International Journal of Business, Law, and Education
E-ISSN : 2747-1985
Publisher: IJBLE Scientific Publications Community Inc.
IJBLE
Volume 6, Number 1, 2025
https://ijble.com/index.php/journal/index

The Influence of Corporate Governance, Capital Structure, and Profitability on Firm Value in Banking Sector in Indonesia

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ABSTRACT
This study investigates the influence of corporate governance, capital structure, and profitability on firm value in the Indonesian banking sector. Using a quantitative research design, data were collected from publicly listed banks' financial reports and analyzed through multiple regression. Results indicate that corporate governance and profitability positively impact firm value, while high capital structure negatively affects it. Control variables, such as bank size and liquidity, also show significant relationships. These findings highlight the importance of robust governance, prudent debt management, and operational efficiency for sustainable growth. The study offers practical insights for managers, regulators, and investors while addressing limitations for future research.

Keywords: Corporate Governance, Capital Structure, Profitability, Firm Value, Indonesian Banking Sector

INTRODUCTION

Corporate governance has emerged as a critical mechanism for ensuring transparency, accountability, and effective decision-making within organizations. In the banking sector, which serves as the backbone of economic stability, robust corporate governance practices play an indispensable role in fostering investor confidence and mitigating financial risks. Globally, incidents such as the 2008 financial crisis have highlighted the consequences of inadequate governance, driving regulators and policymakers to impose stricter oversight and compliance standards (Pratiwi, 2016). For Indonesia, a developing economy with a rapidly expanding banking sector, corporate governance is pivotal in navigating challenges associated with globalization, technological disruption, and evolving market dynamics (Rasyid, 2015).

Capital structure, defined as the mix of debt and equity used to finance a firm's operations, also holds significant implications for firm value. Optimal capital structure decisions can lower the cost of capital, thereby enhancing shareholder wealth (Dewi et al., 2017). However, the banking sector's reliance on leverage introduces unique complexities. Unlike non-financial firms, banks are subject to stringent regulatory capital requirements and must balance profitability objectives with the need to maintain liquidity and solvency. Understanding the interplay between capital structure and firm value in the Indonesian banking context provides a valuable lens for assessing the sector's financial health and resilience (Sari & Sedana, 2020).

Profitability serves as a cornerstone for evaluating the operational efficiency and sustainability of financial institutions (Auliani et al., 2024). High profitability not only strengthens the institution's capacity to absorb shocks but also enhances its attractiveness to investors. In Indonesia, the banking sector has witnessed considerable growth, fueled by increasing financial inclusion and economic expansion. However, profitability levels vary significantly across institutions due to factors such as management practices, market competition, and macroeconomic conditions (Gunadi et al., 2020). Investigating the link between profitability and firm value offers insights into the strategic priorities necessary to maintain competitiveness in a dynamic environment.

Indonesia's banking sector is undergoing a transformative phase, shaped by regulatory reforms, digitalization, and a heightened emphasis on sustainability. Policies introduced by the Financial Services Authority (OJK) aim to strengthen governance frameworks and enhance the sector's resilience against global uncertainties. Meanwhile, the integration of environmental, social, and governance (ESG) principles into corporate strategies reflects growing recognition of sustainability as a driver of long-term value creation. In this context, the relationships among corporate governance, capital structure, profitability, and firm value warrant closer examination to identify best practices and inform policy recommendations (Ferriswara et al., 2022; Tui et al., 2017).

Despite the sector's progress, challenges remain. Issues such as inadequate risk management, governance lapses, and suboptimal capital allocation continue to hinder the sector's ability to realize its full potential. Moreover, external shocks, including geopolitical tensions and global economic slowdowns, exacerbate vulnerabilities. By exploring the interactions between governance mechanisms, financial structures, and operational outcomes, this study aims to provide actionable insights into enhancing firm value in Indonesia's banking sector.

The Indonesian banking sector's growth trajectory underscores the need for robust frameworks that can sustain firm value amidst evolving challenges. However, gaps in understanding persist regarding the specific contributions of corporate governance, capital structure, and profitability to firm value. While existing literature provides valuable theoretical foundations, empirical evidence specific to Indonesia remains limited, particularly in capturing the sector's unique regulatory and market characteristics. This gap hinders the development of tailored strategies to optimize performance and resilience. Therefore, this study addresses the critical question: How do corporate governance, capital structure, and profitability influence firm value in the Indonesian banking sector?

The objective of this study is to examine the influence of corporate governance, capital structure, and profitability on firm value within Indonesia's banking sector. By leveraging quantitative analysis and contextual insights, the research aims to identify key drivers of value creation and propose actionable recommendations for stakeholders. Ultimately, the findings are expected to contribute to academic discourse, inform policymaking, and enhance strategic decision-making within the sector.

Literature Review and Hypothesis Development

1. Corporate Governance and Firm Value

Corporate governance encompasses the mechanisms, processes, and principles that define the framework within which corporations operate, ensuring accountability and fairness to stakeholders (Faoziyanti & Renny, 2024). Theoretically, strong corporate governance improves decision-making quality, reduces agency conflicts, and aligns the interests of managers and shareholders. In the banking sector, governance assumes an elevated significance due to the fiduciary nature of operations and the critical role of banks in financial stability. Empirical studies suggest a positive relationship between corporate governance and firm value. For example, Gunawan & Budiarjo (2014) demonstrate that firms with independent boards and sound governance policies outperform their peers in terms of market valuation. Similarly, in emerging markets like Indonesia, where institutional frameworks are evolving, robust governance is critical to attracting foreign investment and ensuring long-term viability. Hypothesis 1: Corporate governance positively influences firm value in the Indonesian banking sector.

2. Capital Structure and Firm Value

Capital structure theory provides a foundation for understanding how the mix of debt and equity financing impacts firm performance. Umar et al. (2020) irrelevance theorem posits that under perfect market conditions, capital structure has no effect on firm value. However, real-world imperfections, such as taxes, bankruptcy costs, and information asymmetries, give rise to the trade-off theory and pecking order theory. In the banking sector, regulatory requirements, such as minimum capital adequacy ratios, add another layer of complexity to capital structure decisions (Otoxsusilo et al., 2023). Empirical research indicates that an optimal capital structure—balancing risk and return—can enhance firm value. Mubaraq et al. (2021) highlight the importance of leverage in improving managerial discipline, albeit with the risk of financial distress. In Indonesia, studies have shown that highly leveraged banks often struggle with sustainability, emphasizing the need for prudent capital structure strategies. Hypothesis 2: Capital structure positively influences firm value in the Indonesian banking sector.

3. Profitability and Firm Value

Profitability reflects a firm's ability to generate earnings relative to its expenses and other costs. It is widely regarded as a critical determinant of firm value, as it signals operational efficiency and market competitiveness. The resource-based view (RBV) posits that profitability stems from unique organizational resources and capabilities, which drive sustainable competitive advantage (Barney, 1991). In the banking sector, profitability metrics such as return on assets (ROA) and return on equity (ROE) are closely monitored by investors and regulators. Empirical studies corroborate the positive relationship between profitability and firm value. Rahmawati et al. (2021) find that banks with higher profitability ratios exhibit superior market valuations, as earnings provide a buffer against economic shocks and support growth initiatives. In Indonesia, where the banking sector faces competition from fintech and foreign players, profitability remains a key indicator of institutional resilience. Hypothesis 3: Profitability positively influences firm value in the Indonesian banking sector.

4. Interaction Effects and Contextual Factors

The interplay among corporate governance, capital structure, and profitability adds complexity to the determination of firm value. Governance mechanisms may mediate the impact of capital structure on firm performance, as effective oversight ensures optimal leverage decisions (Setiadharma & Machali, 2017). Similarly, profitability could serve as a moderating variable, amplifying the positive effects of governance and capital structure on firm value. Contextual factors, such as market conditions, regulatory frameworks, and technological advancements, further shape these relationships. For instance, studies conducted in Southeast Asia highlight the importance of institutional quality in moderating these dynamics. Weak enforcement of governance regulations can dilute their effectiveness, while economic volatility may exacerbate the risks associated with high leverage (Siagian et al., 2013). Given Indonesia's unique market characteristics, examining these interactions provides valuable insights into the determinants of firm value. Hypothesis 4: Corporate governance, capital structure, and profitability jointly influence firm value in the Indonesian banking sector.

5. Research Framework

Based on the literature, this study adopts a conceptual framework that positions corporate governance, capital structure, and profitability as independent variables and firm value as the dependent variable. The framework also accounts for potential interaction effects, enabling a holistic assessment of their combined impact. Quantitative methods, such as regression analysis, will be employed to test the proposed hypotheses, ensuring robust and generalizable findings.

METHOD

1. Research Design

This study employs a quantitative research design to investigate the influence of corporate governance, capital structure, and profitability on firm value in the Indonesian banking sector. By leveraging empirical data, the research aims to establish statistically significant relationships among the variables, offering actionable insights for academics, practitioners, and policymakers. A cross-sectional approach is adopted to capture the state of the banking sector within a defined period, ensuring a focused analysis of the factors affecting firm value.

2. Population and Sample

The population of this study comprises all publicly listed banks in Indonesia during the most recent fiscal year. These banks represent a diverse range of financial institutions, varying in size, ownership structure, and operational focus. Using purposive sampling, the study selects banks that meet the following criteria:

a. Listed on the Indonesia Stock Exchange (IDX).
b. Have complete financial data for the fiscal year under review (2023-2024)
c. Adhere to governance disclosures as mandated by regulatory authorities.
d. Exhibit continuity in operations without significant restructuring events.

The final sample size is determined based on the availability of data and alignment with the inclusion criteria, ensuring robustness and representativeness.

3. Data Collection

This study relies on secondary data, primarily obtained from:

a. Annual reports of sampled banks, accessed through the IDX database and individual bank websites.
b. Financial statements, governance disclosures, and sustainability reports.
c. Relevant macroeconomic indicators sourced from official publications by theFinancial Services Authority (OJK) and Bank Indonesia.

The collected data is organized into a structured dataset, ensuring consistency and reliability for subsequent analysis.

4. Variables and Measurements

a. Dependent Variable
   Firm Value, measured using the Tobin’s Q ratio, which is calculated as the market value of equity plus total liabilities divided by total assets.
b. Independent Variables
   Corporate Governance, assessed through a governance index based on board composition, audit committee characteristics, and disclosure practices. Capital

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Structure, measured using the debt-to-equity ratio (DER), reflecting the proportion of debt financing relative to equity. Profitability, represented by return on assets (ROA) and return on equity (ROE), indicating the efficiency of asset utilization and equity returns, respectively.

5. Data Analysis

The study employs several analytical methods. Descriptive statistics summarize the characteristics of the sample, including mean, standard deviation, and range for each variable. Correlation analysis examines relationships among variables to identify potential multicollinearity issues and the direction of associations. Hypotheses are tested through multiple regression analysis, quantifying the impact of corporate governance, capital structure, and profitability on firm value. Robustness checks are conducted using alternative measures for the dependent and independent variables to validate the results.

RESULTS AND DISCUSSION

1. Descriptive Statistics

Table 1 presents the descriptive statistics for the variables under study. The mean, standard deviation, minimum, and maximum values indicate the distribution and variability within the dataset.

Table 1. *Descriptive Statistics Result*

Variable	Mean	Std. Deviation	Minimum
Firm Value (Tobin's Q)	1.432	0.315	0.910
Corporate Governance Index	0.724	0.108	0.510
Debt-to-Equity Ratio	1.812	0.674	0.700
Return on Assets (ROA)	0.028	0.010	0.010
Return on Equity (ROE)	0.134	0.045	0.070
Bank Size (Log Assets)	12.456	0.892	10.200
Loan-to-Deposit Ratio	0.789	0.123	0.560

Source: Data Analysis, 2024

The average Tobin's Q of 1.432 suggests that the sampled banks generally exhibit strong market valuation relative to their asset base. Corporate governance indices range from 0.510 to 0.930, with a mean of 0.724, reflecting variability in governance practices across banks.

2. Correlation Analysis

Table 2 shows the Pearson correlation coefficients between the variables, highlighting the strength and direction of their relationships.

Table 2. Correlation Matrix

Variable	Firm Value	Governance	DER	ROA	ROE	Size	LDR
1. Firm Value	1						
2. Corporate Governance	0.521***	1					
3. Debt-to-Equity Ratio	-0.367**	-0.314*	1				
4. Return on Assets (ROA)	0.632***	0.478***	-0.482**	1			
1. Return on Equity (ROE)	0.554***	0.435***	-0.399**	0.816***	1		

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Variable	Firm Value	Governance	DER	ROA	ROE	Size	LDR
2. Bank Size (Log Assets)	0.289*	0.210	-0.152	0.173	0.180	1	
1. Loan-to-Deposit Ratio	0.411***	0.303*	-0.205	0.344*	0.270	0.158	1

Source: Data Processed by Author, 2024

The results indicate significant positive correlations between firm value and corporate governance ($r = 0.521, p < 0.001$), ROA ($r = 0.632, p < 0.001$), and ROE ($r = 0.554, p < 0.001$). Conversely, the debt-to-equity ratio shows a significant negative relationship with firm value ($r = -0.367, p < 0.01$).

3. Regression Analysis

Table 3 displays the results of the multiple regression analysis. The model examines the effects of corporate governance, capital structure, and profitability on firm value, controlling for bank size and liquidity.

Table 3. *Regression Analysis Result*

Predictor	B	Std. Error	Beta	t	Sig.
(Constant)	0.412	0.241		1.711	0.094
Corporate Governance	0.578	0.123	0.421	4.698	0.000
Debt-to-Equity Ratio	-0.145	0.062	-0.201	-2.339	0.023
Return on Assets (ROA)	8.392	1.435	0.559	5.849	0.000
Bank Size	0.087	0.034	0.199	2.559	0.014
Loan-to-Deposit Ratio	0.276	0.088	0.301	3.136	0.003

Source: Data Processed by Author, 2024

The regression model explains 67.2% of the variance in firm value (adjusted R^2 : 64.5%). Corporate governance ($B = 0.578, p < 0.001$), ROA ($B = 8.392, p < 0.001$), and loan-to-deposit ratio ($B = 0.276, p = 0.003$) significantly enhance firm value, while the debt-to-equity ratio ($B = -0.145, p = 0.023$) has a negative impact. Bank size ($B = 0.087, p = 0.014$) also shows a significant positive effect.

Discussion

1. Corporate Governance and Firm Value

The positive and significant relationship between corporate governance and firm value, as evidenced by the regression coefficient ($B = 0.578, p < 0.001$), underscores the pivotal role of governance mechanisms in enhancing market perceptions of a bank's value. This finding is consistent with prior studies, such as those by Hermuningsih (2013); Widigdo (2013), which highlight that effective governance reduces agency problems, ensures transparency, and fosters investor confidence. In the context of the Indonesian banking sector, the corporate governance index used in this study captures critical aspects such as board composition, audit committee effectiveness, and disclosure practices. The results suggest that banks with robust governance structures are better positioned to mitigate risks, attract long-term investors, and achieve higher market valuations. These outcomes are particularly relevant in emerging markets like Indonesia, where regulatory frameworks are evolving to align with global standards. The significant contribution of governance to firm value signals the importance of continuous improvements in governance practices, particularly in adhering to mandates from the Financial Services Authority (OJK).

2. Capital Structure and Firm Value

The negative relationship between capital structure, represented by the debt-to-equity ratio (DER), and firm value (B = -0.145, p = 0.023) indicates that higher leverage may be detrimental to a bank's market valuation. This finding aligns with the pecking order theory Tamrin et al. (2018), which posits that firms prioritize internal financing over external debt to avoid the costs associated with financial distress. For Indonesian banks, the detrimental impact of higher leverage may reflect concerns about debt servicing capabilities and the associated risks during periods of economic uncertainty. High DER ratios can signal potential liquidity constraints or operational inefficiencies, both of which can erode investor confidence. However, the results also suggest that moderate levels of debt, strategically managed, may still play a role in optimizing capital structure without adversely affecting firm value. Policymakers and financial managers must strike a balance between leveraging opportunities and maintaining financial stability, particularly in a sector heavily influenced by macroeconomic fluctuations.

3. Profitability and Firm Value

Profitability, as measured by return on assets (ROA), exhibited the most substantial positive influence on firm value (B = 8.392, p < 0.001). This finding aligns with stakeholder theory Freeman et al. (2007), which emphasizes that firms generating higher returns are better positioned to meet the expectations of shareholders, customers, and other stakeholders. High profitability signals operational efficiency and effective asset utilization, both of which are critical in building investor trust. The strong relationship between ROA and firm value highlights the importance of maintaining operational efficiency in the Indonesian banking sector. In an environment marked by intense competition and regulatory oversight, profitability serves as a key indicator of a bank's financial health and resilience. These results resonate with studies by Ngatno et al. (2021), who found that profitable banks are better equipped to absorb shocks, reinvest in growth opportunities, and deliver consistent returns to investors. Managers should prioritize strategies that enhance profitability while ensuring compliance with regulatory standards and market expectations.

4. Control Variables: Bank Size and Liquidity

Bank size, proxied by the logarithm of total assets, positively influenced firm value (B = 0.087, p = 0.014), indicating that larger banks tend to enjoy higher market valuations. This finding supports the economies of scale argument, where larger banks benefit from cost efficiencies, diversified revenue streams, and greater market power. In the Indonesian context, the size effect may also reflect investor perceptions of stability and systemic importance, with larger banks viewed as less vulnerable to market shocks. Liquidity, measured by the loan-to-deposit ratio (LDR), also showed a significant positive impact on firm value (B = 0.276, p = 0.003). A healthy LDR indicates effective liquidity management, balancing loan disbursement with deposit mobilization. This finding underscores the importance of liquidity as a key determinant of financial stability and operational efficiency in the banking sector. Banks with optimal LDR levels are better positioned to support lending activities while mitigating the risks associated with liquidity mismatches.

5. Comparison with Previous Studies

The findings of this study are consistent with prior research that underscores the multidimensional determinants of firm value in the banking sector. For instance, Reschiwati et al. (2020) found that strong corporate governance enhances firm performance in emerging markets, a conclusion mirrored in the Indonesian context. Similarly, the negative impact of high leverage on firm value aligns with Budiman (2015) propositions, which emphasize the trade-offs between debt and equity financing. However, this study also contributes unique insights specific to the Indonesian banking sector. The strong emphasis on profitability and liquidity reflects the operational dynamics of emerging markets, where economic volatility and regulatory changes necessitate prudent financial management. By integrating control variables such as bank size and macroeconomic conditions, the study provides a holistic understanding of the factors shaping firm value in Indonesia.

6. Practical Implications

The results of this study have significant implications for various stakeholders:

a. Bank Managers

The findings emphasize the need for robust governance frameworks, efficient capital structure management, and strategies that enhance profitability. Managers should prioritize governance reforms, optimize leverage levels, and focus on improving operational efficiency to maximize firm value.

b. Regulators

The strong relationship between governance and firm value highlights the importance of regulatory oversight in promoting transparency and accountability. Policymakers should strengthen governance standards and enforce compliance to foster investor confidence and market stability.

c. Investors

The study provides valuable insights for investors seeking to evaluate the financial health and growth potential of banks. Metrics such as ROA, DER, and governance indices serve as critical indicators of firm value.

7. Limitations and Future Research

While this study provides valuable insights, several limitations must be acknowledged. First, the reliance on secondary data may introduce biases related to data accuracy and completeness. Future studies could incorporate primary data sources, such as surveys or interviews, to capture additional dimensions of corporate governance and financial performance. Second, the cross-sectional design limits causal inferences, as the relationships observed may not fully capture dynamic changes over time. Longitudinal studies could provide a deeper understanding of how governance, capital structure, and profitability influence firm value across different economic cycles. Third, the study focuses exclusively on the Indonesian banking sector, which may limit the generalizability of the findings to other industries or regions. Comparative studies across multiple countries or sectors could offer broader insights into the determinants of firm value.

CONCLUSION

This study highlights the critical role of corporate governance, capital structure, and profitability in shaping firm value within the Indonesian banking sector. The findings underscore the importance of governance reforms, prudent leverage management, and profitability enhancement strategies in achieving sustainable growth and market valuation. By addressing the limitations and exploring new research avenues, future studies can further enrich our understanding of firm value determinants in emerging markets.

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