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Determinants of Firm Value in Consumer Non-Cyclicals: The Quasi-Moderating Role of Firm Size

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ABSTRACT

This study examines the structural effect of Profitability (ROA) on Firm Value (Tobin's Q) and evaluates the moderating role of Firm Size (SIZE) within the Consumer Non-Cyclical sector listed on the Indonesia Stock Exchange (IDX) for the period 2019–2025. Grounded in a hierarchical theoretical framework integrating Signaling Theory, Stakeholder Theory, Agency Theory, and the Deep Pocket Hypothesis, this research resolves empirical debates regarding valuation anomalies in emerging capital markets. Utilizing an explanatory panel data regression under the Swamy-Arora Random Effects Model (REM) with Moderated Regression Analysis (MRA) and procedures via EViews 14, the empirical results reveal three major insights. First, Profitability (ROA) exerts a statistically significant negative effect on Firm Value, uncovering a Decoupling Valuation / Market Anomaly where capital markets temporarily penalize short-term earnings due to perceived ESG compliance and transition costs. Second, standalone Firm Size exerts a statistically significant negative direct main effect on Firm Value, indicating a valuation discount driven by agency costs, organizational complexity, and market maturity saturation. Crucially, third, the interaction model confirms that Firm Size functions as a Quasi-Moderator / Strategic Buffer, successfully reversing and overpowering the primary negative valuation penalties of both ROA and standalone asset scale. Grounded in the Deep Pocket Hypothesis, investors award valuation premiums to corporate earnings if and only if those profits are backed by a massive asset base capable of buffering operational and regulatory risks.

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KEYWORDS: Profitability, Firm Size, Firm Value, Decoupling Valuation, Quasi-Moderator, Deep Pocket Hypothesis, Tobin's Q.

I. INTRODUCTION

The Consumer Non-Cyclicals sector plays a defensive yet fundamental role in emerging markets, such as Indonesia. In recent years, public companies within this sector have faced dynamic pressures, balancing operational profitability with heightened stakeholder demands for environmental, social, and governance (ESG) compliance. Traditionally, corporate finance literature posits that profitability is the primary driver of market valuation. Higher profit margins are expected to transmit positive signals to investors, there by driving up corporate market value (Tobin's Q).

A critical empirical paradox motivating this study is the decoupled movement between corporate profitability and firm valuation within the Consumer Non-Cyclical sector listed on the Indonesia Stock Exchange (IDX) from 2019 to 2025, as depicted in **Figure 1** and **Figure 2**.



Figure 1: Average Profitability Trend 2019–2025)
Source: Indonesia Stock Exchange (IDX) 2019-2025 Period



Figure 2: Average Firm Value Trend 2019–2025)
Source: Indonesia Stock Exchange (IDX) 2019-2025 Period

Grounded in Signaling Theory, an increase in operational profitability ought to directly translate into higher market valuation. However, cross-comparing Figure 1 and Figure 2 reveals a striking empirical contradiction: while corporate profitability recovered steadily from its 2020 low (8.5%) to peak at 10.2% in 2022 (Figure 1), firm valuation experienced a steady decline from 4.2 in 2022 to 3.0 in 2025 (Figure 2). This persistent inverse trajectory underscores that financial markets discount short-term earnings when structural risks are present, highlighting the necessity of examining moderating mechanisms such as firm size.

However, modern accounting perspectives rooted in Stakeholder Theory and Legitimacy Theory suggest potential trade-offs between short-term earnings maximization and long-term value creation. Capital allocation toward environmental management, compliance, and institutional resilience often registers as short-term operational expenses, which can suppress immediate market valuation metrics while building structural resilience.

Furthermore, empirical debate persists regarding how firm scale conditions this relationship. Does a company's asset size function merely as an independent driver, or does it act as a catalytic moderator that amplifies or dampens market response to corporate earnings? This study addresses these issues by evaluating the direct effect of Profitability on Firm Value and determining the precise typology of Firm Size as a moderating variable.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Profitability to Firm Value

Profitability is a fundamental indicator reflecting management effectiveness in generating economic value for shareholders. In the financial literature, the relationship between profitability and firm value is generally viewed as positive and significant, which can be explained through several perspectives:

1. Signaling Theory Perspective. According to Signaling Theory, a high level of profitability acts as a positive signal regarding a company's future prospects. Investors respond to this signal by increasing demand for the company's shares, which then drives up the company's share price and market value (Dewantari, Cipta, and Susila 2019). A company's ability to maintain stable earnings provides the market with confidence that management is capable of effectively navigating business risks.

2. Maximizing Shareholder Welfare. High profitability reflects a company's ability to distribute dividends or reinvest for future growth. This directly increases the company's attractiveness to investors due to the guaranteed welfare and potential capital gains (Setiawati, Mariati, and Dewi 2023). Research consistently demonstrates that profitability ratios, measured by ROA or ROE, are positively correlated with firm value, as proxied by Tobin's Q (Aritopan et al. 2024), (Eko Putranto and Martini Martini 2025), and (Sugosha 2020).

3. Earnings Quality and Business Sustainability: For the Consumer Non-Cyclicals sector, stable profitability indicates brand strength and supply chain efficiency. Investors tend to place a premium on companies that remain profitable despite macroeconomic pressures. However, it should be noted that firm value will only increase if the market perceives such profitability to be high-quality and sustainable over the long term.

4. Contradictory Perspective: The Negative Impact of Profitability on Firm Value. Although the relationship between the two is conventionally viewed as positive, modern financial literature and several market phenomena suggest a possible negative relationship between profitability and firm value. This can be explained through several theoretical arguments:

a. The Phenomenon of Managerial Myopia: Based on the theory proposed by Stein (1989), managers sometimes engage in opportunistic behavior by pursuing high short-term profitability to meet market expectations or personal bonuses, while also cutting strategic costs (such as research, human resource development, or environmental costs). Sophisticated investors perceive this as a threat to the company's future viability and respond to the increase in profits by lowering the company's market value (Tobin's Q).

b. Agency Theory and the Problem of Overinvestment: Very high profitability can trigger agency conflicts. Managers may be inclined to waste money or invest in unprofitable projects (empire building) due to excess cash flow. If the market perceives that these profits are not being managed for efficient growth, investors will discount the company's value (Kogan & Papanikolaou, 2014).

c. Earnings Quality and Uncertainty Risk: A company's value is determined not only by the amount of earnings, but also by the quality of those earnings. If high earnings are perceived as resulting from aggressive accounting practices or a disregard for compliance (such as risky tax avoidance), the market will view those earnings as a source of risk. Under these conditions, increased profitability will actually

undermine investor confidence and distort the company's value in the capital market (Bhandari, 2021).

H1: Profitability has a significant positive impact on firm value (Tobins_q).

2.2 Firm Size to Firm Value

1. Firm size is a crucial structural factor representing a company's operational scale, total resource capacity, and market reach. In corporate finance literature, the direct relationship between firm size and firm value (Tobin's Q) is widely debated, with theoretical arguments supporting both positive and negative mechanisms:
2. **Signaling Theory and Resource-Based View (RBV) Perspective:** Under the **Resource-Based View (RBV)**, a larger asset base reflects a firm's superior ability to accumulate tangible and intangible resources, achieve operational economies of scale, and withstand adverse macroeconomic shocks. According to **Signaling Theory**, large-scale firms convey a strong signal of stability, market leadership, and institutional credibility to external investors. This institutional visibility reduces information asymmetry, lowers the cost of capital, and instills investor confidence, there by driving up market valuation metrics (Tobin's_Q > 1).
3. **Deep Pocket Hypothesis and Risk Mitigation:** Grounded in the **Deep Pocket Hypothesis**, large corporations possess extensive financial buffers that enable them to absorb transition costs, regulatory compliance burdens (such as ESG and Environmental Management Accounting), and unexpected operational risks without threatening core solvency. Capital market investors tend to assign a valuation premium to large-scale enterprises because their extensive asset base acts as a fundamental safeguard against financial distress and bankruptcy risks.
4. **Contradictory Perspective (Inefficiencies of Large Scale and Maturity Saturation):** Conversely, modern organizational theory suggests that excessive firm size can introduce structural drawbacks that negatively impact firm value:
5. **Agency Problems and Bureaucratic Inefficiency:** As firms grow larger, organizational complexity increases, potentially giving rise to principal-agent conflicts, managerial entrenchment, and bureaucratic inertia that hinder swift strategic adaptation.
6. **The Saturation Effect in Mature Firms:** Highly mature corporations may experience diminishing marginal returns on assets. Investors may view large firms as having reached a growth ceiling, leading to lower growth expectations and a valuation discount relative to agile, high-growth mid-cap competitors.

Despite potential scale inefficiencies, within the defensive Consumer Non-Cyclicals sector, large asset scale is generally perceived as a vital buffer that protects firm stability and enhances long-term market reputation.

H2: Firm size has a significant positive impact on firm value (Tobins_Q).

2.3 Profitability, Firm Value, and the Moderating Role of Firm Size

Firm size is positioned as a moderating variable because resource capacity and a company's level of visibility in the capital market are believed to influence investor sensitivity to reported earnings information.

1. Signal Strengthening in Large Companies (Large Caps) Based on the Resource-Based View (RBV), large companies have broader access to resources and more stable business networks. Investors tend to respond more positively to increased profitability in large companies because they are perceived as having a lower risk of failure (too big to fail). In this context, firm size acts as a strengthening variable for the positive effect of profitability on firm value (Bachmann and Kataishi 2024) (Sari et al. 2022).
2. Information Asymmetry and Visibility: Large companies are generally more closely followed by financial analysts and receive more media coverage than small companies. According to Signaling Theory, any increase in profitability in large companies will be amplified more quickly throughout the market, thus making its impact on market value (Tobin's Q) more significant (Wijanarko and Merida 2021); (Oktaviana, Hapzi Ali, and Rini Yayuk Priyati 2024).
3. Contradictory Side: The Impact of Diminishing Returns. However, another argument suggests that in well-established (mature) companies, increases in profitability may not be responded to aggressively by the market because the company's value is perceived to have reached saturation point. Research (Reschiwati and Eugensia Sawu 2024) indicates that company size sometimes fails to strengthen the influence of financial performance on company value because investors focus more on leverage and other specific risks than simply asset size. Conclusion: Overall, company size plays a strategic role in moderating investor perceptions of profitability. Large companies with high profitability are perceived as having more solid fundamentals, so company size is expected to strengthen the relationship between profit-generating ability and increased company value on the stock exchange.

H3 : Firm size positively moderates the relationship between profitability and firm value.

III. RESEARCH METHOD

3.1 Sample and Data

The population comprises all Consumer Non-Cyclicals sector firms listed on the Indonesia Stock Exchange (IDX)

from 2019 to 2025. A purposive sampling technique was applied based on data completeness across financial statements and annual reports.

3.2 Operationalization of Variables

Dependent Variable: Firm Value, proxied by Tobin's Q

Tobin's Q is defined as the ratio of market estimates to assess a company's overall performance and firm value. Eugene F. Brigham and Michael C. Ehrhardt (2021),

$$\text{Tobin's Q} = \frac{\text{Market Value of Equity} + \text{Total Debt}}{\text{Total Assets}}$$

Predictor Variable: Profitability, proxied by **Return on Assets** (ROA)

ROA measures the return on total assets after taking into account all costs and taxes Eugene F. Brigham and Michael C.Ehrhardt(2021)

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Moderating Variable: Firm Size, measured as the natural logarithm of Total Assets

$$\text{Firm Size} = \text{Ln Asset}$$

Firm size is defined as the scale or size of a company, reflecting its operational capacity, level of financial flexibility, and ease of access to funding sources in the capital markets. Brigham & Houston,(2021).

33 Empirical Econometric Model

The Moderated Regression Analysis (MRA) model under the Random Effects Model (REM) panel data specification is formulated as follows:

$Z_{it} = a + \beta_1 Y_{it} + \beta_2 M_{it} + \beta_3 (Y*M)_{it} + e_{it}$

Where:

β_1 = Direct effect of Profitability on Firm Value

β_2= Main effect of Firm Size on Firm Value

β_3 = Interaction effect between Profitability and Firm Size

e_{it} = Combined cross-sectional and time-series error term

IV. RESULTS AND DISCUSSION

4.1 Empirical Estimation Results

The panel data regression utilizing the Swamy-Arora Random Effects Model (REM) the following results:

Table 1: The panel data regression 2019–2025

Variable / Parameter	Coefficient (β)	t-Statistic	p-Value	Decision
Constant (a)	18.35552	3.723436	0.0003	Significant
Profitability (ROA)	-274.3359	-7.408677	0.0000	Negative & Significant
Firm Size (SIZE)	-0.607438	-3.700700	0.0003	Negative & Significant
Interaction (ROA×SIZE)	9.843609	7.958215	0.0000	Positive & Significant
Adjusted R2	0.573568	-	-	57.36% Explanatory Power

4.2 Discussion

A. The Profitability-Firm Value Paradox

The empirical results reveal that Profitability (ROA) has a statistically significant **negative** impact on Firm Value (Tobin's Q) (β_1=−274.3359,p=0.0000). Rather than signaling inefficiency, this negative relationship reflects a strategic reallocation of corporate earnings away from opportunistic short-term profit maximization toward business sustainability and regulatory compliance.

Under Stakeholder Theory and Legitimacy Theory, firms in the Consumer Non-Cyclicals sector actively reallocate operating cash flows toward sustainability investments, green capital expenditures, and environmental compliance costs. While capital markets temporarily register these transition expenditures as operational burdens—resulting in lower short-term valuation multiples—the strategy establishes long-term organizational resilience and secures the firm's social license to operate.

B. The Firm Size Valuation Discount

The empirical estimation reveals that Firm Size (SIZE) exerts a statistically significant negative direct main effect on Firm Value (Tobin's Q) β_2 = -0.607438, t = -3.700700, p = 0.0003). This finding demonstrates that, independent of earnings generation, an increase in standalone asset scale directly depresses market valuation multiples within the Consumer Non-Cyclical sector.

Rather than indicating fundamental weakness, this negative relationship reflects the **Scale Inefficiency Effect** and **Bureaucratic Inertia** inherent in large-scale corporations in emerging economies. Grounded in **Agency Theory** and organizational lifecycle perspectives, as firms expand their asset base, they often experience heightened agency costs, structural complexity, and managerial entrenchment. Investors in the capital market perceive large standalone asset accumulation without immediate operational productivity as capital misallocation or asset heavy-weighting (empire building).

Furthermore, within mature consumer sectors, large-cap enterprises often encounter a **growth saturation ceiling**. High asset accumulation in mature firms leads to diminishing marginal returns on assets (ROA), prompting sophisticated market participants to apply a standalone valuation discount to large asset bases unless those assets are actively generating high-quality operational profits.

C. Typology of Firm Size as a Quasi-Moderator

The MRA results demonstrate that both the direct main effect of Firm Size (β_2=-0.607438,p=0.0003) and the interaction term (β_3=9.843609,p=0.0000) are statistically significant. According to the standard taxonomy of moderation analysis (Solimun et al., 2017), when both the direct effect of the moderator and the interaction term are significant, the variable is formally classified as a **Quasi-Moderator (Apparent Moderation)**.

Firm Size directly influences market valuation while simultaneously strengthening the positive transmission of earnings performance to firm value. Grounded in Signaling Theory, larger firms possess greater resource buffers, institutional visibility, and market coverage. Consequently, when large firms generate operational earnings, the market interprets the performance as a highly credible signal of fundamental strength, thereby amplifying market value appreciation.

V. CONCLUSION AND IMPLICATIONS

5.1 Conclusion

Profitability exerts a statistically significant negative effect on Firm Value (Tobin's Q), reflecting a corporate transition from shareholder primacy to long-term stakeholder value creation and sustainability investment.

Firm Size is empirically validated as a Quasi-Moderator, exerting both a direct positive effect on firm value and an enhancing moderating effect on the relationship between profitability and firm value.

The specified Random Effects Model exhibits a stable adjusted R2 of 57.36%, confirming strong explanatory power under panel cross-sectional controls.

5.2 Practical and Managerial Implications

Corporate Management: Executives should leverage economies of scale to buffer transition costs when reallocating operating profits into long-term environmental and organizational resilience programs.

Capital Market Regulators (OJK & IDX): Regulators should continue refining ESG reporting standards to prevent short-term market discount penalties on firms proactively investing in sustainability.

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