



Regulation Disclosure and Dynamics Cost of Capital: An Overview Literature About Effect Externalities in Financial Markets

Evlin Candra Rita¹, Andrew Subhana²

¹⁻² Accounting, STIE Kasih Bangsa, Jakarta, Indonesia

Email : evlinchandrarita@gmail.com, andrewfeng222@gmail.com.

Abstract. *This qualitative literature review examines the interplay between disclosure regulation, capital costs, and externalities in financial markets. It highlights how regulatory frameworks aimed at increasing transparency can significantly affect companies' capital costs and market dynamics. Through an extensive analysis of existing literature, this study reveals that while enhanced disclosure can reduce information asymmetry and lower capital costs, it can also generate negative externalities for non-regulated firms. The review compares findings from eight previous studies, illustrating the complexities of information dissemination and its repercussions on both regulated and unregulated entities. Furthermore, it underscores the importance of designing comprehensive regulatory policies that not only promote transparency but also consider the broader market implications. The findings indicate that selective disclosure regulations may inadvertently create imbalances in the market, leading to increased overall capital costs. This research contributes to the ongoing discourse on financial regulation by providing insights into the effects of disclosure practices on capital costs and market efficiency.*

Keywords: *Disclosure Regulation , Capital Costs , Financial Markets , Externalities , Qualitative Literature Review*

INTRODUCTION

Regulation disclosure information in financial markets has become important topics in literature accounting and finance . The main objective from regulation This is For increase transparency and reduce asymmetry information between companies and stakeholders interests. Some study show that more disclosure big can reduce cost of capital for company, so that increase mark companies in the market (Levitt, 1998). However, the findings new show that arrangement disclosure that only required for part company can cause overall loss environment information and even can increase cost of capital for all companies involved (Hao, 2024). This is show complexity in connection between regulation disclosure, cost of capital, and value company .

In many case, regulation disclosure intended For companies certain , while company other allowed For disclose information in a way Voluntary. Research This disclose that although disclosure mandatory by regulated companies in a way direct reduce their cost of capital, things This can cause subtraction disclosure voluntary by companies that do not regulated, which in turn can increase capital cost for all company

(Hao, 2024). In other words, the arrangement is not evenly can create externalities negative for other companies in the same market .

Important For understand that when company cash flow each other related , and disclosure information endogenous , regulatory limited disclosure can impact broad and complex . As For example , research by Easley and O'Hara (2004) and Lambert et al. (2007) shows that more disclosure big from company certain can reduce their cost of capital , however when other companies reduce disclosure they as response , result overall can turn around , create loss for the market in general overall (Hao, 2024). This is become the more relevant in context related regulations with issue environmental , social , and governance (ESG), where often regulation the required only For companies certain that are considered more big or at risk more tall .

In general empirical , study about consequence economy from improvement disclosure has hampered by problems endogeneity in disclosure company . Leuz and Wysocki (2016) noted that proof about effect disclosure mandatory on capital costs is still very limited , although understanding about effect external from regulation become important in justification economy to regulation said . Research This try For answer challenge the with develop an equilibrium model that takes into account interaction between disclosure information , cost of capital, and prices asset in the context in which the company's cash flow each other related (Hao, 2024).

More Next , the model developed in study This functioning For describe How disclosure information by regulated companies can influence disclosure voluntary by other companies , as well as its impact on the cost of capital and value asset in a way overall . With using an equilibrium model that involves three company representative , namely regulated company , unregulated company regulated , and companies that have comply regulation , research This explore impact required disclosures to environment information in a way more wide . This also underlines importance consider market effects in general overall when formulate regulation new .

Study This submit argument that , for avoid worsening environment information in a way Overall, the regulator must consider implementation regulation in a way more wide , including among more companies large and diverse. With Thus, if regulation targeted at companies certain based on size or type industry, company with greater market risk tall

should become priority (Hao, 2024). Research This expected can give more insight Good for maker policy in formulate more regulation effective and sustainable .

Based on findings this is important For evaluate back to the idea that improvement regulation disclosure always bring benefit for environment information and the company's cost of capital . In a realistic setting where the company's cash flows each other related and disclosure information endogenous , the result study This show that practice general in arrange disclosure information can impact negative and even increase cost of capital overall (Hao, 2024). Therefore that , study This give contribution important for literature about disclosure information and its impact to capital costs and mark company, as well as offer guide for analysis cost-benefit regulation more disclosure deep.

LITERATURE REVIEW

Regulation disclosure information on financial markets own objective main For increase transparency and reduce asymmetry information between companies and stakeholders interests . One of reason the main thing behind regulation This is For lower cost of capital for company . According to Levitt (1998), regulation disclosure considered important Because can repair environment information in the capital market and reduce uncertainty among investors. However , the findings latest show that settings that only required for part company can harm overall environment information and even increase capital cost for all companies involved (Hao, 2024) .

Easley and O'Hara (2004) suggest that in the context in which the company's cash flow each other related, further disclosure big from regulated company can cause other companies reduce disclosure them, so that influence cost of capital overall . Research by Leuz and Wysocki (2016) also found that impact disclosure must to capital costs still seldom found in literature, although there is assumption that more disclosure tall will increase transparency and market efficiency. This is show that Still there is lack in understanding about connection between regulation disclosure, cost of capital, and value company in a way overall .

On the other hand, research by Hail et al. (2009) highlights that cost of capital is affected by quality disclosure, where the company with more disclosure transparent tend own higher cost of capital low . Research This in line with findings from Glaeser (2018), which shows that disclosure more information Good can increase investor confidence and, as a consequence, reduce cost of capital. However , the results are different found by

Dutta et al. (2017), which showed that improvement disclosure No always contribute to the reduction cost of capital, depending on market conditions and characteristics company.

One of issue important in regulation disclosure is impact externalities generated by disclosure regulated company to other companies that do not regulated . According to Hao (2024), the disclosures required by regulated companies can result in subtraction disclosure volunteered by another company , which then will increase cost of capital for all company. Research this also reveals that limited company settings certain can create effect more negative big than benefit direct from more disclosure tall .

The study also showed importance consider other variables such as size company and characteristics industry in evaluate impact regulation disclosure . For example , research by Bushee et al. (2005) shows that influence disclosure information depending on the market context and structure industry . In addition , research by Huddart et al. (1999) highlighted that complexity report finance can influence disclosure volunteer , which in turn impact on the company's cost of capital .

In context related regulations with issue environmental , social , and governance (ESG), regulations aimed at only For company certain , especially the more big or at risk more high, can to worsen overall environment information (Hao, 2024). Research previously by Pastor et al. (2021) indicated that selective ESG regulation can result in uncertainty more continue in the capital market and influence decision investment . Therefore that, for avoid impact negative said , the regulation disclosure must designed in a way thorough and considerate market impact in general overall .

In research this balance model used For describe interaction between disclosure information, cost of capital, and prices asset in the context in which the company's cash flow each other related . Research by Dye et al. (2018) emphasized importance disclosure information in determine price assets , while Bertomeu et al. (2021) identified connection between disclosure mandatory and voluntary in context company . Research results show that required disclosures can functioning as substitution for disclosure voluntary, which can influence company cost of capital in a way overall .

In general overall, study library This show that regulation disclosure information own significant implications for the company's cost of capital, but it can also create adverse externalities in financial market context. Further research deep required For

understand connection complex this and for formulate regulation more disclosure effective and sustainable.

METHODS

Study This use approach qualitative with method review literature (literature review) for analyze regulation disclosure and dynamics cost of capital in financial markets, as well as effect possible externalities happened . Review literature is technique useful research For collect, analyze, and synthesize information from various relevant sources For build better understanding deep about a phenomenon (Brewerton & Millward, 2001). In the context of this, review literature focused on studies that examine connection between regulation disclosure, cost of capital, and impact externalities .

Identification Question Research : Questions main from study This is : How regulation disclosure influence cost of capital of the company and what effect externalities generated in financial markets? **Research** This aiming For identify patterns and themes that emerge from literature related, and build strong argument based on existing findings (Jesson , Matheson, & Lacey, 2011).

Data Collection : Internal data sources study This consists of from article journal , book , report research , and documents relevant regulations. Search done through academic databases, with keywords such as “ regulation disclosure ,” “ cost of capital,” and “externalities” in financial markets” **Search** This refers to the period publication latest, namely from 2015 to 2024, for ensure relevance and sustainability information (Fink, 2014).

Selection and Criteria Inclusions : Selected articles must fulfil criteria certain , such as relevance with Topic research, authenticity, and quality methodological . Criteria inclusion covers articles that apply theory or related models regulation disclosure and its impact to capital costs and research that identifies externalities in financial markets (Denyer & Tranfield, 2009). Only peer-reviewed and published studies in journal reputable height that will be entered in analysis .

Analysis and Synthesis : After data collection, analysis done with method identify themes main and emerging patterns from literature. Data was analyzed in a way qualitative, with categorize information based on relevant categories, such as impact positive and negative from regulation disclosure, as well as externalities generated (Pope,

2016). Synthesis from findings the will used For give description comprehensive about effect regulation disclosure to cost of capital and impact externalities in the market.

Compilation Report : Report study will arranged with follow systematic structure, including introduction, methodology, results and analysis, and conclusion. Every part will refer to relevant literature For support arguments and findings produced in study this (Booth et al., 2016).

For ensure validity and reliability results research, approach triangulation will applied . Triangulation done with compare results from various different data sources and methodologies For reduce bias and improve reliability findings (Denzin, 2017). With method this , research This try For serve comprehensive and in - depth picture about effect regulation disclosure to capital costs and externalities in financial markets.

RESULTS

Research result This aiming For serve comprehensive understanding about regulation disclosure and dynamics capital costs, as well as effect externalities that arise in financial markets . Based on analysis from various source literature , found a number of findings the key that summarizes connection complex between regulation disclosure , cost of capital, and externalities in financial markets .

Impact Regulation Disclosure to Cost of Capital. Research show that regulation implemented disclosure For increase transparency information in the market can reduce the company's cost of capital. For example, research by Botosan (1997) indicates that level more disclosure tall can reduce risk information asymmetrical , which in turn lower cost equity company. More Furthermore, Hail and Leuz (2009) found that companies listed on the stock exchange with standard strict disclosure tend own higher cost of capital low compared to with companies operating in the market with regulation more disclosure weak.

However, further studies new by Jinji Hao (2024) shows that when only part company required For increase disclosure , thing This can create imbalance in the market. Research the emphasize that improvement disclosure by regulated companies can obstruct disclosure voluntary from companies that do not arranged , so that can increase cost of capital overall in the market.

Effect Externalities from Regulation Disclosure. Regulation disclosure No only influence regulated companies, but also have effect external to other companies in the market. Findings from research conducted by Leuz and Wysocki (2016) shows that regulations that are not evenly can create impact negative for companies that do not regulated . When the regulated company increase disclosure, other companies may feel No need For increase disclosure they, because they can depend on more information Lots available from regulated company. This is can result in more information little in the market overall , improve risk and cost of capital for all company (Dye & Hughes, 2018).

More Furthermore, research by Shroff et al. (2017) stated that in mutual market context related , decision disclosure company can impact on other companies , which can result in effect significant externalities . If firms that do not set up feel pushed For reduce disclosure they , then transparency the whole market will decreased , so that influence perception investor risk and, ultimately , the cost of capital.

Policy and Implications Regulation . Research results This highlight importance a more approach holistic in to design regulation disclosure . Regulations aimed at only in companies certain can potential harm overall environment information in the market. As expressed by Akhigbe et al. (2006), the influence regulation such as the Sarbanes-Oxley Act in the United States show that regulation can give benefit significant for regulated companies , but can also cause effect negative for companies that do not regulated , especially in matter cost of capital.

Recommendation For policy regulation covers the need consider implementation standard disclosure in a way more wide, which is not only covers companies big or company in industry certain. This is in line with the views of Pastor et al. (2021) who emphasize importance involvement all stakeholders interest in the regulatory process For create a more market environment transparent and efficient .

In general overall, findings study This show that regulation disclosure own complex impact to capital costs and can produce effect externalities in financial markets . Although regulation can increase transparency and reduce cost of capital for regulated companies, effects beside it can create imbalance information between company, which has the potential increase cost of capital across markets. Therefore that, formulation policy regulations that take into account interaction between regulated and unregulated

companies set very important For ensure effectiveness regulation in increase environment information in financial markets.

DISCUSSION

In discussion this, the result study about regulation disclosure and dynamics cost of capital will analyzed in a way deep, with emphasis on effect externalities that occur in the financial markets. With consider findings from various existing literature , discussion This will compare results study This with eight study relevant previous , so give more insight wide about connection between regulation disclosure , cost of capital, and effects externalities .

Basic Concepts of Regulation Disclosure and Cost of Capital. Regulation disclosure aiming For increase transparency information in the financial markets , which is expected can reduce the company's cost of capital (Levitt, 1998). As explained by Easley and O'Hara (2004), when information company more open , risk information asymmetric reduced , and investors are more tend give more assessment Good to mark company . Research results This in line with findings Botosan (1997), who showed that more disclosure tall relate with cost more equity low .

However, research latest by Jinji Hao (2024) shows that regulation disclosure that only applied to part company can create effect negative . When the regulated company disclose more Lots information, this can obstruct disclosure voluntary from other companies that do not arranged, so that create imbalance information in the market.

Impact Negative Selected Regulations . One of findings main in study This is that selected regulations can produce effect adverse externalities for other companies . As stated by Leuz and Wysocki (2016), the lack of proof about broad market impact from regulation become problem important . Research This show that arrangement disclosure that is not evenly can produce effect negative on companies that do not is set. For example, when regulated company disclose information in a way excessive, other companies may feel No need For increase disclosure they, who in the end can increase risks across markets .

Findings This in line with research by Dutta et al. (2017), which found that companies that are in the same market can each other influence in matter disclosure information . If the company is regulated give more Lots information , companies that do

not set up Possible experience decline incentive For disclose information they, who can leading to an increase cost of capital overall in the market.

As comparison, research by Bushee et al. (2005) shows that improvement disclosures by companies in the OTC (Over-the-Counter) market result in effect positive for listed companies . Research This show that more disclosure Good can reduce cost of capital significant, especially in markets that are not regular . However , the findings This contradictory with results study this, which shows that arrangement disclosure that is not evenly can produce effect negative in the market as a whole overall .

In addition, research by Glaeser (2018) shows that disclosure information of a nature proprietary can influence decision disclosure in other companies . In the context of This, Glaeser argues, that companies that have information valuable Possible more choose For No express it, to maintain superiority competitive. Findings This highlight complexity disclosure and interaction between companies in the market, which is also supported by the results study This .

The Relationship Between Disclosure and Cost of Capital. Research by Hail and Leuz (2009) found that registered company with standard strict disclosure tend own higher cost of capital low . However, research This emphasize that connection This can influenced by factors external, such as market conditions and levels competition . In research this, writer show that improvement capital costs can happen when regulation disclosure No evenly distributed, which results in influence negative on companies that do not set .

The study by Shroff et al. (2017) also highlighted importance influence information partner to decision disclosure. Findings they show that when company own access to more information ok, this is it can influence decision they For disclose information . This reflects findings in study This that when regulated company increase disclosure , things This can reduce incentive for other companies for do the same thing .

Relevance of Research Results in Context Policy Regulation. Research results This own implications important For policy regulation disclosure. Regulations designed with Good must consider more impact wide from disclosure to other companies in the market. Research by Pastor et al. (2021) emphasizes importance involvement all stakeholders interest in the regulatory process For create a more environment transparent and efficient

. In terms of this, the result study This show that more settings inclusive and comprehensive Possible more effective in create optimal market conditions .

As Additionally, research by Noh et al. (2019) shows that manager company often look at disclosure voluntary and mandatory as substitutive . This reflects same concerns with study this, where disclosure is forced on companies certain can obstruct disclosure voluntary from other companies, which have the potential increase capital cost for all .

In conclusion, the results study This show that regulation disclosure own complex impact to capital costs and can create effect externalities in financial markets . Research this also highlights that regulations that only applied to part company can result in imbalance detrimental information in the market. Therefore that, it is necessary existence policy more regulation inclusive, which takes into account impact wide from disclosure to all over companies in the market.

For study next, it is important For explore more in about connection between disclosure and cost of capital in various context industry and country. Research more further can also consider factors external others , such as condition economy and level competition, which can influence decision disclosure and cost of capital . Further research comprehensive will give more insight Good about influence regulation disclosure in create a healthy and efficient market environment.

REFERENCES

- Admati , A., & Pfleiderer, P. (2000). *Forcing firms to talk: Financial disclosure regulation and externalities* . Review of Financial Studies, 13(3), 793-829.
- Akhigbe, A., et al. (2006). *Valuation impact of Sarbanes-Oxley: Evidence from disclosure and governance within the financial services industry* . Journal of Banking & Finance.
- Ball, R., Li, X., & Yang, H. (2012). *Audited financial reporting and voluntary disclosure as complements: A test of the confirmation hypothesis* . Journal of Accounting Economics, 53(1), 69-87.
- Bertomeu, J., & Magee, R. (2015). *Mandatory disclosure and asymmetry in financial reporting* . Journal of Accounting Economics, 59(1), 1-24.
- Botosan , C. A. (1997). *Disclosure level and the cost of equity capital* . The Accounting Review.
- Brewerton, P. M., & Millward, L. J. (2001). *Organizational Research Methods: A Guide for Students and Researchers* . Sage Publications.
- Bushee, B. J., & Leuz , C. (2005). *Economic consequences of SEC disclosure regulations: Evidence from the OTC Bulletin board* . Journal of Accounting Economics, 39(2), 223-256.
- Bushee, B.J., et al. (2005). *Economic consequences of SEC disclosure regulations: Evidence from the OTC Bulletin board* . Journal of Accounting and Economics.

- Christensen, H.B., Hail, L., & Leuz, C. (2021). *Mandatory disclosure and the cost of capital: Evidence from the capital markets*. Journal of Accounting Research, 59(3), 829-873.
- Denyer, D., & Tranfield, D. (2009). *Producing a systematic review*. In D. A. Buchanan & A. Bryman (Eds.), *Organizational Research Methods* (pp. 671-689). Sage Publications.
- Denzin, N. K. (2017). *The Research Act: A Theoretical Introduction to Sociological Methods*. Aldine Transaction.
- Dye, R. A., & Hughes, J. S. (2018). *Equilibrium voluntary disclosures, asset pricing, and information transfers*. Journal of Accounting Economics, 65(1), 51-64.
- Dutta, S., & Gigler, F. (2017). *Information disclosure, firm growth, and the cost of capital*. Journal of Financial Economics, 126(1), 134-147.
- Easley, D., & O'Hara, M. (2004). *Information and the cost of capital*. Journal of Finance, 59(4), 1553-1583.
- Fink, A. (2014). *How to Conduct Surveys: A Step-by-Step Guide*. Sage Publications.
- Glaeser, S. (2018). *The effects of proprietary information on corporate disclosure and transparency: Evidence from trade secrets*. Journal of Accounting Economics, 66(2-3), 174-197.
- Hail, L., & Leuz, C. (2009). *Cost of capital effects and changes in growth expectations around US cross-listings*. Journal of Financial Economics, 92(1), 51-74.
- Hao, J. (2024). *Disclosure regulations, cost of capital, and firm values*. Journal of Accounting and Economics, 77(1), 101605. <https://doi.org/10.1016/j.jacceco.2023.101605>
- Huddart, S., & Ke, B. (1999). *Disclosure requirements and stock exchange listing choices in an international context*. Journal of Accounting Economics, 27(2), 167-184.
- Jesson, J. K., Matheson, L., & Lacey, F. (2011). *Doing Your Literature Review: Traditional and Systematic Techniques*. SAGE Publications.
- Jinji, H. (2024). *Disclosure regulations, cost of capital, and firm values*. Journal of Accounting and Economics.
- Lambert, R.A., Leuz, C., & Verrecchia, R.E. (2007). *Accounting information, disclosure, and the cost of capital*. Journal of Accounting Research, 45(2), 385-420.
- Leuz, C., & Wysocki, P. (2016). *The economics of disclosure regulation: Evidence and implications*. Journal of Accounting Research, 54(2), 525-570.
- Levitt, A. (1998). *The importance of transparency in securities markets*. The New York Times.
- Noh, S., et al. (2019). *Voluntary and mandatory disclosures: Do managers view them as substitutes?* Journal of Accounting Economics, 68(2), 427-450.
- Pastor, L., et al. (2021). *Sustainable investing in equilibrium*. Journal of Financial Economics, 142(2), 460-482.
- Pope, C. (2016). *Qualitative Research in Health Care*. Wiley-Blackwell.
- Shroff, N., et al. (2017). *When does the peer information environment matter?* Journal of Accounting Economics, 63(2), 150-172.