

The Effect of Conditional Conservatism and Agency Cost on Investment-Cashflow Sensitivity

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ARTICLE INFO	ABSTRACT
<p><i>Keywords:</i> Conditional conservatism, investment-cashflow sensitivity, agency cost, dividend payout ratio, purposive judgement sampling</p> <p>Corresponding author: ratnawardhani@yahoo.com</p>	<p>This research aims to give empirical evidence of the effect of conditional conservatism on company's investment-cashflow sensitivity, and whether the impact is stronger in high agency cost firms compare to in low agency cost firms. This research uses dividend payout ratio to measure the agency cost, because this study uses Indonesia as a research context where companies in Indonesia majority have concentrated ownership and funding through debt so that agency conflict that appears more dominant is the conflict of agency type two and three. This study uses sample from manufacturing companies listed in Indonesia Stock Exchange during the period 2008-2012. The total observation in this research is 474 firm years, which 152 of the samples is classified as high agency cost firms and 322 sample as low agency cost firms. The result shows that as the recognition of economic losses becomes more timely, the sensitivity of firm investment to cashflow decreases. Conditional conservatism decreases investment-cashflow sensitivity in low agency cost firms but increases the sensitivity in high agency cost firms. In fact, before implementation of conditional conservatism, high agency cost firms have smaller investment-cashflow sensitivity compared to the low agency cost one.</p> <p>SARI PATI</p> <p><i>Penelitian ini bertujuan untuk memberikan bukti empiris tentang pengaruh konservatisme kondisional (conditional conservatism) terhadap sensitivitas investasi terhadap arus kas (investment-cash flow sensitivity) perusahaan, dan apakah dampaknya lebih kuat pada perusahaan dengan biaya agensi tinggi dibandingkan dengan perusahaan dengan biaya agensi rendah. Penelitian ini menggunakan rasio pembagian dividend (dividend payout ratio) untuk mengukur biaya agensi, karena penelitian ini menggunakan Indonesia sebagai konteks penelitian dimana perusahaan-perusahaan di Indonesia mayoritas memiliki kepemilikan terkonsentrasi dan pendanaan melalui hutang sehingga konflik keagenan yang muncul lebih</i></p>

dominan adalah konflik keagenan tipe dua dan tiga. Penelitian ini menggunakan sampel dari perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia selama periode 2008-2012. Total observasi dalam penelitian ini adalah 474 tahun perusahaan, dimana 152 sampel diklasifikasikan sebagai perusahaan dengan biaya agensi tinggi dan 322 sampel sebagai perusahaan dengan biaya agensi rendah. Hasilnya menunjukkan bahwa karena pengakuan kerugian ekonomi menjadi lebih tepat waktu (konservatisme yang lebih tinggi), sensitivitas investasi terhadap arus kas perusahaan menurun. Konservatisme kondisional menurunkan sensitivitas arus investasi-arus kas di perusahaan dengan biaya agensi rendah namun meningkatkan sensitivitas pada perusahaan dengan biaya agensi tinggi. Bahkan, sebelum penerapan konservatisme kondisional, perusahaan dengan biaya agensi tinggi memiliki sensitivitas investasi terhadap arus kas yang lebih rendah dibandingkan dengan perusahaan yang memiliki biaya agensi rendah.

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INTRODUCTION

Prior studies in the field of accounting have proven that the quality of accounting information influences company's value (Healy and Palepu, 2001; Bushman and Smith, 2001; Easley and O'Hara, 2004; Lambert et al., 2007; Lara et al., 2009). This statement stimulates our logic to questioning about what kind of quality that could increase company's value. The quality of accounting information, which is reflected in the financial statements, is shown through many ways of reporting. There are many differences in the way of how accounting is done. One is the principle underlying the procedures for making it. One accounting principle that is considered to have a big influence in book keeping methodology is conservatism. Conservatism in accounting is a concept where the increase in the value of assets or income are not easily recognized. According to Basu (1997), conservatism can also be defined as a tendency which is owned by an accountant who requires a higher level of verification to recognize profit (good news in earnings) compared to admit losses (bad news in earnings).

Guay and Verrecchia (2007) and Suijs (2008) state that conditional conservatism could increase company's value, by increasing the ability to get cheaper cost of external capital. In

addition, conditional conservatism also facilitates company's monitoring function that makes a company with conditional conservatism has the advantage in its governance (Lafond and Watts, 2008). Jensen (1986) then state that conservatism is a mechanism that in ex-ante controls management investment decisions and in ex-post facilitates monitoring function of those decisions. Before investing, manager will tend to avoid having a negative NPV project, knowing that conservatism can easily record a loss on that investment. After running investment projects, the results of conservative accounting will make the assessment of management performance becomes more effective.

In determining the amount of investment activity, company will see the availability of internal funds (usually proxied by the amount of cash flow from operations) in advance. If it is not sufficient, company then will consider seeking additional funding from external parties (Stiglitz and Weiss, 1981; Myers and Majluf, 1984). An "ease" in obtaining external funding makes the determination of company's investment activities is less dependent to its internal fund, so they could make investment activities more efficient. In the realm of corporate finance literatures, investment activity level of dependence on the

existence of internal fund is called the sensitivity of investment to internal funds (investment-cash flow sensitivity). This sensitivity shows company's ability to obtain external funding (Kaplan and Zingales, 1997; Hubbard, 1998; Imhof, 2014). The lower the sensitivity shows that corporate investment activities could be funded not only from internal funds, but also from external funds (Fazzari, Hubbard, and Peterson, 1988).

There are factors that correlated with the magnitude of sensitivity, one of which is company's agency cost. Sensitivity will be greater (smaller) when asymmetry information is high (low) between managers and investors, indicated by higher (smaller) agency cost (Jensen, 1986 in Imhof, 2014). Imhof (2014) also state that when the agency cost is relatively high, company will be more difficult to obtain external financing because of the high cost of external capital set by the investors / creditors, thus, the amount of internal funds available will be very influential to predict company's investment activities (high investment-cash flow sensitivity).

Conditional conservatism could reduce the level of company's cost of external capital (Guay and Verrecchia, 2007; Suijs, 2008). Lower cost of external capital will enable company to obtain external funding much easier, so that investment activity is not overly dependent on the availability of internal funds. Referring to this idea, this research argues that the conditional conservatism can reduce the level of investment-cash flow sensitivity. Furthermore, the risk assessment by capital providers is influenced by the amount of agency cost (Arugasian, deMello, and Saini, 2014). This study uses agency cost arising from the agency relationships between fund holders (investors / shareholders vs. creditor) because the focus of this study is on investment-cash flow sensitivity which is closely related to funding decision for investment need. Therefore, to measure the agency cost, this study employs dividend payout ratio because this ratio reflects

the agency conflict between shareholders and creditors. The amount of agency cost indicates the level of information asymmetry that is trying to be mitigated by the company. The greater (the smaller) agency cost, the greater (the smaller) the risk and return expected by capital providers. The greater (the smaller) the risk and expected return, the greater (the smaller) the cost of external capital to be paid by the company. Cost of external capital which is quite expensive (cheap) difficulties (facilitates) the company to obtain additional funding from external sources when investing. As a result, the amount of investment made by the company is very dependent (not dependent) on the amount of internal funds, as indicated by higher (lower) investment-cash flow sensitivity (Imhof, 2014). This research also argues that the level of investment-cashflow sensitivity for companies with higher agency cost is greater than companies with lower agency cost. Finally, in addition to its ability to reduce the cost of external capital, higher conditional conservatism is also able to improve the quality of corporate governance (Lafond and Watts, 2008; Imhof, 2014). Based on the explanation, it can be said that the effect of conditional conservatism in lowering the investment-cash flow sensitivity is stronger in companies that also have problems in governance (high agency cost firm) and weaker in companies that already have a good governance mechanism (low agency cost firm).

This study replicates Imhof's (2014) research entitled "conditional conservatism, agency cost, and the cash flow sensitivity of investment firm", where the study was conducted with samples of firms in the United States which has more diffused ownership structure, thus, the context of the agency problem is more directed to the conflict between shareholders and management. While in Indonesia, most companies have concentrated ownership structure and use debt as their main sources of fund so that the agency problem is more directed to the conflict between the minority shareholders and majority shareholders (who are

usually relatives) plus management and conflict between shareholders and creditor. This research implement this difference by using different proxy compared to the one that Imhof (2014) used when measuring agency cost.

The aim of this study are: (i) to determine whether conditional conservatism could decrease the sensitivity of corporate investment activities to the availability of internal funds; (ii) to determine whether the sensitivity of company's investment activities to its internal fund is higher for companies with relatively high agency cost and lower for firms with relatively low agency cost; (iii) to determine whether the effect of conditional conservatism to reduce investment-cashflow sensitivity is greater for firms with relatively high agency cost and smaller for firms with relatively low agency cost.

This study is expected to provide benefits for the development of science, regulatory, and financial practitioners. For the development of science, this study is expected to show whether the impact of conditional conservatism to investment-cashflow sensitivity in Indonesian companies, which is more bank based, will be different from the impact on US companies, which is more market-based. In addition, this study may add to the list of studies on the impact of agency cost in Indonesia to company's value that is reflected in the flexibility of funding sources in investing. For regulators, the study is expected to demonstrate the benefits of the application of conditional conservatism to increase the company's value so that it can be a useful input related to the development of the quality of accounting standards in Indonesia. For financial practitioners, this study is expected to provide a comprehensive understanding on conditional conservatism and its impact on the company's flexibility in determining the source of funding when investing.

This study is divided into five sections. The first part contains an introduction that will discuss the background of writing, research objectives, and

scope. The second part contains the basic theory and hypothesis development. While the third section will discuss the research methodology that addresses the selection of samples, empirical models used, the operationalization of variables, as well as testing the model. Then in the fourth section the discussion is presented on the results of this study. Finally, in section five this research discuss the conclusions, limitations, and potential for future research.

Theoretical Framework & Hypotheses Development

1. Conditional conservatism with Cost of Capital & Governance's Monitoring Function

Guay and Verrecchia (2007) and Suijs (2008) state that conditional conservatism could increase company's value, by increasing the ability to get cheaper cost of external capital. Commitment to recognize losses in a timely manner (conditional conservatism) causes management to disclose information more thoroughly. It reduces the uncertainty in financial reporting, lowering the risk of the company in the eyes of investors and creditors, and facilitate access to external financing at relatively low cost. In addition, conditional conservatism also facilitates monitoring function that can mitigate information asymmetry. This makes the company with conditional conservatism has advantages in its governance (Lafond and Watts, 2008). As the impact of good governance on the application of conditional conservatism, the manager will tend to avoid having a negative NPV project knowing that conservatism can be easily record a loss on that investment. After running investment projects, the results of conservative accounting will make an assessment of the management performance becomes more effective (Jensen, 1986).

2. Investment-Cashflow Sensitivity

Investment-cash flow sensitivity is an indicator to see the level of dependence (sensitivity) of investment activities on the availability of internal funds. One interpretation of the magnitude of this sensitivity could demonstrate the company's

ability to obtain external funds when investing. The smaller (larger) sensitivity, the more capable (not capable) companies to get external funding for investment activities (Myers and Majluf, 1984; Fazzari, Hubbard, and Peterson, 1988; Hubbard, 1998; Moyen, 2004; Bushman, Smith, and Zhang 2011; Imhof, 2014). Fazzari, Hubbard, and Peterson (1988) in Moyen (2004) conducted a study related to the sensitivity of investment-cash flow from operations and categorizes companies based on their financial constraints. The amount of financial constraint is determined by the magnitude of the cost of external capital. The greater cost of external capital, the greater the resistance. The results showed that companies with the category of most constrained (relatively higher financing obstacles) has a higher sensitivity of investment-cashflow from operations than the company in least constrained (relatively lower funding constraints) category.

3. Agency Cost

Agency conflict is divided into three types (Godfrey et al., 2010). Type one explains the conflict between shareholders and management. Type two explains the conflict between majority shareholder plus management versus minority, and type three explains the conflict between shareholders and creditors. Companies in Indonesia have different characteristic compare to companies such in US or UK. Companies in Indonesia are mostly companies that have concentrated ownership and use debt financing. Because of so, mostly, conflict occurs between the majority shareholder (plus management) and minority shareholders (type two conflict) and conflict between shareholders and creditors (type three conflict). In this condition, dividend is regarded as a more efficient mechanism for measuring agency problems (Rozeff, 1982; Gugler and Yurtoglu, 2001). For the fear of minority shareholders will sell shares in a lower price as a result of the expropriation that happened, the majority shareholder and management tend to give higher dividends as a form of anticipation (Rozeff, 1982; Gugler and Yurtoglu, 2001). On the

other hand, the management and the majority shareholder in the company with a relatively low agency problem is not alarming minority shareholders to do so, so that, dividends tend to be smaller (Rozeff, 1982; Gugler and Yurtoglu, 2001). From the perspective of type three of agency conflict, dividend also a mechanism to control the agency cost between shareholders and creditors. In the debt arrangement, creditors usually limit the dividend payment in the debt covenant. The policy is often done because the creditor wants the company to avoid excessive dividend payment so that the company no longer has internal funding that can be used to support future growth

4. Hypotheses Development

4.1. Conditional conservatism & Investment-Cashflow Sensitivity

Conditional conservatism, is an accountant tendency to be more careful in recording revenue and more timely in recognizing expense. This tendency caused management to disclose information more thoroughly and reliably, so that the accounting information is more qualified. It reduces the uncertainty in financial reporting, lowering the risk of the company in the eyes of investors and creditors, and facilitate access to external financing at relatively low cost. In line with the statement, Guay and Verrecchia (2007) and Suijs (2008) state that conditional conservatism reduce the cost of external capital. Relatively low cost of external capital will enable the company to take external funds as a source of funding for investment activities. This ease makes the company less dependent on the availability of internal funds to invest (Imhof, 2014). This situation is illustrated by the relatively small investment-cash flow sensitivity after implementation of conditional conservatism. Referring to the the above argument, the hypothesis statement is as follow:

H1: *The conditional conservatism has a negative impact on investment-cashflow sensitivity*

4.2 *Investment-Cashflow Sensitivity and Agency Cost*

There are other variables that may be related to the amount of sensitivity. The variables in question is the amount of agency cost (Imhof, 2014). Risk assessment by the capital provider is influenced by the amount of agency cost (Arugasian, deMello, and Saini, 2014). Imhof (2014) state that the amount of agency cost indicates the level of information asymmetry that is tried to be mitigated by the company. The greater (smaller) the agency cost, the greater (smaller) its risk assessed and return expected by capital providers. The greater (smaller) the risk and expected return, the greater (smaller) the cost of external capital to be paid by the company. Cost of external capital which is quite expensive (cheap), difficult (facilitates) the company to obtain additional funding from external sources when investing. As a result, the amount of investment made by the company is more dependent (not dependent) on the amount of internal funds, as indicated by the investment-cash flow sensitivity that relatively large (small). Based on these explanations, the hypothesis:

H2: *Investment-cash flow sensitivity of companies that have high agency cost is greater than the companies that have lower agency cost*

4.3. *The Agency Cost Moderating Effect on Conditional Conservatism Impact to Investment-Cashflow Sensitivity*

Companies with relatively high agency problems have problems in its governance. Lack of good governance made the asymmetry of information tends to be high, so that the company more vulnerable to adverse selection and moral hazard. This situation forced the principal to issue a greater cost as a form of mitigation to the asymmetry of information, which is reflected in the amount of agency cost. Conditional conservatism in this case is considered to become a solution to this situation because it can accommodate an effective oversight function in corporate governance (Lafond and Watts, 2008). Imhof (2014) state that

in firms with poor governance problem, which is characterized by the magnitude of agency cost, the impact of conditional conservatism will be stronger in reducing sensitivity. The reason is, when the adoption of conditional conservatism on high agency cost firm in addition could lower the cost of capital, it also improves the function of corporate governance. This makes the owners of capital provide a higher return when firms with poor governance (high agency cost firm) implement conditional conservatism compared to the application of the same thing in company that already has a good governance (low agency cost firm). Form of appreciation is the ease of being able to get external funds when companies want to invest, or in other words, a lower investment-cash flow sensitivity. From these arguments, the hypothesis is built:

H3: *Negative influence of conditional conservatism to investment-cashflow sensitivity will be greater for firms with higher agency cost rather than firms with lower agency cost.*

METHODS

Data Sources & Sample Selection

The data used in this research is secondary data obtained through thomson reuters and datastream. Sampling is done by purposive sampling method. Criteria used in selecting samples are as follows: (i) the Company listed on the Indonesia Stock Exchange during 2008 to 2012 (This study uses the period 2008 and 2012 because the concept of conservatism is no longer adopted in International Financial Reporting Standard (IFRS) and replaced with the concept of prudence. The concept of prudence has a very different understanding from conservatism. Given that Indonesia has adopted IFRS adoption in the Indonesian Accounting Standards since 2012, this study uses the period up to 2012); (ii) The Company is engaged in the manufacturing industry; (iii) the company has positive equity value (iv) there is completeness of the data required in a row from 2008 to 2012.

Research Model

This study aimed to examine the effect of conditional conservatism in reducing the investment-cash flow sensitivity in Indonesia. It also aimed to test whether the effect will be stronger for firms with relatively large agency cost and weaker in companies with relatively small agency cost. To test these predictions this research uses ordinary least squares regression which is based on Imhof (2014). The dependent variable of this study is the investment-cash flow sensitivity. In measuring the sensitivity, this research regresses the amount of investment companies (INV) on cash flow from operations (CFO) and Tobin's Q (a proxy for measuring the level of investment opportunities) as well as the size, the prior annual stock return and the previous year's investment value as a control variables. It is based on Imhof (2014). The magnitude of the coefficient attached to the CFO (β_1) shows the magnitude of the investment-cash flow sensitivity. To better understand the relationship between investment and cash flow, the model controls the amount of the firm's growth opportunity by using Tobin's Q (1969) according to Imhof (2014). The greater the value of Tobin's Q, the more promising outlook for investment companies so that managers tend to be more likely to invest in new projects (Imhof, 2014).

Independent variable in this study is the conditional conservatism, or in other words the application of conditional conservatism. This research uses Givoly and Hayn (2000) model in measuring conditional conservatism. Givoly and Hayn (2000) measures conservatism with the average amount of the company's accrual, which is derived from net income minus the cash flow from operations, for three years with a median value in period t , multiplied by negative one to ensure that the positive value indicates higher conservatism (the result of this formula is denoted by CONS). To test whether the conditional conservatism affect the investment-cash flow sensitivity, the model interacts operating cash flow (CFO) with conditional conservatism (CONS) into the regression model of

investment-cash flow sensitivity previously described. Because conditional conservatism is believed to have a negative effect on investment-cash flow sensitivity, the hypothesis predicts the magnitude of this interaction (CFO*CONS) will be negative and statistically significant (Imhof, 2014).

Moderating variable in this study is agency cost. This research uses the amount of dividends to measure the agency cost. From the magnitude of the results of these measurements, the companies will be divided into two classifications. Classification is divided by the level of agency cost (expressed in notation AGENCY) as measured by the dividend payout ratio. Variable agency cost is treated as a dummy. Company with AGENCY below the mean value of industry-year classified as a company with lower agency cost and coded 0, while companies with AGENCY above the-year mean value of the industry classified as a company with high agency cost (coded 1). To test the moderation effect of agency cost on the relationship between conditional conservatism and the investment-cash flow sensitivity, the variable of interaction between agency cost and conditional conservatism will be added into the model.

To get a more specific description on the amount of conditional conservatism's negative influences on the investment-cash flow sensitivity, this study uses firm size (SIZE), prior annual stock return (RET_{it-1}), as well as the previous year investment value of (Inv_{it-1}) as control variables. Size (SIZE) may affect the magnitude of the company access to sources of external funding, thus affecting the sensitivity of its investment-cash flow (Gurgler et al., 2000, in Imhof, 2014). In the regression model of investment that has been described previously, a positive relationship between firm size and investment activities is expected. As a further control variable, this study use the prior annual stock return (RET_{it-1}). The argument is based on the argument of Lamont (2000) and Richardson (2006) in Imhof (2014) that the stock return has the information related to the company's growth

prospects which is not caught in the measurement of Tobin's Q.

Based on the explanation above, the following equation will be applied to test the research hypothesis.

Model 1: Investment-cash flow sensitivity, the basic model

$$INV_{it} = \alpha_{it} + \beta 1CFO_{it} + \beta 2Q_{it} + \beta 3SIZE_{it} + \beta 4RET_{it-1} + \beta 5INV_{it-1} + \epsilon_{it} \quad (1)$$

Where :

- INV_{it} : The value of firm *i* investment in period *t*
- CFO_{it} : *Operating cash flows* of firm *i* in period *t*
- Q_{it} : The value of firm *i* investment opportunity (Tobin's Q) in period *t*
- SIZE_{it} : The size of firm *i* in period *t*
- RET_{it-1} : *Annual stock return* of firm *i* in period *t-1*
- INV_{it-1} : The value of firm *i* investment in period *t-1*

Model 2: The testing on the negative influence of conditional conservatism on investment-cash flow sensitivity (Hypothesis 1)

$$INV_{it} = \alpha_{it} + \beta 1CFO_{it} + \beta 2CONS_{it} + \beta 3CFO_{it} * CONS_{it} + \beta 4Q_{it} + \beta 5SIZE_{it} + \beta 6RET_{it-1} + \beta 7INV_{it-1} + \epsilon_{it} \quad (2)$$

Where :

- INV_{it} : The value of firm *i* investment in period *t*
- CFO_{it} : *Operating cash flows* of firm *i* in period *t*
- CONS_{it} : The amount of conditional conservatism firm *i* in period *t*
- Q_{it} : The value of firm *i* investment opportunity (Tobin's Q) in period *t*
- SIZE_{it} : The size of firm *i* in period *t*
- RET_{it-1} : *Annual stock return* of firm *i* in period *t-1*
- INV_{it-1} : The value of firm *i* investment in period *t-1*

Model 3: The Correlation testing of agency cost and investment-cash flow sensitivity (Hypothesis 2)

$$INV_{it} = \alpha_{it} + \beta 1CFO_{it} + \beta 2AGENCY_{it} + \beta 3AGENCY_{it} * CFO_{it} + \beta 4Q_{it} + \beta 5SIZE_{it} + \beta 6RET_{it-1} + \beta 7INV_{it-1} + \epsilon_{it} \quad (3)$$

Where :

- INV_{it} : The value of firm *i* investment in period *t*
- CFO_{it} : *Operating cash flows* of firm *i* in period *t*
- AGENCY_{it} : The value of firm *i* agency cost in period *t*
- Q_{it} : The value of firm *i* investment opportunity (Tobin's Q) in period *t*
- SIZE_{it} : The size of firm *i* in period *t*
- RET_{it-1} : *Annual stock return* of firm *i* in period *t-1*
- INV_{it-1} : The value of firm *i* investment in period *t-1*

Model 4: The Correlation testing of agency cost and investment-cash flow sensitivity (Hypothesis 2)

$$INV_{it} = \alpha_{it} + \beta 1CFO_{it} + \beta 2CONS_{it} + \beta 3CFO_{it} * CONS_{it} + \beta 4AGENCY_{it} + \beta 5CFO_{it} * AGENCY_{it} + \beta 6CFO_{it} * CONS_{it} * AGENCY_{it} + \beta 7Q_{it} + \beta 8SIZE_{it} + \beta 9RET_{it-1} + \beta 10INV_{it-1} + \epsilon_{it} \quad (4)$$

Where :

- INV_{it} : The value of firm *i* investment in period *t*
- CFO_{it} : *Operating cash flows* of firm *i* in period *t*
- CONS_{it} : The amount of conditional conservatism firm *i* in period *t*
- AGENCY_{it} : The value of firm *i* agency cost in period *t*
- Q_{it} : The value of firm *i* investment opportunity (Tobin's Q) in period *t*
- SIZE_{it} : The size of firm *i* in period *t*
- RET_{it-1} : *Annual stock return* of firm *i* in period *t-1*

INVit-1 : The value of firm *i* investment in period *t -1*

Operationalization of the variables used can be seen in Table 1.

Model Testing

The models above will be estimated using OLS regression with pooled data. In this test, *i* also test the fulfillment of BLUE (Best Linear Unbiased Estimate) assumptions where the model must meet the assumption of normally distributed, no heteroscedasticity, and no multicollinearity. Tests carried out using STATA statistical software 12 to obtain estimation of the value of models parameter.

RESULTS AND DISCUSSION

Descriptive Statistic

This study uses sample of manufacturing companies listed in Indonesia Stock Exchange during the period 2008-2012. The number of companies that are used as sample totaling 113 companies with 474 firm years, which 152 of the samples is classified as high agency cost firms and 322 sample as low agency cost firms. Characteristics of the sample can be seen from Table 2, and the results of the descriptive statistics in Table 3. From Table 3 it can be seen that the average value of the variable conditional conservatism (CONS)

is 0.0048 with an average CONS for groups firms with high agency cost is lower when compared with low enterprise agency cost (0.0019 and 0.0061). It shows that the average low agency cost company in Indonesia manufacturing industry is more conservative than the average high agency cost company. In addition, the variable investment (INV) has an average value of 0.0587 with an average INV to a group of companies with high agency cost is higher than the company its low agency cost (0.0706 and 0.0531). This shows that the Indonesian manufacturing industry, the average company of high agency cost invest more in capital expenditure (CAPEX) compared to the average low agency cost company.

The Analysis of Impact of Conditional Conservatism to Investment-Cashflow Sensitivity

To investigate the investment-cash flow sensitivity, Model 1 is tested. To investigate and analyze the influence of conditional conservatism on investment-cash flow sensitivity, the hypotheses is tested using regression equations described in Model 2. The Model 1 and 2 test results can be seen in Table 4 and 5.

Based on Table 4 it can be seen that the adjusted R Square for research model 1 is 0.2968. These result indicates that 29.68% of the variation amount of the investment company can be explained by

Tabel 1. Operationalization of Variable

Variable	Operationalization of Variable
Firm Investment (INVit)	Capital expenditures scaled by beginning period total assets
Operating Cashflow (CFOit)	Cashflows from operations scaled by beginning period total asset
Conditional conservatism (CONSit)	Firm's three year average accruals, calculated as net income before extraordinary items minus cash flows from operations multiplied by -1
Firm's Investment Opportunity (Tobin's Q) (Qit)	Total of market value of ordinary shares outstanding, book value of long term debt, and current liability divided by total assets
Firm Size (SIZEit)	The log of the average total assets
Annual Stock Return (RETit-1)	Company's prior annual stock return
Agency Cost (AGENCYit)	Company's dividend payout ratio. Dividend payout ratio measured by dividing dividend to net income.

Tabel 2. Sample Selection

Criterias	Year					Total
	2008	2009	2010	2011	2012	
Population of Manufacture Industry	134	134	134	134	134	670
Firms with incomplete data	43	38	33	36	46	196
Final Sample	91	96	101	98	88	474
Low Agency Cost	68	70	68	61	55	322
High Agency Cost	23	26	33	37	33	152
Total	91	96	101	98	88	474

Percentage (%)	Average during five years					
Low Agency Cost	75%	73%	67%	62%	63%	68%
High Agency Cost	25%	27%	33%	38%	37%	32%
Total	100%	100%	100%	100%	100%	100%

Tabel 3. Statistic Descriptive

Panel A. Statistic Descriptive for all sample						
Variable	N	Mean	Median	S.D	Min	Max
CONS	474	0.0048	0.0080	0.0908	-0.5348	0.5348
INV	474	0.0587	0.0375	0.0590	0.0000	0.3106
CFO	474	-0.0295	-0.0483	0.1933	-0.8228	2.3019
Q	474	1.5773	1.0626	1.2850	0.3288	6.8926
SIZE	474	14.1746	13.9639	1.4677	11.0413	18.5879
RETURNt-1	474	0.4201	0.1782	0.8936	-0.9500	3.8794
INVt-1	474	0.0557	0.0331	0.0606	0.0000	0.3096
AGENCY	474	0.1020	0.0000	0.1749	0.0000	1.3374

Panel B. Statistic Descriptive Low vs. High AGENCY COST Subsample						
	Mean		S.D		Median	
	Low	High	Low	High	Low	High
CONS	0.0061	0.0019	0.1029	0.0573	0.0109	0.0077
INV	0.0531	0.0706	0.0589	0.0574	0.0318	0.0546
CFO	-0.0586	0.0321	0.1991	0.1649	-0.0773	0.0166
Q	1.2214	2.3311	0.7721	1.7501	0.9695	1.7405
SIZE	13.9549	14.6399	1.3695	1.5619	13.7941	14.2862
RETURNt-1	0.3497	0.5693	0.8891	0.8876	0.0714	0.3499
INVt-1	0.0525	0.0627	0.0620	0.0569	0.0300	0.0416

CONS is a proxy for timely loss recognition, measure by average of the difference from net income with operating cash deflated by the average total asset over three years. INV is capital expenditure divided by total asset in period t. CFO is the amount of cash flow from operating activities of company i in period t divided by the beginning period of total assets. Q is the proxy for measuring the investment opportunity of the company, which is the total sum of market value of the outstanding ordinary shares, book value of long term debt, and current liability which is then divided by total assets (Kroes, 2013). SIZE is natural logarithm of the average total assets. Average total assets are total assets of period t and t-1 divided by 2. RETURNt-1 is annual stock return of firm i in period t-1. INVt-1 is investment (INV) of company i in period t-1. AGENCY is measured by dividing the dividend by the amount of EBIT DA of the firm on the periode t.

Tabel 4. Regression Result for Basic Model (Model 1)

Model 1					
$INVit = \alpha it + \beta 1CFOit + \beta 2Qit + \beta 3SIZEit + \beta 4RETit-1 + \beta 5INVit-1 + \epsilon it$					
Variables	Prediction Sign	Coefficient	Prob	Sig.	VIF
C		-0.0041	0.4270		
CFO	(+)	0.0422	0.0010	***	1.34
Q	(+)	0.0020	0.1745		1.43
SIZE	(+)	0.0023	0.0750	*	1.09
RETt-1	(+)	0.0082	0.0010	***	1.00
INVt-1	(+)	0.4443	0.0000	***	1.06
N			474		
F Test Sign			0.0000		
Adj R Square			0.2968		
***Significant at level 1% (one-tailed), ** Significant at level 5% (one-tailed), * Significant at level 10% (one-tailed)					
INV is capital expenditure divided by total asset in period t. CFO is the amount of cash flow from operating activities of company i in period t divided by the beginning period of total assets. Q is the proxy for measuring the investment opportunity of the company, which is the total sum of market value of the outstanding ordinary shares, book value of long term debt, and current liability which is then divided by total assets (Kroes, 2013). SIZE is natural logarithm of the average total assets. Average total assets are total assets of period t and t-1 divided by 2. RETURNt-1 is annual stock return of firm i in period t-1. INVt-1 is investment (INV) of company i in period t-1.					

Tabel 5. Regression Result for Model 2

Model 2					
$INVit = \alpha it + \beta 1CFOit + \beta 2CONSIt + \beta 3CFOit*CONSIt + \beta 4Qit + \beta 5SIZEit + \beta 6RETit-1 + \beta 7INVit-1 + \epsilon it$					
Variables	Prediction Sign	Coefficient	Prob	Sig.	VIF
C		-0.0187	0.2000		
CFO	(+)	0.0338	0.0140	**	1.79
CONS	(+ /-)	-0.0403	0.0875	*	1.47
CFO*CONS	(-)	-0.1064	0.0030	***	1.47
Q	(+)	0.0018	0.1975		1.50
SIZE	(+)	0.0034	0.0185	**	1.14
RETt-1	(+)	0.0080	0.0010	***	1.08
INVt-1	(+)	0.4485	0.0000	***	1.06
N			474		
F Test Sign			0.0000		
Adj R Square			0.3177		
***Significant at level 1% (one-tailed), ** Significant at level 5% (one-tailed), * Significant at level 10% (one-tailed)					
INV is capital expenditure divided by total asset in period t. CFO is the amount of cash flow from operating activities of company i in period t divided by the beginning period of total assets. CONS is a proxy for timely loss recognition, measure by average of the difference from net income with operating cash deflated by the average total asset over three years. Q is the proxy for measuring the investment opportunity of the company, which is the total sum of market value of the outstanding ordinary shares, book value of long term debt, and current liability which is then divided by total assets (Kroes, 2013). SIZE is natural logarithm of the average total assets. Average total assets are total assets of period t and t-1 divided by 2. RETURNt-1 is annual stock return of firm i in period t-1. INVt-1 is investment (INV) of company i in period t-1.					

the independent variables in the model, and the rest is explained by other variables. While the F test shows that overall independent variables in the model significantly influence the dependent variable.

Based on t test model 1, the independent variables CFO has a probability value of t-statistic of 0.0010 with a coefficient of 0.0422 or $\beta_1 > 0$. That is, the variable CFO has a significant positive effect on the level of confidence of 99% on the dependent variable INV. CFO positive correlation coefficient indicates a dependence (sensitivity) of investment activity on the availability of internal funds. While significant control variable is SIZE (with a significance level of 10%), return_{t-1} (with a significance level of 1%), and INVT-1 (with significance level 1%).

CFO variable has a probability of significant t-statistic with a positive correlation. This is consistent with the prediction that there is a positive relationship between the CFO with INV. Interpretation of the results shows that investment activity does have a positive dependency (sensitivity) for the presence of internal funds. The test results are consistent with research models Stiglitz and Weiss (1981), Myers and Majluf (1984), Kaplan and Zingales (1997), Hubbard (1998), and Imhof (2014).

Q insignificant effect on the level of investment the company shows that the company's investment activities in Indonesia's manufacturing industry is influenced by factors other than the company's opportunity to invest (as measured by Tobin's Q). These factors such characteristics of the company (one of them the size of the company), its performance in the capital markets, as well as investing activities in the previous year. Size as one of the characteristics of the company has a significant positive effect on the size of the investment company. These results are in line with the statement Gurgler et al. (2000) that the size of the company affect its access to external funding, and then affects the investment-cash flow

sensitivity (Imhof, 2014). Prior annual stock return has a significant positive effect on the size of the investment company. This is similar to Lamont (2000) and Richardson (2006) which states that the value of the prior stock return affect the future value of an investment company for storing information related to the company's growth prospects are not explained in Q. The projection of the amount of investment company that will do in the future is not will be far away from his past investment value. This makes the variable INVT-1 has a large positive effect (0.4485) and significant at the 1% level to variable INV.

The results of model 1 indicates the existence of investment activities dependence (sensitivity) on the existence of internal funds. To test hypothesis 1 Model 2 was regressed which already included the effect of CONS. The test results of Model 2 can be seen in Table 5 in Appendix 2. Based on Table 5 it can be seen that the adjusted R Square for model 2 is 0.3177. These result indicates that after being combined with CONS variables, 31.77% of the variation amount of the investment company can be explained by the independent variables in the model and the rest is explained by other variables. While the F test shows that the overall independent variables in the model significantly influence the dependent variable. Based on this Model 2 t test, it can be seen that the CFO * NEG variable has a probability value of t-statistic of 0.0030 (significant at 1%) with a coefficient of -0.1064 or $\beta_3 < 0$. This implies that the the sensitivity of investment-cashflow is lower when companies have higher conditional conservatism. In other words, CFO coefficient which shows the sensitivity of investment-cashflow will be lower after being interacted with CONS. Control variables used in the model 2 is still having similar direct result of t test on the coefficients and their significance to the results of the test model 1.

The test results of model 2 in Table 5 shows that the variable CFO * NEG has a t-statistic probability of a significant negative correlation coefficient.

This correlation coefficients is consistent with the hypothesis. This indicates that the first hypothesis which states “conditional conservatism will decrease the sensitivity of investment-cash flow” cannot be rejected. Interpretation of the results of the testing of this model indicates that companies that implement higher conditional conservatism will have a lower dependence on internal funds when investing. These result is consistent with Imhof (2014).

Explanation for this situation can be expressed as follows: conditional conservatism is considered as an accountant tendency to be more careful in recording revenue and more timely in recognizing loss. This tendency is causing management to disclose information more thoroughly and reliably, so that the accounting information to be more qualified. It reduces the uncertainty in financial

reporting, lowering the risk of the company in the eyes of investors and creditors, and facilitates access to the external cost of capital with relatively low cost (Guay and Verrecchia, 2007; Suijs, 2008). Relatively low cost of external capital will enable the company to obtain external funding as a source of funding for investment activities, so, the company becomes less dependent on internal funds when investing (Imhof, 2014). This situation is illustrated by the relatively low level of investment cash flow sensitivity.

The Analysis of Impact of Agency Cost to Investment-Cashflow Sensitivity

Furthermore, to investigate and analyze the correlation of agency cost with investment-cash flow sensitivity level, this study test Model 3 and the results can be seen in Table 6. Based on Table 6 it can be seen that the adjusted R Square for Model 3

Tabel 6. Regression Result for Model 3

Model 3					
$INV_{it} = \alpha_{it} + \beta_1 CFO_{it} + \beta_2 AGENCY_{it} + \beta_3 AGENCY_{it} * CFO_{it} + \beta_4 Q_{it} + \beta_5 SIZE_{it} + \beta_6 RET_{t-1} + \beta_8 INV_{t-1} + \epsilon_{it}$					
Variables	Prediction Sign	Coefficient	Prob	Sig.	VIF
C		-0.0045	0.4200		
CFO	(+)	0.0485	0.0005	***	1.51
AGENCY	(+ /-)	0.0038	0.2405		1.23
AGENCY*CFO	(+)	-0.0418	0.0830	*	1.59
Q	(+)	0.0026	0.1350		1.84
SIZE	(+)	0.0022	0.0845	*	1.11
RETt-1	(+)	0.0079	0.0015	***	1.07
INVt-1	(+)	0.4472	0.0000	***	1.06
N			474		
F Test Sign			0.0000		
Adj R Square			0.2976		

***Significant at level 1% (one-tailed), ** Significant at level 5% (one-tailed), * Significant at level 10% (one-tailed)

INV is capital expenditure divided by total asset in period t. CFO is the amount of cash flow from operating activities of company i in period t divided by the beginning period of total assets. CONS is a proxy for timely loss recognition, measure by average of the difference from net income with operating cash deflated by the average total asset over three years. Q is the proxy for measuring the investment opportunity of the company, which is the total sum of market value of the outstanding ordinary shares, book value of long term debt, and current liability which is then divided by total assets (Kroes, 2013). SIZE is natural logarithm of the average total assets. Average total assets are total assets of period t and t-1 divided by 2. RETURNt-1 is annual stock return of firm i in period t-1. INVt-1 is investment (INV) of company i in period t-1. AGENCY is measured by dividing the dividend by the amount of EBIT DA of the firm on the period t.

is 0.2976. These result indicates that 29.76% of the variation amount of the investment company can be explained by the independent variables in the model, and the rest is explained by other variables. While the F test shows that overall independent variables in the model significantly influence the dependent variable.

From the results of the t test in this Model 3, CFO has a probability value of t-statistic of 0.0005 with a coefficient of 0.0485 or $\beta_1 > 0$. This means CFO variables have a significant positive effect on the dependent variable INV. AGENCY variable has a magnitude coefficient of 0.0038 but not significantly. This is indicating that the positive effect of AGENCY does not have a significant impact on the amount of investment companies in this study. To test the hypothesis 2, this study will test whether the coefficient AGENCY * CFO (β_3) is significant. The results in Table 6 shows that the variable coefficient AGENCY*CFO is -0.0418 and is at 10% significance level. These results indicate that this variable is significant but the coefficient is negative. Negative coefficient indicates that the lower agency cost firms have a higher investment-cash flow sensitivity compare to higher agency cost firms. The result indicates that hypothesis 2 is rejected.

The results of Model 3 in Table 6 shows that the company which has larger agency cost, their investment activity is more dependent from their internal funds. In other words, the investment-cash flow sensitivity in high agency cost companies tend to be lower. Any increase (decrease) of CFOs in companies with a large agency cost will lower (raise) the amount of their investment activities. The interpretation is not consistent with Imhof (2014), but consistent with Moyen (2004) and Kaplan and Zingales (1997).

The reason for this result can be explain by Moyen (2004) that state that low agency cost firms tend to be more flexible in choosing where to allocates their funds both on investment, dividend payments, or both. While high agency cost firm must choose

one of them. Moyen (2004) state that in addition to cash flow from the issuance of debt, low agency cost firm is more flexible than high agency cost to increase the size of the investment firm along with the amount of dividends paid. This is because there is no requirement to provide a fairly high dividend, thus, low agency cost firm does not have to sacrifice an increase in investment when deciding to pay dividends. Finally, the addition of cash flow from operations (which is infiltrated with additional funding from debt) will be followed by an increase in the value of investment in the same direction and almost as large, so the sensitivity of the company in this category seemed to be high. This trend adds an explanation of why the investment-cash flow sensitivity on low agency cost firms seemed to be higher.

Moyen (2004) also explains why on the high agency cost firm, the sensitivity is relatively low. When getting additional cash flow from operations, high agency cost firm must choose whether to allocate these funds to increase investment or to pay dividends. Why they must choose? because companies in this category tend to give large amounts of dividends. So that when choosing to allocate funds to the payment of dividends, there is no remaining funds to increase its investment. This makes the investment-cash flow sensitivity at high agency cost firms seems to be lower (Kaplan and Zingales, 1997; Moyen, 2004) and even tend to be negative.

For the control variables, in general there is no material change in results. All of variables correlation coefficient direction and significancy, in general, is still the same. This suggests that these control variables in the model have consistent function, without prejudice to the presence of moderating / new variable.

The Analysis Moderating Effect of Agency Cost's on the Relationship between Conditional Conservatism and Investment-Cashflow Sensitivity Furthermore, to examine the moderating effects

of agency cost on the effect of conditional conservatism negative influences on investment-cash flow sensitivity, Model 4 is tested. The results can be seen in Table 7.

Based on Table 7 it can be seen that the adjusted R Square for model 4 is 0.3211. These result indicates that 32.11% of the variation amount of the company investment can be explained by the independent variables in the model, and the rest is explained by other variables. While the F test shows that overall independent variables in the model significantly influence the dependent variable.

From the results of the t test this model 4, the variable CFO*CONS shows the coefficient is

-0.1208 with significance at the 1% level. AGENCY variables showed a positive coefficient of 0.0027 but not significantly. This indicates that the presence of agency cost dummy variables in the model does not affect the size of the company's investment activity. CFO*AGENCY which shows sensitivity of the large agency cost company has a coefficient value of -0.0106 but not significant (t-stat 0.3640). As for the CFO*AGENCY*CONS, it has a coefficient of 0.4140 and significant at the 5% level. This suggests that in high agency cost firm, the relationship between conditional conservatism and investment-cash flow sensitivity is higher compare to lower agency cost firms. In other words, the investment-cash flow sensitivity in high agency cost firms increases after the implementa-

Tabel 7. Regression Result for Model 4

Model 4					
$INV_{it} = \alpha_{it} + \beta_1 CFO_{it} + \beta_2 CONS_{it} + \beta_3 CFO_{it} * CONS_{it} + \beta_4 AGENCY_{it} + \beta_5 CFO * AGENCY_{it} + \beta_6 CFO_{it} * CONS_{it} * AGENCY_{it} + \beta_7 Q_{it} + \beta_8 SIZE_{it} + \beta_9 RET_{it-1} + \beta_{10} INV_{it-1} + \epsilon_{it}$					
Variables	Prediction Sign	Coefficient	Prob	Sig.	VIF
C		-0.0204	0.1815		
CFO	(+)	0.0352	0.0150	**	2.01
CONS	(+ /-)	-0.0350	0.1195		1.49
CFO*CONS	(-)	-0.1208	0.0010	***	1.56
AGENCY	(+ /-)	0.0027	0.3090		1.28
CFO*AGENCY	(+)	-0.0106	0.3640		1.69
CFO*AGENCY*CONS	(-)	0.4141	0.0210	**	1.14
Q	(+)	0.0012	0.3140		1.93
SIZE	(+)	0.0035	0.0165	**	1.18
RETt-1	(+)	0.0084	0.0005	***	1.09
INVt-1	(+)	0.4424	0.0000	***	1.07
N			474		
F Test Sign			0.0000		
Adj R Square			0.3211		

***Significant at level 1% (one-tailed), ** Significant at level 5% (one-tailed), * Significant at level 10% (one-tailed)

INV is capital expenditure divided by total asset in period t. CFO is the amount of cash flow from operating activities of company i in period t divided by the beginning period of total assets. CONS is a proxy for timely loss recognition, measure by average of the difference from net income with operating cash deflated by the average total asset over three years. Q is the proxy for measuring the investment opportunity of the company, which is the total sum of market value of the outstanding ordinary shares, book value of long term debt, and current liability which is then divided by total assets (Kroes, 2013). SIZE is natural logarithm of the average total assets. Average total assets are total assets of period t and t-1 divided by 2. RETURNt-1 is annual stock return of firm i in period t-1. INVt-1 is investment (INV) of company i in period t-1. AGENCY is measured by dividing the dividend by the amount of EBIT DA of the firm on the period t.

tion of conditional conservatism. This shows that the hypothesis 3 is rejected. This situation is not consistent with the Imhof (2014) who found that the negative effect of conditional conservatism on the investment-cash flow sensitivity is strongest in high agency cost firms relative to the low agency cost one. Control variables used in the model 4 is still having a similar direct test results on the coefficients and significance, as the results in hypothesis 1, 2, and 3.

There is an explanation for this situation. Imhof's (2014) research is conducted in the United States where people there having a different characteristics with Indonesian people. This characteristic differences include differences in decision-making, including decisions related to risk assessment and the return expected by the owners of capital. Changes in risk assessment fund owners as a result of an increase in conditional conservatism on the high agency cost firm is greater than the change in the risk assessment firm low agency cost, but reversed. While the risk assessment on the low agency cost firms improved (indicated by a decrease of sensitivity), the risk assessment of high agency cost firm worsen (indicated by an increase in investment-cashflow sensitivity). The main cause can be understood from the characteristics of conditional conservatism itself.

Conditional conservatism drives company to not rush (be careful) when recording revenues / profits, but tend to be more timely in the recording of expense / loss. This principle tends to lowering income, although it improves the quality of earnings. If done by a firm with high agency cost in the United States, owners of capital considered it as a good tendency to be more careful in recording profit. As a result, the cost of external capital required becomes relatively cheaper. In addition, the implementation of higher conditional conservatism on high agency cost firms repair its insight over the governance function. Two things make the company become a lot more easier to obtain external funds when

investing, and that makes the investment-cash flow sensitivity becomes smaller (Guay and Verrecchia, 2007; Suijs, 2008; Lafond and Watts, 2008; Imhof, 2014). However, when performed by Indonesian high agency firms, capital owners consider it bad because basically high agency cost firms had much to allocate funds for the dividend (Kaplan and Zingales, 1997; Moyen, 2004). When companies apply higher conditional conservatism, capital providers are not focusing on the shape of prudence applied by the company. Capital givers is focus more on the assumption that there is no more profit left for them. In effect, the cost of external capital required becomes relatively more expensive. In addition, an increase in expense / loss also makes the company seem to have more bad governance because it can not make a profitable managerial decisions. Two things that make Indonesian high agency cost firms (which implement higher conditional conservatism) becomes more difficult to obtain external funds when investing, thus, the dependence (sensitivity) on its internal fund becomes higher.

MANAGERIAL IMPLICATIONS

The implications of this research for (1) the development of science: research indicates that the relationship between agent and principal in Indonesia is more efficient, not opportunistic. Thus, future studies in Indonesia is expected to be more focused on the exploration of efficient agency relationship; (2) regulators: the IFRS convergence in fact the principle of conservatism has been removed and replaced by prudence (prudence). However, the results of this study may be a standard board might consider to include elements of conditional conservatism in characteristic prudence (prudence) in the conceptual framework. In addition, the empirical evidence that the application of conditional conservatism can improve the company's flexibility in managing its financial resources when investing may be considered by the Securities and Exchange Commission to require the application of conditional conservatism on the companies listed on the exchange. This is

important because later on competition between companies in the ASEAN region will be intense, and the flexibility of determining the source of funds when investing plays an important role in supporting the sustainability of growth companies; (3) financial practitioners: results of this study are expected to broaden the horizon of financial practitioners, investors, creditors, financial analysts, auditors and accountants that conditional conservatism is an accounting principle that is able to increase the company's flexibility in arranging funding sources when investing. It is also expected that future financial practitioners may consider the application of conditional conservatism as an indication with a positive impact to company's value.

CONCLUSION

This study aims to provide empirical evidence that conditional conservatism has a negative effect on investment-cash flow sensitivity, and it will be even greater influence on companies with high agency cost as compared with low agency cost. In addition, this study also wants to prove that before the application of conditional conservatism, companies with high agency cost of investment-cash flow sensitivity is higher than the low enterprise agency cost. Different from previous studies, this study uses the dividend payout ratio to measure the amount of agency cost.

The results show that in terms of reducing investment activity dependence on the availability of internal funds, conditional conservatism has a significant negative effect. This indicates that the application of conditional conservatism is able to reduce the company's dependence on the availability of internal funds when investing. Control variables were shown to affect the amount of investment is the size of the company, prior annual stock return, and the amount of investment in the previous period. These results are consistent with research Imhof (2014) who conducted a similar study with a sample of companies in the United States.

Furthermore, this study shows that high agency cost firms has less investment-cashflow sensitivity than the low agency cost one. Low agency cost firms tend to be more flexible in choosing where to allocates their funds both on investment, dividend payments, or both. While high agency cost firm must choose one of them. High agency cost firm is not focused on investment because they have to prioritize allocation of funds to the provision of a relatively large dividends. This makes the sensitivity is lower for high agency cost firms. (Kaplan and Zingales, 1997; Moyen, 2004). These results are not consistent with the Imhof (2014), but consistent with Moyen (2004) and Kaplan and Zingales (1997).

This study also finds that that in high agency cost firm, the relationship between conditional conservatism and investment-cash flow sensitivity is higher compare to lower agency cost firms. In other words, the investment-cash flow sensitivity in high agency cost firms increases after the implementation of conditional conservatism. These results are not consistent with Imhof (2014).

This study has several limitations to be noted, namely: (1) Referring previous studies, this study used dividend payout ratio to measure agency cost as a proxy of agency cost of type two and type three. One of the potential problem in using this ratio is that dividend is not the only indicator of agency cost, a company which distributes more payouts may not have higher magnitude of agency cost. Further research should also consider other forms of agency costs and use other proxies of agency cost; (2) The number of companies that being sampled only 113 samples with 474 firms-year of five years of research. The number is still relatively small when compared with Imhof's (2014) research which uses 51.897 samples of 10 years of research. Future studies can fix this by adding a period of study in order to get more number of samples. Greater amount of sample will make the research more representative; (3) In calculating the value of conditional conservatism

company, this research only use one measurement. In contrast to Imhof (2014) which uses a model Givoly and Hayn (2000) and Basu (1997) to measure the conditional conservatism. Future studies can use several measurements of conditional conservatism that can be used as a comparison; (4) The study divided firms as high and low agency cost based on the mean value. As a result, my research has the potential for bias in representing the true state of the phenomenon of

investment-cash flow sensitivity in the two groups of companies. Future studies could develop this research to determine the proportion of the amount of high and low sample enterprise agency cost with a specific mechanism adapted to the purpose of research. This minimizes the bias so that research can represent the real situation on the phenomenon of investment-cash flow sensitivity in the two groups of companies. ■

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