CHAPTER I

INTRODUCTION

1.1. Background

The World Bank has set the world economic ranking in terms of Gross Domestic Product (GDP) and Indonesia is in ranked 10th in the world, after America, China, India, Japan, Germany, Russia, Brazil, France, and the United Kingdom (Viva News, 2014). This indicates that the business sector in Indonesia is getting better with increasing levels of public consumption. This increasing forced the management to expand its business, both by devising and intensifying. The expansion of the business has an impact on the increasing need for funds. The need for funds that increases continually along with the increasing of activity of the company will make the company difficult to fulfill it. Therefore it needs other parties who provide funds such as investors and creditors.

To get trust from the community, the companies must be able to show good financial performance. The financial performance of companies shows a picture of the financial condition of a particular company both in terms of the aspect of fund collection and the distributions of funds. Financial performance is certainly expected to always show positive numbers so that public trust will be maintained. Companies as parties who need funds, of course to obtain these funds must incur cost of equity. Cost of equity is an important concept in investment analysis because it can show the minimum level of return that must be obtained from the investment. The results of

cost of equity will be used as basis for decision making to accept or reject an investment proposal.

Such a phenomenon that occurs based on tribunnews.com, Jakarta Senin, December 15, 2014, Bank Indonesia increasingly looks wrong direction. The Meeting of Board of Governors of Bank Indonesia (RDG) on November 13, 2014 decided to maintain the BI rate at 7.50%, with the Lending Facility and Deposit Facility rates remaining at 7.50% and 5.75%, respectively. Not until a week later BI raised the benchmark interest rate by 25 bps and the lending facility rate by 50 bps. This was said by A. Deni Daruri, President Director Centre for Banking Crisis. The policy is not consistent with the efforts to control inflation towards the target of 4.5% in 2014 and 4% in 2015. As a result, workers conducted a large-scale demonstration to raise the minimum wage because BI raised the interest rates. In a statement received by tribunnews.com, it was explained that the increase in interest rate by BI actually added the high cost economy and eroded business profits so that employee felt threatened with the continuity of their works. With increasing interest rate so the cost of equity will also increase when the energy costs also increase, such as fuel and electricity, which in turn increases transportation and consumption costs.

The performance of a company must be very closely related to corporate governance. Good corporate governance will produce good corporate performance. Tarigan (2017) states that corporate governance is even one of the determinants of the severity of the crisis that occurred in Southeast Asia, such governance weaknesses can be seen from the lack of reporting on financial performance, lack of supervision

of management activities by the board of commissioners and auditors, and lack of external intensive to encourage the creation of efficiency in companies through fair competition. Ignatius (2014) also revealed that corporate governance is one of the key elements in increasing economic efficiency, which includes a series of relationship between company management, board of commissioners, shareholders and other stakeholders.

A conflict of interest that occurs in an entity is a phenomenon that is no longer taboo because in an entity it must consist of shareholders or owners and management. In particular, conflicts of interest that occur between shareholders and management are explained by agency theory. The goal of shareholders when investing some of their money is to get a large rate of return on the investment they have made. Whereas managers are obliged to maximize the welfare of shareholders, but on the other hand, managers also have an ego to welfare themselves. Unification of these interests which ultimately creates a problem called agency problems.

A conflict of interest does not only occur between owners and shareholders, but also between controlling shareholders and minority shareholders. Stakeholder theory explains the obligation of the company to provide information about the company to stakeholders. The existence of stakeholders is very necessary for the sustainability of company because without the support of these parties, such as the government, the community, and investors, the company will not be able to develop properly especially for manufacture companies. For this reason, the implementation of the mechanism of good corporate governance, such as risk management committee

and audit committee, is very important in monitoring the running of the company and guaranteeing the interests of minority shareholders and stakeholders. One indicator of weak corporate governance is the lack of supervision over management activities, so it is not surprising that recently there have been many embezzlement cases committed by the company.

The sustainability of the company relies on the support of stakeholders. Manufacture companies need third party to fund their operational activities. To maintain the trust of stakeholders, the company must maintain their performance well and one of them is by managing the risk management. The issue of risk management is an important discipline in business especially in manufacture companies.

Refky (2017) observes that recently, businesses have placed great emphasis on risk management because this determines their survival and business performance. Over time, companies face risks and challenges increasingly complex. The risks and challenges faced by the company are internal and external. The challenges from internal company come from the management of the company itself while the challenges from external company come from the economic conditions of a country where the company operates. Because there are the risks and challenges faced by the company, so the boards of company realize the importance of risk management to be applied in completely uncertain of business world and to increase the value of the company to stakeholders by meeting the principles of good corporate governance. The research conducted by Maizatulakma and Zaleha (2017) conveyed that risk

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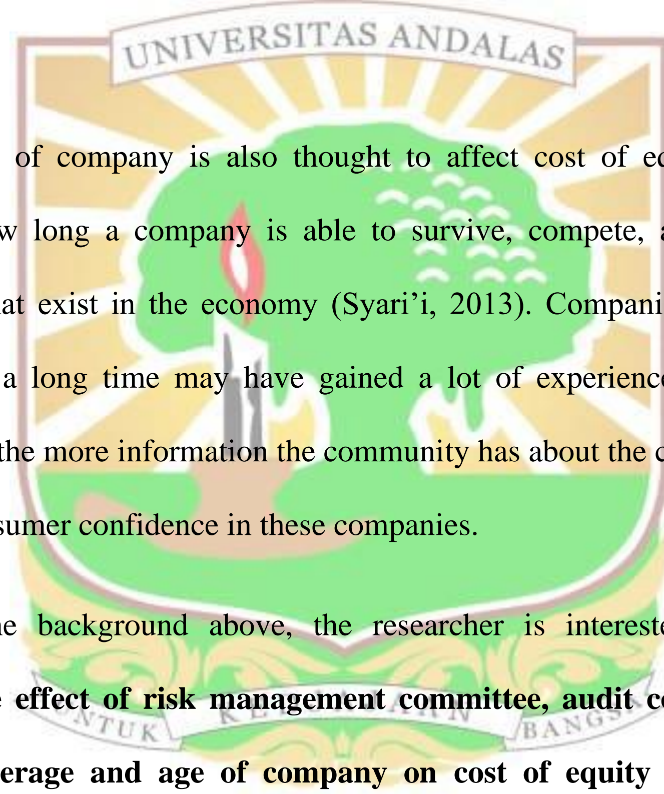
management committee will provide better reliability for investors in evaluating risk management information.

Previous studies state that the audit committee influences the cost of equity. The existence of audit committee is expected to be able to control and monitor the decisions made by the manager is correct. In this context, the decision does not take sides but binds all parties involved in the company. With the existence of the audit committee, the internal control of company can be carried out properly. The audit committee must design a control that limits managers to prosper itself. The funding decisions of company will prefer to issue new shares rather than debt if there are more and more audit committees in the company (Aditya, 2014). With many audit committees within the company, it is expected that the decisions in company funding will be better. Managers no longer try to prioritize their own interests but also the interests of shareholders. The manager will not make funding decisions with debt, because funding with debt will be detrimental to shareholders because the interest burden will increase. The increasing interest expense will reduce corporate profits and dividends received by shareholders will decrease.

The ownership structure is also thought to give an effect on cost of equity. Yao and Sun (2008) show that companies with family ownership as majority shareholders have higher equity costs than other companies. This is because the control held by the majority shareholders and the opportunity to obtain personal benefits is greater so that investors want a higher rate of return to compensate for these risks (Echtidar, 2017). Attig *et al.* also stated that when a company is owned in

the majority by certain families, information risk becomes greater and causes the cost of equity to be higher.

A further factor that affects cost of equity is leverage. Muchlisin Riadi (2016) says that Leverage is “use of funds or assets where the company must cover fixed costs or pay a fixed interest expense.” So leverage arises if the company uses assets or funds so that giving rise to a fixed cost or a fixed expense that must be paid by the company.



The age of company is also thought to affect cost of equity. The age of company is how long a company is able to survive, compete, and take business opportunities that exist in the economy (Syari’i, 2013). Companies that have been established for a long time may have gained a lot of experience. The longer the company lives, the more information the community has about the company. And this will lead to consumer confidence in these companies.

From the background above, the researcher is interested in conducting research on **the effect of risk management committee, audit committee, family ownership, leverage and age of company on cost of equity** for companies in manufacturing that are listed on the Indonesia Stock Exchange in 2015-2017. This research due to an inconsistency of some prior results, the research of the effect of information technology committee on cost of equity is still rarely found and also there are several limitations on prior research.

1.2. Problem Definitions

a) Does risk management committee have significant effect on cost of equity?

b) Does audit committee have significant effect on cost of equity?

c) Does family ownership have significant effect on cost of equity?

d) Does leverage have significant effect on cost of equity?

e) Does the age of company have significant effect on cost of equity?

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1.3. Research Objectives

This research aims to obtain empirical evidence about:

a) The influence of risk management committee on cost of equity in company

b) The influence of audit committee on cost of equity in company

c) The influence of family ownership on cost of equity in company

d) The influence of leverage on cost of equity in company

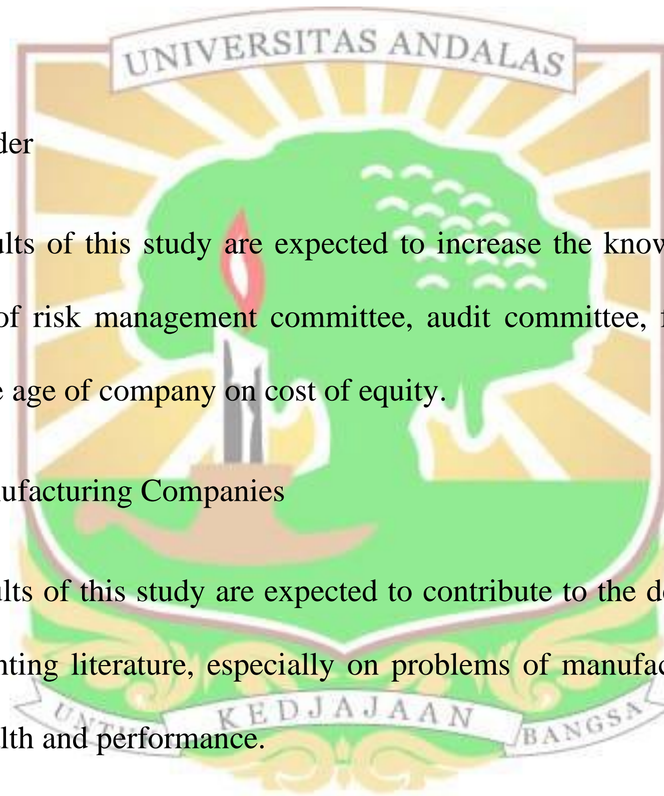
e) The influence of the age of company on cost of equity in company

1.4. Research Benefits

The benefits that can be obtained for some parties from this study include:

1. For Next Researcher

This research can be used as reference material in a library that by students or future researchers who are interested in perfecting and re-examining the variables of this research.



2. For Reader

The results of this study are expected to increase the knowledge for readers about the role of risk management committee, audit committee, family ownership, leverage and the age of company on cost of equity.

3. For Manufacturing Companies

The results of this study are expected to contribute to the development of the financial accounting literature, especially on problems of manufacturing companies that analyze health and performance.

1.5. The Scope of Research

This research was conducted to analyze the factors that influence the cost of equity in company. This study focused on corporate governance factors such as risk management committee, audit committee, family ownership, leverage and the age of company.

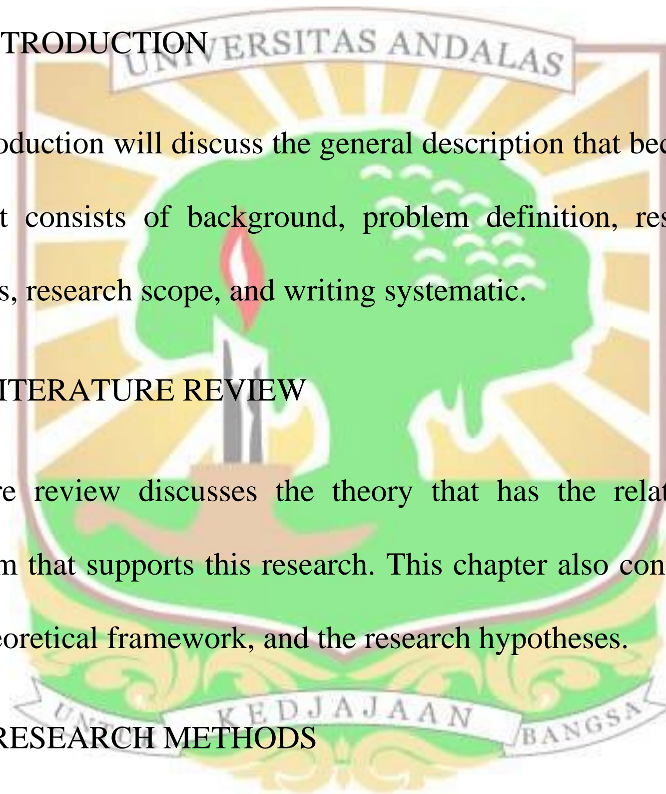
1.6. Writing Systematic

The discussion in this study is described in five chapters with a systematic discussion to make it easier for readers in understanding this research. Writing systematic gives an overview of each chapter as follows:

CHAPTER I INTRODUCTION

The introduction will discuss the general description that becomes the basis of this research. It consists of background, problem definition, research objectives, research benefits, research scope, and writing systematic.

CHAPTER II LITERATURE REVIEW



Literature review discusses the theory that has the relationship with the research problem that supports this research. This chapter also contains the previous research, the theoretical framework, and the research hypotheses.

CHAPTER III RESEARCH METHODS

Research method provides the plan for conducting the research. This chapter contains the research design, research model, operational definition and research variable, population and sampling, data and data collection method, and analysis method.

CHAPTER IV RESULTS AND DISCUSSION

This chapter explains the results of the study and analyzes how the influence of risk management committee, audit committee, family ownership, the age of company and leverage on cost of equity.

CHAPTER V CONLUSIONS

This chapter contains the conclusions from the results of the research that has been done and the suggestions that are expected to be useful for parties with an interest in the results of the study.