

The Effects of Profitability and Liquidity on Capital Structure

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ABSTRACT

This study aims to analyze the effects of profitability and liquidity on the capital structure of real estate companies listed on the Indonesia Stock Exchange. This study employs a quantitative approach with an explanatory research design. The data used consists of secondary data in the form of companies' annual financial statements for the study period. The sample was selected using purposive sampling based on predetermined criteria. Profitability was measured using Return on Assets (ROA), liquidity was measured using the Current Ratio (CR), and capital structure was measured using the Debt-to-Equity Ratio (DER). Data analysis was performed using multiple linear regression with the aid of IBM SPSS. The results indicate that profitability has a negative and significant effect on capital structure, and liquidity also has a negative and significant effect on capital structure. These findings indicate that companies with strong profit-generating capabilities and good liquidity tend to prioritize internal funding sources, thereby reducing their reliance on debt.



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INTRODUCTION

Increasingly intense business competition requires companies to manage their financial resources effectively and efficiently. One crucial aspect of corporate financial management is the decision regarding capital structure. Capital structure describes the composition of a company's funding sources, which consist of debt and equity. Decisions regarding the proportion of debt and equity are critical because they can affect financial risk, a company's ability to meet its obligations, and the sustainability of its operations. Therefore, companies must determine an optimal capital structure to ensure funding needs are met without incurring excessive financial risk.

Capital structure is not only related to a company's decisions regarding the acquisition of funding sources but also reflects the company's strategy in managing risk and utilizing financial resources. The use of debt can help a company obtain additional funds to finance investments and operational activities, but excessive reliance on debt can increase the burden of liabilities and financial risk. Conversely, a higher proportion of equity can reduce financial liability risk but may limit the company's ability to utilize external funding sources. Thus, decisions regarding capital structure are strategic decisions that must be tailored to the company's financial condition and characteristics.

In this study, capital structure is proxied using the Debt-to-Equity Ratio (DER). The DER indicates the ratio of total debt to total equity of the company. This ratio illustrates the extent to which a company uses debt compared to equity to finance its activities. A higher DER indicates greater reliance on debt-based financing. Conversely, a lower DER suggests that the company relies more heavily on equity-based financing.

One internal factor that can influence capital structure is profitability. Profitability reflects a company's ability to generate profits using its available resources. Companies with high profitability generally have a greater capacity to generate internal funds. This reduces the company's need to secure external financing through debt. This relationship aligns with the Pecking Order Theory, which explains

that companies tend to choose funding sources based on a hierarchy of preference: using internal funds first, followed by debt, and issuing shares as a last resort.

High profitability provides management with greater flexibility in determining funding sources. As a company's profits increase, it has the opportunity to use retained earnings to finance both operational activities and investments. Consequently, the need for debt may decrease, and the company's capital structure becomes more efficient. Recent research by Lie and Nugroho (2025) found that profitability has a significant negative effect on the capital structure of companies in the property and real estate sectors listed on the Indonesia Stock Exchange. Similar results were also found by Febriyola and Widyasari (2025), who showed that profitability has a significant negative effect on the capital structure of companies in the primary consumer goods sector.

In addition to profitability, liquidity is another factor that can influence capital structure decisions. Liquidity indicates a company's ability to meet short-term obligations using available current assets. A high level of liquidity reflects a company's ability to meet short-term financial obligations on time. This condition can provide the company with greater capacity to meet funding needs from internal sources, thereby reducing reliance on debt.

The relationship between liquidity and capital structure can also be explained through the Pecking Order Theory. Companies with high liquidity levels possess relatively adequate current assets, which can be used to finance the company's needs without having to increase debt. Thus, the higher the liquidity level, the lower the company's tendency to use debt in its capital structure. Findings by Lie and Nugroho (2025) indicate that liquidity has a negative and significant effect on the capital structure of property and real estate companies. The results of research by Febriyola and Widyasari (2025) also show that liquidity has a negative and significant effect on capital structure.

Other recent studies also provide evidence that the relationship between profitability, liquidity, and capital structure remains a relevant issue for research. Suciani and Darmayanti (2025), who studied companies in the insurance subsector listed on the Indonesia Stock Exchange from 2021 to 2023, found that profitability had no effect on capital structure, whereas liquidity had a significant negative effect on capital structure. These results differ from those of studies that found profitability to have a negative and significant effect on capital structure. This discrepancy indicates inconsistencies in empirical findings regarding the effect of profitability on capital structure.

LITERATURE REVIEW

Profitability

Profitability is a company's ability to generate profits over a specific period through the utilization of all its resources. Profitability ratios indicate the effectiveness of management in managing a company's assets to generate profits. In this study, profitability is proxied using Return on Assets (ROA), which is the ratio of net income to total assets. A higher ROA value indicates that a company is more effective in managing its assets, thereby generating greater profits (Hery, 2017; Kasmir, 2017).

Liquidity

Liquidity is a company's ability to meet its short-term obligations using its current assets. A high liquidity ratio reflects the company's sound financial condition, enabling it to meet its obligations on time. This study uses the Current Ratio (CR) as a proxy for liquidity because this ratio illustrates a company's ability to cover its current liabilities using its current assets (Kasmir, 2015; Alam, 2020).

Capital Structure

Capital structure refers to the combination of long-term debt and equity used by a company to finance its assets. Capital structure decisions are among a company's strategic decisions because they affect financial risk, the cost of capital, and firm value. An optimal capital structure is expected to minimize the cost of capital while maximizing firm value (Musthafa, 2017; Brigham & Houston, 2019). This study uses the Debt-to-Equity Ratio (DER) as an indicator of capital structure because this ratio shows the proportion of debt relative to equity. A higher DER value indicates greater reliance on external financing, which in turn increases the company's level of financial risk (Kasmir, 2015).

Based on the theoretical background described above, the research model is presented as follows:

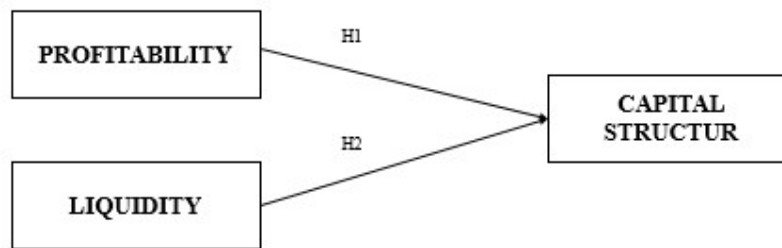


Figure 1. Framework

RESEARCH METHODS

Research Design

This study employs a quantitative approach using explanatory research. A quantitative approach was chosen because this study aims to test the effects of profitability and liquidity on capital structure based on numerical data obtained from the company's financial statements. Explanatory research is used to elucidate the cause-and-effect relationship between independent and dependent variables through hypothesis testing. The independent variables in this study consist of profitability (X1) and liquidity (X2), while the dependent variable is capital structure (Y). Profitability is proxied by Return on Assets (ROA), liquidity is proxied by the Current Ratio (CR), and capital structure is proxied by the Debt-to-Equity Ratio (DER). The population in this study consists of companies listed on the Indonesia Stock Exchange (IDX) during the study period. The selection of research subjects was based on the research objectives and the availability of financial statement data required to calculate the variables of profitability, liquidity, and capital structure. The type of data used in this study is secondary data. Secondary data consists of data that is already available and obtained from sources relevant to the study. The research data consists of the annual financial statements of the companies in the sample during the observation period. Data sources were obtained from the Indonesia Stock Exchange (IDX) and the official websites of each company. Data analysis was performed using multiple linear regression analysis with the aid of statistical software, such as IBM SPSS.

RESULTS AND DISCUSSION

Normality Test

A normality test aims to determine whether the sampled data are normally distributed or not (Ghozali, 2016:52). In this study, the statistical test used to test the normality of the residuals is the nonparametric Kolmogorov-Smirnov (K-S) test. Whether the data is normally distributed or not can be determined by comparing the obtained significance value with the predetermined significance level. If the obtained significance value (p-value) is $> 5\%$ or 0.05 , it means the data is normally distributed. Conversely, if the significance value is $< 5\%$ or 0.05 , it means the data is not normally distributed.

Table 2. Normality Test Results

		Model 1
N		70
Normal Parameters ^{a, b}	Mean	,0000000
	Standard	,24779962
	Deviation	
Most Extreme Differences	Absolute	,109
	Positive	,109
	Negative	−0.099
Test Statistic		0.088
Asymptotic Significance (2-tailed)		,200 ^{c, d}

Table 2 above shows that Model 1 has a significance value of $0.200 > 0.05$, indicating that the data in Model 1 are normally distributed.

Multicollinearity Test

The multicollinearity test aims to determine whether there is correlation among the independent variables in the regression model. A good regression model should not exhibit correlation among the independent variables (Ghozali, 2016:55).

Table 2. Multicollinearity Test Results

Variable	Tolerance	VIF
ROA	0.825	1.212
CR	0.979	1.022

Based on Table 2 above, it can be explained that the results of the multicollinearity test in Model 1 show that each independent variable (Profitability and Liquidity) obtained a Tolerance value > 0.10 and a VIF value < 10 . These results indicate that the variables are not correlated with one another and that there is no multicollinearity issue.

Heteroscedasticity Test

The heteroscedasticity test aims to determine whether there is unequal variance in the residuals from one observation to another within the regression model. If the variance of the residuals remains constant across observations, it is called homoscedasticity; if it varies, it is called heteroscedasticity. A good regression model is one that exhibits homoscedasticity—that is, one in which there is no heteroscedasticity (Ghozali, 2016:89).

Table 3. Results of the Heteroscedasticity Test

Variable	Significant
ROA	0.565
CR	0.987

The results of the heteroscedasticity test indicate that there is no issue of heteroscedasticity, as all variables obtained significance levels greater than 0.05.

Autocorrelation Test

The test used to detect autocorrelation in this study is the *Durbin-Watson* test. The *Durbin-Watson* test is used only for first-order autocorrelation and requires the presence of an *intercept* (constant) in the regression model and the absence of lag variables among the independent variables (Ghozali, 2013:111).

Table 4. Autocorrelation Test Results

Durbin-Watson	Description
1.104	No autocorrelation

Hypothesis Test Results

T-Test Results

The t-test is used to determine the effect of an individual independent variable in explaining the variation in the dependent variable (Ghozali, 2018). The significance level (α) used is 5% (0.05). The criteria for accepting or rejecting a hypothesis are based on the *p-value*. If the *p-value* is greater than α , the alternative hypothesis is rejected. Conversely, if the *p-value* is less than α , the alternative hypothesis is not rejected and is therefore accepted.

Table 5. Results of the Partial Test

	Hypothesis	Calculated t-value	Significant	Conclusion
H1	ROA $\rightarrow$ DER	-4.287	0.025	Hypothesis Accepted
H2	CR $\rightarrow$ DER	-3.933	0.030	Hypothesis Accepted

Discussion

The Effect of Profitability on Capital Structure

The results of the first hypothesis indicate that profitability has a significant negative effect on capital structure. This is because the p-value obtained is less than the 5% significance level ($0.025 < 0.05$). The results of this study show that an increase in profitability leads to a decrease in capital structure among real estate companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. These findings support the research by Lathfita et al. (2022), which demonstrated that profitability has a significant negative effect on capital structure. Oktaviana and Taqwa (2021) found that the higher the profitability, the lower the likelihood that a company will rely on debt financing. Muntahanah et al. (2020) revealed that as profit levels rise, the use of external funds or debt financing decreases; in other words, higher profitability levels lead to a reduction in a company's capital structure. This is because the company has sufficient internal funds to meet its operational needs.

The Effect of Liquidity on Capital Structure

The results of the second hypothesis indicate that liquidity has a significant negative effect on capital structure. This is because the p-value obtained is less than the 5% significance level ($0.030 < 0.05$). The results of this study show that an increase in liquidity leads to a decrease in capital structure among real estate companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. These results support the findings of Wahyanantri (2020), who demonstrated that liquidity has a negative effect on capital structure. The same result was also demonstrated by Rivandi and Novriani (2021), who found that a company's high liquidity can reduce its capital structure. Wahyanantri (2020) argues that companies with high liquidity have the ability to pay off their short-term debt, which tends to reduce debt and thus result in a smaller capital structure. Companies with high liquidity levels tend to rely on relatively low levels of debt because their current assets are sufficient to cover the company's funding needs. Therefore, the higher the liquidity level, the smaller the company's capital structure will be, as the company will prioritize using internal funds over resorting to debt.

CONCLUSION

Based on the results of this study on the effect of profitability and liquidity on the capital structure of real estate companies listed on the Indonesia Stock Exchange, it can be concluded that profitability and liquidity have a negative and significant effect on the capital structure. First, profitability has a negative and significant effect on the capital structure. The test results show a significance level of $0.025 < 0.05$ with a calculated t-value of -4.287, so the first hypothesis is accepted. This indicates that the higher a company's profitability, the lower its capital structure. Companies with high profitability tend to have a greater ability to generate internal funds, thereby reducing the need for debt financing. This finding aligns with *the Pecking Order Theory*, which explains that companies tend to prioritize internal funding sources before resorting to external funding sources. Second, liquidity has a negative and significant effect on capital structure. The test results show a significance value of $0.030 < 0.05$ with a calculated t-value of -3.933, so the second hypothesis is accepted. These results indicate that the higher a company's liquidity level, the lower its capital structure. Companies with high liquidity are better able to meet short-term obligations and provide internal funds to meet both operational and financing needs. Consequently, the company's reliance on debt decreases. Overall, this study shows that a company's internal conditions—particularly its ability to generate profits and meet short-term obligations—are key factors in determining capital structure decisions. Companies with good profitability and liquidity tend to reduce their use of debt because they have more adequate internal funding sources. Thus, companies need to maintain optimal levels of profitability and liquidity in order to manage their capital structure more effectively and reduce the financial risks arising from excessive debt.

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