwati et al., 2021). The role of firm size depends on how size is measured and on its interaction with leverage (Dang et al., 2018; Ibhagui & Olokoyo, 2018), while the relationship between leverage and firm value is positive in some contexts and negative or insignificant in others (Fosu, 2013; Le & Phan, 2017; Vo & Ellis, 2017; Bui et al., 2023).

These results suggest that the valuation relevance of fundamental ratios is context-specific and needs to be re-examined for manufacturing firms in Indonesia, a sector that is capital-intensive and highly dependent on working capital and external financing. Accordingly, this study aims to obtain empirical evidence on the effect of the current ratio (CR), return on assets (ROA), firm size (Size), and debt-to-equity ratio (DER) on the firm value of manufacturing companies listed on the Indonesia Stock Exchange (IDX). The study contributes by interpreting the four ratios through signalling, agency, and capital-structure theories and by reconciling the findings with international and Indonesian evidence. Practically, the results offer guidance for managers in managing liquidity, profitability, and financing policies, and for investors in using financial statement information to assess firm value.

2. LITERATURE REVIEW

2.1. Signalling Theory

Signalling theory originates from the observation that, in markets characterised by information asymmetry, better-informed parties can convey their private information through costly and observable actions (Spence, 1973). In corporate finance, managers know more about the firm's prospects than outside investors, and the market therefore interprets managerial decisions and disclosed financial information as signals of firm quality (Leland & Pyle, 1977; Connelly et al., 2011). When investors lack information, they protect themselves by pricing the firm at a discount; companies can increase their value by reducing information asymmetry through credible signals (Myers & Majluf, 1984).

Financial statements are a principal channel for such signals. High profitability signals favourable prospects, while financing decisions can also carry information: Ross (1977) argues that a higher level of debt can signal managerial confidence in future cash flows because only firms with good prospects can bear the cost of debt. At the same time, agency theory reminds us that the information conveyed by financial ratios is shaped by conflicts of interest between managers, shareholders, and creditors (Jensen & Meckling, 1976). This study uses signalling theory as its main lens, complemented by agency and capital-structure perspectives, to explain how liquidity, profitability, size, and leverage are reflected in firm value.

2.2. Firm Value

Firm value is the investors' perception of a company's success, which is closely related to its share price. In this study, firm value is proxied by the price-to-book value (PBV) ratio, namely the ratio of the market price per share to the book value per share. The book-to-market ratio and its inverse are among the most widely used indicators of how the market values a company's net assets and growth opportunities (Fama & French, 1992; Penman, 1996). A high PBV indicates that the market believes in

the company's performance and prospects, because the share price exceeds the book value of equity (Mardiyati et al., 2012). Market-to-book measures are also closely related to Tobin's q , which is frequently used as a measure of firm performance and value in corporate finance research (Chung & Pruitt, 1994; Lang & Stulz, 1994).

2.3. Liquidity (Current Ratio) and Firm Value

Liquidity is a company's ability to meet its short-term obligations and is commonly measured by the current ratio, namely current assets divided by current liabilities. A high level of liquidity reduces the probability that the company will fail to meet its short-term obligations to creditors, which can increase the confidence of creditors and investors. Firms hold liquid assets for transaction and precautionary motives, particularly when external financing is costly (Opler et al., 1999). However, liquid assets held in excess of operational needs may be wasted by managers or invested in low-return projects, so that the market value of liquidity depends on the quality of governance (Pinkowitz et al., 2006; Dittmar & Mahrt-Smith, 2007).

Evidence on working capital reinforces this trade-off. Efficient management of receivables and inventories improves profitability (Deloof, 2003), aggressive liquidity management is associated with better operating performance and higher corporate value (Wang, 2002), and additional investment in net working capital tends to reduce shareholder value at the margin (Kieschnick et al., 2013). The relationship between working capital and performance is non-linear, so that both too little and too much working capital can harm performance (Baños-Caballero et al., 2014). In Indonesia, R. et al. (2018) and Utami and Welas (2019) report that the current ratio significantly affects firm value, Ambarwati et al. (2021) find a negative and significant effect before the COVID-19 pandemic but no effect during the pandemic, whereas Annisa and Chabachib (2017) and Salainti (2019) find no significant effect. Based on these arguments, the first hypothesis is formulated as follows:

H₁: The current ratio (CR) has a significant effect on firm value.

2.4. Profitability (Return on Assets) and Firm Value

Profitability reflects the effectiveness of management in generating earnings from the resources at its disposal and is measured in this study by return on assets (ROA), namely net income divided by total assets. Higher profitability means a greater capacity to generate earnings and to pay dividends, and profitable firms tend to rely more on internal funds (Fama & French, 2002; Myers, 1984). Under signalling theory, a high ROA is a positive signal to investors that the company is in a favourable condition, which attracts demand for its shares, raises the share price, and thereby increases firm value (Connelly et al., 2011).

International evidence shows that profitability is positively associated with enterprise value (Dang et al., 2019), and Indonesian evidence identifies ROA as a key determinant of firm value (Husna & Satria, 2019). ROA has been found to have a positive and significant effect on PBV (Annisa & Chabachib, 2017; Salainti, 2019; Nugraha & Wirama, 2021; Radiman & Athifah, 2021). In contrast, other studies report no significant effect of ROA on firm value, either before or during the COVID-19 pandemic (Ambarwati et al., 2021) or in the property and real estate sector (Utami & Welas, 2019). The second hypothesis is therefore:

H₂: Return on assets (ROA) has a significant effect on firm value.

2.5. Firm Size and Firm Value

Firm size describes how large a company is and can be expressed by total assets, total sales, or market capitalisation; the choice of proxy can materially affect empirical results (Dang et al., 2018). Larger firms are better known to the public, more diversified, and more transparent in disclosing their performance, which makes it easier for them to obtain external financing because they are trusted by creditors (Titman & Wessels, 1988; Rajan & Zingales, 1995). Size has long been recognised as a priced characteristic in capital markets (Banz, 1981; Fama & French, 1992).

A larger asset base reflects growth and development, which can raise investor confidence and firm value. Size also conditions the effect of other financial characteristics: the negative effect of leverage on performance is weaker for larger firms (Ibhagui & Olokoyo, 2018), and firm size shaped the leverage–performance relationship during the 2007–2009 financial crisis (Vithessonthi & Tongurai, 2015). In Indonesia, firm size has been found to have a positive and significant effect on firm value both before and during the COVID-19 pandemic (Ambarwati et al., 2021). The third hypothesis is:

H₃: Firm size (Size) has a significant effect on firm value.

2.6. Leverage (Debt-to-Equity Ratio) and Firm Value

Leverage, measured by the debt-to-equity ratio (DER), reflects the composition of financing chosen by the company. Capital-structure theory offers competing predictions about its effect on firm value (Harris & Raviv, 1991; Frank & Goyal, 2009). The trade-off theory states that a firm balances the tax benefits of debt against the expected costs of financial distress, implying an optimal capital structure that maximises firm value (Kraus & Litzenger, 1973). The pecking-order theory argues that, because of information asymmetry, firms prefer internal funds to debt and debt to equity (Myers, 1984; Myers & Majluf, 1984). Signalling theory views an increase in debt as a positive signal of managers' confidence in future cash flows (Ross, 1977), while agency theory suggests that debt disciplines managers but can also create conflicts between shareholders and creditors (Jensen & Meckling, 1976; McConnell & Servaes, 1995).

International evidence is accordingly mixed. Higher leverage has been associated with greater efficiency and performance (Berger & Bonaccorsi di Patti, 2006; Margaritis & Psillaki, 2010; Fosu, 2013), whereas studies in transition and emerging economies find negative or mixed effects of debt on performance and value (Abor, 2005; Le & Phan, 2017; Vo & Ellis, 2017; Nenu et al., 2018; Bui et al., 2023). Capital structures in developing countries are also shaped by institutional differences (Booth et al., 2001). In Indonesia, DER has been found to have a positive and significant effect on PBV (Annisa & Chabachib, 2017; Salainti, 2019), a negative effect only before the COVID-19 pandemic (Ambarwati et al., 2021), and no significant effect (R. et al., 2018; Nugraha & Wirama, 2021; Radiman & Athifah, 2021). The fourth hypothesis is:

H₄: The debt-to-equity ratio (DER) has a significant effect on firm value.

2.7. Research Framework

Liquidity, profitability, size, and leverage serve as fundamental signals about the firm's prospects and risks. The research framework of this study, which summarises hypotheses H₁–H₄, is presented in Figure 1.

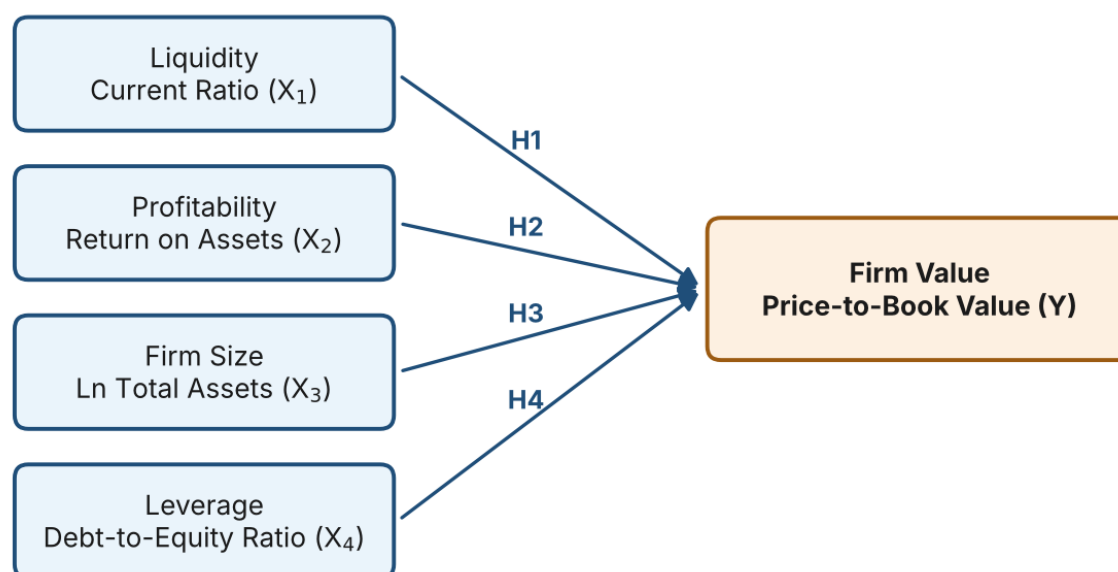


Figure 1. Research Framework
 Source: Developed by the authors (2026)

3. RESEARCH METHOD

3.1. Research Design

This study employs a quantitative explanatory design to test the effect of the current ratio, return on assets, firm size, and debt-to-equity ratio on firm value. The study uses secondary data in the form of the published financial statements and share price information of the sample companies.

3.2. Population, Sample, and Data Collection

The population of this study comprises the manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2018 financial year. The sample consists of 70 manufacturing companies with complete financial statement and share price data for 2018. The data were collected through documentation, namely by recording the required figures from the companies' financial statements published through the IDX (<https://www.idx.co.id>).

3.3. Variable Measurement

The dependent variable is firm value, proxied by the price-to-book value (PBV). The independent variables are liquidity (current ratio), profitability (return on assets), firm size, and leverage (debt-to-equity ratio). Firm size is measured by the natural logarithm of total assets, which is the most commonly used size proxy in corporate finance research (Dang et al., 2018). The operational definitions of the variables are presented in Table 1.

Table 1. Operational Definitions of Variables

Variable	Type	Measurement	Scale
Firm value (PBV)	Dependent (Y)	Market price per share ÷ Book value per share	Ratio
Current ratio (CR)	Independent (X ₁)	Current assets ÷ Current liabilities	Ratio
Return on assets (ROA)	Independent (X ₂)	Net income ÷ Total assets	Ratio
Firm size (Size)	Independent (X ₃)	Ln (Total assets)	Ratio
Debt-to-equity ratio (DER)	Independent (X ₄)	Total liabilities ÷ Total equity	Ratio

Source: Compiled by the authors (2026)

3.4. Data Analysis

The data were analysed using multiple linear regression with the following equation:

$$PBV = \alpha + \beta_1 CR + \beta_2 ROA + \beta_3 Size + \beta_4 DER + e \quad [1]$$

where PBV is firm value, α is the constant, β_1 – β_4 are the regression coefficients, CR is the current ratio, ROA is return on assets, Size is the natural logarithm of total assets, DER is the debt-to-equity ratio, and e is the error term. The hypotheses (H₁–H₄) were tested with the t-test, while the F-test was used as a model fit (goodness-of-fit) test to determine whether the regression model is appropriate for explaining firm value. Both tests used a significance level of 0.05.

4. RESULTS AND DISCUSSION

4.1. Results

The results of the regression analysis of the effect of CR, ROA, Size, and DER on firm value are presented in Table 2.

Table 2. Regression Results of the Effect of CR, ROA, Size, and DER on Firm Value

Independent Variable	Regression Coefficient	Sig. (t-test)	Sig. F (Model Fit)
Current Ratio (CR)	-0.718	0.003*	0.000*
Return on Assets (ROA)	0.569	0.000*	
Size	0.118	0.046*	
Debt-to-Equity Ratio (DER)	-0.164	0.313	

Note: * significant at the 0.05 level. Source: Processed data (2026)

As shown in Table 2, the current ratio (CR) has a negative regression coefficient with a significance value of 0.003, and the debt-to-equity ratio (DER) also has a negative coefficient, with a significance value of 0.313. Return on assets (ROA) and firm size (Size) have positive regression

coefficients, with significance values of 0.000 and 0.046, respectively. Since the significance values of CR, ROA, and Size are below 0.05, H_1 , H_2 , and H_3 are accepted, whereas H_4 is rejected because the significance value of DER exceeds 0.05. The F-test yields a significance value of 0.000, which is below 0.05, indicating that the regression model is fit and appropriate for explaining variation in firm value.

4.2. Discussion

4.2.1. The Effect of the Current Ratio on Firm Value

The current ratio has a negative and significant effect on firm value. This result is consistent with [R. et al. \(2018\)](#) and [Utami and Welas \(2019\)](#), who find that the current ratio significantly affects firm value, and with [Ambarwati et al. \(2021\)](#), who report a negative and significant effect of the current ratio on firm value in the period before the COVID-19 pandemic. Although a high level of liquidity reduces the risk of default on short-term obligations, the negative sign indicates that investors in manufacturing companies interpret a very high current ratio as a sign of idle current assets—excess cash, slow-moving inventories, or uncollected receivables—that are not being used to generate returns.

This interpretation is consistent with agency and working capital research. Liquid assets held beyond operational needs are exposed to managerial discretion, so that their contribution to firm value depends on governance quality ([Jensen & Meckling, 1976](#); [Pinkowitz et al., 2006](#); [Dittmar & Mahrt-Smith, 2007](#)). Efficient management of working capital improves profitability and corporate value ([DeLoof, 2003](#); [Wang, 2002](#)), while additional investment in working capital reduces shareholder wealth at the margin and becomes harmful beyond an optimal level ([Kieschnick et al., 2013](#); [Baños-Caballero et al., 2014](#)). The finding differs from [Annisa and Chabachib \(2017\)](#) and [Salainti \(2019\)](#), who find a negative but insignificant effect, a divergence that may reflect differences in sectors and observation periods.

4.2.2. The Effect of Return on Assets on Firm Value

Return on assets has a positive and significant effect on firm value. High profitability indicates good prospects, so investors respond positively by increasing demand for the company's shares, which in turn raises firm value. This result supports signalling theory, in which profitability is a credible signal of firm quality because it is difficult for low-quality firms to imitate ([Spence, 1973](#); [Connelly et al., 2011](#)). Profitable firms also have greater capacity to pay dividends and to finance growth internally, which reduces their dependence on costly external capital ([Fama & French, 2002](#); [Myers & Majluf, 1984](#); [Alifiani & Suryaningrum, 2020](#)).

The result is consistent with [Annisa and Chabachib \(2017\)](#), [Salainti \(2019\)](#), [Nugraha and Wirama \(2021\)](#), and [Radiman and Athifah \(2021\)](#), who find that ROA has a positive and significant effect on PBV in Indonesia, and with international evidence that profitability is a key driver of enterprise value ([Dang et al., 2019](#); [Husna & Satria, 2019](#)). It is not consistent with [Ambarwati et al. \(2021\)](#), who report no significant effect of ROA before or during the COVID-19 pandemic, or with [Utami and Welas \(2019\)](#), who find no effect in the property and real estate sector.

4.2.3. The Effect of Firm Size on Firm Value

Firm size has a positive and significant effect on the value of manufacturing companies listed on the IDX. Larger firms tend to be more efficient in generating earnings, more diversified, more visible to investors, and more transparent in their disclosures, which reduces information asymmetry and the cost of external financing ([Titman & Wessels, 1988](#); [Rajan & Zingales, 1995](#)). Investors therefore perceive large firms as having more stable prospects and lower risk, which is reflected in a higher PBV.

This finding is consistent with [Ambarwati et al. \(2021\)](#), who find that firm size has a positive and significant effect on firm value before and during the COVID-19 pandemic, and with [Dang et al. \(2019\)](#), who identify firm size as a determinant of enterprise value. It also accords with evidence that larger firms are better able to withstand the adverse effects of leverage and financial shocks ([Vithessonthi & Tongurai, 2015](#); [Ibhagui & Olokoyo, 2018](#)). Nevertheless, the magnitude of the size effect may vary with the proxy used, so future studies should test alternative measures such as sales or market capitalisation ([Dang et al., 2018](#)).

4.2.4. The Effect of the Debt-to-Equity Ratio on Firm Value

The debt-to-equity ratio has a negative but insignificant effect on firm value. This means that, for the sample companies, the level of leverage is not a decisive consideration for investors in valuing the firm. One explanation is offered by the trade-off theory: the tax and disciplinary benefits of debt may be offset by the expected costs of financial distress, so that the net effect of leverage on firm value is close to

zero (Kraus & Litzenberger, 1973; Jensen & Meckling, 1976). In addition, capital structure is only one part of a company's overall financial structure, and investors may rely more on profitability and size signals when assessing the prospects of manufacturing firms.

This result is consistent with R. et al. (2018), Nugraha and Wirama (2021), and Radiman and Athifah (2021), who find that DER does not significantly affect PBV. It is not consistent with Annisa and Chabachib (2017) and Salainti (2019), who report a positive and significant effect, or with Ambarwati et al. (2021), who find a negative and significant effect before the pandemic. The international literature is similarly divided, reporting positive effects of leverage on performance (Margaritis & Psillaki, 2010; Fosu, 2013) as well as negative or mixed effects in emerging markets (Abor, 2005; Le & Phan, 2017; Vo & Ellis, 2017; Bui et al., 2023). Such heterogeneity is consistent with the view that capital-structure effects are shaped by institutional settings and ownership structures, which in Indonesia are characterised by concentrated ownership (Booth et al., 2001; Claessens et al., 2002).

5. CONCLUSION

This study concludes that the current ratio has a negative and significant effect on the firm value of manufacturing companies listed on the Indonesia Stock Exchange, return on assets, and firm size have positive and significant effects, and the debt-to-equity ratio has a negative but insignificant effect. The model fit test confirms that the regression model is appropriate for explaining firm value. These findings indicate that the market rewards profitable and large manufacturing firms, discounts excessive idle liquidity, and does not treat leverage as a decisive valuation signal.

5.1. Implications

Theoretically, the results support signalling theory by showing that profitability and size act as positive signals, while the negative effect of the current ratio is better explained by agency and working capital perspectives on idle liquid assets. Practically, managers of manufacturing companies should maintain liquidity at an adequate rather than excessive level, channel surplus current assets into productive investment, and communicate profitability credibly to the market. Investors can use ROA and firm size as primary indicators when assessing the PBV of manufacturing companies, while recognising that leverage alone may not explain differences in firm value.

5.2. Limitations and Suggestions

This study has several limitations. First, the observation period covers only one financial year, so the results may not capture changes in conditions over time. Second, the sample is limited to manufacturing companies listed on the IDX. Third, the study uses only four independent variables. Future research should use panel data covering several years, extend the sample to all companies listed on the IDX so that the effects can be generalised more broadly, and add other variables such as earnings per share (EPS), the price-to-earnings ratio (PER), the dividend payout ratio (DPR), and corporate governance characteristics to increase the explanatory power of the model.

Abbreviations

CR: Current Ratio; DER: Debt-to-Equity Ratio; DPR: Dividend Payout Ratio; EPS: Earnings per Share; IDX: Indonesia Stock Exchange; PBV: Price-to-Book Value; PER: Price-to-Earnings Ratio; ROA: Return on Assets.

Authors' Contribution

CKH designed the study, collected and analysed the data, and drafted the manuscript. MN supervised the research, contributed to the theoretical framework and interpretation of the results, and revised the manuscript. Both authors have read and approved the final manuscript.

Conflict of Interest

The authors declare that they have no conflict of interest.

Funding

This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

Availability of Data and Materials

The data used in this study are derived from the financial statements of manufacturing companies published on the Indonesia Stock Exchange website (<https://www.idx.co.id>) and are available from the corresponding author upon reasonable request.

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