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FACTORS AFFECTING COST OF EQUITY

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ABSTRACT

This research aims to examine the effect of board commissioners' effectiveness, family ownership, and audit quality on the cost of equity in the Infrastructure sector in Indonesia. The Infrastructure sector in Indonesia lags behind other countries, necessitating greater attention. The sample for this research, based on the purposive sampling strategy, consists of 34 infrastructure firms (168 observations) listed on Indonesian Stock Exchanges for the period 2018 to 2022. These factors include the effectiveness of the board of commissioners (as measured by the good, fair, and poor ratings [DEKOM]), family ownership (as measured by family control rights [FAMOWN]), and audit quality (as measured by the big four KAP and non-big four [QUAD]). SPSS 23 was used to test the data processing in this research. This research analysis uses a multiple regression analysis approach. The first hypotheses is that the effectiveness of the board of commissioners has a negative effect on equity costs. The second hypotheses is that family ownership has a positive effect on equity costs. Lastly, the third hypotheses is that audit quality has a negative effect on equity costs. The findings of this research indicate that the effectiveness of the board of commissioners and family ownership have no effect on the cost of equity. However, audit quality has a positive and significant impact on the cost of equity. Hence, it can be concluded that the first, second, and third hypotheses in this study are rejected.

Keywords: *Effectiveness of Board commissioners, Family Ownership, Audit quality, Cost of Equity, Infrastructure Firms.*

1. INTRODUCTION

Indonesia's infrastructure sector, listed on the 12 IDX-IC sectors of the Indonesia Stock Exchange (IDX), is divided into economic and social infrastructure. The sector's development is reflected in facilities and infrastructure that influence the economy. Indonesia ranks 51st out of 150 countries in infrastructure development, indicating inefficiency and recovery from the COVID-19 pandemic. The Ministry of Public Works and Public Housing emphasizes the need for infrastructure development to boost economic growth and improve human welfare. Therefore, companies must understand the capital costs to finance investment and the company's operational costs to increase economic activity. The cost of capital is the actual expenditure a company incurs from investing capital. It includes debt and equity capital, the two primary financing sources. The cost of debt capital is the interest rate financial institutions require, while the cost of equity capital is the minimum return a company must provide shareholders. This research aims to assess the impact of these factors on the cost of equity capital.

Abuse of power by company managers can lead to agency problems, particularly when managers have more information about the company's prospects than shareholders and other stakeholders, resulting in information asymmetry [42]. This asymmetry can hinder coordination between companies, resulting in information risk and affecting the return expected by investors, thereby increasing the company's cost of capital [23]. Rational investors will demand a higher rate of return to compensate for the risks arising from corporate agency problems. Consequently, the company's cost of equity will increase significantly, impacting the calculation of the cost of equity capital [27].

To make an informed investment selection, investors want knowledge about the company's performance and financial situation [28]. Therefore, companies must implement corporate governance, a system that can regulate and direct company operations while protecting investors [12]. In general, implementing good corporate governance can increase investor confidence in investing their capital [26]. This is expected to reduce the potential for agency conflicts and ultimately result in a reduction in capital costs that the company must bear.

Financial reports are essential for shareholders to monitor company management's actions [37]. Inadequate control, effective monitoring, and transparency of financial information can increase the company's cost of equity [21]. Successful implementation of corporate governance can reduce agency conflicts between management and investors, leading to increased share ownership by investors [43]. This will raise the demand for the company's shares, resulting in a higher share price and a reduced cost of equity for the company [21]. Therefore, better corporate governance leads to lower equity costs for the company [3].

When a business owner appoints family members to the board of directors and commissioners [9], giving them complete control and cash flow rights [17], this is called a family-aligned board. A family, as the primary controlling shareholder, holds the position of director or commissioner [19], allowing them to significantly influence management decisions and company policies, a phenomenon known as the entrenchment effect [10]. The concentration of ownership in companies creates a new class of principals who can directly or indirectly influence company management, but unethical use can lead to expropriation by the majority shareholder [19]. Most shareholders' expropriative actions, like withholding dividends, below-market transactions, and excessive executive payments, disadvantage non-controlling shareholders [19]. This excess control, often seen in family-controlled companies, can decrease company value and increase the cost of equity [29].

As of September 25, 2023, the Ministry of Finance of the Republic of Indonesia reported 478 active Public Accounting Firms with diverse resources, which leads to varying audit quality. Ita Trisnawati [39] and Aurel Salim and Raharja [33] have highlighted the significant impact of auditor quality on financial reporting quality and investor confidence, using the size of Public Accounting Firms as a proxy. High-quality audits are essential for producing reliable financial reports that are a foundation for investors' decision-making [40]. Desiliani and Meiranto [13] assessed audit quality using Big Four and non-Big Four public accounting firms as indicators. Their research suggests that companies audited by Big Four public accounting firms experience reduced equity costs, attributed to their robust reputation compared to non-Big Four firms.

This study demonstrated variances and advancements compared to the research carried out by Mazzota and Veltri [27] and Intan and Diyanty [34]. On the one hand, we included elements that other research had not looked at before that affect the cost of equity. Additionally, our research subjects were distinct from those of studies by Mazzota and Veltri [27], who concentrated on businesses in all Italian sectors except the financial industry, and Intan and Diyanty [34], who examined manufacturing enterprises in particular. Our time frame was the most recent compared to earlier research. Numerous studies have demonstrated the viability of our modification.

The following portions of the paper are organized: Section 2 presents the preliminary findings and discusses the fundamental ideas employed in the research. The research methodology and assumptions used in this study are presented in Section 3. Section 4 then presents the study's findings. Section 5 wraps up the work and outlines potential avenues for future research.

Agency Theory

Agency theory focuses on the contractual arrangement between a principal and an agent [18]. Issues arise when management takes actions not in the shareholders' best interests. Agents tend to prioritize their interests over the principal's in conflicting interests. The primary aim of agency theory is to explain how parties in such contractual relationships can design agreements to minimize costs, particularly in response to information asymmetry and uncertain conditions.

Information Asymmetry Theory

Information asymmetry occurs when an agent has more company information and responsible functions than a principal, using this information for personal decisions [1]. Agency theory suggests this asymmetry exists, but this can be reduced by providing company information through financial report disclosures.

Cost of Equity

The cost of equity represents the anticipated rate of return for an investor's stake in a company [31]. A corporation must meet the cost of equity at a specific level to satisfy the profit expectations on the invested capital [7]. The cost of equity valuation is intricate due to the lack of direct observation or precise knowledge of investors' anticipated return level.

Board of Commissioners

One essential element of the corporate governance structure is the board of commissioners [8]. The board of commissioners oversees management actions and ensures that strategic decisions prioritize shareholders' interests. Following the company's articles of incorporation, the board supervises the directors and provides direction [41].

Family Ownership

The ownership structure is one of the internal factors that influence the implementation of corporate governance practices [14]. In a concentrated ownership structure, the majority shareholder has the power and incentives to negotiate and formulate company contracts with stakeholders actively. This allows majority shareholders to increase their involvement in company management [14]. Concentrated ownership refers to ownership with control rights and cash flows concentrated in certain parties, such as family, government, or financial institutions, who act as controlling shareholders. [14].

Audit Quality

Good corporate governance in a company can be facilitated by external mechanisms, including formal regulations and rules that provide indirect supervision of company performance. These mechanisms also involve external auditors [6]. The potential for an auditor to find and disclose accounting system infractions while adhering to predefined audit criteria is known as audit quality [2]. It is typically associated with the auditor's reputation. High-quality auditors tend to prevent and uncover inappropriate accounting practices and report material errors [4].

The Effect of Board of Commissioners Effectiveness on Cost of Equity

Good corporate governance is critical to a company's success, protecting minority shareholders, improving decision-making, and increasing company value through improved financial performance, thereby increasing investor confidence. Having a corporate governance system will give shareholders confidence that they will get a return on their investment because corporate governance can provide adequate protection for shareholders, thereby minimizing the risk of investments made by investors. In line with reducing the risk investors face, it will be easier for companies to obtain sources of funds to support their operational activities. Thus, the cost of equity that the company must bear will also decrease [44]. In this research, the board of commissioners's efficacy is proxied by good, fair, and poor ratings, which indicate that the company has adequate supervision of company management. Weak legal protection can encourage management and majority shareholders to take expropriative actions against company assets, giving rise to agency problems and information asymmetry and increasing the company's equity cost. Therefore, good corporate governance is essential for a company's success and financial performance.
H1: The effectiveness of the Board of Commissioners has a negative and significant effect on the cost of equity.

The Effect of Family Ownership on Cost of Equity

In this research, family ownership is proxied through the control rights owned by the family in the company. This research is very relevant in Indonesia, where most companies have a family-dominated ownership structure [25]. Family ownership can address the agency dilemma between management and investors by enabling direct monitoring of management performance. However, concentrated ownership structures can lead to agency conflicts, as controlling shareholders can abuse their power for personal gain, making profitable decisions without considering non-controlling shareholders' circumstances. This takeover action will cause struggle between controlling and non-controlling shareholders. This situation encourages investors to look for protection mechanisms by increasing expected profits. An increase in the rate of return expected by investors will increase the cost of equity [22].
H2: Family ownership has a positive and significant effect on the cost of equity.

The Effect of Audit Quality on Cost of Equity

The confidentiality of financial report quality is necessary since financial reports are an investor monitoring tool. Submitting financial reports can be achieved through the involvement of external auditors. A high level of audit quality reflects the credibility of the information presented in the company's financial reports. Investor trust in the data in the financial statements will thus rise in proportion to the quality of a company's audit. Audit quality is proxied by the Big Four and non-Big Four KAPs. The Big Four KAPs are considered more competent at providing better audit quality because they can increase the level of trust in financial reports. Thus, high audit quality will produce accounting information that investors can trust. This can minimize the risk of information asymmetry so that investors have high trust in the company, and this trust will reduce the cost of equity [11].
H3: Audit quality has a negative and significant effect on the cost of equity.

In summary, the hypotheses are shown below:
H1: Board of Commissioners Effectiveness has negative and significant effect on Cost of Equity
H2: Family Ownership has positive and significant effect on Cost of Equity
H3: Audit Quality has negative and significant effect on Cost of Equity

The study's research model, as shown in Figure 1 below:

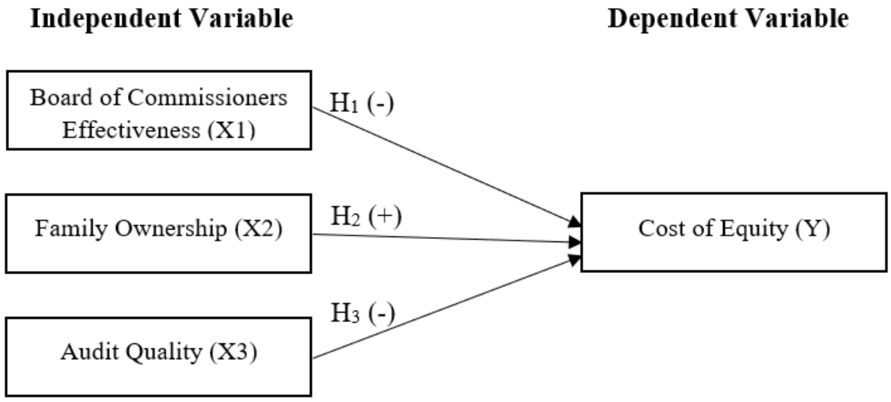

Figure 1. The Research Model

2. RESEARCH METHOD

The study includes all infrastructure sector companies listed on the Indonesia Stock Exchange from 2018 to 2022 as its population. The study sample that was selected consists of 34 firms. The sample selection was carried out by purposive sampling, with the following sample criteria: (1) Infrastructure sector companies listed on the Indonesia Stock Exchange (IDX) in 2018-2022; (2) Infrastructure sector companies listed on the Indonesia Stock Exchange (IDX) after 2018; (3) Infrastructure sector companies delisted from the Indonesia Stock Exchange (IDX) during 2018-2022; (4) Infrastructure sector companies suspended during 2018-2022; (5) Infrastructure sector companies that did not publish complete annual reports in 2018-2022; (6) Infrastructure sector companies with share ownership data that cannot be traced to the final controller so that the amount of family control rights cannot be known. The study utilized multiple regression analysis to test 168 samples, with 34 samples multiplied by 5 periods and 2 outliers, using SPSS version 23 software. Table 1 shows the operationalization of the research variables.

Table 1. The Operationalization of Research Variables

Variable	Proxies and Formulas	Source
Cost of Equity	$COE_E = R_f + \beta_E \times (R_M - R_f)$	Ross et al. (2010)
Board of Commissioners Effectiveness	Scoring: Good = 3 Fair = 2 Poor = 1	Hermawan (2009)
Family Ownership	Final Shareholder Classification	Diyanty et al. (2012)
Audit Quality	KAP big four = 1 KAP non-big four = 0	Desiliani and Meiranto (2015)

3. RESULTS AND DISCUSSIONS

The following table displays the outcome of the descriptive statistical test conducted on 168 samples of dependent and independent variables in infrastructure companies.

Table 2. Descriptive Statistics
Source: Data processing using SPSS version 23

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
DEKOM	168	.67	.96	.8297	.06427
FAMOWN	168	.00	.91	.2631	.25831
QUAD	168	.00	1.00	.2619	.44099
COE	168	.02	.13	.0686	.02579
Valid N (listwise)	168				

Variable	Observations	Measurement	Total
QUAD	168	(1) KAP big four	44
		(0) KAP non big four	124

The study reveals significant findings related to the variables observed. The average effectiveness of the board of commissioners (DEKOM) for the sample companies is 0.8297, indicating effective functioning. Family ownership (FAMOWN) in sample companies is 26.31%, indicating that families do not control most companies. Lastly, non-Big Four public accounting firms audited more sample companies (73.81%) than the Big Four (26.19%) in terms of audit quality (QUAD). The average cost of equity (COE) of companies is 6.85%, indicating the average expected return of investors that the company must meet.

Table 3. Normality Test
Source: Data processing using SPSS version 23

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		168
Normal Parameters	Mean	.0000000
	Std. Deviation	.02331251
Most Extreme Differences	Absolute	.063
	Positive	.063
	Negative	-.038
Test Statistic		.063
Asymp. Sig. (2-tailed)		.200

The One-Sample Kolmogorov-Smirnov value is 0.200. The fact that this number is greater than 0.05 suggests that the distribution of the data is normal.

Table 4. Multicollinearity Test Result
Source: Data processing using SPSS version 23

Coefficients[a]			
Model		Collinearity Statistics	
		Tolerance	VIF
1	DEKOM	.856	1.169
	FAMOWN	.941	1.062
	QUAD	.876	1.142

According to the findings of the multicollinearity test, every independent variable has a VIF value of less than 10 and a tolerance value of more than 0.1. Tolerance and VIF values for the DEKOM variable (X1) are 0.856 and 1.169, respectively; for the FAMOWN variable (X2), they are 0.941 and 1.062, and for the QUAD variable (X3), they are 0.876 and 1.142. The result indicates that this study is free from multicollinearity problems.

Table 5. Heteroscedasticity Test Result
Source: Data processing using SPSS version 23

Correlations							
			DEKOM	FAMOWN	QUAD	COE	Unstandardized Residual
Spearman's rho	DEKOM	Correlation Coefficient	1.000	-.281	.342	.248	.028
		Sig. (2-tailed)		.000	.000	.001	.716
		N	168	168	168	168	168
	FAMOWN	Correlation Coefficient	-.281	1.000	-.123	-.197	-.042
		Sig. (2-tailed)	.000		.112	.011	.587
		N	168	168	168	168	168
	QUAD	Correlation Coefficient	.342	-.123	1.000	.407	.020
		Sig. (2-tailed)	.000	.033		.000	.741
		N	168	168	168	168	168
	COE	Correlation Coefficient	.248	-.197	.407	1.000	.892
		Sig. (2-tailed)	.001	.003	.000		.000
		N	168	168	168	168	168
	Unstandardized Residual	Correlation Coefficient	.028	-.042	.020	.892	1.000
		Sig. (2-tailed)	.716	.587	.793	.000	
		N	168	168	168	168	168

From the table above, the sig (2-tailed) values for the DEKOM, FAMOWN, and QUAD variables are 0.716, 0.587, and 0.741, respectively. These three free factors are worth more prominent than 0.05 or 5%, so it may be presumed that heteroscedasticity has no side effects.

Table 6. Autocorellation Test Result
Source: Data processing using SPSS version 23

Model Summary[b]					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.428	.183	.168	.02352	1.169

A value of 1,169 was derived from the Durbin-Watson test findings in Table 6. This number ranges between -2 and +2, that is, -2 < 1,169 < +2, indicating the absence of autocorrelation.

Table 7. Multiple Regression Analysis Result
Source: Data processing using SPSS version 23

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.428	.183	.168	.02352

ANOVA						
	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.020	3	.007	12.262	.000[b]
	Residual	.091	164	.001		
	Total	.111	167			

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.043	.026		1.700	.091
	DEKOM	.027	.031	.067	0.877	.382
	FAMOWN	-.011	.007	-.106	-1.457	.147
	QUAD	.021	.004	.367	4.870	.000

Table 7 displays the results of the multiple regression analysis. The adjusted R square value in the regression model is 16.8%. This means that the board of commissioners, family ownership, and audit quality variables can explain the cost of equity variable by 16.8%, while other variables influence the rest. With a probability value (F-statistic) of 0.000, the simultaneous significance test (F-test) findings indicate that the independent variable in this research influences the dependent variable concurrently.

The multiple linear regression equation is formulated as:
$COE = 0.043 + 0.027\ DEKOM - 0.011\ FAMOWN + 0.021\ QUAD + \varepsilon$

Based on the findings of the partial significance test (T-test), the independent variable that significantly influences the dependent variable is audit quality, with a probability value below 0.05. The findings are displayed as follows:

Table 8. The Result of Hypotheses Testing

Variable	Coefficient	Significance	Conclusion Ha
Board of Commissioners Effectiveness	0.027	0.382	Rejected
Family Ownership	-0.011	0.147	Rejected
Audit Quality	0.021	0.000	Rejected

Table 8 shows that the Board of Commissioners' effect on the cost of equity is not statistically significant since its output is more than the 5% significance level. This is contrary to the initial hypothesis, which states that an effective board of commissioners will minimize the risk of investments made by investors. As a result, the company will more easily obtain sources of funds to support operational activities, ultimately reducing the cost of equity. This result indicates that the performance of the board of commissioners in the infrastructure sector still needs to protect investors fully. The findings of this research are consistent with those of research by Falatifah and Hermawan [15], Tintia and Muslih [38] and Setiany et al. [35]. Meanwhile, the results of this research contradict by Zabrina and Widiatmoko [44], Kurniawati and Marfuah [20] and Intan and Diyanty [34], which revealed that the effectiveness of the board of commissioners negatively and significantly affects the cost of equity.

A significance value of greater than 5% indicates that the family ownership and the cost of equity were not found to be significantly correlated in this research. This is different from the initial hypotheses because families use their control for the benefit of stakeholders and share information for the benefit of the company. In this way, the risk of information asymmetry will be minimized, so investors will not ask for protection that affects the cost of equity. The findings of this research are consistent with those of research by Rivandi and Marlina [30] and Apriliani and Harto [5]. Meanwhile, the results of this research contradict by Juniarti and Afri Yuyetta [19], La Rosa et al. [22], Intan and Diyanty [34], Mazzotta and Veltri [27], and Rebecca [29], which suggest that family ownership positively and significantly affects the cost of equity.

The audit quality and the cost of equity were shown to be significantly correlated in this study, with a significance value of less than 5%. This research shows that audit quality has a positive and significant effect on the cost of equity, rejecting the third hypothesis, which states that audit quality has a negative impact. This result contradicts the initial hypotheses, which stated that companies audited by the Big Four KAPs are considered to have high competence, so the audit quality will increase the level of trust in the audited financial statements. The study's findings indicate that investors see financial reports that have undergone audits by the Big Four KAPs as having a low audit quality, so public company financial reporting still contains the risk of information asymmetry and increasing the cost of equity. The findings of this research are consistent with those of research by Saadah [32]. Meanwhile, the results of this study contradict by Susanto and Fransiska [36], Le, Ben, and Moore [24], Coffie et al. [11], Intan and Diyanty [34], and Fernando et al. [16], which found that audit quality negatively and significantly affects the cost of equity.

4. CONCLUSIONS AND SUGGESTIONS

Based on the information gathered and provided by this research, the author reached a number of findings.

The first conclusion, H1 is rejected, which means that the effectiveness of the board of commissioners does not affect the cost of equity of infrastructure sector companies listed on the IDX for the 2018–2022. Implementing corporate governance through supervision by the board of commissioners will not reduce agency problems.
The second conclusion, H2 is rejected, indicating that family ownership does not affect the cost of equity of infrastructure sector companies listed on the IDX for the 2018–2022. During this period, family ownership in infrastructure sector companies does not utilize their control for personal interests. Instead, they use their control to benefit all stakeholders, sharing information for the company's benefit and preventing information asymmetry between managers and owners. Consequently, family ownership does not influence the cost of equity.
The third conclusion, H3 is rejected, which means that audit quality positively and significantly affects the cost of equity of infrastructure sector companies listed on the IDX for the 2018–2022. The big four KAPs' financial reports are not deemed high audit quality by investors, resulting in information risk and increasing the company's cost of equity.

The following are some of the limitations of this study.
a) The sample used in this research is limited to infrastructure sector companies, 34 of the 67 listed on the IDX.
b) This research is subjective because measuring the effectiveness of the Board of Commissioners depends on the criteria of good, fair, and poor.
c) Errors in calculating the cost of equity using the CAPM method will impact research data errors, which will cause errors in testing multiple regression analysis.
d) This research only used three independent variables, namely Board of Commissioners Effectiveness, Family Ownership, and Audit Quality.

e) The research period was only five years, from 2018-2022, during which the COVID-19 pandemic occurred, so there were differences in data acquisition.

The following are some recommendations for further research:

a) For further researcher: (a) use appropriate criteria in determining the research sample; (b) expand the information variable on the effectiveness of the board of commissioners by searching for information on the relevant research website; (c) use the Dividend Growth Model method to determine the value of the company's cost of equity; (d) adding other independent variables such as auditor industry specialization, KAP tenure, institutional ownership, audit committee, information asymmetry, and others; (e) expand the research period so that it can reflect the actual situation of a company.
b) For companies: based on this research, optimize the performance of the board of commissioners to gain investor trust.
c) For investors, pay attention to the performance of the board of commissioners and the quality of the company's audits.

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