

# **The Role of Profitability in Moderating the Effect of Capital Structure and Capital Adequacy on Firm Value**

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## **ABSTRACT**

Previous studies have reported inconsistent findings regarding the effects of capital structure and capital adequacy on firm value. Limited attention has been given to the contingent role of profitability, particularly in the banking sector. Addressing this gap, this study examines the influence of capital structure and capital adequacy on firm value, as well as the role of profitability as a moderating variable in banking companies. The study employs a quantitative research design using the annual financial statements of 12 banking companies listed on the Indonesia Stock Exchange during the 2020–2024 period. The findings reveal that capital structure does not have a significant effect on firm value, whereas capital adequacy positively and significantly enhances firm value. Furthermore, profitability significantly moderates the relationships between capital structure and firm value as well as between capital adequacy and firm value, indicating that the effectiveness of financing decisions and regulatory capital depends on banks' ability to generate sustainable profits. The study contributes to the corporate finance literature by providing updated evidence from the Indonesian banking sector during the post-pandemic period.

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## **1. Introduction**

The banking industry occupies a strategic position in the national economy as a financial intermediary institution that simultaneously collects and distributes public funds while supporting various sectors of economic activity (Bernard Azolibe, 2022). According to the Financial Services Authority Otoritas Jasa Keuangan (2021) (OJK, 2021), the public recognition rate of banking institutions in Indonesia reaches 99.07%, making banks the most widely recognized financial institutions among the population. Consequently, the performance and firm value of banking companies have become major concerns for investors, regulators, and other stakeholders who rely on banking stability for broader economic sustainability.

The performance of the Indonesian banking industry indicates relatively strong capitalization, which reflects the resilience of financial institutions in managing risks and maintaining operational continuity. According to the Financial Services Authority (OJK, 2023), the average Capital Adequacy Ratio (CAR) of Indonesian banks reached 27.65% in 2023, far above the regulatory minimum requirement established by authorities. This condition suggests that Indonesian banks possess sufficient capital to absorb potential risks, withstand economic shocks, and maintain operational stability in uncertain financial environments. Nevertheless, the market value of many banking

companies listed on the Indonesia Stock Exchange continues to fluctuate, indicating that strong capitalization alone may not necessarily translate into higher firm value in the eyes of investors.

Firm value represents investors' overall assessment of a company's future prospects and financial performance, which is generally reflected in its market price and perceived growth potential. Previous studies have suggested that firm value is influenced by various internal financial factors, particularly capital structure and capital adequacy, which determine how companies manage their financial resources (Sambo et al., 2023). However, empirical findings remain inconsistent, as some studies report that capital structure positively influences firm value due to tax advantages and expansion opportunities (Orbaningsih, 2022), while others find negative or insignificant effects due to increased financial risk. Similar inconsistencies are also observed in studies on capital adequacy, where higher capital may either strengthen investor confidence by signaling stability or reduce efficiency due to the presence of idle funds that are not optimally utilized. Prior studies have largely focused on direct effects between these variables, with limited attention given to the conditions under which these relationships may vary across different contexts. In particular, the role of profitability as a moderating factor has not been sufficiently explored, especially in the context of Indonesian banking companies operating in the post-pandemic economic recovery period.

Agency Theory and Signaling Theory suggest that investors evaluate not only the level of capital owned by a company but also management's ability to utilize financial resources efficiently to generate sustainable returns. This implies that profitability may strengthen the impact of capital structure and capital adequacy on firm value by signaling effective resource management and operational efficiency. However, empirical evidence on this moderating role remains limited, indicating a clear theoretical gap that needs to be addressed through further research. This study addresses a practical gap that is relevant to stakeholders in the banking industry, particularly in the context of regulatory changes and economic recovery. Despite stronger capitalization following stricter regulations, market valuation among Indonesian banks remains uneven. Moreover, understanding whether profitability enhances the effectiveness of capital structure and capital adequacy is therefore important for improving financial decision-making and strengthening market confidence. This insight can help banking management and regulators design more effective strategies to enhance firm value and maintain financial stability.

This study aims to examine the effect of capital structure and capital adequacy on firm value and to investigate the moderating role of profitability in Indonesian banking companies listed on the Indonesia Stock Exchange during the 2020–2024 period. This study contributes by providing updated empirical evidence that reflects recent economic conditions and regulatory environments affecting the banking sector. Furthermore, it incorporates profitability as a moderating variable to extend existing literature and provide a more comprehensive understanding of financial relationships.

### **Theoretical Foundation: Agency Theory and Signaling Theory**

Firm value has long been explained through Agency Theory and Signaling Theory, both of which provide complementary perspectives on corporate financial decision-making. Agency Theory argues that conflicts of interest arise because managers (agents) possess more information regarding company operations than shareholders (principals) (Naamati-Schneider, 2021; Panda & Leepsa, 2017). Consequently, managers are expected to make financing and investment decisions that maximize shareholder wealth while minimizing agency costs (Cardao-Pito, 2026).

Within the banking industry, agency conflicts become more complex because management is responsible not only to shareholders but also to regulators, depositors, and creditors (Lepetit et al., 2018). Financing decisions involving debt composition and capital adequacy therefore represent strategic mechanisms through which managers balance profitability, financial stability, and regulatory compliance. However, Agency Theory alone cannot fully explain investors' responses because external stakeholders evaluate firms based primarily on publicly available information (Dyer, 2021). Signaling Theory complements this limitation by explaining that corporate financial policies transmit signals regarding managerial quality and future business prospects (Ning et al., 2025). Financial indicators such as leverage, capital adequacy, and profitability become important signals that reduce information asymmetry between managers and investors.

Accordingly, the two theories should not be viewed independently. Agency Theory explains why managers determine financing policies, whereas Signaling Theory explains how investors interpret those policies. This integrated theoretical perspective provides the foundation for understanding how capital structure, capital adequacy, and profitability jointly influence firm value.

### **Financial Policy and Firm Value**

Firm value represents investors' assessment of a firm's future performance and is commonly reflected in its market price (Kong et al., 2023). One widely used indicator is Price-to-Book Value (PBV), which reflects market confidence in the company's future growth prospects. Corporate finance literature consistently suggests that financial policy is among the most important determinants of firm value (Abdullah et al., 2025). Financing decisions influence expected cash flows, financial risk, and ultimately investors' valuation of the firm. Nevertheless, previous empirical studies report inconsistent findings. Several studies argue that higher leverage enhances firm value because debt financing creates tax advantages and supports investment expansion (Pratt et al., 2023). Conversely, other studies report insignificant or even negative effects because excessive debt increases bankruptcy risk and financial distress (Issa et al., 2024). These inconsistent findings suggest that the effect of capital structure cannot be generalized across firms and industries.

The inconsistency becomes even more apparent in banking companies. Unlike non-financial firms, banks operate under prudential regulations that require minimum capital adequacy and continuous risk management. Consequently, investors may evaluate leverage differently in banking institutions than in manufacturing or service companies. These mixed findings indicate that financial policy alone cannot fully explain variations in firm value. Other internal factors may determine whether financing decisions are interpreted positively or negatively by the market.

### **Capital Regulation and Firm Value in Banking**

Capital adequacy constitutes one of the most important financial indicators in the banking industry because it reflects the bank's ability to absorb unexpected losses while maintaining operational stability. The Capital Adequacy Ratio (CAR) measures the relationship between regulatory capital and risk-weighted assets, making it an essential indicator of financial resilience (Hossain et al., 2018). From a regulatory perspective, higher CAR enhances financial system stability and protects depositors (C. Bui et al., 2017). From an investment perspective, adequate capital sends a positive signal regarding bank solvency and long-term sustainability. Consequently, many studies conclude that capital adequacy positively affects firm value.

Nevertheless, empirical evidence remains inconclusive. While stronger capitalization generally increases investor confidence, excessively high capital may indicate inefficient capital allocation because idle capital generates lower returns. Therefore, high CAR does not necessarily guarantee superior market valuation. This inconsistency implies that capital adequacy should not be interpreted solely as a regulatory compliance indicator. Instead, investors may simultaneously consider whether available capital is effectively utilized to generate profits. Therefore, the relationship between capital adequacy and firm value is likely contingent upon managerial performance.

### **Profitability as a Boundary Condition**

Profitability reflects management's ability to transform available financial resources into earnings (Zhang Guoxing, Aftab Hussain Tabasam, Muhammad Nadeem Khan, Anam Ashiq, 2023) and is commonly measured using Return on Equity (ROE). High profitability generally indicates efficient resource utilization and stronger financial performance. Previous studies treat profitability as an independent determinant of firm value (Al-Omari et al., 2024; Pangestuti et al., 2022). However, a growing body of literature suggests that profitability may perform a more important role by altering the strength of relationships between financial policies and market valuation. From the perspective of Agency Theory, high profitability demonstrates managerial effectiveness in utilizing shareholders' resources efficiently, thereby reducing agency concerns. Meanwhile, Signaling Theory suggests that profitability conveys credible information regarding management quality and future business prospects (Heitzman & Huang, 2019; Hong et al., 2020). Consequently, investors may interpret identical levels of leverage or capital adequacy differently depending on the firm's profitability.

This perspective positions profitability as a boundary condition, meaning that the effectiveness of capital structure and capital adequacy in increasing firm value may depend on the

firm's ability to generate profits. Highly profitable banks are more likely to transform debt financing and regulatory capital into sustainable value creation, whereas less profitable banks may fail to convert financial resources into higher market valuation. Although several previous studies have incorporated profitability into firm value models, most examine its direct effect or mediating role. Comparatively fewer studies investigate profitability as a moderating mechanism, particularly in the Indonesian banking industry during the post-pandemic period. This indicates that the conditional role of profitability remains insufficiently explored.

### **Hypotheses Development**

To address the research gaps, this study proposes profitability as a boundary condition that may strengthen or weaken the effects of capital structure and capital adequacy on firm value. By integrating Agency Theory and Signaling Theory, this study argues that investors evaluate financial policies not merely based on capital composition but also on management's capability to transform financial resources into sustainable profitability.

#### **Capital Structure and Firm Value**

Capital structure reflects the proportion of debt and equity used by a firm to finance its operations. According to Agency Theory, the use of debt can serve as a disciplinary mechanism that reduces managerial opportunism by imposing fixed obligations (Huang et al., 2018), thereby aligning managers' interests with those of shareholders. In addition, debt financing may generate tax advantages that increase firm value (Møen et al., 2019). From the perspective of Signaling Theory, higher leverage may signal management's confidence in the firm's future cash flows, as firms with strong prospects are more willing to take on debt. Consequently, investors may interpret higher leverage as a positive signal, leading to an increase in firm value.

However, excessive leverage may also increase financial risk and the probability of financial distress (Ayash & Rastad, 2021; Rahmah & Akbar, 2025), which can negatively affect firm value. Therefore, the relationship between capital structure and firm value remains an empirical issue, particularly in the banking sector where leverage is closely regulated. Based on these arguments, the following hypothesis is proposed:

**H1: Capital structure has a significant negative effect on firm value.**

#### **Capital Adequacy and Firm Value**

Capital adequacy reflects a bank's ability to absorb potential losses and maintain financial stability. From the perspective of Agency Theory, adequate capital reduces the risk of insolvency and protects stakeholders (Hugonnier & Morellec, 2017), thereby minimizing agency conflicts between managers and creditors. Signaling Theory explain that a higher Capital Adequacy Ratio (CAR) sends a positive signal to investors regarding the bank's financial strength and long-term sustainability (Sang, 2021). Investors are more likely to value banks with strong capital positions because they are perceived as less risky and more resilient to economic shocks. Nevertheless, excessively high capital may indicate inefficient use of resources, as idle capital may reduce profitability and limit growth opportunities. Therefore, while capital adequacy is generally expected to enhance firm value, its effect may vary depending on how effectively the capital is utilized. Based on these arguments, the following hypothesis is proposed:

**H2: Capital adequacy has a significant effect on firm value.**

#### **Profitability as a Moderator of Capital Structure and Firm Value**

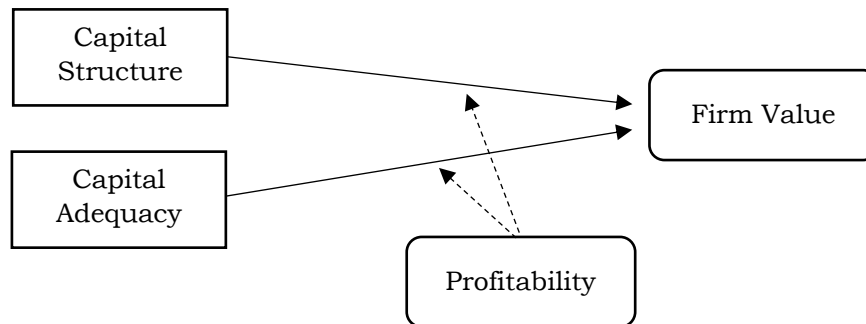
Profitability reflects the firm's ability to generate returns from its financial resources. From the perspective of Agency Theory, high profitability indicates effective managerial performance in utilizing debt financing to generate returns, thereby reducing agency concerns (Nazir et al., 2021). From the perspective of Signaling Theory, profitability serves as a credible signal of firm quality. Investors are more likely to interpret high leverage positively when it is accompanied by strong profitability, as it indicates that the firm can manage its debt efficiently and generate sufficient returns. Conversely, in firms with low profitability, high leverage may be perceived as risky and unsustainable, leading to a negative impact on firm value. Therefore, profitability is expected to strengthen the positive effect of capital structure on firm value. Based on these arguments, the following hypothesis is proposed:

**H3: Profitability can moderate the influence of capital structure on firm value**

### **Profitability as a Moderator of Capital Adequacy and Firm Value**

Profitability also plays an important role in determining how investors interpret capital adequacy. From the perspective of Agency Theory, high profitability indicates that management is capable of utilizing available capital efficiently, thereby reducing concerns regarding resource misallocation (Lovallo et al., 2020). From the perspective of Signaling Theory, profitability enhances the credibility of capital adequacy as a positive signal. A bank with high CAR and high profitability is perceived as both financially stable and operationally efficient, which increases investor confidence and firm value. In contrast, high capital adequacy combined with low profitability may signal inefficiency, as the bank fails to generate adequate returns from its capital base. Therefore, profitability is expected to strengthen the positive relationship between capital adequacy and firm value. Based on these arguments, the following hypothesis is proposed:

**H4: Profitability can moderate the effect of capital adequacy on firm value**



**Figure 1. Research Framework**

## **2. Methods**

Using an associative approach, this analysis employs quantitative methods aimed at identifying the relationship between two or more variables. Quantitative research is considered because the data and information utilized are numerical and processed using statistical analysis techniques (Sugiyono, 2013). The data utilized is secondary, obtained indirectly from the annual financial reports of banking companies listed on the Indonesia Stock Exchange (IDX). This data source was accessed through the official IDX website ([www.idx.co.id](http://www.idx.co.id)) and the official websites of each bank. The population in this analysis is state-owned banks, both public and private, as well as foreign private banks listed on the Indonesia Stock Exchange. A sample of 12 banks was studied during the 2020-2024 period. The sampling technique used purposive sampling, which refers to specific criteria, such as banking companies listed consecutively on the IDX during the study period and having comprehensive financial reports containing all required variables. The Structural Equation Modeling (SEM) method based on Partial Least Square (PLS) was used as a data analysis technique in this study, with the support of WarpPLS software.

## **3. Results**

### **Model Fit Evaluation**

Model Fit and Quality Indices are used to evaluate the feasibility of the research model and ensure its quality. A model is deemed fit if it meets criteria such as significant APC, ARS, and AARS values ( $p < 0.05$ ), AVIF and AFVIF values  $< 5$ , GoF values  $> 0.36$ , and SPR, RSCR, SSR, and NLBCDR values  $> 0.70$ . If all these criteria are met, the research model is declared valid and can be used for hypothesis testing. Based on the findings from data processing using WarpPLS, the following model fit results were obtained:

**Table 1. Model Fit Values and Quality Indices**

Indicator	Value	Criteria	Description
Average Path Coefficient (APC)	0.284	P < 0.05	Good (Significant)
Average R-squared (ARS)	0.553	P < 0.05	Good (Significant)
Average Adjusted R-squared (AARS)	0.521	P < 0.05	Good (Significant)
Average Block VIF (AVIF)	1.188	< 5, ideal < 3.3	No multicollinearity
Average Full Collinearity VIF (AFVIF)	2.251	< 5, ideal < 3.3	No multicollinearity
Tenenhaus GoF (GoF)	0.744	> 0.36	Strong model (large fit)
Simpson's Paradox Ratio (SPR)	1.000	> 0.70, ideal = 1	Very good
R-squared Contribution Ratio (RSCR)	1.000	> 0.90, ideal = 1	Very good
Statistical Suppression Ratio (SSR)	1.000	> 0.70	Very good
Nonlinear Bivariate Causality Direction Ratio (NLBCDR)	1.000	> 0.70	Very good

Source: Output of WarpPLS 7.0

### Coefficient of Determination (R-square)

The coefficient of determination (R-square) is a term used to estimate the extent to which an independent variable explains the dependent variable in a research model. The R-square value indicates the percentage contribution of the independent variable to the dependent variable. The higher the R-square value, the stronger the independent variable's ability to explain the dependent variable, thus improving the quality of the research model.

**Table 2. R-squared Values**

Dependent Variable	R-squared	Adjusted R-squared	Description
Firm Value (Y)	0.553	0.521	Moderate

Source: Output of WarpPLS 7.0

Based on the table above, the R-square of the Firm Value (Y) variable is 0.553. This condition indicates that capital structure (X1), capital adequacy (X2), profitability (Z), and moderating variables are able to explain the firm value variable by 55.3%, while the remaining 44.7% is influenced by other variables outside the research model that are not examined. The Adjusted R-square of 0.521 indicates that the ability of the independent variables to explain the dependent variable remains adequate, even though it has been adjusted to the number of variables contained in the model. This condition indicates that the research model has a fairly strong ability to explain firm value.

### Hypothesis Testing

To assess the significance of the relationship between the independent variable and the dependent variable, a hypothesis is used as a testing tool. Hypothesis determination is carried out by examining the path coefficient and p-value. The hypothesis is accepted if the p-value is <0.05, while the hypothesis is rejected if the p-value is >0.05.

**Table 3. Hypothesis Testing Results**

Hypothesis	Variable Relationship	Path Coefficient	P-value	Description
H1	Capital Structure (X1) → Firm Value (Y)	-0.122	0.164	Negative, not significant
H2	Capital Adequacy (X2) → Firm Value (Y)	0.298	0.007	Positive and significant

Source: Output of WarpPLS 7.0

Based on the results of the WarpPLS analysis, it is known that the capital structure has a path coefficient of -0.122 with a p-value of 0.164. The rejection of the first hypothesis is indicated by a p-value exceeding 0.05, so that the company's value is declared to be insignificantly affected by capital structure. Furthermore, the capital adequacy variable obtained a path coefficient of 0.298 with a p-value of 0.007. The second hypothesis is accepted because the p-value does not exceed

0.05, which indicates that capital adequacy has a positive and significant influence on company value.

### **Moderation Effect Testing**

The moderation effect is tested to determine the extent to which the moderating variable influences or weakens the relationship between the dependent and independent variables. Moderation testing is conducted by observing the path coefficient and p-value of the interaction variable. If the p-value is  $<0.05$ , the moderating variable is considered significant in moderating the relationship between the variables.

**Table 4. Moderation Test Results**

<b>Hypothesis</b>	<b>Moderation Relationship</b>	<b>Path Coefficient</b>	<b>P-value</b>	<b>Description</b>
H3	Profitability (Z) moderates Capital Adequacy (X2) → Firm Value (Y)	0.217	0.037	Significant moderation
H4	Profitability (Z) moderates Capital Structure (X1) → Firm Value (Y)	-0.498	$< 0.001$	Significant moderation

Source: Output of WarpPLS 7.0

The results of the moderation effect test show that the interaction between profitability and capital adequacy ( $Z \times X_2$ ) reveals a coefficient of 0.217 with a p-value of 0.037. This finding indicates that the ability of profitability to moderate the relationship between capital adequacy and firm value is proven, so that the third hypothesis is declared accepted. Furthermore, the interaction coefficient between profitability and capital structure ( $Z \times X_1$ ) is recorded at -0.498 with a p-value  $<0.001$ . These results reveal that firm value is also influenced by capital structure which is moderated by profitability, so that the fourth hypothesis can be confirmed.

## **4. Discussion**

### **Capital Structure and Firm Value**

The findings indicate that capital structure does not significantly influence firm value, suggesting that leverage is not a primary determinant of investors' valuation decisions in Indonesian banking companies (Pratt et al., 2023). This outcome may be attributed to the distinctive characteristics of the banking industry, where leverage and capital management are largely governed by prudential regulations rather than managerial discretion (Casciello et al., 2024; Nițoi et al., 2019). Although, Agency Theory proposes that debt can mitigate agency conflicts by disciplining managerial behavior (Ghorbani & Salehi, 2020; Huang et al., 2018), this governance mechanism appears less effective in a highly regulated banking environment because managers have limited flexibility in determining financing policies. Consequently, differences in leverage provide relatively little additional information about banks' future performance, leading investors to focus on other indicators of corporate quality. This finding also supports Signaling Theory, which suggests that investors respond more strongly to signals reflecting operational performance than to financing composition alone. In the banking sector, profitability and regulatory compliance appear to convey more credible information regarding financial soundness and long-term value creation than leverage, reducing the signaling role of debt in shaping market valuation.

The present finding is consistent with Almomani et al., (2022) and Hamyat et al., (2017), who reported that capital structure has no significant effect on firm value. However, it differs from Bui et al., (2023) and Nurdin et al., (2025) who found a positive relationship. These inconsistencies may arise from differences in industrial characteristics, regulatory environments, and observation periods. Banking firms face stricter capital regulations than manufacturing companies, reducing the informational role of leverage in market valuation.

### **Capital Adequacy and Firm Value**

The findings demonstrate that capital adequacy has a positive effect on firm value, indicating that investors place greater value on banks with stronger regulatory capital because such institutions are perceived as more financially resilient and capable of sustaining long-term operations (Belkhir et al., 2019). From an economic perspective, adequate capital enhances a bank's capacity to absorb

unexpected losses (Abusharbeh, 2025), withstand financial shocks, and reduce perceived default risk, thereby strengthening investor confidence and potentially lowering the cost of capital (Lin et al., 2024). These findings are consistent with Agency Theory, which suggests that sufficient capital mitigates conflicts among managers, shareholders, and creditors by improving financial stability and reducing agency-related concerns. Moreover, the results reinforce Signaling Theory by demonstrating that a high Capital Adequacy Ratio (CAR) functions as a credible signal of prudent risk management and sound financial governance. Consequently, investors interpret stronger capital positions not only as evidence of regulatory compliance but also as an indicator of long-term business sustainability and value creation.

This finding is consistent with Perdana et al., (2023), who reported positive effects of capital adequacy on firm value. Nevertheless, it differs from Kartikasari et al., (2022), who argued that found capital alone did not significantly affect firm value, but the interaction between capital and enterprise risk management did show a significant positive effect.

### **The Moderating Role of Profitability in the Relationship between Capital Structure and Firm Value**

The findings reveal that profitability significantly moderates the relationship between capital structure and firm value, indicating that the effectiveness of debt financing depends largely on a bank's ability to generate sustainable profits (Obadire et al., 2023; Serwadda, 2019). This suggests that leverage contributes to firm value only when it is supported by strong operational performance and efficient resource utilization. From an economic perspective, highly profitable banks are better equipped to meet their financial obligations, allocate borrowed funds productively, and reduce the likelihood of financial distress, thereby strengthening investor confidence. These findings are consistent with Agency Theory, which posits that higher profitability reflects managerial effectiveness in utilizing financial resources and converting debt into productive investments, ultimately reducing agency conflicts. Furthermore, the results reinforce Signaling Theory by demonstrating that profitability enhances the credibility of leverage as a positive market signal, leading investors to interpret debt financing more favorably when it is accompanied by strong and sustainable earnings performance.

The findings support Almomani et al. (2022) and Nurhayati et al. (2021), who also identified profitability as a significant moderator. However, previous studies have generally examined profitability as an independent determinant rather than a contingency factor (Linawati et al., 2022; Rahayu et al., 2019). The present findings therefore provide stronger evidence that profitability changes how investors interpret financing decisions.

### **The Moderating Role of Profitability in the Relationship between Capital Adequacy and Firm Value**

The findings indicate that profitability significantly strengthens the positive relationship between capital adequacy and firm value, suggesting that strong capitalization enhances market valuation only when banks are able to utilize their capital efficiently to generate sustainable profits. From an economic perspective, adequate capital provides financial stability by increasing the bank's capacity to absorb unexpected losses and maintain operational resilience (Sang, 2021), while profitability reflects management's effectiveness in transforming available financial resources into earnings (Kweh et al., 2024). Consequently, investors place a higher value on banks that simultaneously demonstrate strong capital positions and superior profitability because these institutions are perceived as both financially resilient and operationally efficient. This finding is consistent with Agency Theory, which argues that higher profitability reduces concerns regarding inefficient capital allocation (Goel et al., 2020) by signaling effective managerial performance in utilizing corporate resources. Furthermore, the results reinforce Signaling Theory by demonstrating that profitability enhances the credibility of capital adequacy as a positive market signal, leading investors to interpret high Capital Adequacy Ratio (CAR) more favorably when it is supported by strong and sustainable financial performance.

The findings are consistent with Chandrasegaran (2020) and Kunjeda (2024), who emphasized the importance of profitability in strengthening the impact of capital adequacy. Nevertheless, the present study extends previous evidence by demonstrating this moderating mechanism within Indonesian listed banks during the post-pandemic period.

## 5. Conclusion

This study examined the effects of capital structure and capital adequacy on firm value while investigating the moderating role of profitability in Indonesian banking companies listed on the Indonesia Stock Exchange during the 2020–2024 period. The findings indicate that capital structure does not significantly influence firm value, suggesting that leverage is not the primary consideration in investors' valuation decisions within the banking sector. In contrast, capital adequacy positively affects firm value, highlighting the importance of strong regulatory capital in enhancing financial resilience and market confidence. Furthermore, profitability significantly moderates the relationships between capital structure and firm value as well as between capital adequacy and firm value, indicating that financing decisions and regulatory capital create greater firm value only when banks are capable of generating sustainable profits.

The findings contribute to the corporate finance literature by extending Agency Theory and Signaling Theory. Specifically, this study demonstrates that profitability functions as a boundary condition through which investors interpret financial policies in banking institutions. The results suggest that leverage and capital adequacy should not be evaluated independently because their effects on firm value depend on managerial capability in utilizing financial resources efficiently. Consequently, this study provides a more comprehensive explanation for the inconsistent findings reported in previous research regarding the determinants of firm value in the banking sector.

Practically, the findings imply that banking managers should balance financing decisions, capital adequacy, and profitability rather than focusing on a single financial indicator. Regulators should continue promoting adequate capitalization while encouraging efficient capital utilization to strengthen financial stability and long-term market valuation. Investors are also encouraged to evaluate banks using an integrated assessment of profitability, capital adequacy, and financing policies when making investment decisions.

This study is subject to several limitations. First, the analysis focuses exclusively on Indonesian listed banking companies, which may limit the generalizability of the findings to other industries and countries. Second, the model includes only capital structure, capital adequacy, and profitability, while other corporate governance, risk management, macroeconomic, and institutional factors may also influence firm value. Future research is therefore encouraged to incorporate additional explanatory variables, extend the observation period, compare banking systems across countries, and employ alternative analytical approaches to further validate the robustness of the proposed relationships.

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