

Research Article

Influence of Financial Reporting Quality about Financing and Investment

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Abstract.

This paper analyzes the effect of reporting quality on financing and investment. It is important for us to understand the relationship between them in order to prepare Indonesian companies for the ASEAN Economic Community. This study examines the effect of financial reporting quality on the financing and investment of 15 large market capitalized Indonesian companies based on Standard & Poor's Rating Services in its first survey of major corporate credit trends at the Association of Southeast Asian Nations (ASEAN). Those companies may still be underinvested in relation to their regional counterparts. The results showed that (1) the quality of financial reporting has a negative effect on financing.

Keywords: financial reporting quality, financing, investment

Introduction

With respect to the level of regional business partners, Indonesian companies are still underinvested as a consequence of limited capital expenditures, conservative balance sheet management and lack of knowledge of financial markets according to the results of a new report found by the agency. *Standard & Poor's (S&P) Rating Services*. In 2015 the ASEAN Economic Community (AEC), S&P provided integration leading to higher penetration in the country's capital markets and banking sector in the long term, paving the way for companies to obtain external funding sources. As a result, Indonesian companies will face higher competition from their counterparts, who view the country as an attractive and growing market.

The first S&P survey of leading companies in ASEAN highlighted trends in credit risk for the corporate sector includes 15 companies with the largest market capitalization in Indonesia. The fact is that these 15 companies are still underinvested and adopt a conservative use of debt. Conservative balance sheet management will affect the company's ability to invest optimally, this paper tries to expand the study by investigating the role of overall reporting quality in financing and investment in Indonesian companies because it is undeniably important for us to understand the relationship between these two. This is done to prepare Indonesian companies in the MEA. Indonesia is interesting to study because Indonesia is a country with an emerging economy where the Indonesian capital market has undergone significant regulatory changes and has a different

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institutional environment from other countries (Sirait and Siregar, 2013). In terms of the number of issuers, the Indonesian capital market has a low number of issuers when compared to countries in the Asean region. Based on this, it can be concluded that private debt is a source of company finance in addition to issuing shares, in this case the bank has a role in reducing capital market imperfections. Indonesia's capital market has a low number of issuers when compared to countries in the Asean region. Based on this, it can be concluded that private debt is a source of company finance in addition to issuing shares, in this case the bank has a role in reducing capital market imperfections. Indonesia's capital market has a low number of issuers when compared to countries in the Asean region. Based on this, it can be concluded that private debt is a source of company finance in addition to issuing shares, in this case the bank has a role in reducing capital market imperfections.

Manager's selection of financing is highly dependent on company financing capacity. The role of financial statement quality on financing is one of the important questions in accounting research. Financial statement information is very important for the purpose of the agreement. (Watts and Zimmerman, 1990; Ball, 2003; Holthausen and Watts, 2001). In addition, to reduce information asymmetry, it can also link the quality of financial reporting with investment. Biddle, et.al (2009) suggest:

“Higher quality of financial reporting could allow constrained firms to attract capital by making their positive net present value (NPV) projects more visible to investors and by reducing adverse options in issuing securities. Alternatively, higher quality financial reporting may curb managerial incentives to engage in value-degrading activities”.

In other words, higher quality of financial reporting can be highly associated with investment and remove financing constraints to increase investment or increase transparency that can prevent managers from overinvesting (Lubis et al., 2021). The relationship between information asymmetry, financing, and investment is the highest literature subject in corporate finance (Hubbard, 1998; Baker, et.al, 2003). Recently, researchers have begun to study whether and how reporting quality reduces underinvestment associated with financing constraints (Biddle, et.al, 2009). This paper is closely related to recent works that try to highlight the role of financial reporting quality on financing and investment efficiency. Balakrishnan, et. al (2013) examined the relationship between reporting quality and financing and investment using evidence from changes in financing capacity. Biddle, et.al (2009) provide evidence both in documenting a conditionally negative (positive) relationship between financial reporting quality and investment for companies that operate and are more prone to underinvestment. This paper uses financial reporting data for companies located in the United States whose domestic capital markets remain the largest and deepest globally (US Chamber of Commerce, 2008). This might influence the degree of information asymmetry and financing frictions that firms face, and thus lead to bias. al (2009) provided evidence of both in documenting a conditionally negative (positive) relationship between financial reporting quality and investment for companies that operate and are more prone to underinvestment. This paper uses financial reporting data for companies located in the United States whose domestic capital markets remain the largest and deepest globally (US Chamber of Commerce, 2008). This might influence the degree of information asymmetry and financing frictions that firms face, and thus lead to bias. al (2009) provided evidence of both in documenting a conditionally negative (positive) relationship between financial reporting quality and investment for companies that operate and are more prone to underinvestment. This paper uses financial reporting data for companies located in the United States whose domestic capital markets remain

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Literature Review

Most of this literature shows that high-quality financial reporting can increase investment efficiency by reducing information asymmetry that causes economic frictions such as moral hazard and adverse selection (Leuz and Verrecchia, 2000; Bushman and Smith, 2001; Verrecchia, 2001). However, there is little research on whether reporting quality has a role as information that reduces financing constraints. Biddle, et al. (2009) provide preliminary evidence of this relationship by showing that among firms that tend to invest less, reporting quality is positively related to investment. This paper extends their paper by linking the quality of financing reporting to financing and investment.

This paper also investigates whether financial reporting quality is related to investment. To examine the relationship between financial reporting quality and investment, this paper follows Biddle, et.al (2009) and categorizes firms into two subsamples based on their tendency to invest less or more. On the one hand, lower information asymmetry and more reliable accounting numbers, along with higher quality financial reporting, could add to higher oversight based on short-term debt. Consequently, the effect of financial reporting on investment efficiency will be higher for companies with a high level of financial reporting quality and shorter maturity. On the other hand, companies that have a higher level of financial reporting quality, will not really need to monitor the behavior of managers in companies with shorter debt maturities (Bharath et al., 2008). Based on these assumptions, this study expects the importance of financial reporting quality to reduce information asymmetry. Higher quality financial reporting allows for overinvestment and increased transparency which can discourage managers from engaging in value-degrading activities.

Thus, higher quality of financial reporting with regard to investment is likely to reduce adverse selection and eliminate financing constraints. Given this evidence, financing is not the only reason why the quality of financial reporting can affect investment. This can directly affect investment by reducing moral hazard and therefore discourage managers from investing excessively. If reporting quality reduces adverse selection and moral hazard issues, it can certainly be associated with investment because both risks faced by suppliers of capital are the main factors that contribute significantly to managers' investment decisions. In studying this relationship,

Research methods

Studyit will test two hypotheses. First, this study will examine the effect of financial reporting quality on financing. Second, this study will investigate the effect of financial

reporting quality on investment among firms with a higher likelihood of under-investing. The sample used for this paper consists of 15 large Indonesian companies analyzed by Standard and Poor's Rating Services in its first survey of major corporate credit trends at the Association of Southeast Asian Nations (ASEAN). It is the most representative of the major industrial sectors in Indonesia due to its large market capitalization. Follow the approach of Balakrishnan, et.al (2013). Total financing proposed by company as the dependent variable.

$$FIN ET_{t+1} = A + 1FRQ_{t+1} \dots (1)$$

Following Bradshaw, Richardson, and Sloan (2006), this paper measures net debt financing as net cash received from (paid for) debt issuance (reduction). Total financing is the amount of debt and equity financing in a given year as measured by the value of the lagging assets. As before, FRQ is a proxy for reporting quality.

Investment in this study was measured by the model used by Biddle et al. (2009) to estimate the level of investment expected by company *i* in year *t* based on growth opportunities, which is measured by sales growth.

$$Investment_{i,t} = \beta_0 + \beta_1 SalesGrowth_{i,t-1} + \varepsilon_{i,t}$$

where:

Investment *i,t* = total investment of company *i* in year *t*, calculated from the increase in tangible and intangible assets divided by lagged total assets.

SalesGrowth *i,t-1* = rate of change in sales of company *i* from *t-2* to *t-1*.

The residual value of the regression model reflects the deviation from the level of investment expected by the company. We will use the residual value as a proxy for investment inefficiency. A positive residual value indicates that the company invests higher than the investment expected by the company in accordance with sales growth, so that the company experiences overinvestment. While the negative residual value indicates that the company invests lower than the investment expected by the company in accordance with sales growth, so the company experiences underinvestment. The dependent variable in this study will be the absolute value of the residual multiplied by -1. So the highest value indicates high efficiency. (InvEff) Follow the approach of Biddle, et.al (2009). This paper examines whether financial reporting quality is negatively or positively related to investment when firms are more likely to under-invest.

$$Investment_{t+1} = a + 1 FRQ_{dia} + 2 FRQ_{dia} * OverI_{t+1} + 3 more\ than\ me_{t+1} \dots (2)$$

To examine the conditional relationship between reporting quality and investment, the paper uses a firm's cash balances and leverage as proxies for over- and under-investment. The main measures of investment include both capital and non-capital investment. FRQ is a measure of financial reporting quality. more than is a rating variable used to distinguish between settings in which over- or underinvestment is likely. This paper estimates Equation 2 by using Ordinary Least Squares (OLS). This study uses timely loss recognition as a proxy for financial reporting quality. This model assumes that positive and negative returns are proxies for economic gains and losses, respectively. For the purpose of measuring timely loss recognition, this paper follows the approach of Khan and Watts (2009) to construct a measure of

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conservatism at the firm-year level. This approach uses a cross-sectional regression model which is defined as follows:

$$xI = a + 1DI + 2RMy + 3DRI + Me$$

Where I is the index of the company, x is the annual income scaled by the market at the beginning of the year value of equity, R is the 12-month stock return used to measure economic news for the 12 months starting nine months before the end of the fiscal year, D is a dummy variable that is equal to one when $R < 0$ and equals zero otherwise, and is the remainder. Annual profit is the amount of net profit earned by each company each year. Stock returns are calculated using the holding period return formula, which consists of dividend yields plus capital gains. Timeliness measure for newswell captured by 2, while incremental punctuality for bad news above the good news is captured by 3, which is used to measure conditional conservatism. The total timeliness of bad news is captured by 2 + 3 (Khan and Watts, 2009). If 3 is positive, acknowledgment of bad news is timely. Likewise, a positive 2 indicates that the recognition of the good news is timely. The sum of these two coefficients determines the degree of timeliness of total bad news with a positive value indicating timely recognition and vice versa.

RESULTS AND DISCUSSION

1. Results

Descriptive statistics

Table 1 depicts the financing of the 15 Indonesian companies included in the sample during the period 2009 to 2013. Financing is proxied by FIN ET, the amount of debt and equity financing in a given year as measured by the value of the asset left behind. The highest average occurred in 2013 while the lowest average occurred in 2009. This indicates that financing has increased from year to year.

Table 1. Summary of Financing in 15 Indonesian Companies

No	FIN \sim NET _{t+1} (Financing)				
	2009	2010	2011	2012	2013
1	-0,070	0,031	0,054	-0,004	-0,043
2	-0,329	-0,204	-0,012	0,016	0,018
3	-0,074	-0,064	0,057	0,006	0,090
4	-0,208	-0,195	-0,587	-0,345	-0,383
5	-0,090	-0,062	-0,077	-0,059	-0,073
6	0,047	0,028	0,040	-0,007	0,112
7	-0,003	0,055	-0,006	0,053	0,039
8	-3,594	-0,087	-0,063	-0,107	-0,062
9	0,005	0,244	0,065	0,085	0,046
10	-0,090	-0,055	-0,233	-0,128	-0,105
11	-0,114	-0,102	-0,019	-0,058	-0,086
12	-0,070	-0,097	-0,154	-0,074	-0,115
13	-0,375	-0,380	-0,461	-0,400	-0,427
14	0,095	-0,011	-0,104	0,058	0,083
15	-0,059	-0,118	-0,018	0,048	0,062
Mean	-0,329	-0,068	-0,101	-0,061	-0,056
Maximum			-0,056		
Minimum			-0,329		

Source: data analysis

Table 2 depicts investments in the 15 Indonesian firms included in the sample over the period 2009 to 2013. Investment in a given firm year is the sum of capital expenditures, R&D expenditures, and acquisitions minus PPE sales, scaled by total lagging assets. The highest average

occurred in 2010 while the lowest average occurred in 2009. This indicates that investment has decreased in the last three years.

Table 2. Summary of Investment in 15 Indonesian Companies

No	INVESTMENT _{t+1}				
	2009	2010	2011	2012	2013
1	0,060	0,085	0,095	0,068	0,048
2	0,033	0,074	0,224	0,201	0,172
3	0,049	0,040	0,059	0,096	0,136
4	0,035	0,024	0,021	0,042	0,090
5	0,030	0,037	0,041	0,061	0,093
6	0,077	0,069	0,062	0,093	0,183
7	0,109	0,849	0,130	0,027	0,024
8	0,151	0,084	0,101	0,115	0,119
9	0,014	0,009	0,040	0,058	0,026
10	0,070	0,047	0,028	0,054	0,151
11	0,316	0,273	0,213	0,245	0,102
12	0,234	0,158	0,142	0,088	0,186
13	0,335	0,431	0,473	0,386	0,354
14	0,153	0,159	0,267	0,143	0,082
15	0,182	0,188	0,237	0,324	0,227
Mean	0,123	0,168	0,142	0,133	0,133
Maximum			0,168		
Minimum			0,123		

Source: data analysis

Table 3 provides a summary of timely loss recognition for each year. Positive results shown in 2008, 2010, and 2011 indicate that the recognition of timely losses in those years. Meanwhile, negative results in 2009 and 2012 indicate premature recognition of losses. In other words, the amount of income reported in 2009 and 2012 does not reflect the economic conditions during those years. In general it can be concluded that the total timeliness for bad news fluctuated over the period 2008 to 2012. Therefore, the quality of financial reporting varies from year to year.

Table 3. Summary of Timely Loss Recognition (TLR)

Year	β_2	β_3	$\beta_2 + \beta_3$	TLR
2008	0.089	-0.056	0.033	Timely
2009	0.174	-0.483	-0.309	Not Timely
2010	0.030	-0.010	0.020	Timely
2011	0.035	0.000	0.035	Timely
2012	-0.002	-6.702	-6.704	Not Timely

Source: data analysis

Table 4 shows the results of the regression that will analyze the effect of financial reporting on the quality of financing. The resulting regression model is as follows: $FIN ET_{t+1} = -0.140 - 0.012FRQT$ Constant A of -0.140 means that the average value of FIN ET is -0.140 if the value of financial reporting quality is equal to zero. In addition, the regression coefficient of -0.012 means that FIN ET decreases by 0.012 when the value of financial reporting quality increases by 1.

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Table 4. The Effect of Financial Reporting Quality on Financing

Model		Unstandardized		Standardized	t	Sig
		Coeff		Coeff		
		B	SE	Beta		
1	(Constant)	-.140	.057		-2.475	.016
	FRQt	-.012	.019	-.076	-.652	.516

Source: data analysis

The results of testing the first hypothesis indicate that the quality of financial reporting has a negative effect on financing. Given these results, the null hypothesis is accepted and the alternative hypothesis is rejected. However, these results do not indicate that the improvement in the quality of financial reporting is in line with the increase in financing. After considering the results, there are several possibilities. First, it is possible that most of the companies included in the sample do not face financing constraints (Balakrishnan, et.al, 2013). This condition makes the quality of financial reporting irrelevant to financing because companies can have access to financing regardless of financing constraints. Second, companies operating in high-risk environments, such as Indonesia, may adopt less risky financing policies. Indonesia is considered to have a high-risk environment due to lack of knowledge of financial markets and high dependence on foreign investors. S&P's first survey of the most prominent companies in ASEAN found that the most striking difference in the distribution of the country's financial risk profile is the far more conservative nature of Indonesian companies. Taking into account key financial ratios including debt to EBITDA, EBITDA interest coverage, and free operating cash flow to debt, the financial risk profile of 13 of the 15 Indonesian companies is "minimal", "moderate", or "medium". In this situation, Indonesian companies may still prefer to use their own internal cash flows to finance growth. Third, experiencing political instability, With higher energy costs, and tighter monetary policy, the Indonesian stock market is considered the riskiest in Southeast Asia. According to this report, the Indonesian stock market is most vulnerable to capital flight amid expensive valuations and large holdings by foreign investors.

In this case, in addition to the quality of financial reporting, many factors affect the company's ability to obtain financing because investors are exposed to risks other than those caused by information asymmetry, including systematic risk resulting from domestic problems. the company may choose not to issue more shares in order to maintain ownership of existing shareholders. This reason may explain why in the period of this study, only a few companies issued more shares and most of the companies had negative equity financing.

Table 5. The Effect of Financial Reporting Quality on Investment

Model		Unstandardized		Standardized	t	Sig
		Coeff		Coeff		
		B	SE	Beta		
1	(Constant)	.256	.057		4.490	.000
	OverIt,t+1	-.208	.099	-.265	-2.110	.038
	FRQt	-.008	.020	-.152	-.373	.710
	FRQ*Over	-.015	.035	-.180	-.439	.662

Source: data analysis

The resulting regression model is as follows:

$$Investment_{i,t+1} = 0.256 - 0.008FRQ_{i,t} + 0.015FRQ_{i,t} * OverI_{i,t+1} + 0.208 OverI_{i,t+1}$$

The constant is 0.256, meaning that the average value of the investment is 0.256 if it is not influenced by one of the independent variables. In addition, the first regression coefficient of -0.008 means that investment decreases by 0.008 when the value of financial reporting quality increases by 1. Table 5 examines the effect of financial reporting quality on investment. The second hypothesis model is determined as follows:

$$Investment_{i,t+1} = a + \beta_1 FRQ_{i,t} + \beta_2 FRQ_{i,t} * OverI_{i,t+1} + \beta_3 OverI_{i,t+1}$$

Where Investment in a given company year is the sum of capital expenditures, R&D Expenditures, and acquisitions minus PPE sales, scaled by total assets lagging, FRQ is my proxy for reporting quality indicated by timely loss recognition, and over is a rating variable. used to distinguish between settings where over- or underinvestment is likely. The coefficient 1 measures the relationship between financial reporting quality and investment when it is most likely underinvestment. The coefficient 2 measures the additional relationship between financial reporting quality and investment as overinvestment becomes more likely.

Based on these results, the sum of 1 and 2 is equal to 0.007 ($\beta_1 + 2 > 0$). This indicates that H02a is accepted and therefore the quality of financial reporting has a positive effect on investment among firms with a higher probability of overinvestment. Thus the quality of financial reporting has a negative effect on investment among companies with a higher probability of underinvesting. This result is also supported by the output of the T test. The value of T generated in the test is -0.373. Because the value of T (-0.373) is greater than -T in the table (-1.994), the null hypothesis is accepted. The results mentioned above are also followed by the natural consequences which are rejected because they are positive β_2 . That is, contrary to what corollary suggests,

The second hypothesis is divided into two parts depending on whether company more likely to invest more or less. As discussed earlier, the results provide evidence for the effect of financial reporting quality on investments in both settings. First, the quality of financing reporting has a positive effect on investment among firms with a higher likelihood of over-investing. Second, the quality of financial reporting has a negative effect on investment among companies with a higher probability of underinvesting.

2. discussion

Following this is the assumption underlying the alternative hypothesis. Higher quality of financial reporting related to investment among firms with a higher likelihood of overinvesting by increasing transparency which can discourage managers from engaging in value-damaging activities. In addition, higher quality of financial reporting is associated with investment among firms with a higher likelihood of underinvesting by reducing adverse options and removing financing constraints. In the presence of results that turned out to be opposite to the expected effect, several possibilities emerged as to what might be the cause of the result. For firms with a higher likelihood of overinvesting, the positive effect of financial reporting quality on investment seems plausible given the S& P on major corporate credit trends suggests that compared to their regional counterparts, Indonesian firms may still be underinvested as a result of limited capital

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expenditures. This means that the current level of investment of these companies is still relatively low. Therefore, increased investment may not indicate a tendency to overinvest and firms with higher liquidity (hence the likelihood of overinvesting) do not appear to be overinvesting. investment when they increase their investment because it may still be below the optimal level. Thus, better transparency resulting from higher quality financial reporting does not discourage managers from investing more. For companies with high liquidity lower (hence the higher probability of under-investment), there may be several reasons why the quality of financial reporting does not have a positive effect on their investment. First, the quality of financial reporting may not eliminate financing constraints as expected due to several causes described in the previous section, such as the absence of financing constraints, less risky financing policies, and political and economic instability. Therefore, a higher quality of financial reporting cannot guarantee an increase in financing that is important for making investments. Second, the riskiness of investment activities can also influence managers' decisions to invest.

Conclusion

The results of this study indicate that the quality of financial reporting has a negative effect on financing and the quality of financial reporting has a positive effect on investment. Based on this, it can be concluded that the quality of financial reporting contributes to overcoming the problem of over-investment and under-investment, as well as increasing investment efficiency. This means that the quality of financial reporting can be a mechanism that helps companies to increase the optimal level of investment. The results of this study also support the view that there is an influence between the quality of financial reporting on investment efficiency, high levels of financial reporting quality can ease companies in making investment decisions because they are able to reduce information asymmetry. Both parties, namely managers and shareholders, have received balanced information regarding the condition of the company, which has been reflected in the financial statements so as to create efficient investment through low information gaps. This means that there is no more hidden information by the company's management because it is reflected in quality financial reports. The small amount of information asymmetry can result in the company's investment being efficient (Setyawati, 2015). There is an opportunity to expand this research in several ways. First, one can use a different sample or period of research to explore other possibilities that may occur with respect to a particular topic. Second, this study does not take into account several other factors that may affect financing and investment, such as the company's financing policy and the risk of investment activities.

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