Universitas Warmadewa
Editorial Office: Program Studi Magister Manajemen | Program Pascasarjana | Universitas Warmadewa
Jl. Terompong No.24, Sumerta Kelod, Kec. Denpasar Timur, Kota Denpasar, Bali 80239

Jurnal Ekonomi dan Bisnis Jagaditha

Volume 12, Number 2, 2025

ISSN: 2355-4150 (Print) | 2579-8162 (Online)
Publication details, Including author guidelines
visit URL: https://www.ejournal.warmadewa.ac.id/index.php/jagaditha/authorguideline

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Article History
Received: June 12, 2025
Revised: September 29, 2025
Accepted: September 29, 2025

How to cite this article (APA)
SimanJuntak, J. M., Manurung, A. H., Machdar, N. M., FoEH. J. E., & Sinaga, J. (2025). Internal and External Factors on Cost Capital of Apparel and Luxury Goods Companies in Indonesia Stock Exchange. *Jurnal Ekonomi dan Bisnis Jagaditha*. *12*(2), 269-278. https://doi.org/10.22225/jj.12.2.2025.269-278

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ISSN 2355-4150 (Print)
ISSN 2579-8162 (Electronic)

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Internal and External Factors on Cost Capital of Apparel and Luxury Goods Companies in Indonesia Stock Exchange

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Abstract: This study aims to explore the determinants of the cost of capital for apparel and luxury goods companies listed on the Indonesia Stock Exchange. It utilizes annual data from 2016 to 2023 and employs a panel data model. The findings indicate that both internal and external factors influence the cost of capital. Internal factors include leverage, the interest coverage ratio (ICR), and taxes, while external factors include interest rates and exchange rates.

Keywords: Cost of capital; gross profit margin; leverage; interest coverage ratio; exchange rate; interest rate policy

Introduction

The cost of capital is a critical concern for company management in making investment, financing, and product pricing decisions. It serves as an essential metric in valuing a company. The cost of capital is negatively correlated with firm value: as the cost of capital increases, the firm's value tends to decrease, and vice versa. Therefore, managing the cost of capital is especially vital for publicly listed companies. Fluctuations in stock prices caused by changes in the cost of capital can lead to financial losses, making this metric a reflection of a company's performance and, potentially, a negative indicator of its overall value.

Research on the cost of capital is still very interesting and also very limited. (Mangalindung et al., 2025) studied the factors that influence the cost of capital for the multi-finance industry. (Nur Khosim & Adler Haymans Manurung, 2024) discuss the cost of capital in Indonesia. (Pedell, 2006) Regulatory Risk and the Cost of Capital: Determinants and Implications for Rate Regulation. (Lachenmayer, 1984) investigated the Effect of Currency Exchange Risks on the Cost of Equity Capital of International and Multinational Firms. (Seraj & Coskuner, 2021) study the Real exchange rate effect on economic growth. (Wono et al., 2023) Explore the Management of Exchange Rate Risk in SMEs as Reflections on Exchange Rate Pass -through and Hedging of Currency Risk. Grueninger (2009) discusses the calculation of the cost of capital and makes corrections due to inconsistent assumptions on the Cost of Debt. (Radiansyah et al., 2023) discusses debt to Euity Ratio (DER) and Firm Size toward Firm Value that uses the mediating role of Return on Assets.

Based on the description, this study will investigate the internal and external factors of the company. The internal factors of the company are Net Profit Margin (NPM), company leverage, taxes, and Interest coverage ratio. Net profit margin (NPM) is an indicator of profitability which is the result of dividing net profit and income (revenue or sales). This ratio is considered positive with the value of the company and when associated with the cost of capital, the relationship is negative. (Shadab & Sattar, 2015) discusses the cost of capital and

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company value and profitability. The results show that the cost of capital has a negative relationship with the value of the company and profitability. (Mubyarto, 2020) discusses the effect of profitability on the value of the company where the results are very influential. (Li, 2019) discusses the Cost of Capital literature review about Calculation Methods and Influencing Factors.

This study also includes leverage measured by Debt to Total Assets as an independent variable. This variable is expected to have a positive effect on the cost of capital. (Solomon, 1963) discusses the cost of capital and leverage. (Shekhar, 1997) discusses the effect of financial leverage on the cost of capital. Haag and Koziel (2023) discuss leverage and cost of capital. (Bhayani, 2009) studies the effect of financial leverage on the cost of capital of the Company. (Arhinful & Radmehr, 2023) explore the impact of financial leverage on the financial performance of the firms listed on the Tokyo.

Interest Coverage Ratio (ICR) is also included as an independent variable in this study. The greater the ICR, the greater the cost of capital, or a positive relationship occurs. (Ji, 2019) discusses the effect of ICR on company value where the effect is negative. (Dothan, 2006) discusses financial distress and interest coverage ratio. (Noghondari et al., 2022), explored The Effect of a Company's Interest Coverage Ratio on the Structural and Reduced-Form Models in Predicting Credit Derivatives Prices. (Bonazzi & Iotti, 2014) investigate Interest Coverage Ratios (ICRs) and Financial Sustainability.

Tax is an indicator of a company's contribution to the country where the company operates. The amount of TAX is a reduction factor for the cost of capital. Modigliani and Miller (1958) discuss The Cost of Capital, Corporation Finance, and The Theory of Investment King (1974) explored Taxation and the Cost of Capital. (Stiglitz, 1973) investigates the Taxation, corporate financial policy, and the cost of capital.

This study includes external factors, namely macro-economic variables as independent variables. The macroeconomic variables as independent variables include interest (INT), oil prices (OIL), and Exchange Rate (EX). These three variables will be described for their influence on the cost of Capital.

Exchange Rate is an independent variable in this study because the variable greatly influences previous studies, especially on company performance and Cost of Capital is company performance. (Lachenmayer, 1984) investigates the Effect of Currency Exchange Risks on the Cost of Equity Capital of International and Multinational Firms. (Seraj & Coskuner, 2021) study the Real exchange rate effect on economic growth. (Badshah & Borgessen, 2020) Explore the Management of Exchange Rate Risk in SMEs as Reflections on Exchange Rate Pass-through and Hedging of Currency Risk.

The discussion of interest rates on the cost of capital began to be discussed by (Modligiani, 1958) and as a landmark paper in this field. Research on variables that affect the cost of capital is very limited and if there is any, it must make the cost of capital a company's performance. (Lin, X., Wang, C., Wang, N., & Yang, 2018) discuss Investment, Tobin's q, and interest rates. (Merko & Habili, 2023) investigate the Impact of interest rate, exchange rate, and inflation on commercial banks' performance.

Oil prices are included as independent variables that affect the cost of capital. This study is also very limited, but oil prices greatly affect the entire economy of Indonesia. Ismael et.al (2024) discussed oil prices with the capital structure of oil companies. (Toews & Naumov, 2015) discussed The Relationship Between Oil Price and Costs in the Oil and Gas Industry. (Prodromou & Demirer, 2022) discussed Oil price shocks and the cost of capital Does market liquidity play a role?

This study has a period from 2016 to 2023, where in this period there is a known COVID-19 period, namely the period from 2020 to 2022. As a result, this study creates a dummy variable as an independent variable to represent the COVID-19 period. The COVID-19 research study is a dummy variable in the study, namely (Tyas, 2022). The impact of COVID-

19 on firms' cost of equity capital.

Concept and Hypothesis

Cost of Capital is the combined weighted cost of using interest-bearing debt and equity and this cost becomes an element in calculating the value of the company. The cost of capital can also be representative of the Company's Value because an increase in the cost of capital decreases the value of the Company and vice versa, the value of the Company increases due to a decrease in the cost of capital. The weighted cost of capital is intended because when calculating the cost of capital, the ratio of debt to total and also the ratio of equity to total assets are taken into consideration. The Cost of Capital can be used to calculate stock prices (Mangalindung et al., 2025). The Financial Structure Theory presented by Baker and Wurgler (2002) states that companies can use the company's cost of equity to buy their shares. (Arhinful et al., 2024) states that the cost of debt, cost of equity and weighted average cost of capital are used to determine dividend policy. (Shchurina & Mustafina, 2018) investigated dividend policy affecting the cost of capital. Jung (2008) stated that the cost of capital could be determined by the ratio company using the DuPont system. (Magni, 2015) stated that the Cost of Capital is an element of value creation.

The calculation of the average cost of capital based on (Ogier, T., Rugman, 2005; Pratt, 2002) is as follows:

$$CoC_{i,t} = \frac{D}{TA}(1-T)k_d + \frac{E}{TA}k_e \quad (1)$$

CoC = Cost of Capital

D = interest-bearing debt

T = taxes paid

E = Equity

kd = cost of interest-bearing debt

ke = cost of equity

Based on formula (1), the determinant of Cost of Capital can be derived by substituting the debt cost kd = i0 + mbi and ke = rf + risk premium so that equation (1) is as follows:

$$CoC_{i,t} = \frac{D}{TA}(1-T)\{i_0 + mb_i\} + \frac{E}{TA}\{r_f + risk\ premium\} \quad (2)$$

Therefore, the cost of capital can be influenced by leverage, taxes, policy interest rates, interest margins and the Company's risk premium. Leverage in equation (2) is Debt to Total Assets and Equity to Total Assets.

Ratio Analysis

This study uses several ratios as independent variables to influence the cost of capital, namely Net Profit Margin. Debt to total Assets, Interest Coverage ratio and taxes. (Manurung, 2025) states that:

Net Profit Margin (NPM), is calculated using the following formula:

$$\mathbf{NPM} = \frac{Net\ profit}{revenue} x100\% \quad (3)$$

Debt to Total Assets (DTA), is calculated using the following formula:

$$\mathbf{DTA} = \frac{Total\ interest\ bearing\ debt}{Total\ Assets} * 100\% \quad (4)$$

Interset Coverage Ratio (ICR), is calculated using the following formula:

$$ICR = \frac{Interest\ charges}{Debts} x100\% \quad (5)$$

Tax is calculated using the following formula:

$$TAX = \frac{Tax\ paid}{revenue} \quad (6)$$

The four ratios are used as independent variables and are internal factors of the company. This study also uses external factors, namely interest rates, oil price growth and Exchange Rates. This study also includes independent variables that represent the COVID-19 situation with a dichotomous value (0.1) as a dummy variable.

Method

This research uses a Model data Panel to estimate the relationship between some independent variables to determine Free Cash Flow as the dependent variable Net Profit Margin (NPM), Depreciation (Dep), Net Working Capital (NWC), Investment (INV) as an internal factor or fundamental factor Company, Oil Price (OIL), Interest and Economic Growth as an external factor or macroeconomic Factor and also COVID-18 period. Model Data Panel is appropriate for data small which short time series and small companies as samples. Besides that, the model data panel also shows time and the cross-section as samples. (Greene, 2005; Gujarati, 2009; Nur Khosim & Adler Haymans Manurung, 2024; Sul, 2019) stated model data panel is as follows:

Pooled Data Model

The Pooled Data Model is a model that data combine all together and the model is as follows:

$$Y_{i,t} = \beta_1 + \beta_2 X_{2i,t} + \beta_3 X_{3i,t} + \mu_{i,t} \quad (7)$$

i = 1, 2, … , k ; t = 1, 2, … , n

X's are non-stochastic and $E(\mu_{it}) \sim N(0, \sigma^2)$

Fixed Effect Model

FEM is a model that μ_i and X's are assumed correlated.

$$Y_{i,t} = \beta_{1i} + \beta_2 X_{1i,t} + \beta_3 X_{2i,t} + \mu_{i,t} \quad (8)$$

i = 1, 2, … , k ; t = 1, 2, … , n

Random Effect Model (REM)

REM is a model that ε_i and X's are assumed uncorrelated.

$$Y_{i,t} = \beta_{1i} + \beta_2 X_{1i,t} + \beta_3 X_{2i,t} + \mu_{i,t} \quad (9)$$

$$\beta_{1i} = \beta_1 + \varepsilon_i$$

i = 1, 2, … , k ; t = 1, 2, … , n

μ_i is a random error with a mean value of zero and variance of σ_ε^2. (Judge, G. G., R. C. Hill, W. E. Griffiths, 1982; Manurung, 2024; Sul, 2019; Wooldridge, 2002) stated that how we choose FEM or REM as follows:

When T (the number of time series data) is large and N (the number of cross-sectional units) is small, FEM may be preferable.

When N is large and T is small, if we strongly believe that the individual, or cross-sectional, units in our sample are not random drawings from a larger sample, FEM is appropriate. If the cross-sectional units in the sample are regarded as random drawings, the REM is appropriate.

When individual error component ε_i and one or more regressors are correlated, FEM is an unbiased estimator.

REM estimators are more efficient than FEM Estimators, when N is large and T is small and if the assumptions underlying REM hold.

Research Data

Unit Analysis of this research is on apparel and luxury goods companies listed on the Indonesia Stock Exchange. There are 15 apparel and luxury goods companies that are purposively using apparel and luxury goods companies to have annual reports from 2016 to 2023. Data is collected from several sources. Data mostly is yearly for the period 2016 to 2023. Data on Profit, Equity, Debts, Total Assets, Interest Payments and Taxes are collected from the company's annual report. Oil Price (OIL), Interest and Economic Growth data are collected from the Central Bank of Indonesia.

Result and Discussion

In this sub-section, descriptive statistics and analysis will be explained as well as a discussion of the findings.

Descriptive Statistics

The statistics described in the descriptive statistics sub-section for the variables Cost of Capital, Debt to total assets, net profit margin, Interest coverage charges, taxes, interest rates, oil price increases, and the exchange rate of the Dollar against the Rupiah. Descriptive statistics for the research variables are shown in Table 1 below.

Table 1. Descriptive Statistics of Research Variables

Description	BM	DTA	NPM	ICR	TAX	INT	OIL	EX
Minimum	0,006	0,00	-536,76	0,03	0,01	3,50%	-25,32%	-3,64%
Maximum	15,50	2,00	1,15	199,26	4,38	6,00%	55,01%	9,10%
Average	2,02	0,39	-4,75	8,93	0,36	4,84%	13,25%	1,48%
St Deviation	2,20	0,32	48,99	23,44	0,62	0,96%	29,74%	4,28%
Skewness	2,4409	2,0954	-10,9436	5,5105	4,8898	-0,1209	0,1092	0,7833
Kurtosis	11,0160	7,5514	-10,9436	38,2014	26,3070	-1,4814	-1,4310	0,0146
Jaque Bera	495,5007	215,31	3788,271148	7653,35	3593,55	113,297	110,709	63,939

Source: Data processed by the author

The cost of capital as a dependent variable in this study will be described before the others are described. This cost of capital has the smallest cost of 0.006%, the maximum is 15.5% and the average is 2.02% and the standard deviation is 2.2%. This data shows that the average is close to the minimum value. The magnitude of the error from the actual data to the average data is very small. This cost of capital data has a normal distribution as shown by the Jarque Bera value which is greater than the Chi-Square Table value. Therefore, the panel data model used has been met for the assumption of a Normal distribution.

Leverage symbolized by DTA in Table 1 as an independent variable in this study is the next description. This leverage has the smallest value of 0.0%, the maximum is 2% and the average is 0.39% and the standard deviation is 0.32%. This data shows that the average is close to the minimum value. The magnitude of the error from the actual data to the average data is very small. This leverage data has a normal distribution as shown by the Jarque Bera value which is greater than the Chi-Square Table value. Therefore, the panel data model used has been met for the Normal distribution assumption.

Profitability symbolized as NPM (Net Profit Margin) in Table 1 as an independent variable in this study is the next description. This NPM has the smallest value of -536.76%, the maximum is 1.15% and the average is -4.75%, and the standard deviation is 48.99%. This data shows that the average is close to the maximum value. The magnitude of the error from the actual data to the average data is quite large. The occurrence of negative numbers means that many companies experienced losses during the study period, especially during the COVID-19 period. This Profitability Data (NPM) has a normal distribution as shown by the Jarque Bera value which is greater than the Chi-Square Table value. Therefore, the panel data model used has been met for the Normal distribution assumption.

The ability to pay interest symbolized by ICR (Interest Coverage Ratio) in Table 1 as an independent variable in this study is the next description. This ICR has the smallest value of 0.03%, the maximum is 199.26% and the average is 8.93% and the standard deviation is 23.44%. This data shows that the average is close to the minimum value. The magnitude of the error from the actual data to the average data is also quite large. This ICR data has a normal distribution as shown by the Jarque Bera value which is greater than the Chi-Square Table value. Therefore, the panel data model used has been met for the Normal distribution assumption.

The ability to pay taxes symbolized as TAX in Table 1 as an independent variable in this study is the next description. TAX has the smallest value of 0.01%, the maximum is 4.38% and the average is 0.36% and the standard deviation is 0.62%. This data shows that the average is close to the minimum value. The magnitude of the error from the actual data to the average data is quite small. This TAXx data has a normal distribution as shown by the Jarque Bera value which is greater than the Chi-Square Table value. Therefore, the panel data model used has been met for the Normal distribution assumption.

The previous description of the descriptive statistics of internal factors. In connection with the existence of external factors that are also included as independent variables, these variables also need to be described. The interest rate as an independent variable has a minimum value of 3.5%; a maximum value of 6% and an average of 4.84% and a standard deviation of 0.96%. These data show that there is a middle of the data and the magnitude of the error between the actual data and the average is very small. This interest rate data follows a normal distribution as indicated by the Jarque Bera value which is smaller than the Chi-Suare value of the table.

The oil price entered as an independent variable and used for oil price growth has a minimum value of -25.32%; the maximum value is 55.01% and the average is 13.25% and the standard deviation is 29.74%. These data show that the average data is in the middle of the existing data and the magnitude of the error between the actual data and the average is also quite large compared to the previous data. This Oil Price Data follows a normal distribution as indicated by the Jarque Bera value which is smaller than the Chi-Suare value of the table.

The Exchange Rate entered as an independent variable and used for exchange rate growth has a minimum value of -3.64%; a maximum value of 9.10% and an average of 1.28% and a standard deviation of 4.28%. These data show average data close to the minimum value and the magnitude of the error between the actual data and the average is also quite small compared to previous data. This Exchange Rate data follows a normal distribution as indicated by the Jarque Bera value which is smaller than the Chi-Suare value of the table.

Causality

This sub-chapter discusses the variables that affect the Cost of capital using data from 2016 to 2023. The independent variables that affect the cost of the capital variable are Debt to Total Assets (DTA), Net Profit Margin (NPM), Interest Coverage Ratio (ICR), Tax (TAX), interest rate (INT), oil price (OIL) and Exchange Rate (EX) and the COBID-19 period. This research used the Hausman test and Langrange Multiplier test to get an estimation method for the panel data model (Manurung, 2024). The Decision of testing is this research should use the Random Effect Model (REM). The Random Effect model is as follows:

$$CoC_{i,t} = 0.5806 - 1{,}3696\ DTA_{i,t} + 0.0037\ NPM_{i,t} + 0.01927\ ICR_{i,t} + 0.39743\ TAX_{i,t}$$
$$(0{,}26\%) \quad (13.09\%) \quad (0.08\%) \quad (5{,}09\%)$$
$$+ 35.3958\ INT_{i,t} - 0.22091\ OIL_{t} - 9.7689\ EX_{t} + 0.36001\ PDMC_{t} \qquad (10)$$
$$(8.01\%) \quad (65.88\%) \quad (4.16\%) \quad (37.58\%)$$

The numbers in brackets are the probabilities.

$R^2 = 23{,}77\%$

$F_{test} = 4.326$

In Model (10) above, it is seen that the Model is very appropriate as indicated by the significant F value at the 1% level. The Model determination coefficient (R2) is 23.77% and states that all fluctuations in the independent variables can explain the dependent variable, namely the cost of capital, by 23.77%, the rest is influenced by other variables. It turns out that other variables have a very large influence on the fluctuation of the dependent variable, the cost of capital.

In Model (10) it can be seen that DTA significantly affects the cost of capital at a significant level of 1%. DTA negatively affects the cost of capital, which means that an increase in DTA causes the cost of capital to decrease. The direction of the relationship between DTA and the cost of capital is opposite to the theory (Manurung, 2025). The results of this study support previous studies, namely (Arhinful & Radmehr, 2023; Bhayani, 2009; Shekhar, 1997; Solomon, 1963).

In Model (10) it can be seen that ICR significantly affects the cost of capital at a significant level of 1%. ICR positively affects the cost of capital, which means that an increase in ICR increases the cost of capital. The direction of the relationship between ICR and the cost of capital is in accordance with the theory (Manurung, 2025). The results of this study support previous studies by (Bonazzi & Iotti, 2014; Dothan, 2006; Ji, 2019; Noghondari et al., 2022).

In Model (10) it is seen that TAX significantly affects the cost of capital at a significant level of 10%. TAX affects the cost of capital positively, which means that an increase in TAX increases the cost of capital. The direction of the relationship between TAX and the cost of capital is in accordance with the theory (Manurung, 2025). The results of this study support previous studies by (King, 1974; Modligiani, 1958; Stiglitz, 1973).

In Model (10) it can be seen that Interest significantly affects the cost of capital at a significant level of 10%. Interest affects the cost of capital positively, which means that an

increase in Interest increases the cost of capital. The direction of the relationship between Interest and the cost of capital is in accordance with the theory (Manurung, 2025). This study supports previous studies by (Lin, X., Wang, C., Wang, N., & Yang, 2018; Merko & Habili, 2023; Modligiani, 1958).

In Model (10) it can be seen that EX (Exchange Rate) significantly affects the cost of capital at a significant level of 5%. Exchange Rate negatively affects the cost of capital, which means that an increase in EX causes the cost of capital to decrease. The direction of the relationship between EX and the cost of capital is in accordance with the theory (Manurung, 2025). This study supports previous studies by (Lachenmayer, 1984; Seraj & Coskuner, 2021).

The Net Profit Margin (NPM) variable, oil prices and the COVID-19 period do not significantly affect the cost of capital at a significant level of 10%. This result states that the Company does not need to pay attention to the Net Profit Margin on the Company's cost of capital and also includes oil prices and the COVID-19 period in managing the Company for going concern.

Conclusion

This study concludes that both internal and external factors significantly influence the cost of capital for apparel and luxury goods companies listed on the Indonesia Stock Exchange. Internal factors that have a significant impact include leverage, interest coverage ratio (ICR), and taxes. Meanwhile, external factors such as interest rates and exchange rates also play a vital role in determining the cost of capital.

Interestingly, the analysis reveals that leverage has a negative relationship with the cost of capital, indicating that higher leverage may reduce capital costs—contrary to conventional theory. On the other hand, ICR and taxes have a positive impact, suggesting that higher interest coverage and tax obligations contribute to increased capital costs. Among external factors, interest rates and exchange rates significantly affect the cost of capital in a manner consistent with theoretical expectations.

However, other variables such as net profit margin (NPM), oil prices, and the COVID-19 period were found to have no significant effect on the cost of capital. This implies that these factors may not need to be prioritized in cost of capital management for firms in this sector.

These findings can serve as valuable insights for corporate financial managers in making financing and investment decisions. Future research could further explore these relationships by incorporating additional variables or expanding the analysis to other industries or regional markets.

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