Digital Innovation : International Journal of Management
E-ISSN: 3047-9053
P-ISSN: 3047-9681

(Research/Review) Article

Dividend Payout Ratio and Cost of Equity:

A Case Study on the Industrial Sector of the Indonesia Stock Exchange

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Abstract: The industrial sector plays a crucial role in driving Indonesia's economic growth, yet it also faces challenges in optimizing capital structure and shareholder value. One key financial policy that reflects managerial decisions and investor perceptions is the dividend payout ratio, which may influence a firm's cost of equity. This study aims to examine the effect of the dividend payout ratio on the cost of equity among industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2023 period. The research problem arises from inconsistent empirical evidence regarding whether higher dividend payments reduce or increase the cost of equity. Using a quantitative approach, secondary data were collected from annual financial reports, and samples were selected through purposive sampling, yielding 162 valid observations. Linear regression analysis was performed using EViews 13 software. The findings reveal a negative and statistically significant relationship between the dividend payout ratio and the cost of equity. The study concludes that higher dividend payouts can lower firms' cost of equity, supporting the signaling theory.

Keywords: Cost of Equity; Dividend Payout Ratio; Industrial; Leverage; Signaling Theory.

1. Introduction

Capital is defined as a financial resource that can be utilized by companies to fund investments, operations, and growth. Capital serves as one of the most essential elements within a company, as sufficient capital is required to ensure smooth operations and continuous business expansion. A strong capital base allows companies to maintain competitiveness by financing development and achieving long-term sustainability.

Companies may increase their capital from two main sources: internal and external financing. Internal capital primarily originates from retained earnings, which are portions of the company's profits that are not distributed as dividends but are reinvested into the business. Meanwhile, external sources of capital consist of debt and equity. Debt financing involves borrowing funds from external parties with an obligation to repay the principal and interest, while equity financing is obtained through corporate actions such as issuing new shares.

Internal capital sources are often insufficient to meet the funding requirements for business expansion and operations. In such cases, firms must rely on external financing to support growth and maintain competitiveness. However, both debt and equity carry distinct risks and costs. When seeking external funding, firms incur what is known as the cost of capital, defined as the total expense a company must bear to obtain financing. Cost of capital is composed of cost of debt and cost of equity. Understanding this concept is essential, as it serves as the foundation for managerial decision-making to acquire funds efficiently and at the lowest possible cost.

Received: September 09, 2025
Revised: September 23, 2025
Accepted: October 13, 2025
Online Available: October 16, 2025
Curr. Ver.: October 16, 2025

The total cost of capital represents the combined expenses arising from both debt and equity financing. Cost of debt refers to the expected return demanded by lenders, including compensation for default risk. Cost of equity, on the other hand, represents the return required by equity investors as compensation for bearing ownership risk. Since shareholders face higher uncertainty compared to creditors, the cost of equity is generally greater than the cost of debt (Brigham & Huston, 2016).

Investors' required rate of return forms the basis for calculating a firm's cost of equity (Brusov et al., 2022). The magnitude of this rate is largely influenced by the company's perceived risk level, particularly due to information asymmetry, which increases uncertainty and thus raises the cost of equity (Fasihat et al., 2023). A high cost of equity reflects greater business risk and financial instability. Consequently, firms facing high equity costs are pressured to deliver higher returns to meet investor expectations, potentially straining profitability. In contrast, companies with a lower cost of equity enjoy reduced risk, higher capital efficiency, and improved investor confidence.

Recent years have witnessed a global upward trend in the cost of equity. According to KPMG Germany (2023), the average cost of equity in Germany increased from 8.0% in 2020 to 9.4% in 2023, marking a 1.4% rise over four years. Similarly, Austria experienced an increase from 8.6% to 10.2% during the same period. These increases indicate potential challenges for firms, as higher equity costs translate into greater financing expenses.

A similar trend is observed in Indonesia. Between 2020 and 2023, the average cost of equity for publicly listed companies on the Indonesia Stock Exchange (IDX) rose from –2.45% to 6.4%. Among the various sectors, the industrial sector demonstrated the most consistent increase in cost of equity. According to the IDX, this sector comprises firms engaged in manufacturing and providing industrial products and services—such as aerospace, defense, construction materials, electrical equipment, and machinery—as well as commercial and professional services including printing, environmental management, personnel services, and industrial research.

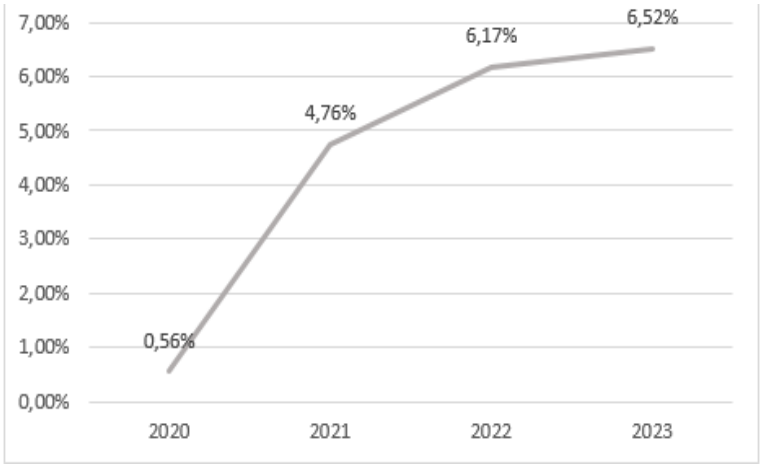

Figure 1. Trend of Cost of Equity in the Industrial Sector, Period 2020–2023.

Figure 1 illustrates the average cost of equity for firms within the industrial sector. The data reveal that this sector consistently demonstrates an upward trajectory in its cost of equity relative to other sectors. Specifically, the cost of equity increased from 0.75% in 2020 to 4.75% in 2021, 6.2% in 2022, and 6.51% in 2023. This steady rise indicates a heightened level of risk, which is disadvantageous since companies in the industrial sector must bear greater expenses to secure equity financing.

Agency theory explain several factors can affect the cost of equity. The theory highlights the conflict of interest between managers (agents) and shareholders (principals) that stems from information asymmetry. Such asymmetry arises because managers may engage in moral hazard behavior—retaining profits for personal gain rather than distributing them as dividends. As a result, shareholders incur bonding costs to mitigate agency conflicts and lower the cost of equity. Dividend distributions can function as a bonding mechanism that reduces information asymmetry by signaling the managers' commitment to shareholders' welfare. Therefore, consistent dividend payments can strengthen investor confidence and help decrease a firm's cost of equity.

The increase in the cost of equity can be influenced by several factors. Mokhova and Zinecker (2019) identify both internal and external determinants, including audit quality, dividend payout ratio, and corporate governance. Empirical studies by Indarti & Widiatmoko, (2021); Le & Moore (2023); Le et al., (2021) found that higher audit quality is associated with lower cost of equity, as improved transparency and credibility in financial reporting reduce information asymmetry and investor risk perception.

Similarly, research by Faysal et al., (2021); Hashmi et al., (2024); Hayek et al., (2023) consistently demonstrated that strong corporate governance practices decrease the cost of equity. In addition, studies by Chouaibi et al., (2024); Hmiden et al., (2022); Yi et al., (2020)showed that firms with effective corporate social responsibility (CSR) practices tend to have a lower cost of equity due to improved reputation and reduced perceived risk.

Research by Chouaibi & Zouari, (2024); Indarti & Widiatmoko, (2021); B. Le & Moore, (2023) also found that earnings management practices increase the cost of equity, as they raise investor uncertainty and risk perceptions. Likewise, studies by Atasel et al., (2020); Li et al., (2023); Zhao & Huang, (2024)revealed that information disclosure reduces cost of equity by enhancing transparency and mitigating information asymmetry.

Further evidence from Mazouz et al., (2023) indicated that higher dividend payments lower the cost of equity, as dividends convey positive information that reduces perceived risk and boosts investor confidence. Similarly, Chen et al., (2022) reported a significant negative relationship between dividends and cost of equity, explaining that dividend payments reflect financial stability and lower firm risk. Kim et al., (2024) also found a negative and significant effect of the dividend payout ratio on cost of equity, attributing this to the reduction of uncertainty and information asymmetry following dividend distribution.

However, some studies have reported differing results. Esqueda & O'Connor (2024) found a positive relationship between cost of equity and dividends, suggesting that firms with higher equity costs tend to increase dividend payments. Similarly, Karimov et al., (2021) argued that firms facing higher political risk—and therefore higher cost of equity—may raise dividend payouts as a compensatory mechanism. He & Zhang (2022) also found a positive relationship, explaining that in countries with low discount rates, investors value future earnings more than immediate dividends, prompting firms to retain profits for strategic projects instead of distributing them.

Previous research thus shows that factors such as audit quality, corporate governance, and information disclosure consistently influence the cost of equity, primarily by reducing information asymmetry and enhancing investor confidence. However, the relationship between dividend payout ratio and cost of equity remains inconsistent across studies. Given the observable upward trend in the industrial sector's cost of equity in Indonesia from 2020 to 2023, further investigation is warranted. This study therefore examines the effect of the dividend payout ratio on the cost of equity in the industrial sector, while controlling for leverage, firm size, and asset growth.

2. Literature Review

Agency Theory

Agency theory explains the relationship between shareholders (principals) and company management (agents). In practice, agents possess more information than principals because they are directly involved in the operation and management of the firm. This unequal access to information gives rise to information asymmetry, which in turn generates agency costs.

The increase in information asymmetry often stems from moral hazard, a situation where managers act irrationally by retaining profits that should otherwise be distributed to shareholders. Such behavior reduces shareholder confidence, increases perceived risk, and ultimately raises the firm's cost of equity. Therefore, companies must take several measures to mitigate information asymmetry and reduce the cost of equity (Bhatia & Kaur, 2024).

Firms can reduce agency conflicts by incurring bonding costs, which are expenses borne by agents to assure principals that they are acting in the principals' best interests. Dividend payments can serve as a form of bonding cost because distributing dividends signals that management is allocating profits fairly rather than using them for personal benefit. This positive commitment enhances investor confidence and reduces perceived risk, thereby contributing to a lower cost of equity.

Dividend Payout Ratio

The Dividend Payout Ratio (DPR) refers to the proportion of a company's earnings that is distributed to shareholders in the form of cash dividends (Konak et al., 2024). It measures the percentage of net income paid out as dividends, calculated by dividing cash dividends per share by earnings per share. In general, investors prefer companies with a higher dividend payout ratio because it provides regular returns and signals financial strength.

Dividends have long been a central topic in corporate finance, playing a crucial role in shaping financial strategies and the relationship between firms and shareholders. Companies typically strive to maintain stable dividend payments and adjust them gradually in response to changes in earnings.

Several theories have been developed to explain the relationship between dividend payments and firm value. The Dividend Irrelevance Theory, which posits that in a perfect market, dividend policy does not affect firm value. However, in real-world markets with imperfections, dividends often influence investor perceptions regarding a firm's future prospects.

This notion aligns with the Signaling Theory, which suggests that dividend announcements act as signals of a firm's performance quality and financial stability. When a company increases its dividend, investors may interpret this as a positive signal reflecting management's optimism about future profitability, thereby potentially raising stock prices.

Furthermore, the Pecking Order Theory explains that companies prefer to finance investments using internally generated funds (retained earnings) before turning to debt or external equity.

Lastly, the Agency Theory also provides insights into the role of dividends in mitigating agency conflicts. According to this theory, dividends serve as a bonding mechanism that reduces conflicts of interest between agents and principals. By distributing dividends, managers demonstrate their commitment to shareholder interests, which strengthens trust and reduces the firm's cost of equity.

Cost of Equity

Cost of equity refers to the return that a company must provide to its investors as compensation for the risk they undertake. It serves as an indicator of investors' perceived risk toward the firm's financial prospects. The concept of cost of equity is not only relevant for evaluating a company's performance but also functions as a measure of risk and investment attractiveness.

The cost of equity can be estimated using several models, one of which is the Capital Asset Pricing Model (CAPM). This model links the expected rate of return to the firm's systematic risk, represented by the beta coefficient. This study employs the CAPM approach to calculate the cost of equity for industrial sector firms.

From a managerial perspective, understanding the factors influencing the cost of equity is essential for optimizing capital structure and maximizing firm value. A high cost of equity reflects greater business risk, which may lead to financial instability. In addition, a high cost of equity places pressure on management to deliver higher returns to satisfy investors' expectations.

To mitigate this condition, companies can reduce their cost of equity by paying bonding costs in the form of dividends to shareholders. Dividend payments are expected to reduce information asymmetry between management and investors, thereby lowering the firm's cost of equity. Based on the theoretical discussion above, the following hypothesis is proposed:

H1: The dividend payout ratio has a negative effect on the cost of equity.

3. Research Methodology

Type of Research and Data Source

This study employs a quantitative research approach, which utilizes numerical data analyzed through mathematical and statistical methods (Sekaran & Bougie, 2017). The data used are secondary data in the form of unbalanced panel data. Secondary data refer to information that has been previously collected by other parties for purposes different from the current study (Sekaran & Bougie, 2017). The data for this research were obtained from the annual financial statements of companies and from the official website of the Indonesia Stock Exchange (IDX).

Population, Sample, and Sampling Technique

The population of this study consists of industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the period 2020–2023. The industrial sector classification is based on the IDX Yearly Statistics 2023. The study employs panel data, which combine time-series and cross-sectional data.

The sampling method used is purposive sampling, a non-probability technique that involves selecting specific samples based on certain predetermined criteria. Purposive sampling is designed to gather information from target groups that possess relevant data or characteristics that meet the researcher's objectives (Sekaran & Bougie, 2017).

Table 1. Sample

No	Sample Criteria	2020	2021	2022	2023
1	Industrial sector companies listed on the Indonesia Stock Exchange (IDX) during 2020–2023	63	63	63	63
2	Companies providing complete data for research purposes	(18)	(18)	(13)	(11)
3	Companies reporting negative equity	(5)	(3)	(3)	(5)
4	Outlier data	(3)	(4)	(5)	(2)
Total Data Per Year		37	38	42	45
Total Observation					162

Cost of Equity

The cost of equity represents the return required by a company's equity investors as compensation for assuming investment risk. This study calculates the cost of equity using the Capital Asset Pricing Model (CAPM), which integrates the risk-free rate, the firm's sensitivity to market risk (beta), and the market risk premium.

The CAPM assumes that financial markets are in an ideal state—where all investors act rationally, have equal access to information, and face no constraints in trading assets (Brusov et al., 2022). CAPM remains one of the most widely adopted models in both academic and professional finance due to its simplicity and its ability to describe the relationship between risk and return in capital markets.

The CAPM formula is expressed as follows:

$$E(Ri) = Rf + \beta i[E(Rm) - Rf]$$

Where:

E(Ri) = Expected return of asset i

Rf = Risk-free rate of return

βi = Beta coefficient of asset i

E(Rm) = Expected market return

(E(Rm) - Rf) = Market risk premium

Dividen Payout Ratio

The Dividend Payout Ratio (DPR) refers to the decision regarding how much of a company's profit will be distributed to shareholders (Konak et al., 2024). DPR measures the proportion of earnings paid out as cash dividends to investors and is calculated by dividing cash dividends per share by earnings per share. The formula for calculating DPR is as follows:

DPR= Earnings per Share / Dividend per Share

Leverage

Leverage is a financial ratio used to assess the extent to which a company uses debt financing to support its operational activities. It is generally measured by comparing total debt to total equity or total assets (Brigham & Huston, 2016). High leverage indicates greater debt usage, which increases financial risk (Brigham & Huston, 2016).

Investors generally avoid firms with high leverage due to the perceived risk and the potential negative impact of excessive debt during economic downturns or market volatility.In this study, leverage is measured using the Debt to Equity Ratio (DER), which is expressed as follows (Brigham & Huston, 2016):

$$\text{Leverage} = \text{Total Debt} / \text{Total Equity}$$

Firm Size

Firm size refers to the scale of a company, commonly measured using the natural logarithm of total assets or total sales (Postiglione et al., 2025). Firm size can influence various aspects of business performance, such as financial stability, market access, and capital structure decisions (Fishman & Jelnov, 2025). In this study, firm size is measured using the natural logarithm of total assets, as formulated below

$$\text{Firm Size} = \ln(\text{Total Assets})$$

Asset Growth

Asset growth represents the increase in a company's total assets over a specific period (Amyar et al., 2024). It indicates the firm's expansion capability and investment activities. The formula for asset growth, following (Hearn et al., 2025), is as follows:

$$\text{Asset Growth} = (\text{Total Assets}_t - \text{Total Assets}_{t-1}) / \text{Total Assets}_{t-1}$$

4. Results and Discussion

Research Result

Descriptive Statistics

Descriptive statistical analysis provides an overview of the characteristics of research variables, including the minimum, maximum, mean, median, and standard deviation values. Table 2 presents the descriptive statistics for each variable used in this study.

Table 2. Descriptive Statistics Result

	N	Min	Max	Mean	Std. Deviation
COE		63	63	63	63
DPR		(18)	(18)	(13)	(11)
LEV		(5)	(3)	(3)	(5)
SIZE		(3)	(4)	(5)	(2)
GRWTH		37	38	42	45

Source: Primary Data Processed by Eviews 13 (2025)

Descriptive statistical analysis provides an overview of the characteristics of research variables, including the minimum, maximum, mean, median, and standard deviation values. Table 2 presents the descriptive statistics. The dependent variable, Cost of Equity (COE), ranges from –0.111413 (PT Astra In-ternational Tbk, 2020) to 0.398655 (PT Singaraja Putra Tbk, 2020), with an average of 0.052389 or approximately 5.24%. Compared to Germany's average cost of equity of 8.5%, Indonesia's industrial sector exhibits a lower level by around 3.26%. The standard deviation of 0.060343, which exceeds the mean, indicates heterogeneity within the data.

The independent variable, Dividend Payout Ratio (DPR), ranges from –0.962218 (PT Surya Toto Indonesia Tbk, 2020) to 13.20833 (PT Multifiling Mitra Indonesia Tbk, 2020), with an average of 0.381082 (38.1%). This figure represents a healthy dividend payout range (35–55%) according to Reuters (2025). The standard deviation (1.341379) being higher than the mean indicates heterogeneous data distribution.

The control variable Leverage (LEV) ranges from 0.002200 (PT Geoprima Solusi Tbk, 2020) to 3.932500 (PT Arkha Jayanti Persada Tbk, 2020), with an average of 0.904333. This value exceeds the ideal range of 0.40–0.70 suggested by Brigham and Houston (2016), indicating that industrial firms rely heavily on debt financing. The standard deviation (0.831633) being smaller than the mean suggests data homogeneity.

Firm Size (SIZE) ranges from 24.67806 (PT Tanah Laut Tbk, 2023) to 33.73062 (PT Astra International Tbk, 2023), with a mean of 27.88323. The standard deviation of 1.831052, being smaller than the mean, also indicates data homogeneity.

Asset Growth (GRWTH) ranges from –0.593312 (PT Bakrie & Brothers Tbk, 2023) to 0.761052 (PT Arita Prima Indonesia Tbk, 2020), with a mean of 0.040905, showing a positive growth trend among industrial companies. The standard deviation (0.166604) is higher than the mean, suggesting heterogeneity in asset growth rates.

Panel Regression Model Selection

To determine the most appropriate estimation method, three tests were performed: the Chow test, the Lagrange Multiplier (LM) test, and the Hausman test.

Table 3. Chow Test Results

Effects Test	Statistics	d.f	Prob.
Cross-section F	0.312311	(47.110)	0.8695
Cross-section Chi-square	44.856990	47	**0.5617**

Source: Primary Data Processed by Eviews 13 (2025)

Since the probability value (0.5617 > 0.05), the Common Effect Model (CEM) is preferred over the Fixed Effect Model (FEM).

Table 4. Lagrange Multiplier (LM) Test Results

	Cross-Section	Test Hypothesis Time	Both
Bresuch-Pagan	4.079646	26.67645	30.75610
	(0.0434)	(0.0000)	(0.0000)

Source: Primary Data Processed by Eviews 13 (2025)

The LM test shows a Breusch-Pagan probability of 0.0434 (<0.05), indicating that the Random Effect Model (REM) is more appropriate than the CEM..

Table 5. Hausman Test Results

	Chi-Sq. Statistic	Chi-sq. d.f.	Prob.
Cross-section random	5.374030	4	**0.2510**

Source: Primary Data Processed by Eviews 13 (2025)

The Hausman test probability (0.2510 > 0.05) confirms that the Random Effect Model (REM) is the most suitable model. The REM applies the Generalized Least Squares (GLS) estimation method, which provides more efficient estimators without requiring classical assumption testing as in the OLS model.

Panel Data Regression Results

Table 6. Panel Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.165806	0.074091	2.237864	0.0266
DPR	-0.007601	0.003644	-2.085559	0.0386**
LEV	0.011404	0.005845	1.951137	0.0528***
SIZE	-0.004353	0.002648	-1.643538	0.1023
GRWTH	0.013009	0.029360	0.443091	0.6583
R-squared	0.07273	Mean dependent var		0.052389
Adjusted R-squared	0.046586	S.D. dependent var		0.060343
S.E. of regression	0.058921	Akaike info criterion		0.545054
F-statistic	2.966693	Durbin-Watson stat		2.370424
Prob(F-statistic)	0.021375			

Source: Primary Data Processed by Eviews 13 (2025)

Based on the results of the panel data regression analysis presented in the table above, the regression model of this study is as follows:

$$COE=0.16580-0.007601(DPR)+0.011404(LEV)-0.004353(SIZE)+0.013009(GRWTH)+e$$

The constant value of 0.165806 indicates that if all independent and control variables are assumed to be constant, the value of the dependent variable, cost of equity (COE), will be 0.165806.

The independent variable dividend payout ratio (DPR) and the control variable firm size (SIZE) have negative regression coefficients, indicating that an increase of one unit in either variable will lead to a decrease in the cost of equity, according to their respective coefficients. Conversely, the control variables leverage (LEV) and asset growth (GRWTH) show positive regression coefficients, implying that an increase of one unit in these variables will increase the cost of equity.

The coefficient of determination test (Adjusted R-squared) aims to measure how well the independent and control variables explain the variation in the dependent variable. Based on Table 6, the Adjusted R-squared value is 0.046586, or 4.6%, indicating that the variables dividend payout ratio, leverage, firm size, and asset growth collectively explain 4.6% of the variation in the cost of equity, while the remaining 95.4% is influenced by other factors not included in the model.

The F-test is conducted to assess the overall model feasibility. The decision is based on the value of Prob(F-statistic). If Prob(F-statistic) is less than 0.05, the model is considered statistically significant. Based on Table 6, the Prob(F-statistic) value is 0.021375, which is below 0.05, indicating that the regression model is feasible and statistically significant.

The t-test evaluates the significance of each independent variable individually. According to Table 6, the variable dividend payout ratio (DPR) has a probability value of 0.0386 (< 0.05), indicating a significant effect at the 5% level on the cost of equity. The control variable leverage (LEV) shows a probability value of 0.0759 (< 0.10), indicating a significant effect at the 10% level on the cost of equity. Meanwhile, firm size (SIZE) and asset growth (GRWTH) have probability values of 0.1023 and 0.6583, respectively, both above 0.10, implying no significant effect on the cost of equity.

Discussion

The effect of Dividend Payout Ratio on Cost of Equity

The regression results show that the Dividend Payout Ratio (DPR) has a negative and significant effect on the Cost of Equity (COE) at the 5% significance level. This finding supports Hypothesis 1 (H1), which posits a negative relationship between dividend payout and cost of equity. The result implies that firms with higher dividend payouts tend to have a lower cost of equity, consistent with agency theory, which argues that dividends can mitigate agency conflicts by signaling managerial commitment to shareholders' interests.

This finding aligns with prior studies by Chen et al. (2022); Kim et al. (2024); Mazouz et al. (2023), which also documented a negative and significant relationship between dividend payout ratios and cost of equity. Mazouz et al. (2023) exp lained that consistent dividend payments enhance firm stability and reduce perceived risk, thus lowering the cost of equity. Similarly, Chen et al. (2022) found that high-growth firms paying dividends convey positive information about future profitability, reducing information asymmetry and investor uncertainty. Kim et al. (2024) further asserted that dividend announcements act as a positive signal, lowering perceived risk and consequently decreasing firms' cost of equity.

Overall, the findings demonstrate that dividend policy functions not only as a distribution mechanism but also as a strategic financial signal that influences investor confidence and capital costs..

5. Conclusion

This study aims to explain the relationship between the dividend payout ratio and the cost of equity. The population used consists of companies listed in the industrial sector of the Indonesia Stock Exchange (IDX), according to the IDX Yearly Statistics 2023 classification. The industrial sector was selected because it shows a consistent increase in the cost of equity compared to other sectors. The research period spans four years, from 2020 to 2023. The empirical results show a negative and significant effect between the dividend payout ratio and the cost of equity. This finding indicates that an increase in dividends reduces the firm's cost of equity. The negative relationship can be explained by the signaling theory, where dividend payments assure investors (principals) that managers (agents) act in their best interest rather than using profits for personal gain. This reduces information asymmetry and consequently lowers the firm's cost of equity. The results support previous arguments that increasing divi-

dends can reduce risk and enhance the firm's image among investors. Reduced risk and improved reputation contribute to lowering the company's cost of equity, enabling the firm to obtain additional capital more efficiently.

This study has several limitations. The population is limited to industrial sector companies listed on the IDX in 2023. Many firms were excluded due to incomplete data availability, reducing the sample size. Additionally, the study employs only one independent variable—the dividend payout ratio—thus limiting the explanatory power regarding the determinants of the cost of equity.

Future studies are encouraged to expand the population to include all listed companies on the IDX or cross-country samples to better generalize the findings. Moreover, future research should incorporate additional independent variables, including external factors such as inflation rate, political stability, and tax rate levels, to provide a more comprehensive explanation of the determinants influencing the cost of equity.

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