REPUTATION-BASED DISCLOSURE AND COST OF CAPITAL: THE ROLE OF CONTROLLING OWNERSHIP

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ABSTRACT

This study aims at examining the effect of reputation-based disclosure on the cost of capital and the role of the controlling ownership as a moderating variable. The sample of the study consists of manufacturing firms listed on the Indonesia Stock Exchange (IDX) for the years 2009–2013. This study uses price-earnings to growth (PEG) as a proxy of the cost of capital. The result demonstrates that reputation-based voluntary disclosure has a negative effect on the cost of capital. The controlling ownership further strengthened this effect. The cost of capital is reduced by higher disclosure. However, the interaction between reputation-based disclosure and ownership structure has a positive effect on the cost of capital. The result of this study is robust, using other measurements of the cost of capital (Fama-French model). It implies that investors can utilize firms’ disclosure as a signal to estimate returns. Firms, however, strive to impress investors positively to reduce the expected returns.

Keywords: reputation, disclosure, ownership structure, cost of capital.

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1. INTRODUCTION

This study aims at examining the effect of reputation-based on the cost of capital and the role of ownership structure as a moderating variable. Reputation is one of the important assets of a company, since it has a significant effect on the firm’s value (Gatzert, 2015). A firm’s reputation refers to its well-communicated consistent performance (Chun, 2005). Firms that maintain a high standard of reputation provide confidence to shareholders regarding their performance. Alternately, if the reputation is damaged, it will have a direct effect on the market value of the firm.
Firm reputation has three important aspects: company communication, competitive advantage, and value creation (Chen & Otubanjo, 2013).

Firm reputation is a way in which firms communicate their strategic values to other companies and shareholders. Firm reputation is a signal to the shareholders regarding the firm’s higher quality standards (Abeysekera, 2019; Houston, 2003). A good reputation serves as an indication that firms offer better performance. Abeysekera (2019) argued that it determines the firm’s future profitability. In the case of concentrated ownership, controlling shareholders enhance the firm’s reputation to convince the minority shareholders of its performance. It is known that minority shareholders use reputation signaling in investment decision making.

Firm reputation is strategically important to a company (Weigelt & Camerer, 1988) to boost shareholder confidence. One way to demonstrate their reputation is through some form of disclosure. The current study investigates reputation based on disclosure in the Indonesian context. Reputation-based disclosure is expected to resolve the dilemma faced by controlling shareholders to intensify the minority shareholders’ trust. The disclosure is instrumental in reducing returns and eventually the cost of capital. Botosan and Plumlee (2002) suggest that the cost of capital is lowered by providing investors the parameters to evaluate the potential returns they will generate. When investors receive more information, adverse selection is less likely to occur and share demand will increase that eventually reduces the cost of capital (Diamond & Verrecchia, 1991; Eaton et al., 2007).

Several studies on the relationship between disclosure and the cost of capital show inconsistent results. Specifically, some studies exhibit their negative relationship (Blanco et al., 2015; Botosan & Plumlee, 2002; Cheynel, 2013; Diamond & Verrecchia, 1991; Lang & Lundholm, 1996; Lopes & de Alencar, 2010). However, Kristandl and Bontis (2007) find that historical disclosure has a positive effect on the cost of capital. Further, Kim and Shi (2011) observe that voluntary disclosure of bad news has a favorable effect on the cost of capital, while disclosure of good news bears no effect.

Armitage and Marston (2008) conducted an interview to finance directors in the UK regarding the relationship between disclosure and the cost of capital. Results show that they have no significant correlation. On the contrary, Richardson and Welker (2001) find that voluntary social disclosure increases the cost of capital in Canadian firms. This inconsistent result might be due to specific characteristics such as different ownership structure. As revealed by previous study, Indonesia has unique characteristics in terms of ownership structure.

Most of Indonesian firms are dominated by controlling owners (Brahmana et al., 2019; Setiawan, et al., 2016; Suprianto et al., 2019), while other countries such as the USA and UK have diverse ownership (La Porta et al., 1999). Controlling shareholders have influence on firm decision such as diversification (Brahmana et al., 2019), dividend (Setiawan, Aryani, et al., 2019; Setiawan et al., 2016), and earnings management (Suprianto et al., 2019). Therefore, this study considers controlling ownership based on the relationship between reputation-based disclosure and the cost of capital.

Cao et al. (2015) analyze the relationship between firms’ reputation and the cost of capital and cost of debt. They find the following explanations. Firstly, investors demand returns in the form of
firms’ overall quality. Secondly, reputation is based on past performance and not by agents’ or managers’ reputation. Overall, their results indicate that reputation is negatively related to the cost of capital. Cao et al. (2015) argue that the study on the relationship between reputation and cost of capital is scarce; therefore, this study tries to fill this gap. Cao et al. (2015) use ranking from Fortune magazine as a proxy for reputation. However, our study develops an index for reputation-based disclosure. The remainder of the paper consists of literature review and hypothesis development. Further, in section 3, we provide the methodology research and in section 4 the results and discussion. In the last section, we present the conclusion, limitation, and suggestion for future study.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Blanco et al. (2015) investigate the effect of segment disclosure on the cost of capital. Firms that voluntarily furnish shareholders with segment disclosure also provide better information for decision making. It is expected that voluntary segment disclosure has a negative effect on the cost of capital. This has been confirmed by Blanco et al. (2015), suggesting that higher voluntary segment disclosure leads to lower cost of capital. Thus, voluntary disclosure has a positive effect on the firm’s outcome. This result is in line with the research by Botosan and Plumlee (2002) who find that the higher level of disclosure in the annual report significantly decreases the cost of capital. Both studies (Blanco et al., 2015; Botosan & Plumlee, 2002) establish the importance of voluntary disclosure to mitigate the cost of capital.

Lopes and de Alencar (2010) and Guidara et al. (2014) analyzed the impacts of corporate disclosure on the cost of capital using the emerging market data. Their study predicts the negative relationship between disclosure and the cost of capital. The findings confirm their hypothesis that the higher disclosure index leads to lower cost of capital. This result is in accord with the previous study by Lang and Lundholm (1996) that corporate disclosure provides beneficial impacts on the number of analyst following and more accurate earnings forecast.

Cheynel (2013) intensively discusses the theory regarding the relationship between voluntary disclosure and the cost of capital. She argues that firms that make voluntary disclosure have a lower cost of capital compared to firms that do not. Therefore, voluntary disclosure has a significant effect on the cost of capital (Bertomeu & Cheynel, 2016). However, its impacts depend on the level of disclosure (Blanco et al., 2015; Botosan & Plumlee, 2002; Lopes & de Alencar, 2010).

Reputation disclosure is a voluntary disclosure of firm information. It is expected to have notable impacts on the cost of capital. Bravo (2016) provides evidence that it significantly affects return volatility. Firms with higher reputation have negatively reduced the stock return volatility. Thus, investors use reputation disclosure to reduce their investment cost. Cao et al. (2015) investigate the association between corporate reputation and the cost of capital. Results show that it can affect the cost of capital. It is further revealed that firms with higher reputation have a lower cost of capital. This then provides important implication regarding the role of reputation in reducing the cost of capital. The result is more pronounced in the higher information asymmetry environment. Pfister and Schwaiger (2016) also acknowledged that firm reputation is an important aspect in considering
the cost of capital. Based on literature review, this study predicts that reputation disclosure will negatively affect the cost of capital. Thus, the first hypothesis is given as follows:

\[ H1: \text{corporate reputation disclosure has a negative effect on the cost of capital} \]

This study considers controlling ownership on the relationship between corporate disclosure and the cost of capital. Most of Indonesian companies are dominated by controlling owners such as family-owned companies (Brahmana et al., 2019; Carney & Child, 2013; Suprianto et al., 2019). Controlling ownership has a considerable influence on firm decision such as diversification (Brahmana et al., 2019), dividend (Setiawan, Aryani, et al., 2019; Setiawan et al., 2016), and earnings management (Siregar & Utama, 2008; Suprianto et al., 2019). Byun et al. (2013) investigate the effect of ownership structure and the cost of debt in Korea. It can be noted that companies that are affiliated with Korean chaebol enjoy the lower cost of debt compared to independent firms. This result shows that ownership structure has important effects on the cost of debt. In addition, Boubakri et al. (2010) demonstrate the positive effect of the cost of capital with family as controlling owners.

Controlling family firms have a higher cost of capital. Boubakri et al. (2010) argue that shareholders consider family firms to have the higher potential opportunity to entrench themselves in business; hence, shareholders seek for higher return from them. A cross-country study shows that controlling owners have a positive impact on the cost of capital (Boubakri et al., 2010; Guedhami & Mishra, 2009). Specifically, Guedhami and Mishra (2009) argue that higher excess control leads to higher cost of capital. This result is in line with Lin et al. (2011) who find that controlling ownership exploits the minority shareholders through tunneling and other methods for their own interest. This leads to an increase in the monitoring cost and the cost of debt. In a previous study, the significant effect of controlling ownership on the cost of capital is also determined (Boubakri et al., 2010; Guedhami & Mishra, 2009; Lin et al., 2011). The second hypothesis is presented as follows:

\[ H2: \text{controlling ownership moderates the relationship between reputation disclosure and the cost of capital} \]

3. METHODOLOGY RESEARCH

Data
The sample of this study consists of manufacturing firms listed on Indonesia Stock Exchange (IDX) from 2009 to 2013 and 227 firm-year observations. The study uses unbalanced panel data. The effects of corporate reputation to the cost of capital and the role of controlling ownership as a moderating variable are investigated. Thus, the independent variable for the study is firm reputation, while the dependent variable is the cost of capital.

Measurement
A self-developed disclosure index is used in this study because the literature does not specify the types and amount of items to be included in the index (Hassan & Marston, 2019). With this index, it is assumed that the number of disclosure items can serve as a proxy of the disclosure quality. The main advantage of using the unweighted index is that by treating all disclosure items equally,
the measurement process will be more objective and therefore does not involve subjective judgment (Chavent et al., 2006). Each information item that is disclosed by a firm is scored 1 and an undisclosed item is scored 0. Thus, the disclosure index is measured by summing the scores of all information items. If a firm discloses all information items, its total scores will be 38. A high value of the disclosure index implies that more information is disclosed by a firm and the firm is more reputable.

Following Francis et al. (2005) and Bhattacharya et al. (2011), this study measures the cost of capital by using the price-earnings to growth (PEG) model. The PEG model is the appropriate model to incorporate the risk factors. Because its focus is on realized return, this model enables the utilization of more samples, relies less on assumptions, and manages to mitigate firm-specific measurement errors (Baginski & Rakow, 2012).

There are two measures on the cost of capital, namely, (1) the implied cost of capital measure (ex-ante cost of capital) and (2) ex-post realized return or expected return measured based on realized return (Bhattacharya et al., 2011). The PEG model refers to the implied cost of capital measure model with a high validity level (Botosan & Plumlee, 2002), while the Fama-French model is based on the ex-post realized return. This study uses the PEG and Fama-French models to test the hypothesis and to check the robustness of the results, respectively.

The controlling ownership as the control right of the controlling shareholders is measured in this study. Previous studies such as Brahmana et al. (2019); Claessens et al. (2000); and Setiawan, Aryani, et al. (2019) are used as reference to determine the controlling ownership through the percentage of shares held by the largest shareholder. In addition, the study employs four control variables consisting of information asymmetry, earnings volatility, total assets, and leverage. It also uses bid-ask spread to measure the information asymmetry and the standard deviation of net income/total assets as a proxy of earnings volatility. Log total assets are considered as a proxy of firm size, while leverage is the percentage of debt to assets.

**Model Specifications**
This study uses panel data to test the hypothesis with the following equation:

\[ \text{CoC}_{i,t} = \alpha + \beta_1 \text{RepDisc} + \beta_2 \text{ContrOwn} + \beta_3 \text{RepDisc} \times \text{ContrOwn} + \beta_4 \text{Asym} + \beta_5 \text{EarnVol} + \beta_6 \text{Assets} + \beta_7 \text{Lev} + \varepsilon \]  

(1)

where:
- \( \text{CoC}_{i,t} \) = cost of capital, using the price-earnings to growth (PEG) model
- \( \text{RepDisc} \) = reputation-based disclosures; content analysis 1 if the company discloses the disclosure item and 0 if not. This study measures the disclosure index by summing the scores of all information items.
- \( \text{ContrOwn} \) = controlling ownerships, percentages of shares held by the largest shareholders
- \( \text{Asym} \) = information asymmetry, measured using bid-ask spread
- \( \text{EarnVol} \) = earnings volatility, standard deviation of net/income to total assets
- \( \text{Assets} \) = log total assets
- \( \text{Lev} \) = leverage, debt to assets ratio
4. RESULTS AND DISCUSSION

4.1. Statistics Descriptive

Table 1: Statistics descriptive

<table>
<thead>
<tr>
<th>Variables</th>
<th>N</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>CoC&lt;sub&gt;i,t&lt;/sub&gt;</td>
<td>227</td>
<td>0.5210</td>
<td>0.0220</td>
<td>0.1660</td>
<td>0.1500</td>
<td>0.0979</td>
</tr>
<tr>
<td>RepDisc</td>
<td>227</td>
<td>37.0000</td>
<td>12.0000</td>
<td>30.3524</td>
<td>31.0000</td>
<td>4.0700</td>
</tr>
<tr>
<td>Asym</td>
<td>227</td>
<td>2.0000</td>
<td>−2.0000</td>
<td>0.0418</td>
<td>−0.0120</td>
<td>0.4807</td>
</tr>
<tr>
<td>EarnVol</td>
<td>227</td>
<td>36.4205</td>
<td>−12.9935</td>
<td>3.5243</td>
<td>2.7568</td>
<td>4.7997</td>
</tr>
<tr>
<td>Assets</td>
<td>227</td>
<td>94.0000</td>
<td>4.0000</td>
<td>44.2070</td>
<td>44.0000</td>
<td>17.5233</td>
</tr>
<tr>
<td>Lev</td>
<td>227</td>
<td>0.9818</td>
<td>0.1017</td>
<td>0.5329</td>
<td>0.5142</td>
<td>0.2284</td>
</tr>
</tbody>
</table>

Notes: CoC<sub>i,t</sub> = cost of capital, using the price-earnings to growth (PEG) model. RepDisc = reputation-based disclosures, content analysis 1 if the company discloses the disclosure item and 0 if not. This study measures the disclosure index by summing the scores of all information items. ContrOwn = controlling ownerships, percentages of shares held by the largest shareholders. Asym = information asymmetry, measured using bid-ask spread. EarnVol = earnings volatility, standard deviation of net/income to total assets. Assets = log total assets. Lev = leverage, debt to assets ratio.

Table 1 shows that the cost of capital ranges from 0.0220 to 0.5210, while the mean and median values are 0.1660 and 0.1500, respectively. Further, the mean and median values of controlling ownership are 0.5329 and 0.5142, respectively. This information indicates that controlling ownership in manufacturing firms listed on Indonesia Stock Exchange has dominated the company shares. It typically holds a company share of more than 50%; thus, controlling owners have the power to push their own agenda for better benefits. This data confirms the previous study such as Carney and Child (2013) and Setiawan et al. (2019) that the largest shareholders in Indonesia own more than 50% of shares in the company. This data also shows the important role of controlling ownership in analyzing the relationship between reputation-based disclosure and the cost of capital. Reputation-based disclosure value ranges from 12 to 37, revealing quite a wide range of disclosure practices. The mean and median values of reputation-based disclosure are 30.3524 and 31.0000, respectively. This denotes that the company provides a higher level of disclosure to the shareholders. Table 1 shows that the mean value of leverage is 44.2070. Thus, on average, the level of company debt is 44.2070% from firm assets. Further, the mean value for information asymmetry is 0.0418, while the mean value for earnings volatility is 3.5243.

4.2. Discussions

Table 2 provides the result of statistical testing of the study.

Table 2: Statistical result for hypothesis testing

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>CoC&lt;sub&gt;i,t&lt;/sub&gt;</td>
<td>0.5750</td>
<td>0.5751</td>
<td>0.6873</td>
</tr>
<tr>
<td></td>
<td>(0.0084)</td>
<td>(0.0076)</td>
<td>(0.0000)</td>
</tr>
<tr>
<td>RepDisc</td>
<td>−0.0033</td>
<td>−0.0035</td>
<td>−0.0074*</td>
</tr>
<tr>
<td></td>
<td>(0.1413)</td>
<td>(0.1382)</td>
<td>(0.0516)</td>
</tr>
<tr>
<td>ContrOwn</td>
<td>−0.0362*</td>
<td>−0.2727**</td>
<td>(0.0881)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.0353)</td>
</tr>
</tbody>
</table>
Table 2 shows the effect of reputation-based disclosure on the cost of capital. Columns 1 and 2 illustrate that reputation-based disclosure has no effect on the cost of capital. However, in column 3, in which there is an interaction between reputation-based disclosure and controlling ownership, reputation-based disclosure is shown to have a significant negative effect on the cost of capital, with the sign test being negative. The result of this statistical test confirms the hypothesis. The higher level of reputation-based disclosure leads to a lower cost of capital. Thus, voluntary disclosure in the form of reputation-based disclosure could reduce the cost of capital. Managers, as agents, use their discretion to convey relevant information regarding the firm’s reputation to the shareholders. Shareholders in turn use this information to make wise investment decisions.

The negative effect of reputation-based disclosure, as voluntary disclosure, to the cost of capital confirms the previous study such as Blanco et al. (2015), who find a negative relationship between segment disclosure and the cost of capital, and Botosan and Plumlee (2002) and Lopes and de Alencar (2010) who find that the level of annual disclosure leads to a lower cost of capital. Diamond and Verrecchia (1991) argue that a higher level of disclosure results in a reduction of information asymmetry, which could lead to a reduction in the cost of capital and attract more analyst following and better forecast (Lang & Lundholm, 1996). Hence, reputation-based disclosure has a crucial role to the firm’s outcome.

It provides a reliable signal to the shareholders regarding the condition of firm’s reputation. Shareholders, in the case of minority shareholders, gather additional information before making investment decisions. A higher level of reputation-based disclosure is important to investors to help them evaluate the returns they will generate (Botosan & Plumlee, 2002). The negative effect of reputation-based disclosure on the cost of capital further is confirmed in the study by Diamond and Verrecchia (1991) and Eaton et al. (2007) that supplemental data on voluntary disclosure helps investors avoid adverse selection and share demand will increase that eventually reduces the cost of capital.
This result also validates the claims by Cheynel (2013) and Bertomeu and Cheynel (2016) on the relationship between the cost of capital and voluntary disclosure, such as reputation-based disclosure. Reputation-based disclosure provides more information to the shareholders, minimizing the information asymmetry between the managers and shareholders. As a result, it negatively affects the return volatility (Bravo, 2016). Thus, firms with higher level of reputation-based disclosure have a lower cost of capital. This study also confirms the findings of Cao et al. (2015) and Pfister and Schwaiger (2016) that reputation-based disclosure has a negative effect on the cost of capital: it leads to its reduction. This result then shows the importance of reputation-based disclosure for shareholders.

Table 2 also shows the significant effect of controlling ownership on the relationship of reputation-based disclosure to the cost of capital. The sign test is positive. The higher level of controlling ownership strengthened the impacts of reputation-based disclosure, resulting in the reduced cost of capital. This shows that shareholders take the ownership structure into account. Companies dominated by controlling owners bear the lower cost of capital. Controlling owners make discretionary decisions to align their interest with that of the minority shareholders, which could lead to a decrease on the level of cost of capital.

A study by Byun et al. (2013) finds that controlling owners in Korea have a negative effect on the cost of capital. This is contrary to the result of the studies conducted by Boubakri et al. (2010), Guedhami and Mishra (2009), and Lin et al. (2011) who presented that controlling ownership positively affects the cost of capital. Controlling ownership, for example, in Indonesia, has provided a favorable effect to the minority shareholders, as owners prefer to pay them more dividend (Setiawan et al., 2016), especially for foreign ownership and state-owned enterprise (Setiawan et al., 2016). However, controlling ownership intensified the negative effect of reputation-based disclosure on the level of cost of capital. A study by Core et al. (2015) shows that disclosure and insider ownership negatively affects the cost of capital. Therefore, it is important to consider the ownership structure in the relationship between disclosure and the cost of capital (Boubakri et al., 2010; Byun et al., 2013; Core et al., 2015; Guedhami & Mishra, 2009).

Control variables such as information asymmetry and earnings volatility have no significant effect on the cost of capital. In addition, the level of information asymmetry and earnings volatility do not have influence on the change in the cost of capital. In column 1, firm size negatively affects the cost of capital. It is shown that bigger firm size has a lower cost of capital. Further, leverage has a positive effect on the cost of capital. Companies with higher level of leverage tend to have a higher cost of capital. Therefore, there is an increase in the cost of capital if the leverage value is higher.

4.3. Robustness Test

Table 3 provides the result of the robustness test for the study.
Table 3: Robustness test

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>CoC$\text{t,i}$</td>
<td>−6.2851</td>
<td>−6.6932</td>
<td>−5.7236</td>
</tr>
<tr>
<td></td>
<td>(0.0399)</td>
<td>(0.0164)</td>
<td>(0.0261)</td>
</tr>
<tr>
<td>RepDisc</td>
<td>−0.0092</td>
<td>−0.0094*</td>
<td>−0.0470***</td>
</tr>
<tr>
<td></td>
<td>(0.1198)</td>
<td>(0.0957)</td>
<td>(0.0000)</td>
</tr>
<tr>
<td>ContrOwn</td>
<td>0.9938*</td>
<td>−1.3198*</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0701)</td>
<td></td>
<td>(0.0792)</td>
</tr>
<tr>
<td>RepDisc*ContrOwn</td>
<td></td>
<td></td>
<td>0.0801***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.0055)</td>
</tr>
<tr>
<td>Asym</td>
<td>−0.0756</td>
<td>−0.0720</td>
<td>−0.0620</td>
</tr>
<tr>
<td></td>
<td>(0.1797)</td>
<td>(0.2127)</td>
<td>(0.2275)</td>
</tr>
<tr>
<td>EarnVol</td>
<td>0.0168*</td>
<td>0.0166*</td>
<td>0.0169**</td>
</tr>
<tr>
<td></td>
<td>(0.0664)</td>
<td>(0.0567)</td>
<td>(0.0496)</td>
</tr>
<tr>
<td>Assets</td>
<td>0.3954***</td>
<td>0.3919***</td>
<td>0.3953***</td>
</tr>
<tr>
<td></td>
<td>(0.0002)</td>
<td>(0.0002)</td>
<td>(0.0002)</td>
</tr>
<tr>
<td>Lev</td>
<td>−0.0095***</td>
<td>−0.0097***</td>
<td>−0.0093***</td>
</tr>
<tr>
<td></td>
<td>(0.0000)</td>
<td>(0.0000)</td>
<td>(0.0002)</td>
</tr>
<tr>
<td>Adjusted R-square</td>
<td>0.0872</td>
<td>0.0959</td>
<td>0.0963</td>
</tr>
<tr>
<td>F-statistic</td>
<td>6.2355</td>
<td>5.8443</td>
<td>5.1726</td>
</tr>
<tr>
<td>Prob (F-statistic)</td>
<td>0.0000</td>
<td>0.0000</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

Notes: CoC$\text{t,i}$ = cost of capital, using the Fama-French model; RepDisc = reputation-based disclosures, content analysis 1 if the company discloses the disclosure item and 0 if not. This study measures the disclosure index by summing the scores of all information items. ContrOwn = controlling ownership, percentages of shares held by the largest shareholders. Asym = information asymmetry, measured using bid-ask spread. EarnVol = earnings volatility, standard deviation of net/income to total assets. Assets = log total assets. Lev = leverage, debt to assets ratio

*,**,***, significant at 10%, 5%, 1%.

For robustness test, the study used Fama-French model to measure the cost of capital. The result shows the negative effect of reputation-based disclosure. The higher level of reputation-based disclosure leads to lower cost of capital. Table 3 also illustrates that the interaction between controlling ownership and reputation-based disclosure has a positive effect on the cost of capital. Thus, controlling ownership strengthened the adverse effect of reputation-based disclosure on the cost of capital. The result of the robustness test qualitatively coincides with the result from the main test.

4. CONCLUSION

This study demonstrates that reputation-based disclosure reduces the cost of capital. The results imply that investors interpret reputation-based disclosure as signals that indicate the firms’ superior performance and differentiate these firms from others. Eventually, investors are more likely to respond positively to reputation-based disclosure by determining the return parameters and reducing expected returns. Thus, this study confirms the previous studies that suggest that voluntary disclosure reduces the cost of capital (Blanco et al., 2015; Botosan & Plumlee, 2002; Diamond & Verrecchia, 1991; Lang & Lundholm, 1996; Lopes & de Alencar, 2010). Specifically this study is in line with the research of Bravo (2016), Cao et al. (2015), and Pfister and Schwaiger (2016) who find the negative effect of reputation-based disclosure to the cost of capital. In addition, this study determines that controlling ownership is an important factor affecting the relationship
between reputation-based disclosure and the cost of capital. Investors perceive that controlling owners use their discretion for their best interest; therefore, the level of cost of capital is increased.

This study has several limitations. First, this study focuses on how controlling ownership affects the relationship between reputation-based disclosure and the cost of capital. As demonstrated by Setiawan et al. (2016) and Setiawan et al. (2019), controlling ownership is divided into ownership structure such as family ownership, foreign ownership, and state-owned enterprises (SOEs). It is suggested that future study should investigate deeply the effect of ownership structure on the cost of capital, particularly in Indonesia. Second, the current study focuses on one aspect of corporate governance which is controlling ownership. Therefore, it is suggested the future study explore more aspect of corporate governance mechanism such as board structure. Indonesia offers interesting settings, Indonesia use two-tier board systems: board of commissioners and board of directors. It is interesting to test the effect of board structure to forward-looking disclosure, since independent commissioners in Indonesia have positive effect to earnings quality (Setiawan, Md Taib, et al., 2019). Third, the current study deals with the association of reputation-based disclosure with the cost of capital in the manufacturing industry. It is interesting to study this relationship using banking industry, since banking industry much more depends on trust.

REFERENCES


