



(RESEARCH ARTICLE)



Accounting conservatism mediates the relationship between corporate governance and equity capital costs

Shuvo kumar mallik *

Department of Economics, southeast university

International Journal of Science and Research Archive, 2024, 13(02), 658–672

Publication history: Received on 03 October 2024; revised on 09 November 2024; accepted on 11 November 2024

Article DOI: <https://doi.org/10.30574/ijrsra.2024.13.2.2169>

Abstract

Purpose: This study examines the effect of corporate governance as proxied by institutional and managerial ownership and profitability on the cost of equity capital, both directly and indirectly, through accounting conservatism as a mediating variable.

Design/Methodology/Approach: The population of this study was manufacturing companies listed on the Indonesia Stock Exchange in 2020–2022. The sample selection was carried out using the purposive sampling method, resulting in 230 data points and then tested using multiple linear regression.

Findings: Institutional ownership and profitability were revealed to have a positive influence on accounting conservatism, while managerial ownership had no influence. Profitability and accounting conservatism exerted a negative effect on the cost of equity capital. However, institutional ownership generated a positive effect, but managerial ownership did not affect the cost of equity capital. Further test results uncovered that the impact of institutional ownership and profitability on the cost of equity capital was mediated by accounting conservatism.

Research limitations/Implications: This research has limitations, including the relatively low adjusted R2 value. Proxies for corporate governance from ownership and board structure should be included in future studies

Originality / value: The findings of this research enrich previous research regarding the economic consequences of corporate governance, profitability, and accounting conservatism in equity markets in developing countries, especially Indonesia.

Keywords: Accounting Conservatism; Cost of Equity Capital; Institutional Ownership; Managerial Ownership; Profitability

GEL Code: G15, A12, M20

1. Introduction

Management has a fundamental responsibility in securing adequate funding for the company's investment projects. Therefore, management will try to minimize funding costs so that the project is financially feasible. Generally, company funding comes from two main sources, namely equity (cost of equity) and debt, in the form of loans and bonds (cost of debt) (Thanatawee, 2023)

* Corresponding author: Shuvo kumar mallik

When it comes to equity capital costs, sound corporate governance is viewed as a powerful draw to the market. Corporate governance comprises guidelines and rules that support management in setting direction, running, and overseeing the company (Gompers et al., 2003; Hong & Linh, 2023). The ownership structure is one of several variables that matter in corporate governance studies since it has a big impact on crucial business decisions (Zattoni, 2011). Moreover, corporate governance mechanisms are vital to control managerial takeovers and protect shareholder interests. Companies can reduce their cost of equity capital by implementing strict corporate governance practices (Hashmi et al., 2024). Good corporate governance practices will reduce the threat of takeover by insiders (Mazzotta & Veltri, 2014), reduce monitoring costs incurred by outside investors (Kano et al., 2021), and mitigate information asymmetry and opportunistic behavior of managers so that the risks faced by external investors will decrease (Broye et al., 2017). This condition will have an impact on reducing the level of return required by investors in the form of capital costs that must be borne by management as compensation for the low risk faced by investors (Hong & Linh, 2023; Thanatawee, 2023).

It has been demonstrated that when a business is exposed to more market risk, the cost of equity capital rises. It has also been exposed that firms with inadequate governance have higher equity capital costs because of a lack of transparency that drives up expenses (AlHares, 2019). Nonetheless, it has been showcased that when insider ownership rises, the cost of equity capital falls. The cost of equity capital can be reduced by removing agency issues, which can be achieved by aligning the interests of managers and shareholders (Jensen & Meckling, 1976; Krismiaji & Raharja, 2018). Additionally, research indicates that strong shareholder rights may become less significant in environments where managerial ownership is prevalent and may even take the place of shareholder rights in determining the cost of equity capital. Furthermore, to safeguard company investments, which lowers company risk, managers and business owners would typically shun actions that devalue the organization. Reduced risk premiums will be accepted by investors as a result of this requirement, which will cut capital costs (AlHares, 2019; Faysal et al., 2020; Krismiaji & Raharja, 2018).

Apart from corporate governance, financial performance, especially company earnings, remains the focus of investors' attention. Earnings are seen as a key marker of a company's financial health since they demonstrate management's capacity to acquire and deploy resources to gain a competitive edge in the capital markets. When making investment decisions, both internal and external users need to know about earnings. The quality earnings information will provide a market perception that the company can achieve a competitive advantage and that the company's sustainability in the future is still maintained. This requirement improves investors' perceptions of the business, which lowers the risk premium on investments made and, ultimately, lowers the cost of equity capital (Ismail & Obiedallah, 2022).

Several previous studies have examined the influence of corporate governance and profitability on accounting conservatism (Agustina et al., 2022; Asiriwuwa et al., 2019; Hajawiyah et al., 2020; Indarti et al., 2021a; Putra et al., 2019; Rustiarini et al., 2021;

Widaryanti, 2022; Widiatmoko et al., 2023) and the cost of equity capital (AlHares, 2019; Faysal et al., 2020; Huo et al., 2021; Ismail & Obiedallah, 2022; Khalifa et al., 2019; Krismiaji & Astuti, 2021; Krismiaji & Raharja, 2018; Muslim & Setiawan, 2021; Widiatmoko et al., 2023), but this was performed partially. Considering the importance of the cost of equity capital for the success of a company, an integrated analysis is needed regarding the impact of corporate governance and profitability on the cost of equity capital that the company must bear. For that, this current research tested both directly and indirectly through the accounting conservatism variable as a mediating variable, which also serves as the novelty of this research. Additionally, the practice of accounting conservatism is essential in developing capital markets. This is because earnings are the main indicator employed by users in making decisions and provide significant information regarding organizational performance (Khajavi et al., 2016; Salehi & Sehat, 2018). Meanwhile, quality earnings will only result from a conservative accounting process (Basu, 1997; Khalifa et al., 2019; Widiatmoko et al., 2023). The findings of several researchers have shown that corporate governance mechanisms, proxied by institutional ownership (Alves, 2020; Hajawiyah et al., 2020; Widiatmoko et al., 2023) and managerial ownership (Indarti et al., 2021; Putra et al., 2019), exerts a positive effect on accounting conservatism. Several studies have also proven that the higher the company's profitability, the more conservative management will act to avoid the high tax burden that must be borne (Asiriwuwa et al., 2019; Widaryanti, 2022; Widiatmoko et al., 2023). Good governance, higher profitability, and accounting conservatism will have an impact on lower risks faced by investors so that the level of return required by investors in the form of equity capital costs will be lower (Khalifa et al., 2019; Krismiaji & Sururi, 2021; Widiatmoko et al., 2023).

This research makes several contributions, both theoretical and practical. Firstly, this study contributes to the existing literature on the economic impacts of corporate governance, profitability, and accounting conservatism in the equity market by incorporating a relatively recent observation period (2020–2022). Secondly, this study focuses on public corporations in developing countries, specifically Indonesia, as opposed to earlier studies that employed data samples

from developed nations. Emerging nations are playing a bigger role in global markets and are providing chances for firms, financial institutions, and international equity investors to diversify their equity portfolios and increase growth. Third, the results of this study might differ from those of other studies because developing countries have lower institutional quality indices than developed countries in terms of political stability, the rule of law, regulatory quality, accountability, and the effectiveness of governance (Khalifa et al., 2019; La Porta et al., 1998).

2. Literature Review and Hypotheses Development

The relationship between corporate governance, accounting conservatism, and the cost of equity capital can be explained using agency theory, pointing out a mismatch between the interests of shareholders and management arising from the separation of ownership and control (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Based on an agency perspective, good corporate governance can be a mechanism for aligning the interests of management and shareholders as well as insider expropriation (Pham et al., 2012; Widiatmoko et al., 2023). Good corporate governance will encourage management to act carefully (conservatively) in maintaining the credibility of financial reports and increasing transparency (Hashmi et al., 2024). This condition will reduce the risk for investors so that the level of return required by investors in the form of equity capital costs will be lower (Khalifa et al., 2019; Krismiaji & Sururi, 2021; Widiatmoko et al., 2023).

In terms of corporate governance, institutional investors are crucial. Institutions that participate in active investing can benefit governance systems because they possess the financial incentive and independence to impartially assess corporate management and policy (Jensen, 1993). Because of that, institutional investors require accurate and timely information to effectively track corporate activity and take part in the development of business strategies (Liu, 2019). Therefore, companies with high institutional ownership tend to have an effective and adequate external monitoring system and have the potential to increase conservatism practices (Rustiarini et al., 2021). According to research by Alves (2020) on non-financial companies listed on the Spanish stock market, accounting conservatism increases with the number of shares held by institutional investors. The results of research on manufacturing companies (Hajawiyah et al., 2020; Widiatmoko et al., 2023) and Indonesian government-owned companies listed on the Indonesian Stock Exchange also prove that share ownership by institutions encourages management to implement accounting conservatism (Agustina et al., 2022). As a result, the ensuing hypothesis is formulated.

H₁: Institutional ownership has a positive effect on accounting conservatism.

From the standpoint of agency relationships, management ownership can lower agency costs by aligning managers' and shareholders' interests (Jensen & Meckling, 1976; Liu, 2019). The percentage of shares held by managers relative to the total number of outstanding shares is represented by managerial ownership. When managers fulfill their responsibilities as shareholders as well, they will behave in the organization's best interests (Indarti et al., 2021b). Because managers who act as shareholders not only steer the company toward high profits but also display greater concern for the company's sustainability, this condition can help minimize agency conflicts. Therefore, management will tend to be careful by implementing conservative accounting (El-habashy, 2019). The more conservative the financial reporting that management provides, the more shares of the company they own. Alves's (2020) study on companies registered on the Spanish and Portuguese stock exchanges demonstrates that managerial ownership promotes accounting conservatism. Numerous research projects carried out in Indonesia also demonstrate that the degree of accounting conservatism practiced increases with the amounts of shares held by management (Indarti et al., 2021a; Putra et al., 2019). The following hypothesis is put out considering the preceding empirical evidence and logical line of reasoning.

H₂: Managerial ownership has a positive effect on accounting conservatism.

Profitability is an indicator used by a company to show its ability to generate earnings during the financial reporting period and display that the company's operations are running efficiently. Earnings are a component of financial reports that provide important information for users and reflect management's success in managing the company so that earnings become the basis for investors and potential investors in making investment decisions. However, companies with higher profitability will face an increasingly higher tax burden. Therefore, management tends to implement accounting policies to manage earnings so that they appear smoothly. This reasoning is consistent with the results of research on firms registered on the Nigerian Stock Exchange by Asiriwa et al. (2019), which showed that profitability positively impacted accounting conservatism. In Indonesia, the same findings were reported by Widaryanti (2022) and Widiatmoko et al. (2023). When creating financial reports, management typically selects conservative accounting practices for companies with higher levels of profitability (Rustiarini et al., 2021). The following research hypothesis is formulated because of the above description.

H₃: Profitability has a positive effect on accounting conservatism.

In agency theory, institutional investors in a company have a significant influence (Hajawiyah et al., 2020). Higher share percentage institutional investors have the power to influence management conduct and regulate earnings behavior, in addition to enhancing the caliber of accounting information. Institutions are active and successful investors because they have the financial interest and independence to assess corporate management and policies impartially (Jensen, 1993). Because of that, institutional investors require accurate and timely information to effectively track corporate activity and take part in the development of business strategies (Liu, 2019). It is expected that big investors, who generally possess greater clout than minority shareholders, will play a pivotal role in exerting pressure on management to make decisions that serve the interests of shareholders (Faysal et al., 2020; Shleifer & Vishny, 1997).

Since long-term institutional investors are more likely to routinely monitor and interact with the company's management, they expect financial reporting with a greater level of conservative accounting (Ramalingegowda & Yu, 2012). In theory, institutional investors stand to gain from actively monitoring management as doing so will raise shareholder value. Institutional investors have all the necessary abilities, know-how, and resources to properly oversee and regulate management operations. The role of institutional investors has been supported by prior research, which demonstrates that larger percentages of institutional investors have greater access to and incentives to watch over managerial behavior, lessen information asymmetry, and concentrate on company performance, all of which influence lowering the cost of equity capital (Huo et al., 2021). Research by Krismiaji and Raharja (2018) found a negative influence of share ownership by institutions on the cost of equity capital. In addition, Huo et al. (2021) reported that a larger number of institutional shares with a longer investment period will be more effective in monitoring management, which will influence lowering the price of equity capital. The same findings were also demonstrated by Muslim and Setiawan (2021) that the cost of equity capital decreased with the amount of shares held by institutions. Hence, the hypothesis is:

H₄: Institutional ownership has a negative effect on the cost of equity capital.

Differences in interests between management and shareholders will encourage management to behave opportunistically and tend to benefit themselves. However, aligning agents' interests with shareholders' interests by providing financial and nonfinancial benefits to managers helps reduce agency costs and improve firm performance. In addition to attempting to match internal owners' objectives with shareholders', managerial ownership lowers agency costs and diminishes the cost of equity funding (Ali et al., 2019; Jensen & Meckling, 1976). Particularly, one of the most crucial corporate governance controls over managers is managerial ownership. According to Crutchley and Hansen (1989), the possession of executives could influence reducing agency issues and raising firm value. The value of a corporation is actively increased by managerial ownership. The notion of agency is reinforced by managerial ownership, as a higher percentage of managerial ownership successfully helps balance the interests of managers and shareholders, reducing agency issues. Theoretically, by limiting conflicts between managers and investors and lowering the price of equity capital, monitoring may help reduce agency costs (Faysal et al., 2020).

Furthermore, data points to the possibility that ownership by managers may take the role of shareholder rights in determining the cost of capital invested in equity, diminishing the significance of powerful investor rights in the presence of substantial managerial ownership. The tendency of insiders to protect company investments will reduce the company's perceived risk, thus encouraging investors to accept a reduced risk premium which results in lower capital costs (Krismiaji & Raharja, 2018). This statement is supported by the findings of AlHares (2019) and Faysal et al. (2020), which have proven that insider ownership has an adverse association with the cost of equity financing. The same findings were also reported by Krismiaji and Raharja (2018), who researched manufacturing companies in Indonesia. Thus, the hypothesis proposed is:

H₅: Managerial ownership has a negative effect on the cost of capital.

The firm's financial performance offers essential information for users, both internal and external, in considering decisions regarding investments. Based on an agency theory perspective, disclosure of a company's financial performance can be a control mechanism that can reduce information asymmetry between management and principal (Mardones & Cuneo, 2019). Financial success, as seen through the eyes of investors, indicates a company's capacity to acquire and utilize resources to generate a competitive edge. The higher the company's ability to produce financial performance, the smaller the risk faced by investors. Consequently, investors expect a lower degree of return in the form of equity capital expenses (Rehman & Zaman, 2011). This logic of thought is supported by the research findings of Ismail and Obiedallah (2022) in Egypt, which proves that companies with better financial performance will bear smaller costs of equity capital. The above line of reasoning serves as the basis for the development of the next hypothesis.

H₆: Profitability has a negative effect on the cost of equity capital.

According to Krismiaji and Astuti (2021), accounting conservatism is concerned with the uncertainty surrounding profit recognition, which is postponed until the doubt has been significantly resolved. Conservatism is a concept of applying the precautionary principle in recognizing transactions that are influenced by economic uncertainty by anticipating smaller amounts for asset values and income but larger projections for liabilities and costs. The aim is to prevent excessive presentation of income in financial reporting and understatement of costs and losses (Asiriwa et al., 2019; Widiatmoko et al., 2023). It is believed that conservatism will lessen managers' ability to inflate earnings and net assets since economic losses in a conservative reporting system are recognized more rapidly than economic profits. Consequently, to reduce the unfavorable effects of information asymmetry and lessen their information disadvantage relative to insiders, equity investors often require conservative reporting. A significant degree of conservatism in a company's operations means reduced risks for investors, which translates into lower levels of return in the form of lower necessary costs for equity capital (Khalifa et al., 2019; Widiatmoko et al., 2023).

According to Chouaibi and Belhouchet (2023), manufacturing companies in Canadian ESG firms saw a price of equity capital that was positively impacted by conservative accounting between 2007 and 2019. They demonstrated how businesses could lower the price of equity capital by implementing accounting conservatism. As Khalifa et al. (2019) asserted, conditional conservatism lowers the cost of equity capital for public enterprises in 37 developing countries. The results of research on manufacturing companies in Indonesia also confirm that accounting conservatism can reduce information asymmetry between management and principals, resulting in a decrease in the cost of equity funding (Krismiaji & Astuti, 2021; Widiatmoko et al., 2023). Based on the description above, the hypothesis is formulated as follows.

H₇: Accounting conservatism has a negative effect on the cost of equity capital.

The research model that describes the influence between variables in this study is depicted in Figure 1.

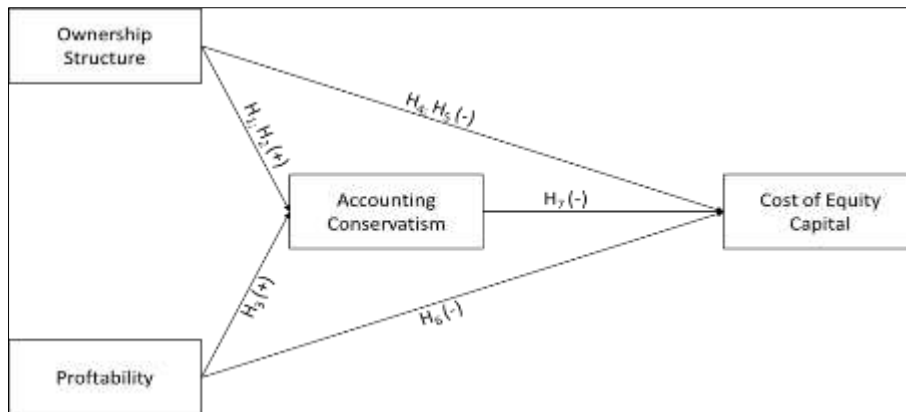


Figure 1 Research Model

3. Research Method

Manufacturing firms registered on the Indonesia Stock Exchange (BEI) in 2020–2022 were used in this study. Using a purposive sampling technique, the research sample was chosen based on the following standards: (1) the business had complete data; and (2) released audited financial reports. These standards were used to generate 230 data points.

This research used cost of equity capital (CEC) as an endogenous variable, institutional ownership (IO), managerial ownership (MO), and profitability (ROA) as exogenous variables, as well as accounting conservatism (CONACC) as a mediating variable. Leverage (LEV) and company size (SIZE) are the other two control variables included in this study. Table 1 presents the measurement variables used in this study.

Table 1 Variable Measurements

Variables	Measurements	References
CEC	$r = (B_t + X_{t+1} \Gamma - P_t) / P_t$ B_t : Cost of Equity Capital X_{t+1} : Book value per share in period t P_t : Earnings per share in period t+1 : Stock price in period t	Ohlson (1995)

CONACC and Hayn (2000) $(Income\ before\ extraordinary\ +\ depreciation\ expense\ -\ net\ operating\ cashflow) \times -1$ Givoly

Total Asset (2000)

IO	$\frac{\text{Number of shares owned by management}}{\text{Number of outstandings shares}}$	Indarti et al. (2021a)
MO	$\frac{\text{Number of shares owned by institutional investor}}{\text{Number of outstandings shares}}$	

ROA	$\frac{\text{Earning after tax}}{\text{Total assets}}$	Asiriwuwa et al. (2019)
LEV	$\frac{\text{Total Debt}}{\text{Total Assets}}$	Widiatmoko et al. (2020)

Firm Size (SIZE)	Total Assets	Indarti & Widiatmoko (2023)
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Two models, Model 1 and Model 2, were employed in this study. Model 1 examined how accounting conservatism was impacted by institutional ownership, managerial ownership, and profitability. In comparison, Model 2 investigated how the cost of equity capital was impacted by managerial and institutional ownership, profitability, and accounting conservatism. The two research models are expressed in the following mathematical equation.

$$CONACC = \beta_0 + \beta_1 IO + \beta_2 MO + \beta_3 ROA + \beta_4 LEV + \beta_5 SIZE + e \dots\dots\dots (1)$$

$$CEC = \gamma_0 + \gamma_1 IO + \gamma_2 MO + \gamma_3 ROA + \gamma_4 CONACC + \gamma_5 LEV + \gamma_6 SIZE + e \dots\dots\dots (2)$$

4. Result and Discussion

4.1. Descriptive Statistics

Descriptive data for each variable used in the study are included in Table 2, together with the lowest, maximum, average, and standard deviation values. Table 2 presents data that indicates a comparatively low average cost of equity capital (CEC), namely -0.175. According to this data, investors in the sample companies typically asked for relatively low returns on their investments. The average value of accounting conservatism (CONACC) was 0.019, indicating that management in the sample companies was relatively conservative.

Table 2 Descriptive Statistics

	N	Average	Minimum	Maximum	Std. deviation
CEC	230	-0.175	-1.142	1.018	0.514
CONACC	230	0.019	-0.187	0.265	0.070
IO	230	0.464	0.000	0.948	0.288
MO	230	0.106	0.000	0.732	0.179
ROA	230	0.041	-0.210	0.467	0.080
LEV	230	0.527	0.001	5.073	0.574
SIZE	230	27.453	18.433	33.999	2.959

Note: CEC = Cost of Equity Capital; CONACC = Accounting Conservatism; IO = Institutional Ownership; MO = Managerial Ownership; ROA = Return On Assets; LEV = Leverage; SIZE = Firm Size

Share ownership by institutions in manufacturing companies in Indonesia showed a relatively high figure, namely 0.464 or 46.40%. In contrast, the average share ownership by management exhibited a relatively low figure, namely 0.106 or 10.60%. The manufacturing companies in this research sample had an average profitability level of 0.041 or 4.10%. This value is relatively low because several companies in the sample experienced losses. The average debt level of sample companies was 0.527 or 52.70% of total assets owned. Company size, as proxied by total assets, demonstrated an average value of 2.745 trillion.

4.2. Pearson Correlation

The coefficient matrix between the variables in this investigation is detailed in Table 3. The results of the analysis indicate that all the figures were below 50% and that the correlation coefficient between the variables was suitable. These results infer that in the regression model, there was no indication of a multicollinearity problem. As a preliminary measure of the impact of the independent variable on the dependent variable, correlation analysis can also be employed. The correlation of institutional ownership (IO) to accounting conservatism (CONACC) was 0.140, significant at the 5% level, and the correlation of profitability (ROA) to CONACC was 0.359, significant at the 1% level. These findings suggest that accounting conservatism was positively impacted by institutional ownership and profitability. With the one percent significance degree, there was a substantial association of -0.421 between ROA and the cost of equity capital (CEC) and 0.592 between CONACC and CEC. This implies that conservative accounting and profitability had a negative relationship with the cost of equity capital. Regression analysis, however, was then done for a more thorough examination to validate this influence and test the hypothesis at the same time.

Table 3 Pearson Correlation Coefficient

	CEC	CONACC	IO	MO	ROA	LEV	SIZE
CEC	1						
CONACC	-0.592***	1					
IO	0.072	0.140**	1				
MO	0.138**	-0.166**	-0.289***	1			
ROA	-0.421***	0.359***	-0.055	-0.035	1		
LEV	0.080	-0.124*	-0.173***	-0.081	-0.161**	1	
SIZE	0.015	-0.027	0.050	-0.161**	0.167**	-0.135**	1

Note: CEC = Cost of Equity Capital, CONACC = Accounting Conservatism, IO = Institutional Ownership, MO = Managerial Ownership, ROA = Return On Asset, LEV = Leverage, SIZE = Firm Size; ***, **, and * represent significance levels of 1%, 5%, and 10%, respectively.

4.3. Test Results of Model 1

Normality tests and classical assumptions were carried out to fulfill the requirements for using multiple linear regression. The results of the residual normality test showed a skewness value of 0.266 with a standard error of 0.157. Based on this value, a z-skewness value of 1.694 was obtained. Given that 1.694 fell between -1.96 and 1.96, the

regression model's residuals had a normal distribution. The Durbin-Watson value, according to the autocorrelation test, was 1.899, falling between the 4-du value of 2.252 and the du value of 1.748. This figure demonstrates that the autocorrelation issue in the regression model was nonexistent. The correlation coefficient between independent variables in Table 3 shows that all independent variables had a correlation coefficient of below 50%, suggesting that multicollinearity was not a problem in the regression model. The Glejser heteroscedasticity findings showed that the beta coefficient values for each variable were not significant at the 5% level, indicating that the regression model did not have a heteroscedasticity problem.

Table 4 Test Result of Model 1

Variables	Coefficients	T statistic	Prob.	Conclusion
(Constant)	0.071	1.733	0.084	
IO	0.033	2.279	0.024	H ₁ is supported.
MO	-0.030	-1.782	0.076	H ₂ is not supported.
ROA	0.396	7.814	0.000	H ₃ is supported.
LEV	-0.008	-1.044	0.297	-
SIZE	-0.003	-1.978	0.049	-
Adjusted R-Square		0.229		
F-statistic		15.281		
Sig.		0.000		

Note: CONNAC = Accounting Conservatism; IO = Institutional Ownership; MO = Managerial Ownership; ROA = Return on Assets; LEV = Leverage; SIZE = Firm Size

Model 1, looking at how profitability, ownership by management, and ownership at institutions affect accounting conservatism, is shown in Table 4. The adjusted R Square value of 0.229 indicates that 22.90% of the variation in the level of accounting conservatism could be explained by the variables institutional ownership (IO), managerial ownership (MO), profitability (ROA), leverage (LEV) and firm size (SIZE), while other variables outside this research model explained the remaining 77.10%. In addition, the Fstatistic value of 15.281 with a significance level of 1% indicates that the variables institutional ownership, managerial ownership, profitability, leverage and company size jointly influenced accounting conservatism so that the regression model could be declared feasible.

Since the ownership of institutions (IO) had a beta coefficient of 0.033 at a significance level of 0.024, the first hypothesis stating that IO has positive effects on accounting conservatism was supported. The hypothesis that managerial ownership has a beneficial impact on accounting conservatism was rejected since the beta coefficient on managerial ownership (MO) was -0.030 at a significance level of 0.076, as indicated by the data. The third hypothesis, which states that profitability affects accounting conservatism, was supported by a significant score of 0.000 and a beta coefficient value of 0.396 for the profitability variable (ROA).

In this study, the control variable of leverage did not affect accounting conservatism. Accounting conservatism was positively impacted by the size of the organization. In other words, the management will act in an extra conservative manner with the larger firm.

4.4. Test Results of Model 2

Model 2 examined how the cost of equity capital is impacted by managerial and institutional ownership, profitability, and accounting conservatism. The skewness value and standard error of skewness, which are based on the test findings, were 0.302 and 0.166, respectively, yielding a z-skewness value of 1.82. Since this number was less than 1.96, Model 2's residual error was regularly distributed. Table 5 demonstrates that the correlation coefficient values of all independent variables were below 50%, suggesting that multicollinearity was not a problem for the model of regression. The results of the heteroscedasticity test showed that all independent variables had an insignificant influence, as indicated by a p-value above 5%, so there was no heteroscedasticity problem in the research model. The adjusted coefficient of determination (R²) was 0.323, meaning that 32.30% of the variation in the cost of equity capital could be explained by accounting conservatism, institutional ownership, managerial ownership, and profitability, with the remaining 67.70% being explained by variables not included in this research model. Besides, the F-statistic revealed the

number 17.986 and was significant at the 1% level. The authors may conclude that Model 2, investigating how management ownership, institutional ownership, profitability, and accounting conservatism affect equity capital costs, could be appropriate for usage.

At the probability value of 0.011, the institutional ownership (IO) variable, as presented in Table 5, showed a beta coefficient of 0.249. As a result, the fourth hypothesis—which holds that institutional ownership raises equity capital costs—was not supported. The regression coefficient on managerial ownership (MO) was 0.066 with a significance value of 0.547, indicating that the fifth hypothesis, which holds that managerial ownership has a negative effect on the cost of equity capital, was also not supported. Meanwhile, at a significant level of 0.002, the profitability (ROA) regression coefficient was -1.214, suggesting that the sixth hypothesis, that is, that profitability has a negative effect on the cost of equity capital, was accepted. The seventh hypothesis, which holds that accounting conservatism has a negative effect on the cost of equity capital, was also accepted. This is indicated by a regression coefficient score of -3.456 at a significance degree of 0.000. As such, the model’s control variables—leverage and firm size—had no bearing on equity capital costs.

Table 5 Test Results of Model 2

Variables	Coefficient	T statistics	Prob.	Conclusion
(Constant)	-0.419	-1.538	0.125	
IO	0.249	2.550	0.011	H ₄ is not supported.
MO	0.066	0.604	0.547	H ₅ is not supported.
ROA	-1.214	-3.201	0.002	H ₆ is supported.
CONACC	-3.456	-8.020	0.000	H ₇ is supported.
LEV	-0.087	-0.814	0.417	-
SIZE	0.009	0.946	0.345	-
Adjusted R- Square		0.323		
F-statistic		17.986		
Sig.		0.000		

Note: CEC = Cost of Equity Capital; CONNAC = Accounting Conservatism; IO = Institutional Ownership; MO = Managerial Ownership; ROA = Return On Asset; LEV = Leverage; SIZE = Firm Size

Testing of mediating variables in this study was conducted using the Sobel test. A variable will function as a mediating variable if: (1) the influence of the exogenous variable on the mediating variable is significant, (2) the influence of the mediating variable on the endogenous variable is significant, and (3) the Sobel test statistic value is above 1.96 without considering the positive or negative sign (Sobel, 1982; Soper, 2024; Widiatmoko et al., 2020). The results of testing the role of accounting conservatism as a mediating variable are presented in Table 6. The regression coefficient value of institutional ownership on accounting conservatism was 0.033, with a significance level of 0.024. The regression coefficient value of accounting conservatism on the cost of equity capital was -3.456 with a significance level of 0.000. To put simply, there is a strong and direct correlation between institutional investor ownership, conservative accounting principles, and the cost of equity capital.

Furthermore, the results of the Sobel Test statistical calculation showed a z-value of 2.122. The minus sign (-) on the z value indicates the direction of the relationship, so what needs to be considered is the z value of 2.122. This number is greater than 1.96, so it can be concluded that the effect of institutional ownership on the cost of equity capital was mediated by accounting conservatism. The regression coefficient value of profitability on accounting conservatism showed a number of 0.396 with a significance level of 0.000. The regression coefficient value of accounting conservatism on the cost of equity capital is 3.456 with a significance level of 0.000. The results of the Sobel test statistical calculation revealed a z-value of -5.578. Ignoring the minus sign, the z value is above 1.96, so it can be concluded that conservative accounting mediated the effect of profitability on the cost of equity capital.

Table 6 Test Results of Sobel Test

Influence	Coefficients	Standard Error	Prob.	Sobel Test Statistic
IO -> CONACC	0.033	0.015	0.024	-2.1216
ROA -> CONACC	0.396	0.051	0.000	-5.5781
CONACC -> CEC	-3.456	0.431	0.000	-

5. Discussion

5.1. Model 1

As hypothesized, accounting conservatism is positively impacted by institutional ownership. To maintain corporate governance, institutional investors are crucial. Institutions, as professional investors, effectively oversee and supervise management by impartially accessing information on the company's prospects and business strategy (Asiriwa et al., 2019; Jensen, 1993). Because of that, institutional investors require accurate and timely information to effectively track corporate activity and take part in the development of business strategies (Liu, 2019). Timely and reliable information will only result from a conservative accounting process (Widiatmoko et al., 2023). The findings of this research support agency theory, which states that institutional shareholders have an effective monitoring role in management. The conclusions of this study are also consistent with those of Alves's (2020) study on Spanish companies, demonstrating the role institutional investors play in enhancing the quality of earnings. Likewise, several studies conducted in Indonesia prove that institutional ownership has a positive impact on conservative accounting practices (Agustina et al., 2022; Hajawiyah et al., 2020; Widiatmoko et al., 2023). The efficient monitoring hypothesis sees institutional ownership as a key component of a firm's governance structure. Institutional investors possess the ability, capability, and means to oversee managers. The results of this study reinforce the opinions of earlier researchers, who found that institutional investors can encourage management to prepare financial reports cautiously, improving the quality of earnings (Bona-Sánchez et al., 2018) and lowering earnings management actions (Alves, 2020).

The second hypothesis's test findings indicate that management's holding of stocks has no bearing on conservative accounting practices. The result goes against agency theory, which holds that management's ownership of shares can serve as a means of aligning management and shareholders' interests (Jensen & Meckling, 1976). This can happen because the average share ownership by management in manufacturing companies in Indonesia is relatively low, and management does not even own shares in some companies. The low level of ownership by management results in a low sense of ownership of the company, so management is not motivated to apply conservative accounting principles (Agustina et al., 2022). Management who are not owners will tend to increase accounting earnings to get bonuses, thereby ignoring the principle of accounting conservatism (El-habashy, 2019). The results of this study are in line with the research findings (Aburishah et al., 2022), which report that managerial ownership does not affect accounting conservatism in companies listed on the Amman Stock Exchange ASE from 2011 to 2020. These findings imply that managerial share ownership has no moral influence or motivates them to apply accounting conservatism. The results of this study also support the findings of previous research, which reported that managerial ownership has no effect on accounting conservatism practices by management (Agustina et al., 2022; Asiriwa et al., 2019; El-habashy, 2019). However, the results of this study conflict with previous research findings, which prove that share ownership by management will encourage them to act conservatively in financial reporting (Alves, 2020; Indarti et al., 2021a; Putra et al., 2019).

As predicted, accounting conservatism is positively impacted by a company's profitability level. Profitable businesses are more likely to use cautious accounting practices. This is because managers can manage earnings to make the results seem smooth and devoid of excessive volatility by using accounting conservatism as a strategy. Companies with high profitability will generate high profits so that they will bear large tax liabilities. This causes companies with high profitability to prefer to apply conservative accounting to reduce the tax burden. The study's findings corroborate those of earlier investigations by Asiriwa et al. (2019), Widaryanti (2022), and Widiatmoko et al. (2023), which demonstrated that management will be more inclined to use conservative accounting techniques the more profitable a company is.

5.2. Model 2

Institutions that possess shares have a positive, beneficial effect on the price of capital that is invested. The cost of equity capital that the company must bear increases with the number of shares held by institutional investors. The agency

theory's contention that the ownership structure of shares could be utilized as a governance tool to cut the costs of agencies is refuted by this fact. One possible explanation is that institutional investors are unwilling to pay the expenses associated with monitoring when all shareholders would get the rewards. Because of that, institutional investors will not actively oversee management, which will raise agency costs and augment the cost of capital (Faysal et al., 2020). The findings of this investigation align with the research conducted by AlHares (2019) on companies included in the FORBES Global 2000 Leading Companies. Unfortunately, the study's findings go counter to research conducted in Indonesia, which indicates that having institutional shareholders can lower the amount of equity capital that a company needs to pay (Krismiaji & Raharja, 2018; Muslim & Setiawan, 2021).

The results of testing the fifth hypothesis revealed that managerial ownership does not affect the cost of equity capital. From an agency standpoint, executive ownership is a useful tool for coordinating management and shareholder preferences. Management with a higher number of share ownership will be more focused on improving performance so that the risk of loss faced by investors is smaller. As a result, investors' needed amount of return will eventually decline, cutting the cost of capital invested in equity. On the other hand, the test results showed that ownership by executives does not reduce the cost of equity capital. One possible explanation is that top managerial ownership is only one type of governance mechanism, and prior research (Ducassy & Guyot, 2017; Faysal et al., 2020) has found no evidence to support the idea that top managerial ownership lowers agency costs. Management as shareholders will use the opportunities, they have to prioritize their interests so that it does not have an impact on reducing the cost of equity capital.

Additionally, this study demonstrates that an organization's cost of equity capital decreases as its profitability increases. The economic health of the business indicates how well management can run the organization and how well it can allocate resources to get a competitive edge. Based on an agency theory perspective, disclosure of a company's financial performance can be an effective control mechanism to reduce information asymmetry between management and shareholders (Mardones & Cuneo, 2019). Company financial performance information is an important basis for making investment decisions. As a company's capacity to produce financial performance grows, investor risk will decline. Consequently, investors are likely to require equity capital expenses at a lower level of return (Rehman & Zaman, 2011). The present study's outcomes are consistent with the research conducted in Egypt by Ismail and Obiedallah (2022), demonstrating that firms exhibiting superior financial performance will incur lower equity capital expenses.

The results of testing the seventh hypothesis uncovered that accounting conservatism has a detrimental effect on the price of equity capital. Investors' expectations for the return on their capital are directly correlated with how risky they believe a company is. Businesses that exhibit a higher degree of conservatism are thought to pose less risk since they provide high-quality financial information. The price of equity capital decreases because of investors' decreased demands for payback for their capital. The results of this examination are consistent with those of Khalifa et al.'s (2019) study, which shows that accounting conservatism and equity capital cost are negatively correlated. The current study also agrees with earlier studies by Krismiaji and Astuti (2021) and Widiatmoko et al. (2023), demonstrating that accounting conservatism negatively impacts equity capital costs. The agency hypothesis, which maintains that accounting conservatism reduces the knowledge asymmetry between stockholders and management at a business and, thus, lowers the cost of investment in equity, is further supported by the study's findings.

Furthermore, the Sobel findings unveiled that accounting conservatism acts as a mediator between ownership by institutions and the cost of equity capital. This finding suggests that institutions' shareholders' presence can act as a watchdog for management, encouraging transparency in the creation of financial reports and the production of high-quality earnings data. Investors will see companies that provide high-quality earnings information positively and will lower the cost of equity capital, which is the necessary amount of return. Agency theory predicts that accounting conservatism will lower knowledge asymmetry between shareholders and management, which will lower the price of equity capital (Khalifa et al., 2019; Krismiaji & Astuti, 2021; Widiatmoko et al., 2023). This is consistent with that outlook.

Accounting conservatism also acts as a mediating variable in the influence of profitability on the cost of equity capital. Profitable businesses run the danger of incurring political expenses, such as significant tax obligations. This condition will encourage management to choose to apply conservative accounting to reduce the tax burden (Asiriwa et al., 2019; Widaryanti, 2022; Widiatmoko et al., 2023). On the other hand, conservative accounting will produce quality profits, which become the basis for investors in making investment decisions. Because investor's view companies with high profits as having lesser risk, they will lower the needed level of return, which a lower cost of capital will represent (Ismail & Obiedallah, 2022; Rehman & Zaman, 2011).

6. Conclusion

This study looks at the direct and indirect effects of institutional ownership, managerial ownership, and profitability on the cost of equity using accounting conservatism as a mediating variable. Accounting conservatism is positively impacted by institutional ownership and profitability, as demonstrated by Model 1's test results. Conservative accounting practices remain unaffected by the ownership of management. The results of the Model 2 test showed that the ownership of institutions has a favorable effect on the cost of equity capital, whereas profitability and accounting conservatism have a negative impact. In the interim, the ownership of management's shares has no bearing on the cost of equity.

The findings in this research have implications, both theoretically and practically. Theoretically, the results of this research provide evidence that institutional investors can be an effective monitoring medium for management, as predicted by agency theory. Meanwhile, share ownership by management is unable to align their interests with shareholders. The use of conservatism by management is greatly aided by profitability, which serves as a gauge of the management team's effectiveness in running the business. In a practical sense, investors might use the research's conclusions as a foundation for business decisions. Accounting conservatism is still seen as an important company practice that can produce quality profits so that investors will reduce the required rate of return on their investments.

Despite the contribution provided, this research has several limitations, including the relatively low adjusted R square value, namely 22.90% in Model 1 and 32.40% in Model 2. Apart from that, only the variable share ownership by institutions has been proven to influence conservative management behavior, ultimately resulting in lowering the cost of equity capital. To predict conservative management behavior and optimize the cost of equity capital, future research should consider corporate governance mechanisms from ownership structures, such as foreign and government ownership, and/or board structures, such as gender diversity, independent commissioners, and audit committees (Aburishah et al., 2022).

Compliance with ethical standards

Acknowledgments

The authors are grateful to the anonymous referees of journal for their extremely useful suggestion to improve the quality of the article.

Disclosure of conflict of interest

The author declared no potential conflicts of interest with respect to the research, authorship and publication of this article. The funders had no role in the design of the study; in the collection, analyses, or interpretation of data; in the writing of the manuscript, or in the decision to publish the results.

Funding

The author received no financial for the research, authorship and publication of this article

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