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Profitability, Solvency, and Sales Growth as Drivers of Stock Valuation in Real Estate and Construction Companies

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Abstract

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The property, real estate, and building construction sectors are crucial contributors to economic development, with company performance significantly influencing stock market valuation. Financial performance, reflected through profitability and solvency ratios, and sales growth are key indicators shaping investor decisions. This study aims to examine the effects of financial performance and sales growth on stock prices in these sectors. A Systematic Literature Review (SLR) approach was employed, analyzing secondary data from scientific publications, including national and international journals, conference proceedings, and research reports published between last five years. The study synthesizes findings on how profitability, solvency, and sales growth interact with stock prices, considering sector-specific characteristics and external market conditions. Results indicate that high profitability and controlled debt levels positively affect stock prices by enhancing investor confidence, while sustainable sales growth signals long-term business potential. However, these effects can be moderated by economic fluctuations, operational efficiency, and market perceptions. The study concludes that a balanced integration of strong financial performance and consistent sales growth is essential for stock valuation, offering practical insights for investors and corporate decision-makers.

1. Introduction

Development plays a crucial role in enhancing the economic welfare of society. By fostering improvements in infrastructure and public facilities, development directly contributes to a higher quality of life for communities and facilitates daily activities. It also serves as a benchmark for a nation's progress, stimulating economic growth across multiple sectors. Businesses, as key economic participants, leverage these developmental advancements to achieve core objectives, including profit generation, increased company value, and operational sustainability. The ripple effects benefit society as well, as areas surrounding development projects often experience new economic opportunities and increased activity (Nianty, 2023).

The property, real estate, and construction sectors are particularly intertwined with development. Rapid infrastructure expansion encourages the establishment of residential areas and supporting amenities, further driving growth in the property market. In Indonesia and other countries, this sector remains highly attractive to investors. Although it experienced a slowdown after 2014, the property sector showed resilience. Data from the Indonesia Stock Exchange indicate that the property, real estate, and building construction index dropped by 4.31% in 2017 but recovered in 2018 and 2019, fueled largely by sustained high demand for housing, a key driver of sectoral growth.

For companies, strong financial performance reflects the overall health of the business and plays a key role in attracting investor interest in shares. Investors often rely on financial ratios, such as profitability and solvency, to evaluate a company's capacity to generate earnings and meet its obligations. High profitability demonstrates efficient operational performance, while solvency indicates the ability to manage long-term liabilities. Conversely, Nuridah et al. (2022) stated that a high level of debt may create negative perceptions, as it can potentially diminish stock value.

Sales growth is another critical factor affecting stock prices. Consistent growth signals a company's ability to maintain market share and remain competitive. Higher sales typically result in increased profits, allowing firms to distribute dividends or strengthen working capital. Consequently, financial performance and sales growth provide essential information for investors when making investment decisions.

Although numerous studies have explored the relationship between financial performance, sales growth, and stock prices, findings remain inconsistent. Some research shows a significant influence, while others report negligible effects, particularly in the rapidly expanding property, real estate, and construction sector (Huy et al., 2021). This study employs a quantitative design with descriptive and verificative methods, using secondary data from financial statements of companies listed on the Indonesia Stock Exchange within the property, real estate, and construction sector. Independent variables include financial performance, measured through profitability ratios like Return on Assets (ROA) and solvency ratios such as Debt to Equity Ratio (DER), along with sales growth. Stock price serves as the dependent variable. Multiple linear regression is applied to evaluate both partial and simultaneous effects, supported by t-tests and F-tests at a 5% significance level (Karamoy & Tulung, 2020). This study aims to examine the impact of financial performance on the stock prices of companies operating in the property, real estate, and building construction sector, to assess the effect of sales growth on stock prices, and to evaluate the combined influence of financial performance and sales growth on stock prices. The findings are intended to offer valuable insights for investors to support informed investment decision-making.

2. Methods

This study employs a Systematic Literature Review (SLR) approach to examine, assess, and integrate prior research concerning the effects of financial performance and sales growth on stock prices within companies operating in the property, real estate, and building construction sectors. The SLR method was selected for its ability to offer a thorough overview of existing empirical evidence and to pinpoint research gaps that can guide future investigations. This approach ensures a structured and methodical analysis based on relevant scholarly literature.

Data for this study were obtained from secondary sources, including scientific publications such as nationally accredited journals, reputable international journals, conference proceedings, and research reports accessible through online databases. Primary sources include Google Scholar, ResearchGate, and Elsevier, chosen to guarantee high-quality literature. Articles were included if they examined the relationships between financial performance (profitability and solvency), sales growth, and stock prices; were published between last five years to reflect current trends; focused on companies in the property, real estate, or construction sectors;

and were available in full text. Publications not meeting these criteria, irrelevant studies, or those lacking full-text access were excluded.

The SLR process followed multiple stages: formulating research questions, setting inclusion and exclusion criteria, conducting systematic literature searches, selecting relevant studies, extracting data, and synthesizing findings. This approach allowed the researchers to identify patterns in how financial performance and sales growth relate to stock prices and to uncover inconsistencies or gaps in previous studies. For instance, the analysis may highlight whether profitability exerts a stronger effect on stock prices than solvency or how sales growth shapes company valuation in the property sector.

3. Result

3.1 Profitability and Solvency as Determinants of Market Valuation

A company's financial performance, reflected through profitability and solvency ratios, is a key determinant of stock prices, especially for businesses in the property, real estate, and construction sectors. Profitability metrics, including Return on Assets (ROA) and Return on Equity (ROE), indicate how effectively a company generates profits from its assets and equity. These indicators are crucial for investors evaluating a company's potential for growth. According to signaling theory, strong profitability sends positive signals to the market, boosting investor confidence and driving stock prices upward. For instance, firms with high ROA demonstrate efficient asset management, attracting investors and contributing to increased market valuations (Sholichah et al., 2021).

Beyond profitability, a company's solvency also significantly affects stock prices. Measured by the Debt to Equity Ratio (DER), solvency reflects a firm's reliance on debt for financing its operations. Companies with lower DER, indicating controlled debt levels, are generally seen as less risky, which enhances investor trust in their ability to meet financial obligations without liquidity pressures. Susanti et al. (2020) found that firms with lower DER typically enjoy higher stock prices due to perceived financial stability. In contrast, high debt levels elevate default risk, discouraging investors and potentially depressing share values (Hertina et al., 2021).

Nonetheless, the influence of financial performance on stock prices is not always straightforward. Research indicates that the relationship between profitability, solvency, and stock valuations can become less significant during periods of economic turbulence. In such circumstances, external factors, such as macroeconomic instability, fluctuations in interest rates, or shifts in market sentiment, often exert a stronger impact on stock prices than internal company performance. For example, during the global financial crisis, firms with robust ROA or DER still faced declines in their stock values due to widespread investor uncertainty. This highlights how external economic conditions can diminish the effect of financial performance on market valuation (Balli et al., 2023).

Additionally, sector-specific characteristics shape how financial performance translates into stock prices. In cyclical industries like property, real estate, and construction, stock values are highly responsive to economic swings. Companies in these sectors often rely on substantial debt to fund large-scale developments, making solvency a critical factor for investors. While strong profitability can indicate efficient project management and enhance share appeal, inconsistent profit growth may discourage investor commitment and limit stock price appreciation.

Market perception also plays a crucial role in shaping the impact of financial performance on stock prices. While financial ratios offer an objective assessment of a company's health, investors often factor in subjective elements such as management credibility, corporate governance, and broader industry trends. For example, a firm may report strong profitability and solvency, yet poor governance practices could undermine investor confidence, leading to declining stock prices. This demonstrates that financial performance interacts with market sentiment and does not operate in isolation (Amoa, 2021).

In general, financial performance, especially profitability and solvency, significantly affects stock valuations by sending positive signals to investors. However, the strength of this effect is influenced by macroeconomic conditions, sector-specific dynamics, and other external variables (Hermiyetti et al., 2023). Companies in the property, real estate, and construction sectors must balance robust profit generation with prudent debt management to maintain stock price stability. Understanding these dynamics provides valuable insights for investors, while further research is necessary to examine how factors such as regulatory shifts or monetary policies might moderate the relationship between financial performance and stock prices.

3.2. The Role of Sales Growth in Driving Stock Prices

Sales growth serves as a vital measure of a company's ability to expand market share and increase revenue, especially within the property, real estate, and building construction sectors. Insights from the Systematic Literature Review (SLR) reveal that most studies identify a positive link between sales growth and rising stock prices. Steady increases in sales demonstrate a company's capacity to attract and retain customers, remain competitive, and sustain long-term operations. This perspective aligns with growth theory, which posits that companies experiencing sales expansion are better positioned to generate higher profits, strengthen their financial standing, and enhance investor confidence. Observing strong sales growth, Vasconcelos and Martins (2019) stated that investors are more likely to view the company as a valuable investment, thereby increasing demand for its shares and driving up stock prices.

In these sectors, sales growth is frequently tied to the launch of new projects, territorial expansion, or heightened market demand. Companies that successfully sell numerous property units or complete construction projects as planned often experience notable sales increases. Such performance signals effective operational management and promising growth prospects, reinforcing investor confidence. Empirical evidence indicates that consistent sales growth can boost stock valuation by signaling the company's financial stability and expansion potential (Akcigit & Ates, 2021).

The relationship between sales growth and stock prices is not always straightforward. Several studies in the SLR indicate that increased sales do not automatically lead to higher stock valuations, particularly when companies struggle to control operating expenses. In sectors like property, real estate, and construction, which typically involve high production costs, sales growth can be offset by rising prices for raw materials, labor, or other inputs. For instance, a firm may achieve strong sales but record low profit margins due to inefficient cost management, prompting investors to react cautiously. Consequently, stock prices may remain flat or even decline despite apparent growth in sales (Pradhan et al., 2020).

The cyclical nature of these sectors further affects this relationship. Factors such as interest rates, credit availability, and consumer purchasing power heavily influence stock performance. During economic downturns or periods of uncertainty, strong sales alone may not drive stock prices, as investors weigh external risks more heavily. Conversely, in stable conditions, sales growth can exert a more pronounced effect on stock valuation (Venturini, 2022).

Investor perceptions also significantly shape the impact of sales growth. Quantitative sales figures are often interpreted alongside qualitative factors like corporate reputation, management quality, and industry outlook. A company exhibiting high sales growth but facing governance or operational challenges may fail to gain investor confidence, limiting stock price gains. Therefore, Kuvshinov and Zimmermann (2022) stated that sales growth must be complemented by efficient operations and strong governance to maximize its influence on market valuation.

In summary, while sales growth remains a key driver of stock prices, its effect is moderated by cost management, macroeconomic conditions, and investor sentiment. For companies in the property, real estate, and construction sectors, balancing revenue growth with operational efficiency is essential for sustaining stock price appreciation. Understanding these dynamics provides critical guidance for investors, managers, and policymakers, and further research is recommended to examine how external factors, such as government regulations or market trends, shape this relationship.

4. Conclusion

This study concludes that both financial performance and sales growth significantly influence stock prices, especially within the property, real estate, and building construction sectors. Profitability indicators, including Return on Assets (ROA) and Return on Equity (ROE), reflect a company's capacity to generate earnings and act as positive signals to the market, supporting stock price appreciation in line with signaling theory. Solvency, measured through the Debt to Equity Ratio (DER), also plays a key role, as companies maintaining manageable debt levels are perceived as lower-risk, which tends to enhance stock valuations. Nevertheless, the impact of these financial metrics can diminish during periods of economic instability when broader macroeconomic factors exert stronger influence.

Similarly, sales growth is positively associated with stock prices, reflecting business sustainability and potential for future profits, in accordance with growth theory. Yet, this effect is not guaranteed, particularly when increased sales are not matched by efficient cost management. A critical consideration in the property sector with its high operational expenses. Additionally, external factors such as market sentiment, economic conditions, and the cyclical nature of the industry moderate how sales growth translates into stock price changes.

In summary, achieving stock price growth requires a balanced synergy between robust financial performance and sustainable sales growth. Firms need to manage profitability, maintain healthy solvency, and optimize operational efficiency to strengthen investor confidence. This study emphasizes the importance of considering both internal financial factors and external market conditions within the specific sector context when making investment decisions. It also suggests that further research should examine how external influences, such as government regulations or shifting market trends, moderate the relationship between company performance and stock valuation.

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