Opinion

Economy

Equity Increases the Overall Cost over Expectation

Aliaa Hassan*
Cairo University, 1 Gamaa Street, Oula, Al Giza, Giza Governorate 12613, Egypt
*: All correspondence should be sent to: Dr. Aliaa Hassan
Author's Contact: Dr. Aliaa Hassan, J.D., M.A., E-mail: aliaa.hassan@gmail.com
DOI: https://doi.org/10.15354/si.24.op227
Funding: No funding source declared.
COI: The author declares no competing interest.
AI Declaration: The author affirms that artificial intelligence did not contribute to the process of preparing the work.

When equity is prioritized, resources are allocated to ensuring fair treatment and opportunities for all individuals, which may require additional investments in recruitment efforts, training programs, and systems to monitor and address inequities. Furthermore, achieving equity often involves addressing historical injustices or disparities that may require significant financial commitments to rectify. Additionally, maintaining equity requires ongoing efforts to prevent any regression into unequal treatment or practices, necessitating continuous monitoring and interventions which can incur costs as well. While investing in equity may initially result in increased expenses beyond initial expectations, studies show that organizations that prioritize equity tend to see improved employee morale, productivity, and retention rates in the long run – ultimately leading to overall cost savings through enhanced performance and reduced turnover.

Keywords: Equity; Overall Cost; Financial Commitment; Solution; History

Science Insights, 2024 December 31; Vol. 45, No. 6, pp.1669-1672.

EQUITY is a term that denotes the impartiality and justice that exist within a society or organization (Wiles & Kobayashi, 2020). It is frequently linked to the concept of equal opportunity and access to resources for all individuals (Bourguignon et al., 2006). Nevertheless, equity may have a distinct meaning in the financial sector (Leclerc et al., 2011). Equity is the ownership interest in a company or investment in the context of finance and business (Pope & Puxty, 1991). Equity is generally perceived as a positive aspect of financial markets; however, it can also have negative implications in terms of cost (Handschin, 2012).

The issuance of new shares is one method by which equity can increase the overall cost beyond expectations (Dimovski et al., 2007). The ownership interest of existing shareholders is diminished when a company decides to raise capital by issuing new shares of stock (Carlson & Dietz, 1982; Kozyr, 2016). This dilution may result in a decline in the value of the shares and a reduction in earnings per share (Smith, 1953). Consequently, this can result in a reduction in the overall return on investment for shareholders, thereby increasing the cost over expectation.

The payment of dividends is another method by which equity can increase costs (Scott, 1992). Although dividends are frequently perceived as a beneficial aspect of owning equity in a company, they can also negatively impact the overall return on investment (DeAngelo et al., 2004). This is due to the fact that dividends are distributed from the company's earnings, which means that shareholders receive a portion of their return in cash rather than through capital appreciation (Amadasu, 2011; Gao & Li, 2024; Weigand & Baker, 2009). Consequently, the cumulative return on investment may be less than anticipated, resulting in an increase in expenses.

The payment of taxes can result in equity increasing costs beyond what is anticipated (Bagwell & Shoven, 1989; Herman & Chaidir, 2023). Shareholders are obligated to pay taxes on their gains when they sell their shares at a profit or receive dividends (Chodorow-Reich et al., 2024; Susko, 2003). This can result in a decrease in the overall return on investment and an increase in the cost of owning equity in a company. For high-income individuals or those with substantial investment portfolios, the tax implications of equity ownership can be substantial in certain instances (DeAngelo et al., 2004; Fichtner, 2000).

The payment of management fees can result in equity costs exceeding expectations (Core, 2001; Gao & Li, 2024; Karlinsky & Krochka, 2004). In order to acquire exposure to a diversified portfolio of equities, numerous investors opt to invest in exchange-traded funds (ETFs) or mutual funds (Elton et al., 2019). Nevertheless, these funds frequently impose management fees, which can reduce the overall return on investment. These fees can be quite high in certain instances, particularly for actively managed funds. Consequently, investors may incur additional fees that exceed their expectations, resulting in an increase in expenses (Gao & Livingston, 2008; Haslem et al., 2007; Khorana et al., 2008).

Equity can result in costs exceeding expectations due to market inefficiencies (Haslem et al., 2007; Millo et al., 2023). The stock market is not always efficient, which means that stock prices may not always accurately reflect the true value of a company (Albrecht & Decker, 2024; Butler et al., 2005). This can result in the overvaluation or undervaluation of equities, which can affect the overall return on investment. In situations where equities are overvalued, investors may end up paying more for shares than they are actually worth, resulting in a decrease in returns (Chi & Gupta, 2009; Marciukaityte & Varma, 2008; Neumann & Cohen, 2024). In contrast, investors may overlook potential gains when securities are undervalued, resulting in an increase in costs beyond expectations (Dong et al., 2012).

The payment of transaction costs can result in equity increasing costs beyond what is anticipated (Collins & Fabozzi, 1991; Kissell, 2006). Brokerage commissions and other fees are frequently assessed when investors acquire or dispose of stock shares (Anand et al., 2021; Benesh & Celec, 1984). Over time, these expenses may accumulate and diminish the overall return on investment. Although transaction costs may appear insignificant on an individual basis, they can have a substantial effect on the total cost of owning equity in a company (Iqbal et al., 2024).

The payment of legal and regulatory fees can result in equity costs exceeding expectations (Dimovski et al., 2007; Lee et al., 1996). Companies that are publicly traded or issue equity are subject to a variety of legal and regulatory requirements (Bairagi & Dimovski, 2012). This may encompass the cost of filing registration statements with the Securities and Exchange Commission (Gustafson & Iliev, 2017), employing legal counsel to guarantee compliance with securities laws, and funding audits and other financial reporting obligations (Cai & Haque, 2024; Kolins & Jones, 1994). These fees can accumulate over time and elevate the overall expense of owning equity in a company.

Finally, the payment of opportunity costs can result in equity increasing costs beyond what is anticipated (Bhojraj, 2020; Daves & Ehrhardt, 2007). Investors forfeit the opportunity to invest in other assets, including bonds, real estate, or cash equivalents, when they allocate capital to equity investments (Chen et al., 2007). Investors may be overlooking potential advantages from other investments if the return on equity investments fails to meet expectations (Katti & Phani, 2016). This can result in an overall increase in the cost of equity ownership, as investors are not fully realizing the potential of their investment portfolio.■

References

Albrecht, B. C., & Decker, R. A. (2024). Rising markups and declining business dynamism: Evidence from the industry cross section. FEDS Notes, 2024-03-08–2, None. DOI: https://doi.org/10.17016/2380-7172.3471

Amadasu, D. (2011). Dividend Is Relevant: A Restatement. African Research Review, 5(4). DOI: https://doi.org/10.4314/afrrev.v5i4.69259

Anand, A., Samadi, M., Sokobin, J., & Venkataraman, K. (2021). Institutional Order Handling and Broker-Affiliated Trading Venues. Review of Financial Studies, 34(7), 3364–3402. DOI: https://doi.org/10.1093/rfs/hhab004

Bagwell, L. S., & Shoven, J. B. (1989). Cash Distributions to Shareholders. The Journal of Economic Perspectives, 3(3), 129–140. DOI: https://doi.org/10.1257/jep.3.3.129

Bairagi, R. K., & Dimovski, W. (2012). The direct costs of raising external equity capital for US REIT IPOs. Journal of Property Investment and Finance, 30(6), 538–562. DOI: https://doi.org/10.1108/14635781211264513

Benesh, G. A., & Celec, S. E. (1984). A comment on the cost of new issues of common stock. Decision Sciences, 15(1), 137–141. DOI: https://doi.org/10.1111/j.1540-5915.1984.tb01201.x

Bhojraj, S. (2020). Stock compensation expense, cash flows, and inflated valuations. Review of Accounting

Studies, 25(3), 1078–1097. DOI: https://doi.org/10.1007/s11142-020-09549-6
Bourguignon, F., Ferreira, F. H. G., & Walton, M. (2006). Equity, efficiency and inequality traps: A research agenda. The Journal of Economic Inequality, 5(2), 235–256. DOI: https://doi.org/10.1007/s10888-006-9042-8
Butler, A. W., Grullon, G., & Weston, J. P. (2005). Stock Market Liquidity and the Cost of Issuing Equity. Journal of Financial and Quantitative Analysis, 40(2), 331–348. DOI: https://doi.org/10.1017/s0022109000002337
Cai, F., & Haque, S. (2024). Private Credit: Characteristics and Risks. FEDS Notes, 2024-02-23–2, None. DOI: https://doi.org/10.17016/2380-7172.3462
Carlson, P. G., & Dietz, A. T. (1982). On the cost of new issues of common stock: An amendment to the constant growth model. Decision Sciences, 13(3), 405–415. DOI: https://doi.org/10.1111/j.1540-5915.1982.tb00158.x
Chen, A. H., Kensinger, J. W., & Terrell, R. (2007). The impact of employee stock ownership on firms' investments and market value. International Journal of Services Technology and Management, 8(4/5), 293. DOI: https://doi.org/10.1504/ijstm.2007.013921
Chi, J., & Gupta, M. (2009). Overvaluation and earnings management. Journal of Banking & Finance, 33(9), 1652–1663. DOI: https://doi.org/10.1016/j.jbankfin.2009.03.014
Chodorow-Reich, G., Smith, M., Zidar, O., & Zwick, E. (2024). Tax Policy and Investment in a Global Economy. DOI: https://doi.org/10.3386/w32180
Collins, B. M., & Fabozzi, F. J. (1991). A Methodology for Measuring Transaction Costs. Financial Analysts Journal, 47(2), 27–36. DOI: https://doi.org/10.2469/faj.v47.n2.27
Core, J. (2001). Stock option plans for non-executive employees. Journal of Financial Economics, 61(2), 253–287. DOI: https://doi.org/10.1016/s0304-405x(01)00062-9
Daves, P. R., & Ehrhardt, M. C. (2007). Convertible Securities, Employee Stock Options and the Cost of Equity. Financial Review, 42(2), 267–288. DOI: https://doi.org/10.1111/j.1540-6288.2007.00171.x
DeAngelo, H., DeAngelo, L., & Stulz, R. (2004). Dividend Policy, Agency Costs, and Earned Equity. DOI: https://doi.org/10.3386/w10599
Dimovski, W., Brooks, R., & Van Eekelen, A. (2007). The costs of raising equity capital for closed-end fund IPOs. Applied Financial Economics Letters, 3(5), 295–299. DOI: https://doi.org/10.1080/17446540701222391
Dong, M., Hirshleifer, D., & Teoh, S. H. (2012). Overvalued Equity and Financing Decisions. Review of Financial Studies, 25(12), 3645–3683. DOI: https://doi.org/10.1093/rfs/hhs112
Elton, E. J., Gruber, M. J., & De Souza, A. (2019). Passive mutual funds and ETFs: Performance and comparison. Journal of Banking & Finance, 106, 265–275. DOI: https://doi.org/10.1016/j.jbankfin.2019.07.004
Fichtner, J. J. (2000). Encouraging Personal Saving and Investment: Changing the Tax Treatment of Unrealized Capital Gains. SSRN Electronic Journal. DOI: https://doi.org/10.2139/ssrn.668581
Gao, J., & Li, S. (2024). Regulating for-hire autonomous vehicles for an equitable multimodal transportation network. Transportation Research Part B Methodological, 183, 102925. DOI: https://doi.org/10.1016/j.trb.2024.102925
Gao, X., & Livingston, M. (2008). The Components of Mutual Fund Fees. Financial Markets Institutions and Instruments, 17(3), 197–223. DOI: https://doi.org/10.1111/j.1468-0416.2008.00139.x
Gustafson, M. T., & Iliev, P. (2017). The effects of removing barriers to equity issuance. Journal of Financial Economics, 124(3), 580–598. DOI: https://doi.org/10.1016/j.jfineco.2017.03.008
Handschin, L. (2012). Risk-Based Equity Requirements: How Equity Rules for the Financial Sector can be Applied to the Real Economy. Journal of Corporate Law Studies, 12(2), 255–293. DOI: https://doi.org/10.5235/jcls.12.2.255
Haslem, J. A., Baker, H. K., & Smith, D. M. (2007). Identification and Performance of Equity Mutual Funds with High Management Fees and Expense Ratios. The Journal of Investing, 16(2), 32–51. DOI: https://doi.org/10.3905/joi.2007.686410
Herman, N., & Chaidir, R. (2023). The Influence of Operating Cash Flows, Investments Cash Flow, and Funding Cash Flow on the Company Value in Technology Sector. Ilomata International Journal of Tax and Accounting, 4(3), 546–560. DOI: https://doi.org/10.52728/ijtc.v4i3.780
Iqbal, A., Rajgopal, S., Srivastava, A., & Zhao, R. (2024). A Better Estimate of Internally Generated Intangible Capital. Management Science. DOI: https://doi.org/10.1287/mnsc.2022.01703
Karlinsky, S., & Krochka, J. (2004). An introduction to US tax aspects of executive/employee compensation with a stock option focus. Journal of Derivatives Accounting, 01(01), 111–123. DOI: https://doi.org/10.1142/s0219868104000087
Katti, S., & Phani, B. (2016). Underpricing of Initial Public Offerings: A Literature Review. Universal Journal of Accounting and Finance, 4(2), 35–52. DOI: https://doi.org/10.13189/ujaf.2016.040202
Khorana, A., Servaes, H., & Tufano, P. (2008). Mutual Fund Fees Around the World. Review of Financial Studies, 22(3), 1279–1310. DOI: https://doi.org/10.1093/rfs/hhn042
Kissell, R. (2006). The Expanded Implementation Shortfall. The Journal of Trading, 1(3), 6–16. DOI: https://doi.org/10.3905/jot.2006.644083
Kolins, W. A., & Jones, G. T. (1994). Accounting, auditing, and reporting issues associated with environmental contingencies. Journal of Corporate Accounting & Finance, 5(3), 337–351. DOI: https://doi.org/10.1002/jcaf.3970050305
Kozyr, Y. V. (2016). Overview of Additional Issue of Shares and Debt in the Process of Value Appraisal of Shares and Planning of Additional Issue Parameters. Journal of Economics and Public Finance, 2(2), 298. DOI: https://doi.org/10.22158/jepf.v2n2p298
Leclerc, P. D., McLay, L. A., & Mayorga, M. E. (2011). Modeling Equity for Allocating Public Resources. In International series in management science/operations research/International series in operations research & management science (pp. 97–118). DOI: https://doi.org/10.1007/978-1-4614-0806-2_4
Lee, I., Lochhead, S., Ritter, J., & Zhao, Q. (1996). The costs of raising capital. The Journal of Financial Research, 19(1), 59–74. DOI:

https://doi.org/10.1111/j.1475-6803.1996.tb00584.x
Marciukaityte, D., & Varma, R. (2008). Consequences of overvalued equity: Evidence from earnings manipulation. Journal of Corporate Finance, 14(4), 418–430. DOI: https://doi.org/10.1016/j.jcorpfin.2008.05.002
Millo, Y., Spence, C., & Valentine, J. J. (2023). Active fund managers and the rise of passive investing: Epistemic opportunism in financial markets. Economy and Society, 52(2), 227–249. DOI: https://doi.org/10.1080/03085147.2023.2172252
Neumann, P. J., & Cohen, J. T. (2024). Are We Valuing Prescription Drugs Appropriately? [Dataset]. In Forefront Group. DOI: https://doi.org/10.1377/forefront.20240130.833652
Pope, P. F., & Puxty, A. G. (1991). What is Equity? New Financial Instruments in the Interstices between the Law, Accounting and Economics. Modern Law Review, 54(6), 889–911. DOI: https://doi.org/10.1111/j.1468-2230.1991.tb01856.x
Scott, M. F. (1992). The cost of equity capital and the risk premium on equities. Applied Financial Economics, 2(1), 21–32. DOI: https://doi.org/10.1080/758527543
Smith, D. T. (1953). Corporate taxation and common stock financing. National Tax Journal, 6(3), 209–225. DOI: https://doi.org/10.1086/ntj41789962
Susko, P. M. (2003). Turnover Rates and After Tax Returns. The Journal of Wealth Management, 6(3), 47–60. DOI: https://doi.org/10.3905/jwm.2003.320490
Weigand, R. A., & Baker, H. K. (2009). Changing perspectives on distribution policy. Managerial Finance, 35(6), 479–492. DOI: https://doi.org/10.1108/03074350910956945
Wiles, J. L., & Kobayashi, A. (2019). Equity. In Elsevier eBooks (pp. 285–290). DOI: https://doi.org/10.1016/b978-0-08-102295-5.10175-1

Received: November 01, 2024 | Revised: November 21, 2024 | Accepted: November 26, 2024