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Mediating role of profitability in the relationship between institutional ownership and firm value: Evidence from Indonesia

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Abstract: *This study examines the effect of institutional ownership on profitability and firm value, with profitability as a mediating variable, in manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022, variable control is firm size and interest rate. The research sample includes 54 purposive-sampled manufacturing enterprises. Secondary data from IDX and company yearly financial statements is used. STATA version 17 is used for structural equation modelling (SEM) with bootstrapping data analysis. The study found that institutional ownership increases profitability (ROE) and firm value (PBV) at 5% and 10% significance levels, respectively. Profitability also increases company value at a 1% significance level. Profitability also mediates the effect of institutional ownership on firm value at the 10% significance level, indicating that institutional ownership can*

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increase firm value through increased profitability. This study helps explain how institutional ownership boosts business value through profitability. This research has implications for regulators (OJK & IDX) and policymakers regarding corporate governance. Managers need to strengthen governance and transparency to maximize profitability and enhance company value. To better understand how institutional ownership affects business value, future research should expand variables, incorporate data from various industries, and conduct cross-country studies.

Keywords: *firm value; Indonesia; institutional ownership; profitability*

Peran mediasi profitabilitas dalam hubungan kepemilikan institusional dan nilai perusahaan: Bukti dari Indonesia

Abstrak: *Penelitian ini menguji pengaruh kepemilikan institusional terhadap profitabilitas dan nilai perusahaan, dengan profitabilitas sebagai variabel mediasi, pada perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (BEI) dari tahun 2018 hingga 2022, variabel kontrolnya adalah ukuran perusahaan dan suku bunga. Sampel penelitian mencakup 54 perusahaan manufaktur yang diambil sampelnya secara purposif. Data sekunder dari BEI dan laporan keuangan tahunan perusahaan digunakan. STATA versi 17 digunakan untuk structural equation modelling (SEM) dengan analisis data bootstrapping. Penelitian ini menemukan bahwa kepemilikan institusional meningkatkan profitabilitas (ROE) dan nilai perusahaan (PBV) masing-masing pada tingkat signifikansi 5% dan 10%. Profitabilitas juga meningkatkan nilai perusahaan pada tingkat signifikansi 1%. Profitabilitas juga memediasi pengaruh kepemilikan institusional terhadap nilai perusahaan pada tingkat signifikansi 10%, yang menunjukkan bahwa kepemilikan institusional dapat meningkatkan nilai perusahaan melalui peningkatan profitabilitas. Penelitian ini membantu menjelaskan bagaimana kepemilikan institusional meningkatkan nilai bisnis melalui profitabilitas. Penelitian ini memiliki implikasi bagi regulator (OJK & IDX) dan pembuat kebijakan terkait tata kelola perusahaan. Manajer perlu memperkuat tata kelola dan transparansi untuk memaksimalkan profitabilitas dan meningkatkan nilai perusahaan. Untuk lebih memahami bagaimana kepemilikan institusional memengaruhi nilai bisnis, penelitian di masa mendatang sebaiknya menambah variabel, memasukkan data dari berbagai industri, dan melakukan studi lintas negara.*

Kata kunci: *Indonesia; kepemilikan institusional; nilai perusahaan; profitabilitas*

INTRODUCTION

Large institutions, including pension funds, insurance firms, and investment managers, own institutional shares. Institutions have more resources and experience to monitor and influence business practices than shareholders. Institutional ownership can boost firm transparency and information generation, say Boone & White (2015). Higher transparency helps management make better decisions, improving operational efficiency and business profitability. The Agency Theory also suggests that institutional ownership reduces manager-shareholder disputes. Managers may overpay or take unwarranted risks to benefit themselves, hurting shareholders. Lin & Fu (2017) find that institutional ownership reduces agency concerns by tightening oversight and ensuring managers behave in shareholder interests. Better supervision helps managers focus on long-term corporate performance, which can boost profits.

Institutional ownership increases corporate profitability through several ways, according to empirical studies. Ridha et al. (2019) found that institutional ownership boosts Indonesia Stock Exchange-listed companies' profitability. Institutional shareholders can coach managers to be more efficient and strategic, improving the company's financial performance. Cao et al. (2020) found that institutional ownership improves company investment efficiency, increasing profitability. Other studies show that institutional ownership can influence corporations to promote social responsibility and sustainability, which can boost long-term profitability. Buchanan et al. (2018) show that strong institutional ownership can drive enterprises to be more socially responsible, improving corporate reputation, consumer loyalty, and investment attractiveness. Thus, empirical evidence and The Agency

Theory support the hypothesis that "institutional ownership has a positive effect on profitability" by suggesting that institutional shareholders' supervision and control will improve the company's operational efficiency and financial performance.

H_1: Institutional ownership has a positive effect on profitability.

Institutional ownership has historically been linked to corporate value. Institutional shareholders include pension funds, insurance firms, and investment managers. These entities can better supervise and regulate corporate management than individual investors. Institutional ownership can boost firm transparency and information generation, according to Boone & White (2015). Investors like transparent companies because it decreases information uncertainty, which boosts firm value. Institutional ownership can also mitigate manager-shareholder agency concerns by monitoring. The Agency Theory suggests that managers (agents) and shareholders (principals) have a conflict of interest that can lead to poor company management. Lin & Fu (2017) discovered that institutional ownership can reduce this agency problem by tightening monitoring and motivating managers to make shareholder-friendly decisions. Companies become more efficient and lucrative with greater supervision, increasing firm value. Numerous research demonstrates that institutional ownership can boost business value in numerous ways. Buchanan et al. (2018) find that strong institutional ownership can make enterprises more socially responsible, improving their reputation and investor appeal. Good reputations boost customer loyalty, market share, and business value. Ridha et al. (2019) found that institutional ownership influences business profitability, a crucial performance metric that affects market value, in Indonesia. Institutional ownership increases business value in various market and industry scenarios, according to numerous research. Schmidt & Fahlenbrach (2017) believe exogenous institutional ownership changes affect corporate governance and value. In Indonesia, Utami et al. (2025) and Sudiyatno et al. (2020) found that enterprises with substantial institutional ownership have greater market values. Based on this empirical evidence, the hypothesis that "institutional ownership has a positive effect on firm value" proposes that institutional ownership improves supervision and reduces agency problems, boosting firm value.

H_2: Institutional ownership has a positive effect on firm value.

Investors evaluate a company's financial success using profitability. Company profitability demonstrates management efficiency and effectiveness by generating profits from operational activities. Utami et al. (2025) found that profitability affects company value in Indonesia's property and real estate sector. Profitable enterprises have higher market values because investors see them as financially healthy and promising. High profitability generates cash flow, which can be utilized to pay dividends or reinvest in profitable ventures, according to traditional finance theory. Jihadi et al. (2021) show that increasing profitability makes firms more attractive to investors. Better cash flow lets organizations invest in growth prospects, which boosts their value. Other empirical study shows that profitability increases business value. Buchanan et al. (2018) discovered that high-profit corporate social responsibility (CSR) can boost reputation and market value. Machmuddah et al. (2020) found that profitability drives company value in Indonesia. High profitability shows that the organization manages resources well, which boosts market confidence and investor confidence. Sudiyatno et al. (2020) found that profitability drives business value. Successful organizations have more financial flexibility to engage in expansion projects, pay higher dividends, or reduce debt. All these elements boost the firm's value. Given this empirical evidence, the hypothesis that "profitability has a positive effect on firm value" can be proposed, as higher profitability indicates better financial performance and brighter prospects, which increases the firm's value to investors.

H_3: Profitability has a positive effect on firm value.

Institutional ownership can affect firm performance and value through management oversight and openness. Institutional ownership can promote firm transparency and information generation, reducing manager-shareholder agency concerns, according to Boone & White (2015). The Agency Theory implies that institutional shareholders have incentives and resources to monitor management performance more effectively, encouraging improved decisions and operational efficiency, according to Lin & Fu (2017). As the main financial performance metric, profitability helps bridge institutional ownership and business value. Ridha et al. (2019) found that institutional ownership significantly affects business profitability and value. Better governance from institutional shareholders helps management focus on long-term profitability, which boosts operational cash flow and investor appeal. Studies also suggest that high profitability increases company value through numerous pathways. Buchanan et al.

(2018) claim that more profitable enterprises have a stronger reputation and investor appeal, which enhances their market value. Utami et al. (2025) and Jihadi et al. (2021) found that profitability affects business value in various Indonesian sectors. High profitability from institutional control boosts investor confidence and corporate value. Machmuddah et al. (2020) and Sudiyatno et al. (2020) also found that profitability drives business value in Indonesia. The mediation path shows that institutional ownership that boosts firm profitability also boosts firm value. Thus, the hypothesis that "profitability mediates the effect of institutional ownership on firm value" suggests that institutional shareholders' oversight and control improve financial performance and market value by increasing profitability.
H_4: Profitability mediates the effect of institutional ownership on firm value.

This study makes theoretical and practical contributions to increase Indonesian manufacturing firm performance and value. Profitability, as a mediating variable, adds to the literature on institutional ownership, profitability, and company value. Based on The Agency Theory, this study shows how institutional ownership can improve supervision and motivate management to focus on long-term performance, increasing business profitability. These findings support earlier research on institutional control and corporate performance (Boone & White, 2015; Lin & Fu, 2017). In an emerging market context, particularly in the Indonesian manufacturing sector, this study shows that profitability bridges the effect of institutional ownership on firm value (Utami et al., 2025; Jihadi et al., 2021). Indonesian corporate managers, institutional shareholders, and policymakers can learn from this study. Financial performance and firm value are improved by effective institutional monitoring, according to corporate managers. Managers should cooperate with institutional shareholders to ensure transparency and strong governance to boost profits and investor interest. This study shows institutional shareholders' importance in monitoring and influencing managerial actions to maximize firm value. These findings can also be used to promote capital market institutional engagement and monitoring, which can improve market efficiency and economic welfare (Cao et al., 2020; Ridha et al., 2019).

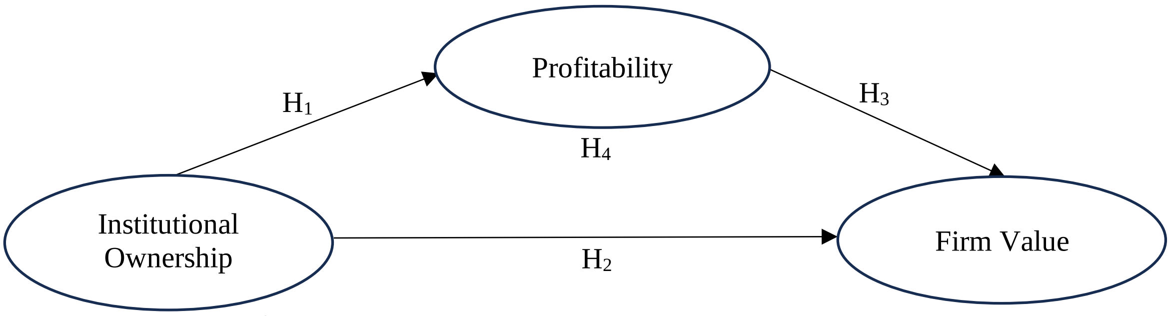

Figure 1. Conceptual framework diagram
Source: Author processed data (2024)

METHOD

This research uses a quantitative approach to test the hypothesis that has been proposed. The quantitative approach was chosen because this study aims to measure the relationship between variables statistically and test the effect of institutional ownership on firm value with profitability as a mediating variable. The population in this study are manufacturing companies listed on the Indonesia Stock Exchange (ISE) during the 2018-2022 period, with a total of 157 companies. The sampling technique used is purposive sampling, namely sample selection based on certain criteria relevant to the research objectives (Ahmed, 2018). Based on these criteria, 54 manufacturing companies were selected as samples for this study. The data used in this study are secondary data sourced from the Indonesia Stock Exchange (ISE) and the company's annual financial statements. The data analysis in this study used STATA software version 17. The analysis method used is structural equation modelling (SEM) with bootstrapping techniques.

Table 1. Research sample criteria manufacturing companies

No	Criteria	Number of companies
1	Companies included in the manufacturing sector listed on the IDX 2018-2022.	157
2	Companies that do not fully publish their 2018-2022 financial reports.	(55)
3	Companies that do not have complete data related to research variables.	(48)
	Number of companies	54

Source: Author processed data (2024)

The independent variable in this study is institutional ownership. Institutional ownership is measured by the percentage of shares owned by institutions against the total shares outstanding in a company. While the mediating variable in this study is profitability. Profitability in this study uses the ROE proxy. ROE shows the efficiency of the company in using shareholders' capital to generate profits. ROE is measured by net income divided by total equity. Meanwhile, the dependent variable in this study is firm value. The company value in this study uses the PBV proxy. PBV is calculated by the formula stock price divided by book value per share. In addition, this study uses two control variables, namely interest rates and company size. Interest rates are measured using the benchmark interest rate that applies during the study period, such as the BI (Bank Indonesia) interest rate. Meanwhile, firm size is measured using the logarithm of the company's total assets (Ln total assets).

RESULTS AND DISCUSSION

Results

Table 2. Descriptive statistics

Variable	Obs	Mean	Std dev	Min	Max
Institutional ownership	270	68.15	18.82	13.99	94.92
ROE	270	12.52	22.52	-38.30	145.08
PBV	270	0.81	1.31	0.10	12.20
Interest rate	270	4.75	0.97	3.50	6.00
Size	270	28.99	1.66	25.95	33.65

Sources: Author processed data (2024)

Table 2 presents the descriptive statistics for the variables used in this study, namely institutional ownership, return on equity (ROE), price to book value (PBV), interest rates, and firm size. The data is taken from 270 observations. Institutional ownership has an average of 68.15% with a standard deviation of 18.82%, and minimum and maximum values of 13.99% and 94.92%, respectively. The ROE variable shows an average of 12.52% with a relatively high standard deviation of 22.52%, and a range of values from -38.30% to 145.08%. For the PBV variable, the average value is recorded at 0.81 with a standard deviation of 1.31, and a range from 0.10 to 12.20. The interest rate has an average of 4.75% with a standard deviation of 0.97%, and minimum and maximum values of 3.50% and 6.00%, respectively. Finally, the firm size variable shows an average of 28.99 with a standard deviation of 1.66, and a range from 25.95 to 33.65.

Table 3. Correlation matrix

Variable	Institutional ownership	ROE	PBV	Interest rate	Size
Institutional ownership	1				
ROE	0.1306**	1			
PBV	0.1152*	0.0563*	1		
Interest rate	0.0082	0.1363**	0.0204	1	
Size	-0.0970	0.2251***	-0.0003	-0.0170	1

p-values in parentheses *p<0.1, **p<0.05, ***p<0.01
Sources: Author processed data (2024)

Table 3 presents the correlation matrix between the variables in this study, namely institutional ownership, return on equity (ROE), price to book value (PBV), interest rates, and firm size. The correlations are measured using Pearson correlation coefficients. Institutional ownership shows a significant positive correlation with ROE (B = 0.1306, $p<0.05$) and PBV (B = 0.1152, $p<0.1$). However, there is no significant correlation between institutional ownership and interest rates (B = 0.0082), nor between institutional ownership and firm size (B = -0.0970). ROE has a significant positive correlation with PBV (B = 0.0563, $p<0.1$) and interest rates (r = 0.1363, $p<0.05$), and a stronger correlation with firm size (B = 0.2251, $p<0.01$). PBV shows a significant positive correlation with ROE, but no significant correlation with interest rates (B = 0.0204) or firm size (B = -0.0003). Interest rates do not show a significant correlation with firm size (B = -0.0170). Firm size only shows a significant correlation with ROE (B = 0.2251, $p<0.01$), but no significant correlation with the other variables.

Table 4. Regression

Variable	Model 1 ROE	Model 2 PBV
Institutional ownership	0.156** (0.032)	0.00844* (0.055)
ROE		0.0180*** (0.002)
Interest rate		-0.0346 (0.492)
Size		-0.00917 (0.915)
_cons	1.872 (0.715)	2.267 (0.154)
N	270	270
R^2	0.0171	0.0495

p-values in parentheses *p<0.1, **p<0.05, ***p<0.01
Sources: Author processed data (2024)

Table 4 shows two models' regression findings. ROE is the dependent variable in model 1, while PBV is in model 2. Model 1 shows a considerable positive impact of institutional ownership on ROE, with a coefficient of 0.156 ($p<0.05$). The more institutional ownership a corporation has, the higher its profitability. Institutional investors oversee management better, enhancing operational efficiency and corporate profits. The R^2 value of 0.0171 suggests that while the effect is considerable, the model only explains roughly 1.71% of variation in ROE. Additionally, model 2 indicates a positive correlation between institutional ownership and PBV, with a coefficient of 0.00844 and a significance threshold of 10% ($p<0.1$). Despite a weak association, companies with increased institutional ownership have higher market prices. Additionally, ROE has a substantial positive impact on PBV (coefficient 0.0180; $p<0.01$), showing that profitable companies are valued higher by the market. The interest rate and firm size variables do not affect PBV strongly. The R^2 value of 0.0495 suggests that this model explains 4.95 percent of PBV variation. These findings show that institutional ownership improves a company's financial performance and market value, but its impact is limited and presumably influenced by other factors.

Table 5. Bootstrapping mediation

Variable	Coefficient	Bootstrap std. error	Significant
Institutional ownership → Profitability → Firm value	0.006175	0.007612	0.0517*

p-values in parentheses *p<0.1, **p<0.05, ***p<0.01
Sources: Author processed data (2024)

Table 5 shows the bootstrapping mediation test findings to assess if profitability mediates the association between institutional ownership and firm value. The study found a substantial indirect relationship between institutional ownership and business value through profitability (coefficient = 0.006175, standard error = 0.007612, significance threshold = 0.0517, $p<0.1$).

Discussion

Institutional ownership boosts Indonesian manufacturing companies' profits. This confirms the first hypothesis and the Agency Theory, which states that institutional ownership can improve managerial efficiency and effectiveness through tougher control. Institutional ownership increases corporate openness and reduces manager-shareholder agency concerns, according to Sakawa & Watanabel (2020). Institutional shareholders' monitoring might encourage managers to make better decisions and focus on long-term success, enhancing profitability. This is congruent with Fitri & Hakim (2021), who found that institutional ownership boosts Indonesia Stock Exchange-listed companies' profitability. Strong institutional ownership may guide and motivate management to be more efficient and strategic, enhancing financial performance. This suggests that institutional investors improve business profitability in Indonesian manufacturing enterprises by improving oversight and transparency. Thus, organizations with more institutional ownership perform better financially.

Indonesian manufacturers gain from institutional ownership. This confirms the second premise and the Agency Theory that institutional ownership promotes business value through tougher oversight and openness. According to Smith et al. (2019), institutional ownership increases corporate transparency, reducing investor uncertainty, and enhancing business value. Sutrisno & Ulfah (2020) say institutional ownership ensures managers make shareholder-beneficial decisions, enhancing operational efficiency, profitability, and firm value, reducing agency problems. The analysis suggests institutional ownership boosts corporate value in various ways. Strong institutional ownership encourages social responsibility, which Buchanan et al. (2018) found boosts corporate reputation and investor appeal. Bao & Lewellyn (2017) say institutional ownership influences business profitability and market value. Schmidt & Fahlenbrach (2017) study demonstrated that exogenous institutional ownership changes affect corporate governance and firm value. These findings suggest that institutional investors boost Indonesian manufacturing business value by improving governance and transparency. Investors regard institutionally owned enterprises as more transparent and well-managed, enhancing their prices.

Profitability boosts Indonesian manufacturing enterprises' value. This validates the third hypothesis and classical finance theory that profitable companies have higher market prices. Management efficiency and effectiveness, in using firm resources to generate revenues, determine profitability. The more lucrative a company, the more cash it may earn to pay dividends or invest in profitable projects, raising firm value. This confirms prior empirical investigations. Nugroho & Hakiman (2020) observed that profitability influences Indonesian property and real estate firm value. Jihadi et al. (2021) found that firms with higher profits attract investors. Machmuddah et al. (2020); Putri & Suseno (2024); and Sudiyatno et al. (2020) found that profitability drives business value in Indonesia. Financial flexibility to invest in expansion, pay higher dividends, or reduce debt, can improve firm value in profitable enterprises. These findings suggest that profitability affects firm value in Indonesian manufacturing enterprises. Profitable organizations are seen as financially healthy and have better prospects, which boosts investor confidence and market value.

Profitability mediates institutional ownership's impact on company Indonesian manufacturers. Profitability mediates the effect of institutional ownership on corporate value. This proves the fourth hypothesis that institutional ownership affects corporate value through profitability. The Agency Theory states that institutional ownership promotes corporate governance and transparency, decreasing manager-shareholder agency issues. Management can focus on long-term success with stronger institutional shareholder oversight, enhancing operational efficiency and profitability. Ridha et al. (2019) found institutional ownership impacts firm value and profitability. Management focuses on long-term profitability with institutional shareholder supervision, boosting operational cash flow and investor appeal. Buchanan et al. (2018) found that profitable companies had better reputations and investor appeal, raising their market value. In line with Putri & Suseno (2024) found that profitability affects firm value across Indonesian sectors. Investors appreciate profitable companies with strong institutional oversight more because they are more reliable and promising. These findings imply institutional ownership can increase Indonesian manufacturing firm profitability. Greater monitoring and transparency from institutional shareholders can increase the company's financial performance and market value.

CONCLUSION AND SUGGESTIONS

This study examines the effect of institutional ownership on profitability and company value, with profitability as a mediating variable, in Indonesia Stock Exchange-listed manufacturing companies from 2018 to 2022, adjusting for firm size and interest rate variables. According to structural equation modelling (SEM) using bootstrapping, institutional ownership positively affects profitability (measured by ROE) at a 5% significance level. Institutional ownership can improve managerial efficiency and effectiveness through greater control, increasing corporate profitability. Institutional ownership also increases firm value (PBV) at a 10% significance level. Through transparency and oversight, institutional ownership can boost business value. A 1% significance threshold shows that profitability increases company value. Profitable companies have higher market values since they are financially healthier and have better future possibilities. Profitability also mediated institutional ownership's effect on business value at 10% significance. Institutional ownership can boost firm value through profitability, a key method. This study helps explain how institutional ownership boosts business value through profitability. Company management, institutional shareholders, and policymakers can use these results to improve financial performance and firm value.

Further research should include corporate governance, capital structure, and dividend policies, which may affect firm value and profitability. For a deeper insight, research can prolong the study time or include data from other industries besides manufacturing. Qualitative or mixed methods can help explain how institutional ownership affects business value. Institutional ownership can also affect firm value and profitability in different nations with varied economic and regulatory circumstances through cross-country studies. Using dynamic models to study the long-term effects of institutional ownership and profitability on firm value can also reveal how institutional ownership changes affect corporate performance.

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