

Analysis of Profitability on Stock Prices: Capital Structure as a Mediator, Firm Size as a Control

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Abstract

Objective: This study aims to empirically investigate the role of the Debt-to-Equity Ratio (DER) as a mediating factor between Return on Assets (ROA) and stock prices in food and beverage companies listed on the Indonesia Stock Exchange (IDX). It seeks to expand existing knowledge by analyzing the connections between these financial metrics and stock prices, offering valuable insights into corporate financial performance and its influence on market valuations.

Design/Methods/Approach: Using regression analysis, the study tests the mediation of DER in the relationship between ROA and stock prices. The sample consists of firms in the food and beverage industry listed on the IDX. The hypotheses are tested through regression models to examine both direct and indirect effects.

Findings: The results show that DER does not significantly affect ROA or stock prices. While ROA still significantly influences stock prices when DER is included as a mediating variable, DER itself does not mediate the relationship. This suggests that investors focus more on profitability (ROA) when making decisions, rather than considering DER.

Originality/Value: This research introduces a novel perspective by exploring DER's mediating role, challenging the traditional view of its significance in investment decisions within the Indonesian food and beverage sector.

Practical/Policy implication: Investors should focus on profitability (ROA) when evaluating stock prices, not DER. The research shows that DER does not significantly affect ROA or stock prices, and does not mediate the relationship between them. Therefore, ROA is more relevant for investment decision-making.,

Keywords: *Return on Assets; Debt Equity Ratio; Stock Prices; Firm Size.*

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Introduction

In the dynamic world of financial markets, information plays a pivotal role in shaping investors' decisions and, ultimately, in determining a company's stock performance. According to signaling theory, stock price fluctuations reflect the information available to investors, which becomes the foundation for their investment choices. Consequently, stock prices serve as a crucial indicator for investors when deciding whether to buy or sell a company's shares.

A significant driver of stock price changes is a company's profitability, typically measured by ratios such as Return on Assets (ROA) or Return on Equity (ROE). Profitability indicates a company's ability to generate profit from its operations (Sambelay et al., 2017). Higher profitability is often perceived as a sign of financial strength, which attracts investor interest and, in turn, can drive stock price increases. Companies with robust profits are in a better position to distribute dividends or reinvest in business expansion, thereby enhancing their market valuation.

Existing literature supports a positive relationship between profitability and stock prices, with studies such as (Sholichah et al., 2021) and (Alamsyah, 2019) suggesting that companies with high profitability send positive signals to investors, which increases the attractiveness of their stocks. However, other studies, such as that by (Umar et al., 2020), found a negative relationship between profitability and stock prices, especially when ROA is used as a proxy for profitability. Moreover, studies by (Anggraini & Ruzikna, 2018) and (Rosita et al., 2018) have observed no significant impact of ROA on stock prices. The inconsistency in previous findings due to differences in sample selection, measurement methods for profitability (previous research using other proxies), and varying market conditions during the studies. These factors could lead to contrasting results on the relationship between profitability and stock prices. This inconsistency in findings raises critical questions about the role of other factors that could mediate or moderate the relationship between profitability and stock prices.

This study aims to fill this research gap by introducing capital structure (specifically, Debt-to-Equity Ratio, DER) as a mediating variable in the relationship between profitability (ROA) and stock prices. The existing literature largely overlooks the potential role of capital structure in explaining how profitability affects stock prices, with limited focus on the nuances of how firms with high profitability choose their financing sources. Companies that rely heavily on debt may be perceived by investors as riskier, which could dampen their stock prices. In contrast, companies that primarily use retained earnings might foster greater investor confidence, potentially enhancing stock prices. Therefore, this study uniquely positions capital structure as a crucial intermediary that clarifies the profitability-stock price relationship.

Additionally, firm size is considered as a control variable in this study, addressing its potential effect on investors' perceptions and stock valuations. Firm size, determined by total assets, plays a significant role in how investors assess risk and market stability (Eugene & Joel, 2010). Larger firms are often perceived as less risky and more stable, which can contribute to stronger stock performance. Including firm size as a control variable allows this study to isolate the impact of profitability and capital structure on stock prices more accurately.

This research is particularly significant given the unique characteristics of the Indonesian market, where capital structure decisions may have distinct implications compared to more developed financial markets. The Indonesia Stock Exchange (IDX) represents a growing yet dynamic market, where investors may face different risk perceptions due to varying levels of financial transparency and market maturity. By investigating the mediating role of capital structure in this context, the study will provide critical insights into how Indonesian firms manage profitability and leverage financial strategies to enhance market valuation. This study aims to contribute not only to the academic literature on corporate finance but also to the practical understanding of how emerging market dynamics, such as investor risk perception and market volatility, shape financial decision-making and stock performance.

The novelty of this study lies in its approach to examining the mediating role of capital structure in the profitability-stock price relationship, a perspective that has not been fully explored in the context of firms listed on the Indonesia Stock Exchange (IDX). This research adds value by not only providing empirical evidence on the profitability-stock price link but also by challenging the conventional view of capital structure, offering fresh insights into how financial strategies influence stock market outcomes.

By considering capital structure and firm size as key factors, this study contributes to a deeper understanding of the complexities surrounding stock price movements. It offers valuable implications for investors, analysts, and policymakers, particularly in emerging markets where these relationships may differ from those observed in more developed financial systems. Given the inconsistency of findings in previous studies, this research seeks to provide a more comprehensive and nuanced understanding of the factors driving stock prices, specifically through the lens of capital structure and firm size.

This article examines the role of capital structure, specifically the Debt-to-Equity Ratio (DER), as a mediating variable in the relationship between profitability (ROA) and stock prices of companies listed on the Indonesia Stock Exchange (IDX). By considering firm size as a control variable, this study fills a gap in the existing literature, which often overlooks the impact of capital structure on market valuation. This research provides new insights into the dynamics of the capital market and how capital structure decisions affect stock performance, offering important implications for investors, analysts, and policymakers in formulating more effective financial strategies.

Literature Review and Hypothesis Development

Signaling Theory

The signaling theory explains how imperfect information is transmitted from one party to another in the context of decision-making, (Mohammadian et al., 2021). In financial markets, this theory is used to understand how companies send signals to investors regarding their financial condition and future prospects. Since investors often do not have direct or complete access to accurate information about the company, the company needs to communicate its financial situation and future prospects through variables that investors can understand. In this regard, signaling theory plays a crucial role in explaining how companies utilize available information to provide signals that influence investors' perception, (Svetek, 2022)

Signaling theory states that companies send signals to investors through available financial information, such as profitability ratios and capital structure (Eldomiaty et al., 2024). This information is critical because it can indicate the company's financial strengths or weaknesses, which in turn affect the investment decisions made by investors. Therefore, financial ratios such as profitability and capital structure play an important role in delivering these signals, as both reflect the company's financial performance, which can influence investment decisions, (Silver et al., 2023).

Packing Order Theory

The Pecking Order Theory explains that companies prefer internal financing first, such as retained earnings, to avoid further disclosure costs. Internal financing is considered more efficient because the company does not need to disclose additional information to external investors, which could reduce their competitive position (Guizani, 2020). When internal sources are insufficient, companies tend to use debt, which is cheaper than issuing new shares (Guizani, 2020).

Issuing new shares is considered a last resort because it can lead to the dilution of control for existing shareholders. Moreover, it requires disclosing more information to the public, which could increase uncertainty in the market (Guizani, 2020). Thus, the Pecking Order Theory

explains how companies manage their capital structure by considering disclosure costs and the risks associated with information asymmetry (Pan et al., 2021).

Profitability

Company profitability is often measured by Return on Assets (ROA), which indicates how efficiently a company generates profit from its assets. ROA provides an overview of a company's ability to utilize its assets to generate profit. The higher the ROA, the better the company is at generating profit relative to the assets used. Net income refers to the profit a company makes after deducting all costs, taxes, and interest, while total assets encompass all assets owned by the company during the relevant period, both current and fixed assets.

This measurement is used because it provides a clear picture of the company's efficiency in managing assets to achieve profit, which is crucial for investors in assessing a company's operational performance. According to (Palepu & Healy, 2012), ROA is often used to evaluate how efficiently management utilizes available resources. Moreover, (Md., 2019) also states that ROA is an essential indicator reflecting a company's ability to generate profit from its total assets, which, in turn, helps investors make more informed investment decisions.

Capital Structure (Debt to Equity Ratio - DER)

Capital structure refers to the comparison between debt and equity in a company's financing. Debt to Equity Ratio (DER) is used to measure a company's capital structure, indicating the extent to which a company uses debt compared to equity in its financing. Total debt includes all financial obligations of the company, both short-term and long-term, while total equity represents the investment held by shareholders, including paid-in capital, retained earnings, and other reserves (Susilawati et al., 2022).

The measurement of DER is used because it provides a clear picture of how much a company relies on debt for financing compared to equity (Yustika Rahmawati, 2022). High DER indicates that the company uses more debt in its financing, which can increase potential returns but also raises financial risk. Conversely, a low DER suggests that the company is more conservative in using debt and relies more on equity, which can reduce financial risk but may also decrease returns for shareholders. Therefore, DER is crucial for investors and analysts in assessing the financial risk level of the company.

Stock Price

The stock price of a company reflects its value in the eyes of investors. It represents the market's perception of the company's performance, growth potential, and stability. As a key indicator in the capital market, stock prices can fluctuate depending on internal company factors and external conditions, such as economic conditions and industry trends. Therefore, stock prices are often used by investors and analysts to assess investment potential and predict the company's future performance (Abdildayeva et al., 2024).

Stock price is measured using the closing price within the specified period of the study. The closing price reflects the stock's value at the end of the trading session, considered the most accurate and representative price to reflect market perception of the company's stock on that day. This measurement is used because it avoids price fluctuations during the trading session that may be influenced by temporary factors. By using the closing price, researchers and investors can obtain a more stable and reliable view of the company's market value (Enow, 2022).

Firm Size

Firm size refers to the operational scale and resource capacity of a company. This variable is often used as a control variable in financial research to examine the effect of other factors on company performance. Firm size can influence strategic decisions, capital structure, and financial outcomes. Therefore, considering firm size appropriately is important for producing valid and

reliable analysis, (Jaremski & Rousseau, 2018), larger companies tend to have more resources and greater operational capacity, which can provide a competitive advantage in the market. Firm size is commonly measured using total assets. The use of total assets as a measure of firm size is based on the consideration that total assets reflect the capacity of resources owned by the company, which can influence its ability to generate revenue and profit (Ahmed et al., 2023)

Hypothesis Development

Profitability and Stock Price

According to signaling theory, high profitability sends a positive signal to investors about a company's financial stability and growth prospects. A high Return on Assets (ROA) indicates efficient asset use in generating profits, enhancing stock appeal and increasing its price (Sholichah et al., 2021). Studies support this positive link: (Alamsyah, 2019) showed that asset efficiency drives investor interest, while (Alifatussalimah & Sujud, 2020) noted that investors in emerging markets are highly responsive to strong profitability. (Agis Pratiwi et al., 2023) found that higher profitability boosts investor confidence, influencing demand and stock price. (Panggabean, 2020). added that firms with high ROA often enjoy positive valuations and stronger dividend potential. This is reinforced by (D. M. Sari et al., 2022), who confirmed ROA's significant effect on manufacturing stock prices.

H1: ROA has a positive and significant effect on stock price.

Profitability and Capital Structure

The Pecking Order Theory states that highly profitable firms tend to prioritize internal financing—such as retained earnings—over external debt for funding operations and growth (Millenia, 2024). This reduces reliance on borrowing, resulting in lower debt ratios. Several studies confirm a negative relationship between profitability and capital structure. (Z.A et al., 2021) found that profitable firms prefer retained earnings, thus lowering leverage. Similarly, (Selviana & Badjra, 2018) argued that such firms have adequate internal funds for investment. (Setiadi et al., 2023) noted their tendency to avoid risky debt to maintain stability. Supporting this, (Putu et al., 2018) concluded that profitability influences financing choices through a preference for internal capital.

H2: Profitability has a negative effect on capital structure.

Capital Structure and Stock Price

Based on signaling theory, a high capital structure—reflected in a high Debt to Equity Ratio (DER)—may indicate greater financial risk to investors, potentially lowering stock prices (Mahendra & Daljono, 2023). Elevated DER levels can increase interest burdens, reduce earnings, and raise default risk (D. P. Sari & Sari, 2025), prompting investor caution and affecting market value. Studies support this: (Wandita & Khairudin, 2017) found that firms heavily reliant on debt face falling stock prices. (Syofyan et al., 2020) noted a negative correlation between DER and stock price, especially in firms with unstable income. (Musdafia, 2019) emphasized DER's role in increasing price volatility during uncertain markets. Additionally, pecking order theory suggests that profitable firms prefer retained earnings over debt, reducing financial risk and increasing investor trust (Putu et al., 2018).

H3: DER has a negative and significant effect on stock price

Capital Structure as a Mediating Variable

According to signaling theory, high profitability signals financial stability and growth potential to investors. However, its effect on stock price may be indirect, as firms choose different capital structures—via retained earnings or debt. Those relying on retained earnings face lower financial risk, increasing investor confidence and stock value. In contrast, highly profitable firms still depending on debt may signal greater risk, potentially lowering stock prices. Thus, capital

structure may mediate the link between profitability and stock price. Supporting this, (Wulandari & Paramita, 2018) and (Putri, 2017) found that profitability affects capital structure, influencing stock value. (Musdafiah, 2019) and (Putu et al., 2018) showed profitable firms favor retained earnings, enhancing investor trust. (Faluthy, 2021) also affirmed capital structure's mediating role in this relationship.

H4: Capital structure mediates the effect of profitability on stock price.

Method

Sample

The sample in this study consists of food and beverage sector companies listed on the Indonesia Stock Exchange (IDX) during the period of 2018-2022, selected using the purposive sampling method. The selection criteria include companies that consistently publish annual financial reports, have complete data related to the research variables, and whose stocks are actively traded. The choice of this sector is based on the industry's relatively stable characteristics, which are attractive to investors, allowing for a more specific analysis of the relationship between profitability, capital structure, and stock prices. The final sample includes 18 companies that meet the purposive sampling criteria.

Variables

- Dependent Variable (Stock Price): Measured by the closing price of the stock at the end of each month during the measured period, using the closing price.
- Mediating Variable (Capital Structure): Represents the ratio between total liabilities and total equity in the company, measured by the formula: $(\text{Total Debt}) / (\text{Total Equity})$.
- Independent Variable (Profitability): Represents the ratio that measures the ability to generate profit, measured by the formula: $(\text{Net Income}) / (\text{Total Assets})$.
- Control Variable (Ln.Total Asset): The natural logarithm of total assets, measured by the formula: $\text{Ln}(\text{Total Assets})$.

Statistical Method

To analyze the relationship between Stock Price as dependent variable, Return on Assets (ROA) as Independent Variabel, Debt to Equity Ratio (DER) as intervening variable, and LnTA (Log of Total Assets) as control variable, the following regression method and mediation test are applied.

Direct Effect Tests

Testing the effect of DER on Stock Price:

$$\text{StockPrice} = \beta_0 + \beta_1\text{DER} + \beta_2\text{LnTA} + \varepsilon \dots\dots\dots (\text{Equation 1})$$

Testing the effect of ROA on DER:

$$\text{DER} = \gamma_0 + \gamma_1 \text{ROA} + \gamma_2 \text{LnTA} + \varepsilon \dots\dots\dots (\text{Equation 2})$$

Testing the effect of DER and ROA on Stock Price:

$$\text{StockPrice} = \alpha_0 + \alpha_1\text{DER} + \alpha_2\text{ROA} + \alpha_3\text{LnTA} + \varepsilon \dots\dots (\text{Equation 3})$$

$$\text{StockPrice} = \alpha_0 + \alpha_1\text{DER} + \alpha_2\text{ROA} + \varepsilon \dots\dots\dots (\text{Equation 4})$$

Mediation Test

This test examines Equations 3 and 4 to determine whether ROA as the intervening variable remains significant after DER is included. If ROA is significant and the effect of DER weakens or becomes insignificant, then ROA is considered a partial or full mediator. Additionally, a Sobel test can be conducted for mediation.

Control Variable (LnTA) Test

Compare Equations (3) and (4), which include the control variable, with equations without it. By examining the coefficient β_3 (LnTA), we can determine whether the control variable has an effect on the dependent variable. If significant, it indicates that the control variable affects the dependent variable.

Classical Assumption Test

Before hypothesis testing, classical assumption tests are conducted to ensure the regression model meets basic assumptions, making estimation results valid, unbiased, and efficient. These include normality to check if residuals are normally distributed, multicollinearity to avoid strong correlations between independent variables, heteroscedasticity to ensure constant residual variance, autocorrelation to detect residual correlation, and linearity to confirm that the relationship between independent and dependent variables is linear. Meeting these assumptions makes the regression model more accurate and reliable.

Result and Discussion

Result

Normality Test

The results of the normality test using the Jarque-Bera Test (table 1) indicate that all regression models have p-values higher than 0.05, meaning the residuals from each equation are normally distributed. This suggests that the normality assumption in regression is met.

Table 1. Normality Test Jarque-Bera

Equation	P.Value	Keputusan
StockPrice = $\beta_0 + \beta_1 \text{DER} + \beta_2 \text{LnTA} + \epsilon \dots (1)$	0.9343	>0,05, Normal
DER = $\gamma_0 + \gamma_1 \text{ROA} + \gamma_2 \text{LnTA} + \epsilon \dots (2)$	0.433	>0,05, Normal
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \alpha_3 \text{LnTA} + \epsilon \dots (3)$	0.395	>0,05, Normal
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \epsilon \dots (4)$	0.142	>0,05, Normal

Sumber: data diolah penulis, 2026

Multicollinearity Test (VIF)

Based on the multicollinearity test results, the Variance Inflation Factor (VIF) values for DER, ROA, and LNTA, as shown in Table 2, indicate that there is no significant multicollinearity in the regression model because all VIF values are well below the threshold of 3. Therefore, the independent variables in the model can be utilized to explain the dependent variable, namely Stock Price, without distortion caused by strong correlations among the independent variables.

Table 2. Multicollinearity Test

Equation	Variables	VIF
StockPrice = $\beta_0 + \beta_1 \text{DER} + \beta_2 \text{LnTA} + \epsilon \dots (1)$	DER	1.059
	LNTA	1.059
DER = $\gamma_0 + \gamma_1 \text{ROA} + \gamma_2 \text{LnTA} + \epsilon \dots (2)$	ROA	1.059
	LNTA	1.059
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \alpha_3 \text{LnTA} + \epsilon$	DER	2.105
	ROA	1.842
	LNTA	2.718
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \epsilon$	DER	1.001
	ROA	1.001

Sumber: data diolah penulis, 2026

Based on the multicollinearity test using the Variance Inflation Factor (VIF), all variables in the model show VIF values less than 3, indicating no multicollinearity issues.

Heteroskedasticity Test (Breusch-Pagan Test)

Based on the heteroskedasticity test using the Breusch-Pagan Test (Tabel 3), all regression models show p-values greater than 0.05, indicating that there is no heteroskedasticity in the tested models. This indicates that the residual variance is constant and unaffected by changes in independent variables, thus meeting the homoscedasticity assumption in regression.

Table.3. Heteroskedasticity Test (Breusch-Pagan Test)

Equation	P-Value
StockPrice = $\beta_0 + \beta_1 \text{DER} + \beta_2 \text{LnTA} + \varepsilon \dots (1)$	0.293
DER = $\gamma_0 + \gamma_1 \text{ROA} + \gamma_2 \text{LnTA} + \varepsilon \dots (2) \dots (2)$	0.938
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \alpha_3 \text{LnTA} + \varepsilon$	0.241
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \varepsilon$	0.183

Sumber: data diolah penulis, 2026

Autocorrelation Test (Durbin-Watson Test)

Based on the autocorrelation test using the Durbin-Watson Test (Table 4), all regression models show DW values within the range indicating no autocorrelation. DW values approaching 2 indicate that residuals in the regression models show no specific pattern and are random, thus fulfilling the independence assumption for residuals.

Table.4 Autocorrelation Test (Durbin-Watson Test)

Equation	Nilai DW
StockPrice = $\beta_0 + \beta_1 \text{DER} + \beta_2 \text{LnTA} + \varepsilon \dots (1)$	1.814
DER = $\gamma_0 + \gamma_1 \text{ROA} + \gamma_2 \text{LnTA} + \varepsilon \dots (2) + \varepsilon \dots (2)$	2.413
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \alpha_3 \text{LnTA} + \varepsilon$	1.584
StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \varepsilon$	1.814

Sumber: data diolah penulis, 2026

Hypothesis Test

Based on the estimation results in Table 5, the testing of the first hypothesis (H1) using Equation Model 3 shows that profitability (ROA) has a positive coefficient of 1.116 with a p-value of 0.000. This proves that ROA has a positive and significant effect on stock prices, so H1 is accepted. On the other hand, in the second hypothesis (H2) testing through Equation Model 2, the ROA variable is found to have a negative coefficient of -0.3856 but with a p-value of 0.845. Since this value is far above 0.05, H2 is rejected because profitability does not significantly affect capital structure (DER).

For the third hypothesis (H3), the test results from Equation Models 1 and 3 consistently show that capital structure (DER) does not have a significant effect on stock prices. Although the coefficient is negative, the p-values of 0.258 (Model 1) and 0.126 (Model 3) exceed the 0.05 significance level, so H3 is rejected. Next, the fourth hypothesis (H4) regarding the mediation role was tested by integrating the results from Equation Models 2 and 3. The results indicate that H4 is rejected because the mediation condition is not met; ROA is not significant to DER (Model 2), and DER is not significant to stock price (Model 3). This confirms that the effect of ROA on stock prices is a direct effect without mediation by capital structure.

Finally, the control variable LnTA (Company Size) testing in Equation Models 1, 2, and 3 shows that company size plays an important role in the model. It is proven in Model 1 that LnTA has a highly significant positive effect (p-value 0.001) on stock prices, indicating that the larger the assets owned by the company, the higher its stock value tends to be in the market.

Table.5. Hypothesis Test

Equation	Variable	Coefficient	P. Value
1. StockPrice = $\beta_0 + \beta_1 \text{DER} + \beta_2 \text{LnTA} + \varepsilon$	DER	-0.2691	0.258
	LNTA	1.1224	0.001
2. DER = $\gamma_0 + \gamma_1 \text{ROA} + \gamma_2 \text{LnTA} + \varepsilon \dots (2)$	ROA	-0,3856	0.845
	LNTA	1.5710	0,085
3. StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \alpha_3 \text{LnTA} + \varepsilon$	DER	-0.379	0.126
	ROA	1.116	0.000
	LNTA	0.0085	0,083
4. StockPrice = $\alpha_0 + \alpha_1 \text{DER} + \alpha_2 \text{ROA} + \varepsilon$	DER	0.1975	0,001
	ROA	0.0133	0,053

Sumber: data diolah penulis, 2026

Discussion

The results of this study indicate that profitability (ROA) has a positive and significant impact on stock price, in line with signaling theory. A high ROA provides a positive signal to investors about the company's financial stability and growth potential, which increases investor confidence and leads to a rise in stock price. Research by Alamsyah (2019) supports this by showing that companies with high profitability are more attractive to investors due to efficiency in asset management, which results in better stock valuation.

This study proves that high profitability reflects a company's efficiency in managing its assets to generate profit, ultimately increasing stock attractiveness in the market. The study confirms research by (Sholichah et al., 2021) and (Alifatussalimah & Sujud, 2020), which shows that investors in emerging markets respond more positively to companies with high ROA. It also supports research by (Agis Pratiwi et al., 2023), which emphasizes that increased profitability significantly boosts demand and stock prices. Furthermore, this study proves that companies with high ROA tend to have higher stock valuations, making them attractive to investors and subsequently driving up stock prices, as evidenced by research by (Agis Pratiwi et al., 2023).

In testing the relationship between Return on Assets (ROA) and Debt to Equity Ratio (DER), a negative relationship was found, but this effect was not significant. This finding aligns with the Pecking Order theory, which suggests that companies with high profitability tend to prefer internal financing over debt (Millenia, 2024). Companies with high profitability typically use retained earnings to finance operations and expansion, which reduces reliance on debt. This result confirms several previous studies supporting a negative relationship between profitability and capital structure. (Z.A et al., 2021)) and (Selviana & Badjra, 2018) reveal that companies with high profitability are more likely to use retained earnings rather than debt, thus lowering their debt ratio. Additionally, research by (Setiadi et al., 2023) and (Putu et al., 2018) indicates that more profitable companies tend to avoid external financing to maintain financial stability.

The results of the Debt to Equity Ratio and stock price tests show a negative relationship, though the effect was not significant. This aligns with signaling theory, which indicates that a high debt ratio may send a negative signal to investors, as it reflects greater financial risk for the company. (Mahendra & Daljono, 2023). Large interest expenses due to debt can compress profits available to shareholders and increase the likelihood of default, making investors more cautious when investing in companies with high debt levels. This finding reinforces research by (Wandita

& Khairudin, 2017) and (Syofyan et al., 2020), who reveal that companies with high DER typically experience a decline in stock prices due to increased financial risk.

The mediation test results show that capital structure is not proven to be a mediator in the relationship between profitability and stock price. According to the Pecking Order theory, companies with high profitability typically prefer internal financing, such as retained earnings, over using debt. Therefore, more profitable companies generally have lower debt ratios, which should have a positive impact on stock prices through better financial risk management. However, in this study, the mediation effect was not found to be significant.

In this study, despite the negative relationship between profitability and DER, and the negative relationship between DER and stock price, the mediation effect was not significant, indicating that capital structure is not the main factor bridging these relationships. The lack of significant mediation may be explained by the fact that, in some situations, companies with high profitability still choose to use debt as a way to increase capital efficiency or take advantage of tax incentives from debt interest expenses. This may explain why capital structure mediation was not significant in this study. Therefore, it can be concluded that, although previous theories and studies suggest a potential mediating role for capital structure, in the context of this study, this relationship was not empirically validated.

Conclusion and future direction

Conclusion

The findings of this study highlight several important aspects regarding the relationship between profitability, capital structure, and stock prices. The main result shows that profitability, measured through Return on Assets (ROA), has a positive and significant impact on stock price. This indicates that companies with better financial performance are generally more attractive to investors, which ultimately contributes to an increase in stock prices. In other words, the higher a company's return on assets, the greater its appeal in the capital market.

This study finds that profitability negatively affects capital structure (DER), aligning with the Pecking Order theory, which states that profitable firms prefer internal financing over debt. However, the effect is not statistically significant, implying no strong causal link. Other factors may therefore have a more dominant influence on a company's capital structure decisions in this context.

Future Research:

Future research could expand on this study by exploring additional variables that might influence capital structure decisions, such as market conditions, industry-specific factors, and corporate governance practices. Furthermore, longitudinal studies could provide a more in-depth understanding of how these relationships evolve over time and in different economic cycles. Including a broader range of companies from various sectors and regions could enhance the generalizability of the findings and offer a more comprehensive understanding of the dynamics between profitability, capital structure, and stock prices.

Implication

Managerial Implications

The findings of this study indicate that high profitability has a positive impact on stock prices, emphasizing the importance of management focusing on operational efficiency and asset management. To increase the company's appeal in the capital market, managers should encourage profitability improvements through strategies that enhance productivity and reduce costs. Additionally, the finding that profitability reduces dependence on debt implies that managers should carefully plan the company's capital structure, opting for internal financing, such as retained earnings, to maintain financial stability and avoid risks associated with excessive debt. This approach will lead to better risk management and promote long-term company growth.

Theoretical Implications

This study makes significant contributions to signaling theory and the Pecking Order theory. The finding that ROA positively affects stock prices supports signaling theory, which suggests that a company's profitability can send a positive signal to investors about its stability and growth prospects, thereby driving up stock prices. Furthermore, the finding that profitability negatively impacts capital structure, although not statistically significant, enriches the Pecking Order theory, which asserts that companies with high profitability tend to use internal financing rather than debt. This study opens opportunities for further research into other factors that may influence capital structure decisions and deepens the understanding of the relationship between profitability and financing decisions.

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