

Corporate governance attribute, blockholder ownership and accounting conservatism: Which aspects reduce the cost of equity?

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ABSTRACT

This study focuses on investigating the effect of block ownership, board of director diversification, duality of the board of directors, independent level of board of commissioner, audit committee effectiveness, and accounting conservatism on the cost of equity. The study examines 121 manufacturing companies listed in Indonesia Stock Exchange. The panel regression indicates that block ownership positively affects the cost of equity. Conversely, accounting conservatism has a negative effect on the cost of equity. The company is expected to increase its accounting conservatism practice as it can reduce the cost of equity. Furthermore, regulators especially Financial Services Authority should protect investors' rights from block holder expropriation in Indonesia. Companies need to be encouraged to implement corporate governance not merely in compliance laws and regulations but for sustainable business.

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1. Introduction

As a consequence of the issuance of shares in the capital market, company bears cost as a return on investment made by the investor. For investors, this cost is their expectation of stock return. Meanwhile, for the company this cost is called cost of equity. Cost of equity is the amount of rate by investors to discount dividends that are expected to be received in the future. It can also be defined as the rate of return required by investors for the funds they invest in the company (Botosan, 2006; Bozec et al., 2014; Embong et al., 2012; Kang et al., 2015; dan Khlif et al., 2015). Reverte (2009) emphasizes that rational investor demands a premium on the risks that arise as a result of information asymmetry. The higher the level of investment risk, the higher the risk premium or return desired by the (Embong et al., 2012); Cuadrado-Ballesteros, 2016). Excessive cost of equity shows poor performance because it indicates that the level of investment risk in the company is also high. Therefore, cost of equity needs to be considered and maintained under the company's capacity to pay (Embong et al., 2012). However, a study by University of Oxford in 2014 found that companies in Indonesia bear the highest cost of equity in ASEAN and 3 other countries (People's Republic of China, Japan and Korea) in 2000 - 2012. This finding is supported by Schroder (2016) which described that investors in Indonesia want 12% of return rate. This rate of return is greater than the global rate of return of only 9.1%. The rate of return demanded by domestic investors is irrational given that the average equity yield is only 3.8% and interest rates worldwide is under 1% (Schroder, 2016).

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Table 1

Cost of Equity in ASEAN+ 3 Market in 2000-2012

No	Country	Average of Cost of Equity (CAPM)	Deviation Standard
1	Indonesia	12,3188	6,3284
2	Malaysia	9,4224	3,8064
3	Thailand	7,2956	3,1356
4	Republic of Korea	7,2436	4,1028
5	Philippine	4,7632	3,8428
6	Singapore	3,8324	3,2292
7	Japan	-2,6468	2,4544
8	People's Republic of China	-3,0368	3,302

Source: University of Oxford, 2014

High cost of equity demands consideration due to its impact on the economics. University of Oxford (2014) stated that every 1 point decrease in capital costs, where the cost of equity is a part of it, investment demand from investors will increase by \$ 1.55-2.02 billion in ASEAN + 3 countries (People's Republic of China, Japan and Korea). This indicates that low cost of equity opens opportunities for companies to gain more investment from investors. In addition, low capital costs can stimulate economic growth in the long term and increase national prosperity (University of Oxford, 2014). This research differs from previous studies in several ways. The cost of equity is measured using industry-adjusted earnings-to-price ratio. This measurement can be adjusted to the elements of risk and growth in each industry group based on the Global Industry Classification Standard (GICS). The existing references mostly explore companies in a one-tier system, while this research investigates the cost of equity, block ownership and governance aspects in a two-tier system country. To the author's knowledge, this paper is the first study of block ownership and board characteristics as a determinant of equity costs.

2. Literature Review & Hypothesis Development

Agency theory perspective points out that high equity costs can occur due to poor corporate management practices. Corporate governance is unable to guarantee that the company is well run and full commitment to provide its best services. Wahyudin and Solikhah (2017) report that good corporate governance can improve company performance. It is also supported by adherents of shareholder theory who believe that company should provide maximum value for shareholders. Nevertheless, positive accounting theorists believe some companies have different policies in accordance with the situation and conditions faced by the company. Corporate governance becomes an interesting and mostly studied by previous researchers as determinant of cost of equity. Previous research found negative effect of corporate governance to cost of equity (see Chen et al., 2009; Reverte, 2009; Tran, 2014; dan Teti et al., 2016). However, there are some limitations in their findings. Teti et al. (2016) suggested that research of corporate governance on cost of equity to be undertaken in countries with weak legal contexts. Meanwhile, the use of scoring index method of a particular institution that is widely used in previous research received criticism from Chen et al. (2009) as the results of the analyst may contain biases. Some researchers also analyze the effect of conservatism on cost of equity. Francis et al. (2004) found insignificant effect of conservatism on cost of equity. Nevertheless, Chan et al. (2009) and Lara et al. (2011) found negative and significant impact of conservatism to cost of equity. Those different findings is studied by Gamaliel and Sugiri (2013) who found that different measurement of conservatism produces different results. This condition is also supported by Chan et al. (2009) who examined the effect of ex ante conservatism and ex post conservatism on cost of equity in England but found different effect, in which ex ante conservatism has negative effect on cost of equity whereas the ex post conservatism positively affect cost of equity. Based on the description, this study aims to examine the effect of corporate governance and conservatism on cost of equity in Indonesia. This study differs from previous studies in several respects. Corporate governance is not measured by a scoring index, this study uses two governance dimensions, which are block ownership and board characteristics (diversification of Board of Director, duality of Board of Director, independent level of Board of Commissionaire and Audit Committee effectiveness). In addition, Indonesia's unique characteristics as a country with very high ownership concentration, using two-tier system and weak law protection of investors are expected to contribute to the literature on cost of equity. Within the agency theory framework, the percentage of block ownership gives more power to block holder to direct managers in line with their interests. However, at some level, block ownership may result in arbitrary of block holder. The existence of majority shareholder may exercise excessive control and harming the minority shareholders (Basu et al., 2015; Haryono et al., 2015). The opinion is supported by Khlif et al. (2015) who found that diverged ownership with low ownership concentration led the company to bear low cost of equity. However, Tran (2014) stated that companies with block holders owned by corporations, managers and governments have negative and significant effect on cost of equity. Indonesia is a country with low law enforcement. In terms of investment, minority shareholders do not enjoy high legal protection in Indonesia. This allows minority shareholders to face high investment risks. The existence of block ownership can aggravate this condition because they control the manager and have a high control over all decisions set by manager. Finally, investors will demand a high rate of return as a guarantee of the risks they incur and thus company will also bear a higher equity cost.

H₁: Block Ownership has positive and significant effect on cost of equity.

Within the framework of agency theory and shareholder theory, Board of Director diversification is a competitive advantage for companies to gain shareholder confidence and avoid conflict between shareholder and managers. Fidanoski et al. (2014) revealed that board diversification can improve good corporate governance. Women's directors tend to have high caution when considering a risky decision (Lenard et al., 2014), therefore they may reduce stock return variability. Instead, Ramadhani & Adhariani (2015) found that female director competence was questioned because of the tendency of family intervention in appointing female directors. Diversification of Board of Director is able to assist the company in implementing good governance. The presence of female director in the Board of Director can enrich decision making and strengthen the determination of each policy. This creates a firm competitive advantage, and thus companies can bear lower cost of equity. Despite the possibility of family company intervention, to be elected as a director, a woman should go through many stages and meet certain requirements mandated in Article 4 paragraph (1) e POJK No. 33 / POJK.04 / 2014. Thus, author believes that female director has the competence and expertise to carry out her duties as a board member.

H₂: Diversification of Board of Director has negative and significant effect on cost of equity.

Agency theory stated that director is the executor of responsibilities mandated by shareholders. Therefore, duality role of director is deemed to create distraction and resulting ineffective performance of the director. Reverte (2009) emphasizes the importance of division and segregation of duties to create effectiveness in corporate governance and enhance the effectiveness of shareholder oversight over management decisions. In addition, Yammeesri and Herath (2010) found that duality of director reflects poor internal control qualities and reduces corporate value. However, Rodriguez-Fernandez et al., (2014) did not find any correlation between role duality on firm performance. Board of Directors is fully responsible for company managerial as the highest executive and administrative in the company. Although a Director is allowed to concurrently occupy a position with certain criteria in the Regulation of the Financial Services Authority No. 33 / POJK.04 / 2014, however a director's dual position may create a role ambiguity. Duality of director's role in the Board of Commissionaire or Committee in the same company is feared to cause counter-functions and conflict of interest, hence the director's role becomes biased. Ultimately, the duality of the Board's role causes the company to face higher cost of equity because shareholders perceive that the mechanism is risky.

H₃: Duality of Board of Director has positive and significant effect on cost of equity.

Within the framework of agency theory, Board of Commissionaire plays a role in overcoming the moral hazard problem, a problem that occurs when the principal is unable to control the actions of the agent. The existence of independent members within the Board of Commissionaire creates more credible and accountable oversight. Reverte (2009) concluded that Board of Commissionaire cannot guarantee the optimization of firm performance, thus independent member is necessary. The more effective the Board of Commissionaire, the lower the cost of equity beard by the company (Sari & Diyanty, 2015). However, Yammeesri & Herath (2010) did not find significant effect of independent level of Board of Commissionaire on firm value. Investors view the existence of an independent member within the Board of Commissioners as a guarantee that managers perform maximally according to shareholders interests. Of course, this reduces investment risk and increases shareholder confidence in managers. Thus, shareholders become more satisfied with the company's management mechanism and demand a lower rate of return. Ultimately, cost of equity is reduced.

H₄: Independent level of Board of Commissionaire has negative and significant effect on cost of equity.

Agency theory assumes that opportunistic managers will be self-interested, even if their decisions have a negative impact on shareholders. The existence of Audit Committee may contribute to assisting the supervision of Board of Commissionaire, which is to ensure that management has prepared financial statements in accordance with applicable standards and oversees company's management in accordance with internal company policy. Reverte (2009) disclosed that companies with great corporate governance should have the functions of Audit Committee. This is legally supported and stipulated in the Financial Services Authority Regulation No. 55 / POJK.04 / 2015 in article 2, that the public company is required to have an Audit Committee. The Audit Committee is believed to guarantee relevant and credible information. Sari and Diyanty (2015) also found that Audit Committee has negative and significant effect on cost of equity. Audit Committee is a legal requirement for companies, especially for go-public companies. Thus, authors assume that companies should have such committees as one of the corporate governance mechanisms. In addition, Audit Committee is corporate responsibility to shareholders that the company is run independently, objectively and responsibly. Skidding by managers is becoming increasingly difficult. Risks borne by shareholders are also reduced, hence company bears a lower cost of equity.

H₅: Audit Committee Effectiveness has negative and significant effect on cost of equity.

In positive accounting theory, firms have the freedom to make policies about conservatism in financial reporting. While shareholder theory believes that conservatism is a mechanism that benefits shareholders because it can reduce the probability of risk in the future. Chan et al. (2009) stated that conservative reporting helps to monitor management performance and improve information quality. In addition, conservatism is also closely related to earnings quality (Francis et al., 2004) and low cost of equity (Chan et al., 2009). However, Francis et al. (2004) found that conservatism has no impact on cost of equity. Conservatism becomes a policy that reduce uncertainty. Conservative practices have a long-term positive effect because company will avoid misrepresenting profits that allow the company to suffer a decrease in its profits or even future accumulative losses.

Conservatism can also reduce information risk and provide benefits to the capital market. Authors assume that conservative managers produce better financial statements because companies avoid greater losses risk. Thus, the desired return of shareholders becomes lower and the firm can reduce the cost of equity.

H₆: Conservatism has negative and significant effect on cost of equity.

Based on the explanation, below is the research model of this study:

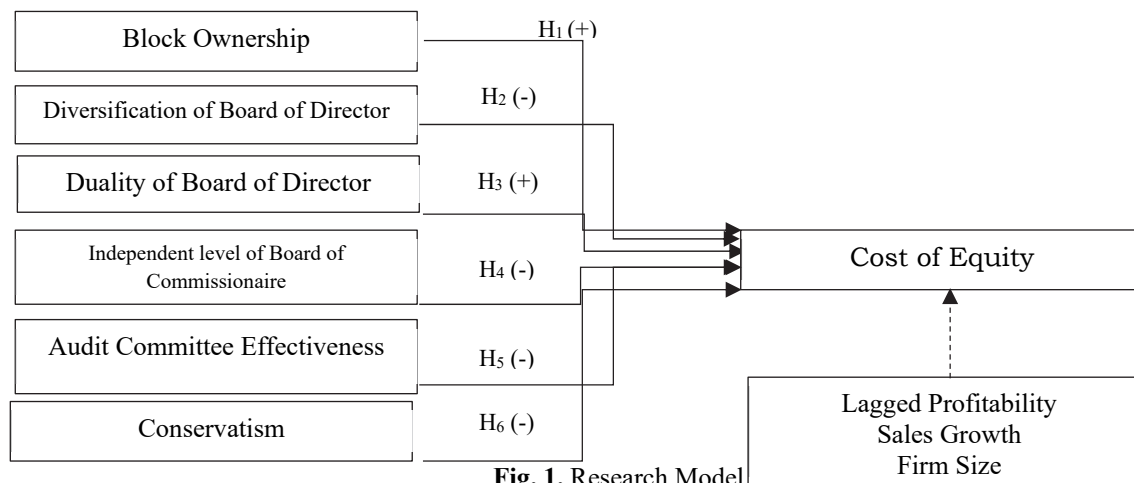


Fig. 1. Research Model

3. Methods

This study uses quantitative approach. The data is secondary data of annual report from Indonesia Stock Exchange site at www.idx.co.id. In addition, population of this study is manufacturing companies continually listed in Indonesia Stock Exchange during the period of 2011-2015, as much as 121 companies. Moreover, sample is selected by purposive sampling technique. Final sample is 65 manufacturing companies with 325 firm-year observation. In sum, sample is selected as described in Table 2 below:

Table 2
Criteria on Sample Selection

No	Criteria	No	Yes
1.	Manufacturing company continually listed in Indonesia Stock Exchange during the period of 2011-2015	-	121
2.	Manufacturing company with financial statement ended at December 31	6	115
3.	Manufacturing company with positive equity	6	109
4.	Manufacturing company with block ownership >=25%	9	100
5.	Manufacturing company with complete data	35	65
Research Sample		-	65
Firm-year observations		-	325

Table 3
Operational Definition of Variables

	Operational Definition	Measurement	Reference
Cost of equity/ IndEP	Expected rate of return by stockholders against their ownership in the company	$\frac{EPS}{\text{stock price}} - EP \text{ industry}$	Candra & Ekawati (2015)
Block Ownership/ BLOCK	Stock ownership more or equal to 25%	Percentage of block ownership	Thomsen et al., (2006)
Diversification of Board of Director / DIV_BOARD	Female composition in the Board of Director	$\frac{\text{Female Director}}{\text{Member of Board of Director}} \times 100\%$	Ramadhani & Adhariani (2015)
Duality of Board of Director/ DUAL_BOARD	Role duality of Board of Director within the company	1 if there is role duality, and 0 if there is single role of Director	Reverte (2009)
Independent level of Board of Commissionaire/ INDCOM	Independent level of Board of Commissionaire based on its independent member	$\frac{\text{independent commissionaire}}{\text{Member of Board of Commissionaire}} \times 100\%$	Reverte (2009)
Audit Committee effectiveness/ COM	Audit Committee effectiveness in conducting its duties	Content analysis by 21 item involving activity, size, skill and competence of Audit Committee	Hermawan in Sari & Diyanty (2015) (revised)
Conservatism/ CON_TA	Consideration of future uncertainty and reporting principles	$\frac{NI + D - CFO}{TA}$	Xie et al. (2012)
Lagged Profitability/ ROA_{t-1}	Las year profitability	$\frac{EBT_{t-1} \times 100}{TA_{t-1}}$	Yamneesri & Herath (2010)
Sales Growth/ GROWTH	Sales growth of the company	$\frac{TS_t - TS_{t-1}}{TS_{t-1}} \times 100$	Yamneesri & Herath (2010)
Firm size/ SIZE_MC	Firm size in a certain period	Natural logarithm of market capitalization	Reverte (2009)

This study uses cost of equity as dependent variables. Moreover, the independent variables are block ownership, diversification of Board of Director, duality of Board of Director, independent level of Board of Commissionaire, Audit Committee effectiveness and conservatism. In addition, this study employs three firm characteristics as control variable, consist of lagged profitability, sales growth, and firm size. Operational definition of each variables is demonstrated in Table 3. Data is collected by documentation method of financial statement issued by company. Furthermore, this study uses panel data regression with Eviews 9 for data analysis and hypothesis testing. In addition, the classical assumptions used in this study are multicollinearity test and heteroscedasticity test.

4. Results and Discussion

Panel data regression shows that the most appropriate model in this research is fixed effect model (FEM). This study also conducted a classic assumption test of selected models, which are multicollinearity test and heteroscedasticity test. Multicollinearity test shows that the highest correlation occurred in control variables, particularly in lagged profitability and firm size of 0.46. This value indicates that the correlation between independent variables is low, thus the data is free from multicollinearity issue. Meanwhile, park test describes that independent variables have no effect on residual logarithmic regression of panel data because the p values are above 0.05. Therefore, the research model is free from heteroscedasticity problems. In addition, descriptive statistics can be described in Table 4.

Table 4
Descriptive Statistic

Variable	Descriptive Statistic			
	Mean	Minimum	Maximum	Std. Dev.
Cost of Equity	0.00135	-0.91935	0.87016	0.13919
Block Ownership	56.48%	25.00%	98.18%	0.20844
Diversification of Board of Director	11.71%	0.00%	88.89%	0.15894
Duality of Board of Director	0.07385	0.00000	1.00000	0.26192
Independent level of Board of Commissionaire	39.21%	20.00%	80.00%	0.09267
Audit Committee effectiveness	0.59639	0.33333	0.93651	0.09094
Conservatism	-0.01693	-0.30750	0.80064	0.08802
Lagged Profitability	10.08%	-10.25%	81.32%	0.11539
Sales Growth	9.92%	-57.66%	125.35%	0.18088
Firm Size	28.17914	23.93572	33.71177	2.13380

Based on panel data regression, adjusted R^2 shows a value of 26.88%. Therefore, independent variables in this study can explain 26.88% of cost of equity. Meanwhile, the remaining of 73.12% is influenced by variables outside the research model. Table 5 below reveals hypothesis testing of this study.

Table 5
Hypotheses Testing

Hypotheses	Coefficient	prob $\alpha = 5\%$	α	Results
Block Ownership has positive and significant effect on cost of equity (H_1)	0,5510	0,0184	0,05	accepted
Diversification of Board of Director has negative and significant effect on cost of equity (H_2)	-0,7972	0,4585	0,05	rejected
Duality of Board of Director has positive and significant effect on cost of equity (H_3)	0,0499	0,3488	0,05	rejected
Independent level of Board of Commissionaire has negative and significant effect on cost of equity (H_4)	-0,0547	0,6149	0,05	rejected
Audit Committee effectiveness has negative and significant effect on cost of equity (H_5)	-0,0276	0,8343	0,05	rejected
Conservatism has negative and significant effect on cost of equity (H_5)	-0,2180	0,0143	0,05	accepted
Lagged profitability	-0,0737	0,4900	0,05	
Sales growth	0,0333	0,4332	0,05	
Company size	0,0810	0,0000	0,05	

The Effect of Block Ownership on Cost of Equity

Results show that block ownership has positive effect on cost of equity. In agency theory framework, conflicts between managers and shareholders can be overcome if shareholders have certain power to direct managers. Nevertheless, excessive power can actually lead to arbitrary by blockholder. Data shows that block ownership in Indonesia is concentrated with more than 50% ownership. This condition creates conflict between block holders and minority shareholders (Thomsen et al., 2006; Khelif et al., 2015; dan Sari & Diyanty, 2015). High block ownership produces expropriation by block holder (Haryono et al., 2015). The higher the block ownership, market tends to give negative responses (Thomsen et al., 2006). This phenomenon is exacerbated by weak legal protection of investor in Indonesia. Sari & Diyanty (2015) assumed that weak legal protection against investors encourages management and controlling shareholders to take over wealth. Nevertheless, this finding is in contrary to Tran (2014) who found that company with block ownership tends to have lower risk, can supervise the managers and thus reduce cost of equity.

The Effect of Diversification of Board of Director on Cost of Equity

This study finds that diversification of Board of Director has no effect on cost of equity. This result conflicts agency theory and shareholder theory which assume that female director can minimize opportunistic behavior in the Board of Director, thus the board provide better supervision of management. Based on the data analysis, 56% of analytical unit do not have female director in the Board of Director. It means that there is low level of diversification in Board of Directors. This condition leads the presence of female director as a minority, thus unable to have a significant impact on cost of equity. Darmadi (2013) argued that female director in the Board of Director tends to be selected in small companies and family-controlled firm. Large companies are considered to provide smaller opportunities for women to become members of the Board of Director. A woman serves as director due to family relationships with company owners or controlling shareholders. In addition, Brunzell and Liljebloom (2014) stated that female directors can undermine board performance as their small experience of operational and leadership, their marginalized status and historical and corporate culture. Nevertheless, this finding contradicts Fidanoski et al. (2014) and Kılıç & Kuzey (2016) who found that female director creates better corporate governance.

The Effect of Duality of Board of Director on Cost of Equity

Results show that duality of Board of Director does not have significant effect on cost of equity. This result is in contrary of agency theory which assumes that duality of Board's role leads to conflict of interest and functional performance. Research data shows that only 7.38% of the analytical unit have dual position Director. These findings indicate that manufacturing firms in Indonesia tend not to give double positions to their directors. Nevertheless, basically the Regulation of the Financial Services Authority No. 33 / POJK.04 / 2014 allows a Director to have duality role in certain criteria. Carty & Weiss (2012) emphasized that duality of Board of Directors merely encompasses challenges regarding the job descriptions of individual positions. However, the process for a person to be appointed as a Director, Commissioner or a member of the Committee cannot be ignored. In the selection process, only the qualified and competent persons will be selected and joined management team, thus offsetting the negative consequences of board duality. This argument is supported by Rodriguez-Fernandez et al., (2014) who found that there is no significant impact of duality of Board of Director on firm performance. However, this finding is not similar to Yammeesri & Herath (2010).

The Effect of Independent Level of Board of Commissionaire on Cost of Equity

Theoretically, based on agency theory and shareholder theory, the existence of independent commissioners can overcome moral hazard and provide benefits to shareholders. However, the hypotheses testing results indicate that the independent level of Board of Commissionaire does not have significant effect on cost of equity. Based on the analysis, 96.92% of analysis unit has met POJK 33 / POJK.04 / 2014 with independent commissioner composition greater than 30%. Therefore, the company is deemed to appoint an independent commissioner to comply with the requirements set in the laws and regulation (Yammeesri & Herath, 2010). Supervisory will be ineffective when the appointment of independent commissioners is not really aimed at establishing good corporate governance. In addition, independent commissioner is an outsider party who served as supervisor, thus the time they contribute to develop the company is limited (Daily & Dalton, 2003; Yammeesri & Herath, 2010). Daily & Dalton (2003) also stated that the number of independent commissioners cannot guarantee the independence of Board of Commissionaire. By high ownership concentration, independent commissionaire existence is increasingly ineffective (Gaur et al., 2015). This results contradicts to Reverte (2009) dan Sari & Diyanty (2015) who assumed that independence of Board of Commissionaire can improve the effectiveness of monitoring activities within the company, thereby reducing the cost of equity.

The Effect of Audit Committee Effectiveness on Cost of Equity

Within the agency theory framework, Audit Committee may contribute to the supervision of Board of Commissionaire. Meanwhile, shareholder theory assumes that an effective Audit Committee becomes company's efforts to ensure that the company is run to increase shareholder profits. Based on the data analysis, only 20.62% of the analytical unit has an ineffective Audit Committee. Nevertheless, the results of this study indicate that the effectiveness of the Audit Committee does not affect the cost of equity. It is presumably because the effectiveness of Audit Committee disclosed in the financial statements is a disclosure policy to show that the company has good governance mechanisms and that the company has complied statutory provisions. Appiah and Amon (2015) stated that Audit Committee may lose its independence to carry out the mandated task, and thus managers are able to behave opportunistically. In addition, Bronson et al. (2009) found that the supervision of independent Audit Committee cannot be performed optimally unless all members of the Audit Committee are professionals from external parties. Vinteen & Lee (1993) also found that the effectiveness of Audit Committee could be threatened when the company's management builds unrealistic expectations for the Audit Committee. However, this finding contradicts researches by Reverte (2009) and Sari and Diyanty (2015) who stated that Audit Committee effectiveness has negative and significant effect on cost of equity.

The Effect of Conservatism on Cost of Equity

This study finds that conservatism has negative and significant effect on cost of equity. Positive accounting theory and shareholder theory believes that companies have the authority to apply conservatism practices to increase shareholder value. Based on the results of the analysis, firms that apply conservatism practices with values at high category intervals have low even negative cost of equity. This suggests that firms that are cautious in recognizing profits and more quickly recognize the loss in financial statements bear lower cost of equity. Lara et al. (2011) stated that without conservatism, company's disclosure becomes less precise and leads to increasing uncertainty. Bertin & Moya (2013) also argued that subjectivity and uncertainty directs the financial statements acknowledging the existence of "bad news", in which market will demand a greater return if the company does not recognize the bad news. Conservative reporting also helps oversee management performance (Chan et al., 2009), increase information quality (Hu et al., 2014), and help predict future performance of the company (Smith et al., 2011). Accounting conservatism creates more accurate earnings, hence accounting numbers in financial statements become more qualified and lead to a decrease in cost of equity (Francis et al., 2004; Chan et al., 2009). Nevertheless, this finding contradicts to Francis et al. (2004) and Xie et al. (2012).

5. Conclusion and Recommendation

Manufacturing companies in Indonesia have very high block ownership, their share claim is concentrated. Meanwhile, the practice of accounting conservatism in Indonesia is very low. This is consistent with previous researchers (Solikhah et al., 2018) that manufacturing companies in Indonesia have not implemented conservatism in their accounting practices, managers tend to be more prudent in choosing accounting policies. In terms of internal corporate governance, this research reveals that the company has implemented the governance principles required by regulation. Results show that higher block ownership directs company to bear higher cost of equity. Block ownership creates excessive expropriation of block holder, thus increasing the cost of equity. Meanwhile, conservatism can significantly reduce the cost of equity. Conservative practices are considered to improve reporting quality and reduce future uncertainty. However, corporate governance mechanisms in board characteristics, consist of diversification of Board of Director, duality of Board of Director, independent level of Board of Commissionaire and Audit Committee effectiveness have insignificant impacts on cost of equity. Based on the results, company is expected to improve conservatism practice as it can reduce the cost of equity. Meanwhile, regulators, particularly the Financial Services Authority, is recommended to create legal rules to protect investors' rights, thus avoiding the exploitation of block holders and increasing the value of good corporate governance practices. In addition, further research is expected to use questionnaires as a comparison to measure Audit Committee effectiveness and analyze the effect of block ownership on the cost of equity based on block holder status.

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Appendix 1.

Audit Committee Effectiveness Measurement Index

Number	Discription	Score
A. Audit Committee Activities		
1-5	<p>Assessment the accountability of the Audit Committee's activities from the company's annual report, using indicators:</p> <ol style="list-style-type: none"> 1. Evaluating internal controls 2. Proposing external auditors 3. Reviewing Financial Statements 4. Evaluating compliance with internal rules and policies 5. Preparing the Audit Committee Report <p><i>If each indicator is met or information available, the company gets a "good" score. If the indicator is not met or there is no information, the company gets a "bad" score.</i></p>	
6	<p>How many audit committee meetings are held during a period?</p> <p><i>If the Audit Committee meets more than 6 times a year, the company gets a "good" score. If the Audit Committee meets 4-6 times in 1 year, the company gets a "fair" score, and If the Audit Committee meets less than 4 times a year or there is no information, the company gets a "bad" score.</i></p>	
7	<p>What is the percentage of attendance from the Audit Committee members in each meeting?</p> <p><i>If all members of the Audit Committee have an attendance rate of more than 80%, the company gets a "good" score. If the attendance rate is 70-80%, the company gets a "fair" score, and the company gets a "bad" score if the attendance meeting rate is less than 70%.</i></p>	
8	<p>Does the Audit Committee carry out a meetings with the Board of Commissioners and external auditors?</p> <p><i>If the audit committee carry out a meetings with both parties, the company gets a "good" score. If the Audit Committee carry out a meeting with one of the parties, the company gets a "fair" score. If there are no meetings with both or no information, the company gets a "bad" score.</i></p>	
9-15	<p>Has the Audit Committee received a certificate / award regarding the following matters:</p> <ol style="list-style-type: none"> 1. Duties, responsibilities and authorities 2. Composition, structure and membership requirements 3. Work precedures 4. Meeting policy 5. Reporting system 6. Complaint system 7. Period of work <p><i>In each category, if the item is disclosed, the company gets a "good" score. If there is no information about the item, the company gets a "bad" score.</i></p>	
16	<p>Does the Audit Committee evaluate the scope, accuracy, cost effectiveness, independence and objectivity of the external auditors?</p>	

Number	Discription	Score
	<p><i>If the Audit Committee evaluates all items (5 items), the company gets a "good" score.</i></p> <p><i>If only a few items (2-4 items) are evaluated, the score is "fair".</i></p> <p><i>If few or no items (0-1 items) are evaluated, the firm gets a "bad" score.</i></p>	
B. Audit Committee Size		
17	<p>How many members of the Audit Committee?</p> <p><i>If there are more than 3 members on the Audit Committee, the company gets a "good" score.</i></p> <p><i>If there are 1-3 members in the Audit Committee, the company gets a "fair" score.</i></p> <p><i>And if there are no members on the Audit Committee or there is no information, the company gets a "bad" score.</i></p>	
C. Audit Committee Independence		
18	<p>How many independent members are on the Audit Committee?</p> <p><i>If there are 2 or more independent members, the company gets a "good" score.</i></p> <p><i>If there is 1 independent member on the Audit Committee, the company gets a "fair" score.</i></p> <p><i>And if there are no independent members or no information, the company gets a "bad" score.</i></p>	
D. Expertise and Competence of the Audit Committee		
19	<p>Do members of the Audit Committee have a financial / accounting education background?</p> <p><i>If there is more than 1 member with a financial / accounting background, the company gets a "good" score.</i></p> <p><i>If there is only 1 member with a finance / accounting background, the company gets a "fair" score.</i></p> <p><i>And if there are no members with financial / accounting expertise or no information, the company gets a "bad" score.</i></p>	
20	<p>What is the average age of the audit committee members?</p> <p><i>If the average member age is > 40 years, the company scores a "good" score.</i></p> <p><i>If the average member age is 30-40 years, the company gets a "fair" score.</i></p> <p><i>And if the average age is under 30 or without information, the company gets a "bad" score.</i></p>	
21	<p>Do members of the Audit Committee have sufficient experience (for example as an auditor or an Audit Committee in another company?)</p>	

If > 50% of members have experience, the score is "good".

If only 30% -50% of the members are experienced, the company gets a "fair" score.

And if only <30% of members have experience, the company gets a "bad" score.

Total Scores

Score conversion criteria:

1. Good = 3
2. Fair = 2
3. Bad = 1



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