

Research Article

Earnings Management, Firm Size, and Voluntary Disclosure: Do They Really Influence the Cost of Equity Capital?

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Abstract

This study aims to examine the effect of earnings management, company size, and voluntary disclosure on the cost of equity capital. Earnings management in this study is measured using the modified Jones model, company size is measured by the natural log of total assets, and voluntary disclosure is measured by the Wallace index. This study uses a sample of consumer sector manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2013-2017 period. The sampling technique in this study was purposive sampling and obtained a sample of 17 companies. This study uses secondary data, namely financial reports obtained from the official website of the Indonesian Stock Exchange (IDX) and annual reports obtained from the company's official website. The results show that the variables of company size and voluntary disclosure have a significant effect on the cost of equity capital. Earnings management does not have a significant effect on the cost of equity capital. The managerial implication that can be taken is that company management should place more emphasis on increasing transparency through relevant and quality voluntary disclosure to reduce investor risk perceptions so that the cost of equity capital can be reduced.

Keywords: Earnings Management, Firm Size, Voluntary Disclosure, Cost of Equity Capital

JEL Classification: G32, M41, M48

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1. Introduction

The cost of equity capital has become an essential concern in corporate finance because it reflects the return expected by investors when allocating funds to a company (Brigham & Houston, 2011). Companies with lower cost of equity capital generally enjoy a competitive advantage in accessing external financing sources and expanding their operations (Perwira & Darsono, 2015). In contrast, when the cost of equity is high, firms face challenges in obtaining sufficient resources for investment, which can hinder their growth and long-term sustainability (Putra, 2016).

In practice, the phenomenon of equity capital costs has emerged in various corporations, particularly in emerging markets such as Indonesia, where investors rely heavily on financial information to make rational decisions (Utami, 2005). Several cases in the Indonesian Stock Exchange illustrate that companies facing high equity costs tend to experience fluctuations in share prices and investor confidence (Admadianto, 2017). Therefore, understanding the determinants of the cost of equity is crucial both for corporate managers in formulating financing strategies and for investors in assessing firm value (Dewi et al., 2017).

Prior research has identified multiple factors that may influence the cost of equity capital, including earnings management, company size, and voluntary disclosure (Boesso & Kumar, 2007). Earnings management is widely debated because it involves managerial discretion in financial reporting that can obscure true economic performance (Subramanyam, 2010). When managers engage in opportunistic earnings management, the quality of reported earnings declines, increasing information risk perceived by investors and thereby raising the cost of equity (Putra, 2016). However, empirical studies have shown inconsistent results: while Utami (2005) finds a significant positive association between earnings management and equity costs, Balvers (2009) reports no significant relationship.

Another factor often discussed is company size. Larger firms typically have more diversified operations, broader market coverage, and better access to financing, which can reduce perceived risks among investors (Hartono, 2016). Several studies suggest that company size is negatively related to cost of equity because larger firms tend to provide more information and are more closely monitored by regulators and analysts (Imran, 2012; Rika, 2018). Yet, other evidence indicates a positive relationship, where large firms may also bear higher information costs, which in turn increases their equity costs (Admadianto, 2017). These mixed findings highlight the need for further investigation into how firm size actually interacts with investor expectations.

In addition, voluntary disclosure plays a vital role in mitigating information asymmetry between firms and investors. According to Ali and Tarmizi (2015), voluntary disclosure refers to the decision of managers to provide information beyond mandatory requirements, signaling transparency and commitment to accountability. Several studies reveal that extensive voluntary disclosure reduces investor uncertainty, lowers perceived risks, and consequently decreases the cost of equity capital (Khlif et al., 2018; Petrova, 2012). Nonetheless, some findings suggest that voluntary disclosure does not always significantly affect equity costs, especially when investors doubt the credibility of disclosed information (Njoroge, 2018).

The research gap arises from these inconsistencies. Some studies confirm that earnings management and voluntary disclosure significantly affect equity capital costs, while others demonstrate otherwise (Ifonie, 2012; Setiani, 2016). Furthermore, only a limited number of studies have simultaneously examined the combined effect of earnings management, company size, and voluntary disclosure on the cost of equity capital, particularly in the context of manufacturing companies in Indonesia. Most prior research tends to focus on single variables or specific market segments, leaving a lack of comprehensive insight into how these three factors jointly influence equity financing costs (Embong, 2012; Moss, 2016).

This study aims to fill the gap by examining the effect of earnings management, company size, and voluntary disclosure on the cost of equity capital among manufacturing companies listed on the Indonesia Stock Exchange. The objectives of this research are threefold: first, to test the partial influence of earnings management on equity costs; second, to analyze whether company size significantly shapes equity financing requirements; and third, to evaluate the extent to which voluntary disclosure reduces or increases the cost of equity. By integrating these variables in a single framework, the study provides a more holistic view of the determinants of equity financing costs.

The practical benefits of this research include offering managers a better understanding of how financial reporting behavior, firm characteristics, and disclosure practices impact financing costs, thereby helping them design effective corporate policies (Ghozali, 2018). For investors, the findings will serve as a reference to evaluating companies not only based on financial outcomes but also on reporting quality and transparency (Sekaran & Bougie, 2017). For policymakers, the results are expected to provide input regarding the formulation of regulations on corporate disclosure and monitoring practices.

The novelty of this study lies in its integrative approach to analyzing three critical variables earnings management, company size, and voluntary disclosure simultaneously within the Indonesian manufacturing sector. Unlike previous studies that examined these factors separately, this research emphasizes their combined effect on the cost of equity capital, thus offering a more comprehensive contribution to the literature on corporate finance and capital markets (Kristandl, 2007; Wulandari, 2012).

2. Literature Review and Hypothesis

Literature Review

Cost of Equity Capital

The cost of equity capital is the minimum rate of return investors expect on their investment in a company (Brigham & Houston, 2011). This concept is important because it serves as a reference for management in making financing and investment decisions (Harmono, 2016). Lubis (2014) explains that the cost of equity capital is closely related to a company's ability to maintain its stock market value and attract new investors. Sunarto (2010) adds that equity capital can be obtained from retained earnings or the issuance of new shares, both of which have consequences for the cost of capital. Research by Utami (2005) emphasizes that the quality of financial reporting influences the cost of equity capital because it can influence investors' perceptions of risk. Thus, the cost of equity capital is influenced by the quality of the information presented, the size of the company, and the extent to which the company discloses information (Kristandl, 2007).

Earnings Management

Earnings management is an accounting practice undertaken by management to manage earnings according to specific interests (Fahmi, 2014). Harahap (2011) explains that earnings management is carried out by exploiting the flexibility of accounting standards to adjust earnings to appear more stable or in line with targets. Subramanyam (2010) defines earnings management as management intervention in the preparation of external financial reports to influence the earnings reported to stakeholders. Moss (2016) found that earnings management practices can increase the cost of equity capital by creating information asymmetry that poses risks to investors. Research by Supawadee (2016) also found that earnings management has a positive effect on the cost of equity capital. However, Perwira and Darsono (2015) found that earnings management had no significant effect on the cost of equity capital, indicating inconsistencies in the research findings. Houge (2017) even found a significant negative effect, indicating that investors may interpret earnings management as a specific efficiency strategy. This indicates that the relationship between earnings management and the cost of equity capital still requires further research.

Company Size

Company size is often used as an indicator of a company's ability to manage risk and attract investors. Hartono (2016) states that company size reflects the size of its assets and the capacity of its operations. Brigham and Houston (2005) argue that larger companies tend to have broader access to capital markets, but at the same time face higher demands for transparency. Niresh and Velnampy (2014) explain that company size can be measured through total assets, total sales, and market capitalization. Research by Admadianto (2017) shows that company size has a significant positive effect on the cost of equity capital, meaning that the larger the company, the higher the cost of capital borne due to the increased need for public information. Conversely, research by Imran (2012) found that company size has a negative relationship with the cost of equity capital, as larger companies are more trusted by investors, thus reducing investment risk. Research by Anastasia (2016) also supports the finding that company size has a significant negative effect on the cost of equity capital. The differences in these research findings indicate that the influence of company size on the cost of equity capital remains a matter of debate.

Voluntary Disclosure

Voluntary disclosure is the provision of additional information by companies beyond that required by accounting standards. Chariri and Ghazali (2007) state that disclosure is the provision of relevant information to support the decisions of users of financial statements. Suwardjono (2011) added that voluntary disclosure is a management strategy to increase transparency through additional information deemed important by investors. Ali and Tarmizi (2015) emphasized that voluntary disclosure aims to reduce information asymmetry, thereby increasing stakeholder trust. Boesso and Kumar (2007) found that broader disclosure can lower the cost of equity capital by reducing investor uncertainty. Petrova (2012) and Khlif et al. (2018) also showed similar results, indicating that voluntary disclosure has a significant negative relationship with the cost of equity capital. However, Njoroge's (2018) study found that voluntary disclosure had no significant effect, indicating that the benefits of disclosure depend heavily on a country's capital market conditions.

Hypothesis

Earnings Management and the Cost of Equity Capital

Earnings management is a managerial practice of managing earnings reports by exploiting the flexibility of accounting standards for specific purposes (Fahmi, 2014; Harahap, 2011). Subramanyam (2010) states that earnings management can be implemented to increase or decrease profits in line with management targets. This practice has the potential to increase information asymmetry between management and investors, thereby increasing investment risk and ultimately increasing the cost of equity capital (Moss, 2016; Supawadee, 2016). However, research by Perwira and Darsono (2015) found an insignificant effect, while Houge (2017) found a significant negative effect. Nevertheless, earnings management is generally assumed to increase information risk, potentially increasing the cost of equity capital.

H1: Earnings management has a positive and significant effect on the cost of equity capital.

Company Size and Cost of Equity Capital

Company size reflects the size of its assets and business capacity (Hartono, 2016). Large companies are generally better known to the public and have broader access to capital markets, but they also face higher transparency demands (Brigham & Houston, 2005; Niresh & Velnampy, 2014). Several studies have found mixed results. Admadianto (2017) found that company size has a positive effect on the cost of equity capital, while Imran (2012) and Anastasia (2016) showed a significant negative relationship. Despite the varying results, company size is considered an important factor that can influence investor risk perceptions.

H2: Company size has a significant effect on the cost of equity capital.

Voluntary Disclosure and the Cost of Equity Capital

Voluntary disclosure is the disclosure of additional information beyond that required, aimed at increasing transparency (Chariri & Ghazali, 2007; Suwardjono, 2011). Ali and Tarmizi (2015) emphasized that voluntary disclosure can reduce information asymmetry and increase investor confidence. Boesso and Kumar (2007) and Petrova (2012) found that voluntary disclosure lowers the cost of equity capital. Khlif et al. (2018) also confirmed a significant negative relationship. However, Njoroge's (2018) study showed an insignificant effect, indicating differences across contexts. In general, the more extensive the disclosure, the lower the information risk and the cost of equity capital.

H3: Voluntary disclosure has a negative and significant effect on the cost of equity capital.

Earnings Management, Company Size, Voluntary Disclosure, and Cost of Equity Capital

Previous research has shown that earnings management, company size, and voluntary disclosure can influence the cost of equity capital, either partially or simultaneously. Kristandl (2007) and Setiani (2016) emphasize the importance of a combination of internal and external factors in determining the cost of equity capital. Balvers (2009) and Petrova (2012) also emphasize that reporting quality and transparency play a role in shaping investor perceptions. Therefore, examining these three variables simultaneously can provide a more comprehensive understanding.

H4: Earnings management, company size, and voluntary disclosure simultaneously have a significant effect on the cost of equity capital.

Framework

This study uses earnings management, firm size, and voluntary disclosure as independent variables, and the cost of equity capital as the dependent variable. The purpose of this study is to determine the influence of earnings management, firm size, and voluntary disclosure on the cost of equity capital. The relationship between these four variables can be illustrated in the conceptual framework in Figure 1 below:

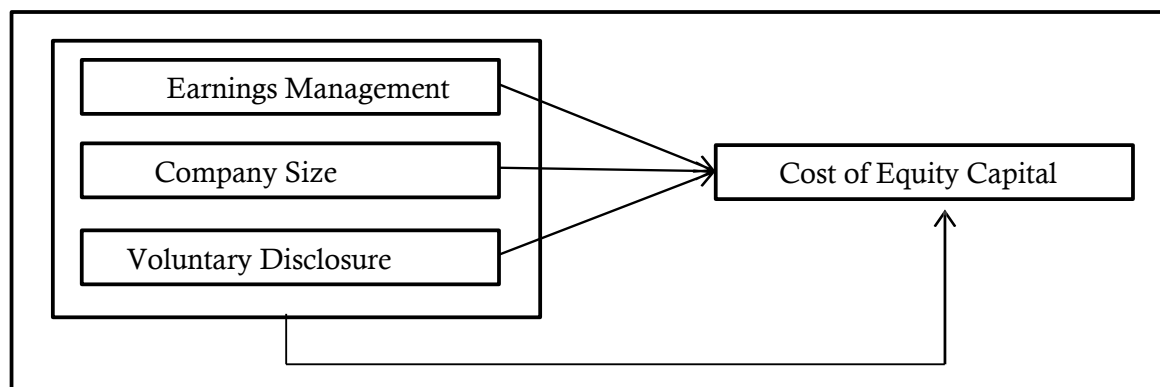


Figure 1. Framework

3. Data and Method

Type of Research

In accordance with the problem being studied, the type of research used is a quantitative research approach, and the data used is secondary data. According to Sugiyono (2017), a quantitative research approach is a method used to study specific populations and samples by collecting and analyzing data statistically, with the aim of testing predetermined hypotheses. The data consists of financial reports and annual reports from each sample company for the years 2013 to 2017.

Population and Sample

According to Sekaran and Bougie (2017), a population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate, and from which the researcher hopes to form an opinion (based on sample statistics). The population of this study is manufacturing companies in the consumer industry sector listed on the Indonesia Stock Exchange. According to Sekaran and Bougie (2017), a sample is a portion of a population. A sample consists of a number of members selected from the population. In other words, some, but not all, elements of the population constitute the sample. The sampling technique used to determine the sample in this study was purposive sampling, which involves non-random selection of samples that must meet criteria tailored to the research objectives or problems.

Data Collection Method

Data Type and Data Source

The data used in this study is secondary data. According to Sekaran and Bogie (2017), secondary data refers to information collected from existing sources. The data used were those with a fiscal year ending December 31, covering the period from 2013 to 2017. The data used in this study were reports from manufacturing companies listed on the Indonesia Stock Exchange. This research data was obtained from the websites of each sample company. The data collected included book value, earnings per share, share price, total assets, net income, cash flow from operating activities, revenue, and receivables.

Data Collection Technique

The technique used in this study was documentation. Documents are records of past events (Sugiyono, 2017). This was done by collecting and utilizing financial report data and annual reports from manufacturing companies in the consumer sector for the period 2013-2017, obtained from the Indonesia Stock Exchange.

Data Analysis Method

The analytical method used in this study was multiple linear regression using Statistical Product and Service Solutions (SPSS) Version 25.

4. Results

Normality Test

According to Ghozali (2018), the normality test aims to determine whether the confounding variables or residuals in a regression model have a normal distribution. A good regression model has residual values that are normally or nearly normally distributed. The graphical method for testing residual normality is to examine the distribution of data along the diagonal of a Normal Probability Plot (PP Plot) of regression standardized residuals and a histogram. The following is an image of a Normal Probability Plot (P-Plot):

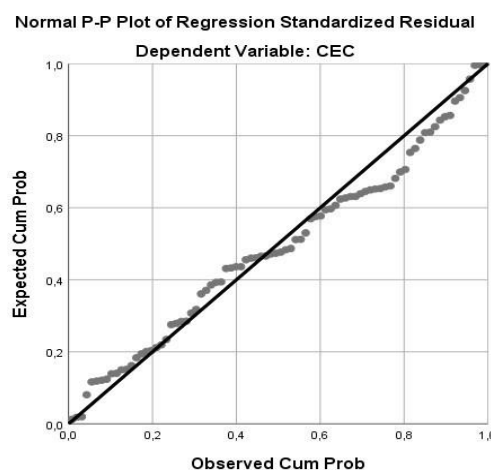


Figure 2. Normality Test

From Figure 2 above, the points are spread around the diagonal line, indicating a normal distribution pattern, so it can be concluded that the regression model meets the assumption of normality. The statistical test used to test the normality of the residuals is the non-parametric Kolmogorov-Smirnov (K-S) statistical test.

Multicollinearity Test

According to Ghozali (2018), the multicollinearity test aims to determine whether a regression model detects correlation between independent variables in the regression equation. If the Tolerance value is greater than 0.10 and the VIF value is less than 10, multicollinearity is absent. Conversely, if the Tolerance value is less than or equal to 0.10 and the VIF value is greater than 10, multicollinearity is present. A good regression model should have no correlation between independent variables.

Table 1. Multicollinearity Test Results

	Unstandardized Coefficients			Standardized Coefficients			Collinearity Statistics	
	Model	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	2,590	,569		4,554	,000		
	ML	-,032	,248	-,010	-,131	,896	,974	1,027
	SIZE	-,088	,019	-,414	-4,606	,000	,654	1,530
	VD	-,471	,230	-,150	-2,047	,044	,986	1,014
	LAG_Y	,426	,090	,423	4,708	,000	,655	1,527

Source: Processed Research Results (2018)

Based on Table 1, earnings management (ML) shows a tolerance value of 0.974 and a VIF of 1.027. The company size variable (SIZE) shows a tolerance value of 0.654 and a VIF of 1.530. The voluntary disclosure variable (VD) shows a tolerance value of 0.986 and a VIF of 1.014. Each variable has a VIF value around 1 and less than 10, and the calculated tolerance value for each variable shows a value above 0.10. Thus, it can be concluded that there is no multicollinearity among the independent variables in the regression model.

Autocorrelation Test

According to Ghozali (2018), the autocorrelation test aims to determine whether there is a correlation between the nuisance error in period t and the error in period $t-1$ in a regression model. The autocorrelation test in this study uses the Durbin-Watson test. Based on the analysis results, the Durbin-Watson test value was 1.064. A regression equation is said to meet the assumption of no autocorrelation if the Durbin-Watson (DW) test value is close to two or falls between d_U and $(4-d_U)$. The Durbin-Watson statistic value for d_U with $n = 85$ and $k = 3$ is 1.7210, resulting in $(4-d_U)$ being 2.279. The DW result is 1.064. This value does not fall within the range of d_U to $(4-d_U)$, which would cause autocorrelation. To address this issue, the data was transformed again into Natural Log (LN) form. After the data was transformed, $\text{Lag}(Y)$ values were added to the independent variables to avoid autocorrelation. After adding $\text{Lag}(Y)$ values, the Durbin-Watson test was performed again, with the results shown in the following table.

Table 2. Autocorrelation Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin Watson
1	,763 ^a	,583	,562	,23150	1,943

Source: Processed Research Results (2018)

Based on the table above, the Durbin-Watson value after data transformation and the addition of $\text{Lag}(Y)$ is 1.943. Therefore, the DW value of 1.943 falls within the range of d_U values of 1.7210 to $(4-d_U)$

dU) of 2.279. Therefore, it can be concluded that there is no autocorrelation in the research data.

Heteroscedasticity Test

According to Ghozali (2018), the heteroscedasticity test aims to test whether the regression model exhibits unequal variances and residuals between observations. If a specific pattern is observed, such as points forming a regular pattern (wavy, widening, then narrowing), heteroscedasticity has occurred. If there is no clear pattern, and the points are randomly distributed above and below 0 on the Y-axis, heteroscedasticity does not occur.

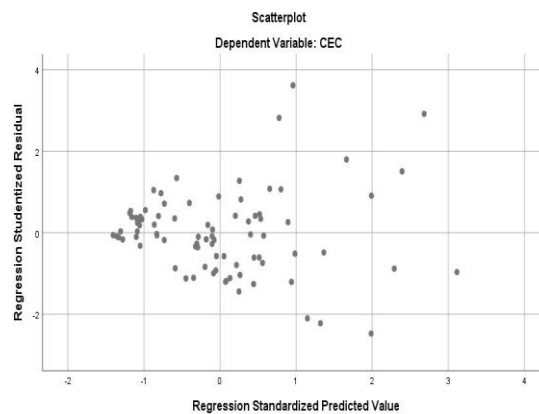


Figure 4. Heteroscedasticity Test Results – Scatterplot Graph

The scatterplot graph results in this study indicate that the points are spread above and below 0 on the Y-axis. Therefore, it can be concluded that there is no heteroscedasticity problem in the model. Therefore, the regression model is suitable for predicting the effect of Earnings Management, Company Size, and Voluntary Disclosure on the Cost of Equity Capital.

Multiple Linear Regression Analysis

Multiple linear regression analysis is used to examine the factors that influence the independent variables on the dependent variable, where more than one independent variable is used in this study. The results of the multiple linear regression are as follows:

Table 3. Multiple Linear Regression Test

	Model	Collinearity Statistics Beta
1	(Constant)	2,590
	ML	-,032
	SIZE	-,088
	VD	-,471
	LAG_Y	,426

Source: Processed Research Results (2018)

Partial Test Results (t-Statistic Test)

The t-statistic test is used to determine the extent to which an individual independent variable influences the dependent variable. Table 4.5 shows the probability values for each variable. If the probability value is >0.05 , H_0 is rejected; if the probability value is <0.05 , H_a is accepted.

Table 4. Partial Test Results (t-Statistic Test)

		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	Model	B	Std. Error	Beta		
1	(Constant)	2,590	,569		4,554	,000
	ML	-,032	,248	-,010	-,131	,896
	SIZE	-,088	,019	-,414	-4,606	,000

VD	-,471	,230	-,150	-2,047	,044
LAG_Y	,426	,090	,423	4,708	,000

Source: Processed Research Results (2018)

Partial test results indicate that earnings management has no effect on the cost of equity capital, while company size has a significant negative effect, indicating that the larger the company, the lower the cost of equity capital. Furthermore, voluntary disclosure also has a significant negative effect, indicating that the more information a company discloses, the lower the expected return for investors. Meanwhile, the previous year's lag variable has a significant positive effect on the cost of equity capital, indicating a link between historical performance and the cost of capital in the following period.

5. Discussion

Earnings Management and Cost of Equity Capital

Research findings indicate that earnings management is related to the cost of equity capital. This can be explained through information asymmetry theory, where earnings management practices create uncertainty regarding the quality of financial reports. When investors doubt the credibility of the information presented, investment risk increases, resulting in a higher cost of equity capital. These results align with research by Moss (2016) and Supawadee (2016), which found that earnings management has a positive effect on the cost of equity capital. However, other studies, such as those by Perwira and Darsono (2015) and Houge (2017), report different results. This inconsistency suggests that the effect of earnings management on the cost of equity capital can vary depending on the context of industry, regulatory quality, and applicable corporate governance mechanisms.

Company Size and Cost of Equity Capital

The analysis shows that company size plays a role in influencing the cost of equity capital. Larger companies tend to have greater public visibility and broader access to funding sources. This can lower the risk perceived by investors, thereby reducing the cost of equity capital. This finding is consistent with research by Imran (2012) and Anastasia (2016), which showed a negative relationship between company size and the cost of equity capital. However, research by Admadianto (2017) differed, finding a positive effect. This difference may occur because, in some cases, larger companies also face higher disclosure demands, which can actually increase the cost of capital. Thus, the effect of company size on the cost of equity capital is highly contextual and dependent on disclosure mechanisms and investor perceptions in the capital market.

Voluntary Disclosure and Cost of Equity Capital

Voluntary disclosure has been shown to be related to the cost of equity capital because broader disclosure can reduce information uncertainty among investors. By reducing information asymmetry, investors perceive lower risk, thus tending to lower the cost of equity capital. This supports the findings of Boesso and Kumar (2007), Petrova (2012), and Khlif et al. (2018), which emphasize the role of transparency in reducing the cost of equity capital. However, Njoroge (2018) found a different result, finding an insignificant effect, indicating that the benefits of voluntary disclosure can vary depending on market conditions and investor needs. Thus, voluntary disclosure can be considered a corporate strategy to improve transparency and lower the cost of capital, although its effectiveness is not uniform across contexts.

Simultaneous Effect of Earnings Management, Company Size, and Voluntary Disclosure on the Cost of Equity Capital

When earnings management, company size, and voluntary disclosure are considered simultaneously, the results indicate that all three factors contribute to the cost of equity capital. This combination of variables provides a more comprehensive picture of how financial reporting quality, company scale, and transparency levels can influence investor decisions. These results support research by Setiani

(2016), which found that earnings management, voluntary disclosure, and information asymmetry jointly influence the cost of equity capital. Furthermore, research by Kristandl (2007) and Petrova (2012) also confirms that reporting quality and information disclosure play a significant role in lowering the cost of equity. Thus, it can be concluded that companies need to pay attention to these three factors simultaneously because each contributes to the formation of investor risk perceptions which ultimately determine the level of equity capital costs.

6. Conclusion

Based on the research results, it can be concluded that earnings management has no effect on the cost of equity capital, indicating that investors are unaware of earnings management practices by management. Conversely, company size has a significant negative effect on the cost of equity capital, meaning that the larger the company, the lower the cost of equity capital. Furthermore, voluntary disclosure also has a significant negative effect, meaning that the more extensive the company's disclosure, the lower the expected return for investors on their investments. Simultaneously, earnings management, company size, and voluntary disclosure variables were shown to influence the cost of equity capital.

The managerial implication of these findings is that companies should consider size and transparency in their financial reporting as a strategy to reduce the cost of equity capital. Management needs to improve the quality and scope of voluntary disclosure to reduce information asymmetry and strengthen investor confidence. Furthermore, large companies are expected to maintain good reputations and governance, as investor trust in company size can lower expected required returns. Therefore, the combination of managing company size and information transparency is key to creating a more efficient cost of capital structure.

Recommendation

Companies should enhance voluntary disclosure to improve transparency and reduce information asymmetry, thereby lowering the cost of equity capital. Larger firms are advised to leverage their scale to build investor confidence through consistent communication and reliable reporting practices. Investors should evaluate not only financial performance but also disclose quality when making investment decisions. Regulators and policymakers are encouraged to strengthen guidelines for voluntary disclosure to ensure comparability and reliability across firms. Future research may explore other factors such as corporate governance or risk management practices that could further influence the cost of equity capital.

Limitations and avenue for future research

This study is limited by its focus on specific variables earnings management, company size, and voluntary disclosure without considering other potential determinants of the cost of equity capital such as corporate governance or risk profiles. The data set is restricted to a certain period and sample, which may not fully capture broader market dynamics. Methodologically, the study employs regression analysis, which may not address all causal complexities. Future research could expand the scope by incorporating additional variables, applying longitudinal or cross-country designs, and using advanced analytical methods to enhance the robustness and generalizability of findings.

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