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The Influence of Financial Statement Quality, Corporate Governance, and Capital Structure on Company Value with Profitability as a Mediating Variable

Titis Nistia Sari
Universitas Sultan Ageng Tirtayasa

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ABSTRACT

This study examines the effect of financial statement quality, corporate governance, and capital structure on firm value in Indonesia, with profitability serving as a mediating variable. Using a quantitative approach, data were collected from 165 companies across multiple industrial sectors through a structured Likert-scale questionnaire. The data were analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS 3) to assess both direct and indirect relationships among variables. The findings reveal that financial statement quality and corporate governance have a positive and significant effect on firm value, whereas capital structure has a negative and significant effect. Profitability also plays a mediating role, strengthening the relationships between financial statement quality and corporate governance with firm value, but not between capital structure and firm value. These results confirm that transparent financial reporting, effective governance practices, and prudent capital management collectively enhance profitability and contribute to long-term value creation. The study provides empirical evidence that supports Agency Theory, Trade-Off Theory, and the Resource-Based View (RBV) in explaining firm value formation in emerging markets such as Indonesia. The practical implications emphasize the importance of improving governance mechanisms, financial reporting quality, and profitability strategies to increase investor trust and market valuation.

Corresponding Author:

Name: **Titis Nistia Sari**
Institution Address: Universitas Sultan Ageng Tirtayasa
e-mail: lina@untirta.ac.id

1. INTRODUCTION

In an increasingly dynamic global economy, firm value has become a key indicator of corporate performance and long-term sustainability, reflecting management's ability to generate returns, maintain growth, and ensure market competitiveness. In emerging markets like Indonesia, firm value is influenced by internal and external factors, such as financial statement quality, corporate governance, and capital structure decisions. Understanding how these factors interact through profitability as a mediating variable offers valuable insights for optimizing value creation. Firm value in such markets is shaped by governance, intellectual capital, capital structure, and profitability. Research emphasizes the importance of strategic management in enhancing corporate

performance. Good Corporate Governance (GCG) has been shown to negatively impact profitability and firm value in the property sector, suggesting a misalignment with value creation strategies [1]. Intellectual Capital (IC) does not significantly impact profitability or firm value in the property sector, but in the consumer goods sector, IC significantly boosts both [2]. Regarding capital structure, leverage positively affects firm value in the property sector but not profitability [1], while in healthcare, high debt levels harm firm value [3]. Profitability is a critical factor in enhancing firm value across sectors, mediating the relationship between investment, growth, and firm value [2], [3], [4]. It plays a vital role in translating strategic initiatives into shareholder value [5]. Firms should focus on profitable investments and sustainable growth to maximize market valuation [5].

The quality of financial statements is a fundamental aspect of corporate transparency and accountability, playing a crucial role in enabling investors and other stakeholders to make informed decisions by providing relevant, reliable, and timely information. In contrast, low-quality financial reports can obscure a firm's true financial condition, leading to mispricing of shares and diminished investor trust. This issue is particularly relevant in developing countries like Indonesia, where earnings management, weak enforcement, and inconsistent application of accounting standards often create challenges for ensuring the reliability of financial information. Assessing how financial reporting quality affects firm value is vital for evaluating the credibility and efficiency of the financial information system, especially in Indonesia. High-quality financial reporting improves investment efficiency and firm value by providing accurate data that reduces overinvestment and underinvestment, thus aiding better decision-making [6]. The adoption of International Financial Reporting Standards (IFRS) in Indonesia has been shown to decrease earnings management, further enhancing the quality and relevance of financial information for investment decisions [7]. Financial reporting quality, measured by accrual quality and earnings management, significantly affects firm value, with earnings management having a positive impact on firm value proxies such as share price and Price to Book Value [8]. Additionally, corporate governance practices, when paired with high-quality financial reporting, are positively associated with firm value, suggesting that firms with better governance and reporting practices are perceived as more valuable by investors [9]. Although IFRS adoption has improved financial reporting quality in Indonesia, challenges remain in fully realizing its benefits, particularly regarding timely loss recognition [7]. Strong corporate governance, combined with high-quality financial reporting, further enhances firm value by ensuring transparency and accountability, which are critical for maintaining investor confidence [9]

Corporate governance, capital structure, and profitability are critical determinants of firm value, particularly in the context of Indonesia's evolving market. Good corporate governance (GCG) aligns managerial actions with long-term objectives, reducing agency conflicts and enhancing investor confidence. In Indonesia, regulatory bodies like the Financial Services Authority (OJK) and the Indonesia Stock Exchange (IDX) emphasize transparency, accountability, and fairness, which are essential for firm valuation. Empirical evidence has shown that companies with strong governance structures tend to have higher valuation multiples, as effective governance mitigates opportunistic behavior and promotes sustainable performance. An optimal capital structure, characterized by efficient debt utilization, can enhance firm value by providing tax shields and reducing capital costs. However, excessive leverage may negatively impact firm value, particularly in sectors like banking, where prudent debt management is crucial [10].

Profitability serves as an important mediating variable, connecting corporate governance and capital structure decisions to firm value. It reflects operational efficiency and financial health, positively influencing

firm value by demonstrating the firm's ability to generate economic gains. Prior studies suggest that the effect of financial statement quality, corporate governance, and capital structure on firm value occurs indirectly through profitability. For instance, better governance and higher-quality reporting can improve managerial decision-making and operational performance, thereby increasing profits and enhancing firm value. Similarly, an optimal capital structure can reduce financing costs and improve profitability levels [11], [12]. Therefore, understanding these factors and their interplay is essential for comprehensively analyzing how internal financial and governance mechanisms contribute to firm value creation.

Several previous empirical studies have examined the relationship between financial reporting, governance, capital structure, and firm value, but their findings remain inconsistent. Some studies found that financial statement quality positively impacts firm value due to reduced information asymmetry. Financial reporting quality, measured through accrual quality and earnings management, has shown mixed effects on firm value. While accrual quality may not significantly impact firm value, earnings management has been found to positively influence firm value in certain contexts, such as the manufacturing sector in Indonesia [8]. High-quality financial reporting is linked to reduced information asymmetry, supporting the signaling theory that suggests better financial disclosures can enhance firm value by providing clearer information to investors [13]. Corporate governance can directly and indirectly enhance firm value, with effective governance improving earnings quality, which in turn positively affects firm value, indicating a mediating role of earnings quality in the governance-value relationship [14]. The impact of corporate governance on firm value is more pronounced in firms with robust internal and external governance mechanisms, such as institutional ownership and analyst coverage [15]. Integrated financial and extra-financial narrative disclosures in management commentary are positively associated with firm valuation, with this effect being stronger in firms with better governance structures, highlighting the importance of comprehensive disclosures in enhancing firm value [15]. However, other studies found insignificant or negative effects, suggesting that market participants may not always perceive financial disclosures as reliable indicators. Similarly, the influence of corporate governance has been mixed—some research supports its positive role in enhancing firm value, while others suggest that governance effects are context-dependent and vary across institutional settings. The relationship between capital structure and firm value has also produced conflicting results, with certain studies supporting the trade-off theory and others aligning with the pecking order theory.

Given these research gaps, this study aims to provide a deeper empirical understanding of how financial statement quality, corporate governance, and capital structure jointly influence firm value in Indonesia, with profitability serving as a mediating variable. The study uses a quantitative approach with company samples representing various industrial sectors and employs Structural Equation Modeling–Partial Least Squares (SEM-PLS 3) to test both direct and indirect relationships. This approach allows for a comprehensive examination of the factors affecting firm value and their interrelationships within the Indonesian context.

This research contributes both theoretically and practically in several ways. Theoretically, it enriches the literature on firm valuation by integrating key determinants from financial reporting, governance, and capital structure perspectives, specifically within the context of emerging markets. Practically, the findings provide valuable insights for corporate managers to enhance firm value through improved reporting quality, governance practices, and optimal financial leverage. Moreover, policymakers and regulators can use the results to strengthen frameworks for financial transparency and governance compliance, thereby improving the overall investment

climate in Indonesia. In summary, this study seeks to answer the following research questions: 1) Does financial statement quality significantly affect firm value in Indonesia? 2) Does corporate governance influence firm value? 3) Does capital structure have a significant effect on firm value? 4) Does profitability mediate the relationship between financial statement quality, corporate governance, and capital structure on firm value?

2. LITERATURE REVIEW

2.1 Firm Value

Firm value is a multifaceted concept influenced by a variety of internal and external factors, often measured using indicators like Tobin's Q, which reflects the market's perception of a firm's future cash flows and risk profile. It is significantly affected by systematic and unsystematic risks, financial performance, governance, and macroeconomic conditions, which collectively shape investor confidence and perceptions of a firm's profitability and management effectiveness. Systematic risk, related to market-wide factors, tends to increase Tobin's Q, suggesting that investors may perceive higher potential returns from firms with higher market-related risks [16]. Conversely, unsystematic risk, which is firm-specific, generally decreases Tobin's Q, indicating that investors view these risks as detrimental to firm value [16]. Financial performance indicators such as leverage, asset tangibility, and liquidity positively influence firm value by signaling financial health and operational efficiency [17], [18]. Good corporate governance, including board independence and frequent meetings, enhances firm value by promoting transparency and accountability [17]. Macroeconomic events like the global financial crisis and the COVID-19 pandemic can have complex effects on firm value, with some crises negatively impacting firm value, while others may have a positive effect due to adaptive strategies [17]. Industry-specific factors, such as firm size and sales in the Malaysian plantation sector, are also crucial determinants

2.2 Financial Statement Quality

Financial statement quality is a critical factor in accurately reflecting a company's economic performance and position, influencing firm value and investment efficiency. High-quality financial statements, characterized by relevance, reliability, comparability, and timeliness, help mitigate information asymmetry between managers and shareholders. Empirical studies have shown that financial reporting quality positively impacts firm value by enhancing investor confidence and supporting valuation efficiency. However, the relationship between financial statement quality and firm value can vary depending on market conditions and investor sophistication. Financial reporting quality, measured through accrual quality and earnings management, affects firm value, with earnings management having a positive and significant effect on firm value proxies like share price and Price to Book Value, except for Market Value-Added [8]. High-quality financial statements improve investment efficiency, which in turn enhances firm value. Investment efficiency, including overinvestment and underinvestment, mediates the effect of financial statement quality on firm value [6]. Financial reporting quality reduces information asymmetry between firms and financial statement users, aligning with signaling theory. High-quality financial information decreases information asymmetry, enhancing transparency and investor confidence [13]. Timely and relevant financial reporting is crucial for reducing asymmetric information in capital markets, supporting effective decision-making, and fostering investor

confidence [13]. Various proxies, such as the modified Jones model and performance-matched model, are used to measure financial reporting quality, with these models being essential for assessing financial reporting quality and enhancing reporting standards [19].

2.3 *Corporate Governance*

Good corporate governance (GCG) is crucial for aligning managerial decisions with shareholder interests, ensuring transparency, fairness, and accountability. In Indonesia, empirical evidence supports the positive impact of GCG on firm performance and value. Studies indicate that robust governance practices, such as board independence and ESG disclosures, significantly enhance firm value, particularly in emerging markets like Indonesia, where investor protection may be weaker. This is evident in the positive correlation between governance practices and key performance indicators such as ROA, ROE, and EPS, as well as market-based performance measures like Tobin's Q. These findings underscore the strategic importance of GCG in fostering investor confidence and positioning firms for sustained growth. A study involving 112 Indonesian firms found that a one-unit increase in the Corporate Governance Perception Index (CGPI) score led to improvements in ROA, ROE, and EPS, highlighting the role of governance in enhancing financial performance [20]. Research on 120 non-financial companies showed that board independence positively impacts firm value, while board size had a negative but insignificant effect, suggesting that the quality of governance structures is more critical than their size [21]. Additionally, institutional and managerial ownership positively affect firm value, although audit committees did not show a significant impact, indicating that ownership structures may play a more vital role in governance effectiveness [22].

2.4 *Capital Structure*

The question of whether capital structure is relevant to firm value has been debated since Modigliani and Miller's (1958) proposition of its irrelevance under perfect market conditions. However, real-world factors such as taxes, bankruptcy costs, and asymmetric information have led to the development of theories like the trade-off and pecking order theories, which suggest that capital structure decisions are significant. Empirical evidence presents mixed results, with some studies supporting the trade-off theory, while others highlight the negative impact of leverage on firm value. This complexity is further illustrated in the Indonesian context, where high leverage is perceived negatively by investors. The trade-off theory posits that firms balance the tax benefits of debt against the costs of financial distress to determine an optimal capital structure [23], [24]. Empirical studies, such as those by Abor (2005), support this theory by showing that moderate leverage can reduce capital costs and increase firm value [25]. However, excessive debt can lead to higher financial risk and reduced firm value, as noted by Zeitun & Tian (2007) [25]. The pecking order theory suggests a preference for internal financing, followed by debt, and finally equity, to minimize information asymmetry and control dilution [23], [24]. This theory is supported by the observation that firms often deviate from target leverage ratios, indicating a preference for internal over external financing [24]. Empirical findings are mixed, with some studies reporting a negative relationship between leverage and firm value, contradicting the trade-off theory [25]. In Indonesia, high

leverage is perceived as a sign of financial instability, negatively affecting firm value [25].

2.5 *Profitability as a Mediating Variable*

Profitability plays a crucial role in mediating the relationship between internal corporate factors and firm value, reflecting a firm's ability to effectively utilize its resources to achieve a competitive advantage, thereby attracting investors and enhancing market valuation. Empirical studies have demonstrated that profitability, often measured by Return on Assets (ROA) or Return on Equity (ROE), significantly influences firm value. This influence is further shaped by factors such as financial reporting quality, governance practices, and capital structure. Profitability, as measured by ROA, has a significant positive effect on firm value, represented by Price to Book Value (PBV) [26]. Studies show that profitability directly enhances firm value, with a positive and significant influence when capital structure is controlled [27]. Capital structure, represented by Debt to Equity Ratio (DER), has an insignificant negative effect on firm value when considered independently [26]. The indirect effect of profitability on firm value through capital structure is negative and significant, indicating that while profitability boosts firm value, the capital structure can mediate this relationship negatively [27]. Effective governance practices, such as managerial ownership and public ownership, significantly enhance profitability, which in turn positively affects firm value [28]. However, some governance elements like independent commissioners and institutional ownership do not significantly impact profitability or firm value through profitability [28].

2.6 *Theoretical Framework and Hypothesis Development*

Based on the literature and theoretical perspectives, this study builds on three main theoretical pillars: 1) Agency Theory, which explains how information asymmetry and managerial opportunism are mitigated through financial reporting and governance mechanisms [29]; 2) Trade-Off and Pecking Order Theories, which describe how firms balance financing decisions to optimize firm value [30], [31]; and 3) Resource-Based View (RBV), which emphasizes the role of internal capabilities, such as profitability, in creating sustained competitive advantage [32]. From these foundations, the conceptual relationships are as follows: high financial statement quality enhances transparency, reduces information asymmetry, and positively affects firm value, both directly and indirectly through profitability; strong corporate governance improves managerial accountability and operational performance, thereby increasing profitability and firm value; and capital structure affects firm value depending on the balance between risk and return, with profitability potentially mediating this relationship. Accordingly, the study formulates the following hypotheses:

H1: Financial statement quality has a positive and significant effect on firm value.

H2: Corporate governance has a positive and significant effect on firm value.

H3: Capital structure has a significant effect on firm value.

H4: Financial statement quality has a positive and significant effect on profitability.

H5: Corporate governance has a positive and significant effect on profitability.

H6: Capital structure has a significant effect on profitability.
H7: Profitability has a positive and significant effect on firm value.
H8: Profitability mediates the relationship between financial statement quality, corporate governance, and capital structure on firm value.

3. METHODS

3.1 Research Design

This study adopts a quantitative explanatory research design, aimed at testing the causal relationships between financial statement quality, corporate governance, capital structure, profitability, and firm value. The explanatory approach was chosen to provide empirical evidence regarding the magnitude and direction of the relationships among the studied variables, as well as to determine whether profitability mediates the effects of financial statement quality, corporate governance, and capital structure on firm value. The study uses a cross-sectional design, where data were collected from respondents during a single period. The unit of analysis is the company, represented by managerial respondents with sufficient understanding of financial reporting, governance practices, and capital structure decisions.

3.2 Population and Sample

The population of this study includes companies operating in Indonesia that have published audited financial statements and applied corporate governance principles in their operations, including firms listed on the Indonesia Stock Exchange (IDX) across various sectors such as manufacturing, finance, services, and consumer goods. The sampling technique used is purposive sampling, based on specific inclusion criteria to ensure data relevance and validity. The inclusion criteria are: 1) Companies listed on the IDX for at least three consecutive years prior to the study; 2) Companies that consistently publish annual reports and financial statements; 3) Companies that disclose corporate governance information (e.g., board composition, audit committee, and ownership structure); and 4) Respondents occupying managerial or financial positions (e.g., finance directors, accounting managers, or internal auditors). A total of 165 valid samples were obtained from distributed questionnaires and verified company data. This sample size meets the minimum requirement for SEM-PLS analysis, as Hair et al. (2019) recommend a sample of at least 10 times the number of indicators used in the model.

3.3 Data Collection Method

The study employed both primary and secondary data sources: Primary data were collected through a structured Likert-scale questionnaire distributed to managerial-level respondents, with items adapted from validated instruments in previous studies related to financial statement quality (Dechow et al., 2010), corporate governance (OECD, 2015), capital structure (Myers & Majluf, 1984), profitability, and firm value (Brigham & Houston, 2019). Secondary data were obtained from company annual reports, IDX databases, and official publications of the Financial Services Authority (OJK). These data were used to cross-validate responses and ensure consistency between reported perceptions and actual financial outcomes. Respondents were assured of confidentiality and anonymity to minimize response bias and encourage honest answers. Questionnaires were distributed both online and in printed form to ensure wider coverage.

3.4 Operational Definition and Measurement of Variables

Each construct in this study was measured using multiple indicators based on prior empirical and theoretical literature. All items were assessed using a five-point Likert scale, where 1 = "Strongly Disagree" and 5 = "Strongly Agree." Financial statement quality (X_1) refers to the extent to which financial reports reflect the firm's actual financial condition, reliability, and transparency. It was measured using four indicators: X_1.1:

Relevance and reliability of financial information; $X_1.2$: Freedom from material misstatement or manipulation (earnings quality); $X_1.3$: Compliance with accounting standards and disclosure requirements; and $X_1.4$: Timeliness and transparency in financial reporting. Corporate governance (X_2) represents the principles and mechanisms used to direct and control company management. Indicators for corporate governance were developed based on the OECD (2015) and OJK regulations: $X_2.1$: Board of Commissioners' independence; $X_2.2$: Effectiveness of the audit committee; $X_2.3$: Ownership structure and shareholder rights; and $X_2.4$: Transparency and accountability mechanisms. Capital structure (X_3) refers to the proportion of debt and equity financing used by the firm. Indicators were based on Myers and Majluf (1984) and Brigham & Houston (2019): $X_3.1$: Ratio of total debt to total equity (leverage); $X_3.2$: Cost of debt and interest coverage; $X_3.3$: Management's risk tolerance in financing decisions; and $X_3.4$: Ability to maintain optimal debt-equity balance. Profitability (Z) measures the firm's ability to generate profit from its operational activities and serves as a mediating variable in the model. Indicators were adapted from Brigham & Houston (2019): Z_1: Return on Assets (ROA) growth; Z_2: Return on Equity (ROE) performance; Z_3: Net Profit Margin (NPM); and Z_4: Operational efficiency and cost management. Firm value (Y) represents the market perception of the firm's overall performance and future potential, measured using indicators adapted from Tobin's Q model: Y_1: Market-to-book value ratio; Y_2: Investor confidence and perception; Y_3: Share price performance; and Y_4: Firm reputation and growth potential.

3.5 Data Analysis Technique

Data were analyzed using the Structural Equation Modeling–Partial Least Squares (SEM-PLS) approach through SmartPLS 3.0 software. This technique was chosen because it allows for simultaneous analysis of multiple dependent relationships, is suitable for complex models with mediating variables, and accommodates non-normal data distributions and smaller sample sizes (Hair et al., 2019). The analysis consisted of two major stages: 1) Measurement Model Evaluation (Outer Model), which assesses the validity and reliability of the measurement model through tests such as convergent validity (evaluated using factor loadings >0.70 and Average Variance Extracted (AVE) >0.50), discriminant validity (assessed using the Fornell-Larcker criterion and cross-loading comparison), and internal consistency reliability (measured using Composite Reliability (CR) and Cronbach's Alpha with acceptable thresholds >0.70); and 2) Structural Model Evaluation (Inner Model), which tests the hypothesized relationships among latent constructs by examining path coefficients (β) to determine the strength and direction of relationships, the coefficient of determination (R^2) to assess the model's explanatory power, predictive relevance (Q^2) to evaluate predictive accuracy, effect size (f^2) to measure the magnitude of influence of each predictor, and significance testing (Bootstrapping) with 5,000 subsamples to assess p-values and t-statistics (significance level $\alpha = 0.05$). The mediation test followed the approach by Baron and Kenny (1986) and Zhao et al. (2010), where the indirect effect of financial statement quality, corporate governance, and capital structure on firm value through profitability was analyzed using bootstrapped confidence intervals.

4. RESULTS AND DISCUSSION

4.1 Data Description and Respondent Profile

This section presents a detailed description of the data collected and the characteristics of the respondents who participated in the study, providing an overview of the data collection process, company profiles, respondent demographics, and the descriptive statistics of the research variables. The data were obtained through a structured survey using a five-point Likert-scale questionnaire distributed to companies operating in Indonesia. The survey targeted managerial-level respondents with

knowledge and responsibility related to financial reporting, governance practices, and strategic financial management. A total of 200 questionnaires were distributed, and 172 were returned (86% response rate), with 165 valid responses after data cleaning. This high response rate indicates strong engagement from Indonesian firms in research related to financial statement quality, governance, and firm value, issues that have gained attention due to OJK regulations on transparency and good corporate governance. The companies in the study varied in sector, size, ownership type, and age, reflecting a broad cross-section of the Indonesian corporate landscape. The manufacturing sector dominated the sample (35%), followed by services, finance, and consumer goods. Most firms (70%) were publicly listed on the IDX, while the remaining 30% were private companies adopting OJK and IFRS-based disclosure standards. In terms of age, 60% of firms had been in operation for more than 10 years, indicating that the respondents represented well-established businesses.

The respondents were selected based on their managerial position and involvement in financial and governance decision-making, with 51% holding positions directly related to financial management and accounting. In terms of education, 68% had a bachelor's degree, 28% had a master's degree, and 4% held professional certifications like CPA, CA, or CMA. Descriptive statistics for the research variables—Financial Statement Quality (FSQ), Corporate Governance (CG), Capital Structure (CS), Profitability (PROF), and Firm Value (FV)—were calculated to understand their distribution and central tendencies. Most variables had mean values above 4.00, indicating high-quality financial reporting, strong governance practices, and good performance in profitability and firm value. For example, FSQ had a mean of 4.12, suggesting that firms produce reliable, timely, and transparent financial reports. CG had a mean of 4.05, indicating strong governance implementation. CS had a moderate mean of 3.58, showing a balanced but cautious approach to leverage. PROF had a mean of 3.95, indicating healthy profitability levels, and FV had a mean of 4.08, suggesting positive market perception and investor confidence. The low standard deviations (<0.55) suggest that responses were consistent across participants.

4.2 Measurement Model Evaluation (Outer Model)

The measurement model evaluation, also known as the outer model assessment, is conducted to test the validity and reliability of the constructs before proceeding to the structural (inner) model analysis. This process ensures that the indicators used accurately measure each latent variable—namely Financial Statement Quality (X_1), Corporate Governance (X_2), Capital Structure (X_3), Profitability (Z), and Firm Value (Y). The evaluation includes three key stages: (1) Convergent Validity, (2) Discriminant Validity, and (3) Reliability Testing, using SmartPLS 3.0 software. The measurement model was analyzed through the PLS algorithm and bootstrapping procedures, following Hair et al. (2019) standards.

4.2.1 Convergent Validity

Convergent validity assesses the degree to which indicators of a construct are correlated and measure the same concept. The evaluation is based on outer loading values and Average Variance Extracted (AVE). According to Hair et al. (2019), the outer loading of each indicator should be greater than 0.70, and the AVE for each construct should exceed 0.50 to demonstrate sufficient convergent validity. The results of the convergent validity test are presented below:

Table 1. Convergent Validity

Construct	Indicator	Outer Loading	AVE	Remarks
Financial Statement Quality (X_1)	FSQ1	0.841		Valid
	FSQ2	0.872		Valid
	FSQ3	0.816		Valid
	FSQ4	0.788	0.691	Valid
Corporate Governance (X_2)	CG1	0.824		Valid
	CG2	0.865		Valid
	CG3	0.841		Valid
	CG4	0.812	0.681	Valid
Capital Structure (X_3)	CS1	0.795		Valid
	CS2	0.824		Valid
	CS3	0.802		Valid
	CS4	0.776	0.626	Valid
Profitability (Z)	PROF1	0.853		Valid
	PROF2	0.876		Valid
	PROF3	0.832		Valid
	PROF4	0.801	0.714	Valid
Firm Value (Y)	FV1	0.864		Valid
	FV2	0.882		Valid
	FV3	0.847		Valid
	FV4	0.819	0.732	Valid

Table 1 presents the results of the convergent validity test for the constructs in the study, showing the outer loadings and Average Variance Extracted (AVE) for each indicator. Convergent validity assesses whether the indicators of a construct are closely related and measure the same concept, ensuring that each construct is adequately represented by its indicators. For each construct, the outer loadings are all above the recommended threshold of 0.70, as specified by Hair et al. (2019), indicating that the individual indicators are highly correlated with their respective constructs and contribute meaningfully to the measurement model. For example, the Financial Statement Quality (X_1) construct includes indicators FSQ1, FSQ2, FSQ3, and FSQ4, all of which have outer loadings ranging from 0.788 to 0.872, well above the 0.70 threshold, and the AVE for X_1 is 0.691, which exceeds the minimum requirement of 0.50, confirming sufficient convergent validity. Similarly, the Corporate Governance (X_2), Capital Structure (X_3), Profitability (Z), and Firm Value (Y) constructs all show outer loadings above 0.70 for each indicator and have AVE values exceeding 0.50, with the highest AVE being 0.732 for Firm Value (Y). This consistent finding across all constructs demonstrates that the indicators used are valid and appropriately represent the latent variables. Overall, the convergent validity results indicate that the measurement model is robust, and the indicators are reliable in measuring the intended constructs.

4.2.2 Discriminant Validity

Discriminant validity tests whether each construct is distinct from the others and captures unique aspects of the model. It was evaluated using two methods: 1) Fornell–Larcker Criterion, which compares the square root of the AVE for each construct with its correlations with other constructs. Discriminant validity is achieved when the

square root of the AVE is higher than the inter-construct correlations; and 2) Cross-Loading Analysis, which verifies that an indicator's loading on its associated construct is higher than its loadings on other constructs. The results of the Fornell–Larcker Criterion show that each construct's diagonal (√AVE) value is greater than its correlations with other constructs, confirming strong discriminant validity. For example, the square root of AVE for Financial Statement Quality (FSQ) is 0.831, which is greater than its correlation with other constructs, such as Corporate Governance (CG) at 0.528. This confirms that financial statement quality, governance, and capital structure measure conceptually distinct dimensions of the model. The Cross-Loading Analysis further supports discriminant validity, as all indicator loadings on their intended constructs are higher than their loadings on other constructs. For instance, FSQ1 loads at 0.841 on Financial Statement Quality but only 0.45 or less on other constructs. This confirms that no indicator cross-loads significantly, supporting discriminant validity.

4.2.3 Reliability Testing

Reliability tests were conducted using Composite Reliability (CR) and Cronbach's Alpha to assess the internal consistency of each construct. According to Hair et al. (2019), CR and Cronbach's Alpha values above 0.70 indicate strong reliability. The results show that all constructs have CR and Cronbach's Alpha values exceeding 0.80, which indicates high reliability. Specifically, Financial Statement Quality (X_1) has a CR of 0.905 and Cronbach's Alpha of 0.869, Corporate Governance (X_2) has a CR of 0.902 and Cronbach's Alpha of 0.864, Capital Structure (X_3) has a CR of 0.872 and Cronbach's Alpha of 0.821, Profitability (Z) has a CR of 0.918 and Cronbach's Alpha of 0.883, and Firm Value (Y) has a CR of 0.924 and Cronbach's Alpha of 0.891. These results demonstrate that the indicators within each construct exhibit consistent internal relationships, ensuring measurement stability and reliability.

4.3 Structural Model Evaluation (Inner Model)

The evaluation of the structural model (inner model) aims to determine the strength and significance of the relationships between latent constructs—namely Financial Statement Quality (X_1), Corporate Governance (X_2), Capital Structure (X_3), Profitability (Z), and Firm Value (Y). This stage is conducted to test the research hypotheses and assess the model's explanatory power using SmartPLS 3.0 software. Following the recommendations by Hair et al. (2019), the inner model evaluation consists of five main components: (1) coefficient of determination (R^2), which measures the explanatory power of the model; (2) predictive relevance (Q^2), which tests the model's ability to predict endogenous variables; (3) effect size (f^2), which determines the magnitude of influence of each exogenous variable; (4) collinearity assessment (VIF), used to ensure there is no multicollinearity among predictors; and (5) hypothesis testing through path coefficients obtained via the bootstrapping method.

4.3.1 Collinearity Assessment (VIF Test)

Before testing hypotheses, the model must be free from multicollinearity issues. This is confirmed using the Variance Inflation Factor (VIF), where values below 5.00 indicate the absence of collinearity problems.

Table 2. Inner VIF

Construct Relationship	VIF Value	Remarks
Financial Statement Quality → Profitability	2.314	No multicollinearity
Corporate Governance → Profitability	2.527	No multicollinearity
Capital Structure → Profitability	2.193	No multicollinearity
Financial Statement Quality → Firm Value	2.608	No multicollinearity

Corporate Governance → Firm Value	2.472	No multicollinearity
Capital Structure → Firm Value	2.215	No multicollinearity
Profitability → Firm Value	2.386	No multicollinearity

Table 2 presents the results of the Variance Inflation Factor (VIF) analysis, used to assess multicollinearity in the structural model. Multicollinearity occurs when there is high correlation between predictor variables, potentially distorting the estimation of model parameters and leading to unreliable results. According to Hair et al. (2019), a VIF value greater than 5 or 10 indicates problematic multicollinearity, while values below these thresholds suggest no significant multicollinearity. In this case, all VIF values for the relationships between the constructs are well below the threshold, with the highest being 2.608 for the relationship between Financial Statement Quality and Firm Value. The VIF values for other relationships, including Financial Statement Quality → Profitability (2.314), Corporate Governance → Profitability (2.527), Capital Structure → Profitability (2.193), Corporate Governance → Firm Value (2.472), Capital Structure → Firm Value (2.215), and Profitability → Firm Value (2.386), all fall below 3.0. These results indicate no multicollinearity among the constructs, ensuring that the relationships between the variables are stable and the model is suitable for further analysis without concerns of multicollinearity affecting the results.

4.3.2 Coefficient of Determination (R^2)

The R^2 value measures how much of the variance in endogenous variables can be explained by exogenous variables. For this study, the R^2 value for Profitability (Z) is 0.611, indicating moderate to strong explanatory power, meaning that 61.1% of the variation in profitability is explained by financial statement quality, corporate governance, and capital structure. The R^2 value for Firm Value (Y) is 0.682, indicating strong explanatory power, as 68.2% of the variation in firm value is explained by financial statement quality, corporate governance, capital structure, and profitability. According to Chin (1998), R^2 values of 0.19 (weak), 0.33 (moderate), and 0.67 (substantial) suggest that both endogenous variables in this study demonstrate strong predictive power, with firm value showing substantial explanatory power and profitability showing moderate to strong explanatory power.

4.3.3 Predictive Relevance (Q^2)

The Stone–Geisser Q^2 test was performed using the blindfolding procedure to evaluate the predictive relevance of the model. A Q^2 value greater than zero indicates that the model has predictive capability for the endogenous constructs. The Q^2 value for Profitability (Z) is 0.458, indicating high predictive relevance, while the Q^2 value for Firm Value (Y) is 0.517, indicating very high predictive relevance. Both Q^2 values exceed 0.35, suggesting that the model has strong predictive relevance and can reliably predict the dependent constructs in the model.

4.3.4 Effect Size (f^2)

The effect size (f^2) assesses the contribution of each exogenous variable to the R^2 value of the endogenous variables. The benchmarks for effect size are 0.02 (small), 0.15 (medium), and 0.35 (large).

Table 3. Effect Size

Relationship	f^2 Value	Effect Size	Interpretation
FSQ → Profitability	0.253	Medium	Moderate influence
CG → Profitability	0.198	Medium	Moderate influence
CS → Profitability	0.124	Small	Weak but significant influence
FSQ → Firm Value	0.118	Small	Weak but direct influence
CG → Firm Value	0.214	Medium	Moderate influence

CS → Firm Value	0.091	Small	Weak negative influence
Profitability → Firm Value	0.352	Large	Strong influence

Table 3 presents the effect size (f^2) values for the relationships in the model, which measure the magnitude of the influence that each predictor variable has on the dependent variables. The f^2 values are interpreted as follows: values greater than 0.35 indicate a large effect, values between 0.15 and 0.35 indicate a medium effect, and values below 0.15 indicate a small effect. In this study, the relationship between Financial Statement Quality (FSQ) and Profitability shows a medium effect size ($f^2 = 0.253$), indicating a moderate influence. Corporate Governance (CG) has a similar moderate effect on Profitability ($f^2 = 0.198$). Capital Structure (CS) has a small effect on Profitability ($f^2 = 0.124$), reflecting a weak but significant influence. For Firm Value, FSQ shows a small effect ($f^2 = 0.118$), indicating a weak but direct influence, while CG has a moderate effect ($f^2 = 0.214$), suggesting a moderate influence on Firm Value. CS has a small negative effect on Firm Value ($f^2 = 0.091$), indicating a weak negative influence. Finally, Profitability has a large effect on Firm Value ($f^2 = 0.352$), signifying a strong influence. These results highlight the varying degrees of influence that different factors have on Profitability and Firm Value, with Profitability having the most significant impact on Firm Value.

4.3.5 Hypothesis Testing (Path Coefficients and Bootstrapping Results)

To test the significance of each hypothesized path, a bootstrapping analysis with 5,000 resamples was performed. The results are summarized as follows:

Table 4. Hypothesis Testing

Hypothesis	Path Relationship	Coefficient (β)	t-Statistic	p-Value	Significance	Result
H1	Financial Statement Quality → Firm Value	0.238	4.215	0.000	Significant	Supported
H2	Corporate Governance → Firm Value	0.271	3.984	0.000	Significant	Supported
H3	Capital Structure → Firm Value	-0.198	2.756	0.006	Significant	Supported
H4	Financial Statement Quality → Profitability	0.314	5.227	0.000	Significant	Supported
H5	Corporate Governance → Profitability	0.284	4.615	0.000	Significant	Supported
H6	Capital Structure → Profitability	-0.165	2.432	0.015	Significant	Supported
H7	Profitability → Firm Value	0.417	6.193	0.000	Significant	Supported
H8	Indirect Effects (Mediation via Profitability)	0.128	3.267	0.001	Significant	Supported (Partial Mediation)

Table 4 presents the results of hypothesis testing, showing the path relationships, coefficients (β), t-statistics, p-values, significance, and the results of each hypothesis. The coefficients (β) represent the strength and direction of the relationships between the variables, while the t-statistics and p-values indicate the significance of these relationships. The results demonstrate that all hypotheses are supported, with statistically significant relationships across the board. Hypothesis H1, examining the relationship between Financial Statement Quality (FSQ) and Firm Value, shows a positive and significant coefficient (β = 0.238, t = 4.215, p = 0.000), indicating that higher financial statement quality positively influences firm value. Similarly, Hypothesis H2 (Corporate Governance → Firm Value) and H3 (Capital Structure → Firm Value) show significant positive relationships (β = 0.271, t = 3.984, p = 0.000 and β = -0.198, t = 2.756, p = 0.006, respectively), suggesting that good corporate governance enhances firm value, while capital structure has a negative but significant impact. Hypotheses H4, H5, and H6, analyzing the relationships between financial statement quality, corporate governance, capital structure, and profitability, show significant positive effects (β values ranging from 0.284 to 0.314), confirming that better financial reporting and governance improve profitability, while capital structure negatively impacts it. The strongest influence is seen in Hypothesis H7 (Profitability → Firm Value), where profitability has a large and significant effect on firm value (β = 0.417, t = 6.193, p = 0.000). Finally, Hypothesis H8 tests the indirect effects through profitability as a mediator, with results (β = 0.128, t = 3.267, p = 0.001) indicating partial mediation, suggesting that profitability partially mediates the relationships between financial statement quality, corporate governance, and capital structure on firm value. Overall, all hypotheses are supported, with profitability playing a key mediating role in the model.

4.4 Discussion

The results indicate that financial statement quality has a positive and significant effect on firm value (β = 0.238, p < 0.05), suggesting that companies producing transparent, reliable, and timely financial information are more highly valued by investors. This aligns with Agency Theory, which posits that high-quality reporting reduces information asymmetry and agency costs between management and shareholders. The finding supports Francis et al. (2004) and Chen et al. (2011), who indicated that accurate financial reporting improves investors' perceptions of firm credibility and enhances valuation multiples. In Indonesia, where capital market participants are increasingly sensitive to transparency, reliable financial statements serve as a strong signal of integrity and managerial competence. Moreover, transparent financial information allows better decision-making and resource allocation, reinforcing the signaling theory where high-quality financial reporting boosts investor trust and firm valuation.

Corporate governance also positively and significantly impacts firm value (β = 0.271, p < 0.05), confirming that effective governance mechanisms enhance shareholder confidence, reduce opportunistic behavior, and improve firm performance. This finding aligns with Klapper & Love (2004) and Hermawan & Mulyani (2014), who showed that strong governance systems, including independent boards and active audit committees, lead to higher firm value. This supports both Agency Theory, which suggests that governance mitigates conflicts between shareholders and management, and Stakeholder Theory, which views governance as balancing the interests of various stakeholders. In the Indonesian context, regulatory frameworks like OJK Regulation No. 21/POJK.04/2015 standardize governance practices, improving accountability and serving as a positive signal to investors.

The study also reveals that capital structure negatively and significantly affects firm value (β = -0.198, p < 0.05), suggesting that firms with higher leverage ratios tend to have lower firm value due to increased financial risk and interest obligations. This supports the Trade-Off Theory, which argues that while debt provides tax advantages,

excessive leverage leads to financial distress and higher bankruptcy costs. Empirical evidence by Dewi & Wirajaya (2013) and Zeitun & Tian (2007) supports this, showing that high debt ratios erode investor confidence, especially in volatile markets like Indonesia. Therefore, maintaining an optimal capital structure that balances risk and return is crucial for preserving firm value. The study also finds that financial statement quality has a positive and significant effect on profitability ($\beta = 0.314$, $p < 0.05$), suggesting that high-quality reporting enhances internal decision-making, leading to better operational efficiency and profitability, which aligns with the Resource-Based View, where reliable financial information is seen as an intangible resource that strengthens profitability.

Corporate governance also significantly impacts profitability ($\beta = 0.284$, $p < 0.05$), with the study showing that firms with effective governance structures tend to exhibit higher profitability. This relationship supports Bhagat & Bolton (2013) and Arora & Sharma (2016), who found that robust governance mechanisms enhance profitability by improving strategic oversight and internal controls. From the Agency Theory perspective, governance ensures that managers act in shareholders' best interests, improving profitability metrics like Return on Assets (ROA) and Return on Equity (ROE). The study further reveals that capital structure has a negative and significant effect on profitability ($\beta = -0.165$, $p < 0.05$), suggesting that higher debt levels reduce profitability due to increased financial costs. This aligns with the Pecking Order Theory, which posits that firms prefer internal financing to maintain profitability and reduce debt reliance. Finally, profitability has the strongest direct effect on firm value ($\beta = 0.417$, $p < 0.05$), indicating that profitable firms are perceived more favorably by investors, leading to higher firm valuation. Profitability represents a reflection of managerial capability and operational efficiency, translating into market confidence and stronger stock performance.

The study also finds that profitability partially mediates the relationships between financial statement quality, corporate governance, and firm value ($\beta = 0.128$, $p < 0.05$), suggesting that while both financial statement quality and governance directly enhance firm value, their effects are strengthened when profitability is considered. This partial mediation aligns with Zhao et al. (2010) and Baron & Kenny (1986), who suggest that partial mediation occurs when an independent variable affects the dependent variable both directly and indirectly through a mediator. In this context, profitability serves as a strategic link between internal mechanisms, such as financial reporting and governance, and external market outcomes. From the Resource-Based View, profitability represents a performance capability that transforms strong internal governance and reporting practices into market-based success, demonstrating that firms with high reporting quality and strong governance can achieve superior firm value due to enhanced operational performance and profitability.

5. CONCLUSION

The results of this study provide important insights into the determinants of firm value among companies in Indonesia. Using the SEM-PLS 3 analysis, several key conclusions can be drawn: First, high-quality financial statements significantly enhance firm value by improving transparency, reliability, and investor confidence. Consistent with Agency Theory, accurate reporting reduces information asymmetry and signals strong managerial integrity, thereby improving market valuation. Second, effective corporate governance mechanisms—such as independent boards, active audit committees, and clear accountability structures—positively influence firm value. This finding supports both Agency Theory and Stakeholder Theory, confirming that strong governance improves oversight, reduces agency costs, and aligns managerial actions with shareholder interests. Third, excessive leverage negatively affects firm value due to increased financial risk and potential distress costs, aligning with the

Trade-Off Theory, which suggests that while moderate debt can optimize tax benefits, over-leverage erodes investor trust and firm stability.

Additionally, profitability acts as a key mediator, significantly mediating the relationships between financial statement quality and corporate governance with firm value, though not between capital structure and firm value. This indicates that operational efficiency and profit generation are essential channels through which internal corporate mechanisms translate into market-based outcomes. The findings collectively validate the integration of Agency Theory, Trade-Off Theory, and the Resource-Based View (RBV). Financial transparency and governance quality reduce information asymmetry (Agency Theory), prudent capital management ensures an optimal financing balance (Trade-Off Theory), and profitability serves as an internal resource that drives sustainable competitive advantage (RBV). Practically, the study suggests that Indonesian firms should focus on strengthening financial reporting, implementing effective governance systems, and managing capital prudently to improve profitability and firm value. Policymakers such as the Otoritas Jasa Keuangan (OJK) and the Indonesia Stock Exchange (IDX) should enforce stricter governance and disclosure standards to enhance corporate transparency and investor protection. Future research should explore expanding this model by incorporating macroeconomic variables and non-financial indicators, such as environmental, social, and governance (ESG) performance, to offer a more comprehensive understanding of firm value dynamics in emerging markets.

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