

# The Effect of Liquidity Ratio, Capital Structure and Activity on Company Profitability

*Liquidity Ratio,  
Capital Structure and  
Activity*

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**Submitted:  
25 AUGUST 2024**

**Accepted:  
28 OCTOBER 2024**

## **ABSTRACT**

*The study aims to measure the impact of liquidity ratio, capital structure and activity on profitability in financial sector companies. This study uses an associative quantitative approach with secondary data sourced from the annual reports of companies listed on the Indonesia Stock Exchange (IDX) for the 2023 period. Sampling was carried out using the purposive sampling method with certain criteria, namely the company must consistently publish financial reports during 2023, use the rupiah currency, and include values for the liquidity ratio, capital structure, asset activity ratio, and profitability. Based on these criteria, 97 companies met the requirements. Multiple regression analysis is a method for measuring research hypotheses through the use of SPSS v.29 statistical software. The results of this study indicate that the company's liquidity ratio, capital structure and asset activity ratio can have an effect on the profitability of the finance sector in 2023.*

**Keywords:** ROE, Current Ratio, DER, Finance, IDX

## **ABSTRAK**

*Penelitian ditujukan untuk mengukur dampak dari rasio likuiditas, struktur modal dan aktivitas terhadap profitabilitas pada perusahaan sektor finansial. Penelitian ini menggunakan pendekatan kuantitatif asosiatif dengan data sekunder yang bersumber dari laporan tahunan perusahaan yang terdaftar di Bursa Efek Indonesia (BEI) periode 2023. Pengambilan sampel dilakukan dengan metode purposive sampling dengan kriteria tertentu yaitu perusahaan harus secara konsisten menerbitkan laporan keuangan selama tahun 2023, menggunakan mata uang rupiah, serta mencantumkan nilai untuk rasio likuiditas, struktur modal, rasio aktivitas aset, dan profitabilitas. Berdasarkan kriteria tersebut, diperoleh 97 perusahaan yang memenuhi persyaratan. Analisis regresi berganda merupakan metode untuk mengukur hipotesis penelitian melalui penggunaan software statistik SPSS v.29. Hasil penelitian ini menunjukkan rasio likuiditas, struktur modal dan rasio aktivitas aset perusahaan dapat memberikan pengaruh terhadap profitabilitas sektor finansial pada tahun 2023.*

**Kata kunci:** ROE, Current Ratio, DER, Keuangan, IDX

## **INTRODUCTION**

Competition between companies in the financial sector is getting tighter, especially amidst economic uncertainty which often gives rise to the risk of sudden bankruptcy. In order to survive and grow, companies need to monitor their conditions and performance regularly. This performance, which is primarily measured by profit, is an important indicator in seeing a company's ability to survive in a competitive market. Profit can be

**JIMKES**

Jurnal Ilmiah Manajemen  
Kesatuan  
Vol. 12 No. 6, 2024  
pp. 2165-2172  
IBI Kesatuan  
ISSN 2337 – 7860  
E-ISSN 2721 – 169X  
DOI: 10.37641/jimkes.v12i6.2916

defined as the difference between the actual income obtained from business transactions and the costs incurred to obtain that income in a certain period (Sholikhin et al., 2021; Ningrum et al., 2024). The main purpose of running a business is to generate sustainable profits. With profit, the company is able to cover operational costs and maintain the continuity of its business. If the company's financial performance shows positive results, then profit growth tends to increase. Conversely, if the company's performance is less than optimal, profit growth tends to decline.

With the increasing economic growth, many new companies have emerged in various commodity and service sectors. This adds to the variety and tightness of competition in the financial market. Although each company has different goals, in general one main goal that is expected is the achievement of long-term income. This long-term income will maintain the sustainability of the company, even amidst the risk of bankruptcy that may occur. Therefore, many companies focus on managing and allocating their financial resources effectively, in order to maximize profits and support long-term business goals. The company's financial performance itself can be measured through financial reports, such as balance sheets, income statements, cash flow statements, and statements of changes in financial position. In addition, financial statement analysis requires the right approach in order to provide relevant benchmarks in assessing the company's financial health and strength (Rizki & Yandri, 2019; Opferkuch et al., 2021).

In 2022, the Indonesia Stock Exchange (IDX) noted that many companies in the financial sector face significant challenges and opportunities in maintaining the stability of their financial performance. Various external factors such as interest rate fluctuations, increasingly intense business competition, government regulatory policies, and global market dynamics are factors that influence the company's financial stability. Financial performance in this financial sector is very crucial, because it indicates the company's ability to manage and optimize available resources. Strong financial performance can provide a competitive advantage in the market and significantly increase the company's value in the eyes of investors and other stakeholders (Kahupi et al., 2021; Oktaviani et al., 2024).

Profitability is one of the most important aspects in measuring a company's financial performance. Profitability indicates the level of a company's ability to generate profits from assets owned or from capital used (Purba & Africa, 2019). Several factors that affect profitability are liquidity ratio, capital structure, and company activity. The liquidity ratio serves as an indicator of the company's ability to meet short-term obligations, while capital structure relates to how the company manages financing sources, both from equity and debt (Salman, 2019). Company activity measures the extent to which assets owned can be used to generate income. The combination of these three factors greatly affects the level of profitability of companies in the financial sector.

This study aims to analyze the effect of liquidity ratio, capital structure, and activity on the profitability of companies listed on the Indonesia Stock Exchange (IDX) in 2023. Thus, the results of this study are expected to provide deeper insight into the important factors that affect profitability in the financial sector, as well as assist companies in developing more effective financial strategies. In addition, this study is also expected to contribute to the development of literature on financial performance in the financial sector and provide a basis for investors to make the right investment decisions amidst dynamic economic conditions.

## **LITERATURE REVIEW**

A company's liquidity demonstrates its ability to meet short-term obligations. Companies that can fulfill these commitments are considered liquid, while those that cannot are classified as illiquid. This study evaluates liquidity using the current ratio, which is calculated by comparing current assets on the balance sheet with current liabilities. According to Sari (2021), profitability refers to a company's capacity to generate profits through its capabilities and resources over a specific period. This is indicated by the profit margin, which reflects the company's positive outlook for the future.

According to Anggrainy (2019), the capital structure, assessed through the level of leverage, serves as an indicator of how much a business relies on debt to finance its assets. This capital structure defines the ratio of a company's equity to the debt used for asset financing. A company's financial performance is significantly influenced by its capital structure, which in turn affects its overall financial situation. A low capital structure is associated with increased profitability, while a high capital structure can lead to decreased profitability. The use of substantial debt raises the interest burden on the organization, increasing its obligations to meet debt repayments, which can ultimately heighten the risk of bankruptcy (Nainggolan, 2022; Benmelech et al., 2024). Activity ratios measure a company's efficiency in using its assets. This ratio measures the efficiency and efficacy of the company's use of resources. Efficiency is applied, for example, in the areas of Sales, Inventory, and Receivables, as well as in other areas. Activity ratios are used to assess a company's capacity when carrying out daily operations (Jenni et al., 2019; Bazaluk et al., 2022)

Financial performance is an evaluation of a company's capacity to carry out its operations referring to financial regulations. Analyzing a company's financial records is very important to assess its financial performance (Akbar & Fahmi, 2020). In measuring the performance and financial health of a company in the financial sector, there are several indicators used, including liquidity ratio, solvency, and profitability. Liquidity ratio measures the company's capacity to meet short-term obligations. A higher percentage indicates the company's obligations to creditors are guaranteed. This ratio assesses the company's ability to meet short-term obligations through the use of its existing assets (Nirawati et al., 2022). Lee (2022), found that a higher current ratio correlates with an increase in the current asset component, resulting in a greater risk of idle capital and potential loss of profits for the organization. If receivables increase, there is a potential danger of uncollectible receivables or bad debts, thereby reducing income. Excess inventory can be harmful to a business because it increases warehousing and maintenance costs. When these costs are high, they can impede future income and decrease the profits generated by the organization. Research by Wage et al. (2021); Sulasti (2022); Ihsan et al. (2023), indicates that the liquidity ratio can positively influence profitability. However, a study by Nadeak & Pratiwi (2019), found that the combined effects of liquidity and capital structure ratios only account for 22.5% of a company's profitability.

**H1:** The liquidity ratio has significant effect on company's profitability

Capital structure represents the balance between short-term liabilities, long-term liabilities, preferred stock, and common stock. Capital structure represents the balance between the use of long-term debt and equity financing. This shows that the quantity of equity and long-term debt is used to increase equity optimization. In essence, capital structure refers to the company's funding sources, especially the combination of debt and equity used to pay for its operational activities. If the company's debt exceeds its own capital, the company can experience losses (Yanti & Darmayanti, 2019)

Capital structure theory outlines a company's financial strategy, emphasizing the balance between debt and equity to optimize its value. When a company's debt surpasses its equity, it poses significant risks to investors, which may lead to substantial dividends. While high risk can decrease a stock's price, it may also increase due to these large payouts. A company's stock price reflects its value; thus, when the stock price rises, the overall value of the company also increases. Research by Rohendi & Sudradjat (2021), found that solvency has a negative effect on profitability. Capital structure indicates the company's capacity to settle its obligations using its assets, meaning that assets are used as collateral for the debt. This study evaluates solvency through the use of the debt-to-equity ratio (DER), which measures the proportion of a company's debt relative to its equity (shareholders' funds). In this DER, debt is anticipated not to exceed equity, because a scenario like this will result in an increase in interest expenses that must be paid. Based on the findings of Gea & Natalia (2020) and Sulasti (2022), said that the value formed by

the influence of the company's capital structure ratio can provide an increase in the company's profitability value, not only by increasing its profitability but also being able to encourage the company's legitimacy value in society.

**H2:** Capital structure ratio has significant effect on company's profitability value

The profitability ratio assesses the overall success of management by evaluating the amount of profit generated compared to sales and investments. Meanwhile, according to Nirawati et al. (2022), the profitability ratio evaluates the company's capacity to generate profits. According to the expert's opinion, it can be concluded that the profitability ratio is the ratio used to assess the company's capacity to seek profits. This ratio assesses the level of return or profit in relation to sales or assets, evaluating the company's capacity to generate profits related to sales, assets, or equity. This ratio shows the management's ability to generate profits and is the end result of many policies and actions taken by management. Profit growth refers to the change in annual profits, expressed as a percentage. Increased profit growth can affect the rate of return for current and potential investors, so that it can guide their investment decisions. Thus, profit growth is very crucial for companies and investors (Block et al., 2019). One way to assess the quality of a performance is through the level of output produced by a company. Financial performance assessment is carried out using financial ratios taken from financial statements. This is referred to as the company's basic factors, which are assessed through technical fundamental analysis and financial ratio analysis. An increase in the asset turnover ratio indicates that the organization is increasing the efficiency of its asset management, which indicates an increase in sales levels. This explanation is reinforced by research from Jenni et al. (2019), which found that total asset turnover had a significant effect in relation to profitability.

**H3:** Asset turnover ratio has significant effect on company's profitability value

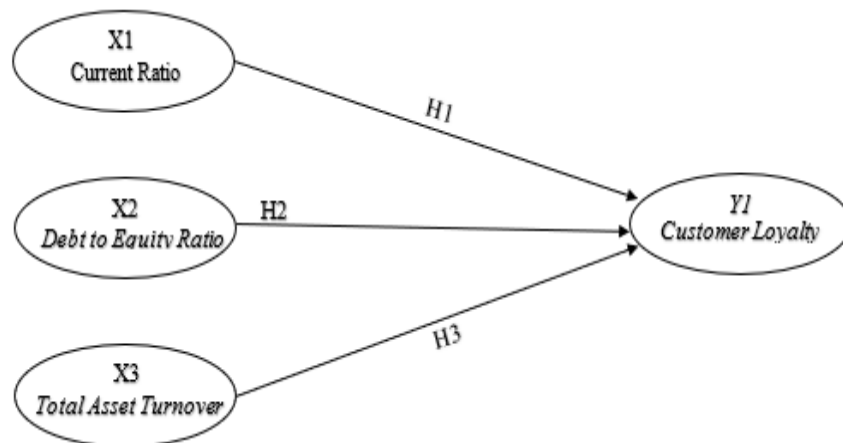


Figure 1. Research framework

## METHODS

This study uses an associative quantitative approach with secondary data sourced from the annual reports of companies listed on the Indonesia Stock Exchange (IDX) for the 2023 period. Sampling was carried out using a purposive sampling method with specific criteria: companies must consistently publish financial reports during 2023, use the rupiah currency, and include values for the liquidity ratio, capital structure, asset activity ratio, and profitability. Based on these criteria, 97 companies were obtained that met the requirements, making the total research sample 97 companies. Data analysis used the classical assumption test and multiple regression with SPSS version 29. The financial sector was chosen because it plays an important role in assessing the health and stability of a country's economy. This sector supports Indonesia's economic growth, especially

after experiencing significant developments after the 1997 Asian financial crisis (Adityawan, 2023). This study measures several key financial ratios to assess company performance. The profitability ratio, represented by Return on Equity (ROE), assesses the rate of return for shareholders. The liquidity ratio, calculated using the Current Ratio, shows the company's ability to meet its short-term obligations. Debt to Equity Ratio (DER) reveals the extent to which a company uses debt compared to its equity capital. The Total Asset Turnover activity ratio provides an overview of the effectiveness of asset use in generating sales. These ratios collectively provide valuable insights to stakeholders into the financial health and performance of a company.

## RESULTS

Descriptive statistical methods are carried out to determine the values contained in the measurement process, including the description or depiction of data. The Profitability variable has an average of 0.07428, a minimum value of -1.343, a maximum of 1.712 and a standard deviation of 0.287931. Liquidity has an average value of .0.3647, a minimum value of -5.81, a maximum of 4.26, and a standard deviation of 1.83860. The Capital Structure variable has an average value of -2.9275 with a minimum value of -6.91, a maximum value of 0.00, and a standard deviation of 1.43390. The Activity variable has an average value of -2.9491, a minimum value of -6.21, a maximum value of 0.54, and a standard deviation of 1.23083.

**Table 1.** Descriptive Statistical Values

Description	N	Min	Max	Mean	Std. Deviation
ROE	97	-1.343	1.712	0.07428	0.287931
CR	97	-5.81	4.26	0.3647	1.83860
DER	97	-6.91	0.00	-2.9275	1.43390
TATO	97	-6.21	0.54	-2.9491	1.23083

Then in the measurement of classical assumptions presented with the acquisition of normal normality values with a value of 0.250 ( $> 0.05$ ). Measurements on multicollinearity and heteroscedasticity also found that the data is normal data with no indication of multicollinearity and heteroscedasticity because it obtained a VIF value of  $\leq 10$  and a sig value of not less than 0.05. Another finding in the autocorrelation test was carried out by identifying if the DW value finding is more than +2 or below -2 then there can be a chance of the hypothesis being rejected but a Durbin Watson value of 0.378 was found so that it was said that the data did not have symptoms of autocorrelation.

**Table 2.** Classical Assumption Test

Items	Tolerance	VIF	Heteroskedasticities
CR (X1)	0.511	1.957	0.190
DER (X2)	0.544	1.837	0.894
TATO (X3)	0.899	1.113	0.490
Autocorrelation (DW-Test)			2.378
Normality Test			0.250

The findings are then entered into the regression. Furthermore, the measurement of the f value on each test variable is 0.006, which is a value that is worthy of further study because it is less than 0.05. Furthermore, it is known that the r square value on a test model is 0.149 or 14.9% explained that the value is known for the influence given by the liquidity ratio, capital structure ratio, and asset activity ratio of the company on the profitability of the company with the finance sector.

Table 3. Multiple Regression Analysis Value

Items	Regression	t	sig
Constant	-2.342	-7.325	0.000
CR	0.327	2.510	0.014
DER	0.216	2.015	0.047
TATO	0.286	2.986	0.004
Adj. R2	0.149		
F statistic	4.422		
F sig.	0.006		

The findings stated that the measurement of the current ratio or liquidity ratio gets a sig value of 0.014 with a t value of 2.510 which states that the first hypothesis test is accepted because the sig value measurement result is not more than 0.05. From the results of the study mentioned, there is evidence that shows that liquidity has a significant effect on the profitability of companies in the financial sector. This also proves that good liquidity gives companies financial flexibility that allows them to take advantage of business opportunities quickly. This creates conditions conducive to increasing profits because companies are not only able to survive short-term obligations but also invest in efforts to increase revenue (Ningrum et al., 2024).

Therefore, adequate liquidity can increase a company's ability to generate profits, as evidenced by Yameen et al. (2019), which states that liquidity has a partial positive impact on profitability. Not only that, liquidity refers to how quickly a company's assets can be converted into cash to meet its short-term obligations. When a company has a high level of liquidity, this means that the company has enough funds to pay debts, provide dividends to shareholders, fund operations, and make investments that can generate income in the future. Several previous studies also support this finding, as explained by Yameen et al. (2019), who found that liquidity has a positive impact on profitability partially. Similar things were also conveyed by Wage et al. (2021); Sulasti (2022); Ihsan et al. (2023), who emphasized that there was a strong and significant influence on the level of profitability. This finding is consistent with financial theory which states that good liquidity can support the growth of company profits.

The second measurement is proven by conducting on factors influenced by the capital structure ratio to profitability, the measurement is proven by the results of the findings of a significant value of less than 0.05 or 0.47 with a t value of 2.015 which states that the second hypothesis test is accepted because the figure found is not more than the maximum research limit ( $<0.05$ ). The results of this study reveal that capital structure has a positive effect on company profitability, which means that companies with well-managed capital structures tend to experience increased profitability (Sulasti, 2022).

Capital structure refers to the balance between debt and equity used to finance company activities. An effective capital structure allows companies to reduce capital costs while maintaining a balance between risk and expected returns. Several theories also mention the Trade-Off Theory model. Megawati et al. (2021) state that companies need to balance the tax benefits of debt (tax shield) with the risk of bankruptcy that may arise from the use of excessive debt. An optimal capital structure is able to maintain a balance between risk and return, which in turn increases net income per share. Thus, decisions related to capital structure, such as the proportion of debt and equity, are essential in a company's financial strategy. Wise use of debt can increase profits through savings in capital costs, provided that the financial risks incurred remain under control. The results of these studies, including those from Gea & Natalia, (2020); Sulasti (2022), support the conclusion that a well-managed capital structure can maximize returns and increase a company's stock returns.

The next measurement is the measurement of profitability which is influenced by the company's asset activity ratio, based on the findings it is stated that the sig value is below the fixed value of 0.05 so that the third hypothesis is accepted. This is in line with research developed by Jenni et al. (2019). Increasing asset turnover indicates that the company is increasingly effective in managing its assets, which contributes to operational efficiency.

In other words, the faster the company turns over its assets, the greater the potential sales volume and profit that can be achieved. This shows that good asset management not only supports sales, but also has the potential to increase overall profitability. Therefore, companies need to focus on strategies to improve TATO as one way to optimize financial performance by optimizing asset management by conducting periodic audits of owned assets to ensure that all assets are used efficiently. Identify unproductive assets and consider selling or deactivating them with audit actions, the company can cut the budget for the company's operational needs.

## CONCLUSION

Data findings indicate that a high liquidity ratio significantly impacts profitability. Companies with ample liquidity are better equipped to avoid financial disruptions, thus ensuring smooth operations and enhanced profitability. In addition to liquidity, capital structure and asset activity management are also crucial for profitability growth. By balancing debt and equity, companies can leverage the benefits of debt to amplify returns while maintaining the financial stability that strong equity provides. An optimal blend of both can enhance profitability by optimizing capital costs and mitigating financial risk. Companies' adept at managing liquidity, capital structure, and asset activities achieve a stronger competitive position, paving the way for sustained profit growth. The analysis also reveals an f-square value with a significance level of 0.006, indicating a statistically significant effect. However, the model's r-square value is relatively low, at 14.9%, suggesting that the independent variables explain only a small portion of the variance in profitability. This finding implies that while the examined factors are essential, additional variables likely contribute to profitability and should be considered in future analyses for a more comprehensive understanding.

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