CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter discuss about theoretical, dependent variable, independent variable, conceptual framework, hypotheses development. empirical review, underpinning theories, research framework, hypotheses, and conclusion. These will assist the reader in understanding the topic of the research.

2.2 Investment Efficiency

According to Sugiyono (2019), the dependent variable is often referred to as the output variable, criteria and consequents. The dependent variable is the variable that is affected or is the result because of the burden variable. The dependent variable in this study is investment efficiency.

The results of several studies undertaken by earlier academics suggest that better investment judgements are made when accounting information is of a higher quality. According to Chen et al. (2011), discovered that the effectiveness of investments is positively impacted by the accuracy of accounting information. In addition, according to Zhai & Wang (2016), found that reliable accounting information is critical for monitoring and motivating management to optimize investment choices and ultimately maximize shareholder returns. In the maturity period rather than the decline period, there is a larger correlation between capital investment and earnings quality. When a company can invest optimally, the company can avoid underinvestment and overinvestment. According to Garcia-Lara et al. (2010), conducted research and found evidence that conservatism can reduce overinvestment and underinvestment, namely reducing the sensitivity of cash investment flows to corporate overinvestment and facilitating access to external funding for corporate underinvestment.

According to Basalamah and Haming (2010), Investment is one-way companies do to develop and increase company value. Investments can be in the form of investing in other companies or buying bond certificates. This is in accordance with the general understanding of investment, namely the decision to spend funds at this time to buy real assets (land, houses, cars, etc.) or financial assets (stocks, bonds, mutual funds, notes, etc.) bigger in the future. In addition, companies invest not only to enrich the company, but also to establish close business relationships with other companies.

Investment decisions are made based on circulating information. Managers must avoid information asymmetry that exists among stakeholders so that managers can make investment decisions and avoid overinvestment and underinvestment problems (Sari & Suryana, 2014). Overinvestment is a condition where the company's investment is higher than expected. Contrary to overinvestment, underinvestment is a condition where the company's investment is lower than expected.

Pranata & Fitriyah (2020), studied The Effect of Financial Reporting Quality and Capital Structure on Investment Efficiency in Listed Manufacturing Companies. According to the study financial reporting quality has a positive and significant effect on investment efficiency.

2.3 The Quality of Financial Statements

Independent variables are variables that affect the dependent variable or the dependent variable. According to Sugiyono (2019), independent variables are variables that influence or cause changes or the emergence of the dependent variable. The independent variable in this study is the quality of financial statements.

According to Rodrigo (2006), the quality of financial statements is negatively related to underinvestment or overinvestment. A financial statement's quality is more closely related to underinvestment for companies facing cost restrictions and overinvestment for companies with large amounts of cash where the quality of financial statements is also related to efforts to minimize information asymmetry arising from poor project selection or agency conflicts. The quality financial statements is a report that contains a company's business that is informative for investors or users. Financial statements can be said to be of high quality if the reports produced are useful for those who make decisions. This indicates that the qualitative aspects of the data contained in financial statements are significant and acceptable (Manossoh, 2016).

Financial statements include not only financial reports but also other information reporting media, which are directly related, to information provided by the accounting system, namely about economic resources, debt, periodic profits and others (Rahmawati, 2014). According to IAI (2017), states that financial statements are meant to provide details on the cash flows, financial performance, and overall financial status of a company that the majority of report users will find helpful in making financial choices.

According to Giri (2017), receivables are demands to customers and other parties to obtain certain money, goods and services in the future, as a result of the current delivery of goods or services. According to Samryn (2016), income is an increase in assets or a reduction in liabilities originating from the delivery of goods or services in the context of the company's commercial activities.

For stakeholders, the accuracy of financial accounts is crucial. The qualitative features of the company's financial statements allow stakeholders to judge the quality of the financial statements. According to Verdi (2006), describes how accurate of financial statements that transmit information about a company's operations, particularly the anticipated cash flows to inform equity investors. The appropriate judgements can be made with the support of accurate financial statements. According to Gomariz and Ballesta (2013) quality financial statements will enable better supervision so that managers are more accountable.

Angela & Aryancana (2017), studied The Effect of Financial Reporting Quality on Financing and Investment. According to the study financing statements quality has positive effect on investment.

2.4 Theory of the Study

2.4.1 Agency Theory

Agency theory appears that there is a separation between owners and management (Rayu, 2011). The owner or shareholder acts as the principal, while the management acts as an agent, plus an auditor as a third party. Work contracts that manage the distribution of each party's rights and obligations while taking into account the overall advantages can implement agency theory. Designing suitable contracts to align the interests of the principal and agent in the case of a conflict is the essence of agency theory.

Based on agency theory, conditions of overinvestment and underinvestment can be described by the presence of information asymmetry between parties who have an interest. Information asymmetry is a situation when shareholders do not have access to information about company prospects, while managers have access. Financial information about a corporation that has been manipulated in financial statements is of poor quality, which can lead to errors when making decisions. One of them is the error in making investment decisions, which has an impact on investment inefficiency. This information asymmetry problem needs to be addressed because it can cause losses for many parties, especially shareholders.

Previous studies have found that by improving the quality of corporate financial statements, information asymmetry can be reduced (Bushman and Smith, 2001). According to Ballesta and Gomariz (2013) argue that if the published financial statements are categorized as of good quality, then the supervision carried out will also be good so that managers can be more responsible. Previous research according to Biddle and Hillary (2006), have proven that accurate financial statements enhance the efficiency of investments.

Information asymmetry can also be overcome by applying conservatism. Financial statement conservatism is a governance procedure that can reduce the opportunity for managers to manipulate and exaggerate financial performance of the company while making the company's value and cash flow higher (LaFond and Watts, 2008). Lara et al. (2016) argues that through the application of conservatism, investment losses due to bad decisions taken will be known as quickly as possible. If managers invest in projects that are detrimental, shareholders will know about it immediately, so that the manager's ability can be assessed as poor, therefore, the application of conservatism will reduce inefficient investments.

It can be stated that agency theory is a theory that involves two parties who have different interests in a company. These parties are managers and shareholders.

Agency theory also discusses the problem of information asymmetry that occurs between the two parties. And in these conditions, the party that feels disadvantaged is the shareholder because this party has less information about the company compared to the manager who knows the ins and outs of the company.

2.5 Hypotheses Development

The purpose of this research is to identify the factors that impact investment efficiency. For this purpose, hypotheses were developed based on the conceptual framework identified in the previous section.

2.5.1 The quality of Financial Statement and Investment Efficiency

To make the best investment choice and ensure the efficiency of the investment made, investors base their decisions on the quality of financial statement. The amount of firm information reported in the financial statements increases with the level of the quality of financial statement. It has been demonstrated by Biddle et al. (2009) and Chen et al. (2011) that the quality of financial statements has an impact on the effectiveness of investments and can help prevent overinvestment and underinvestment issues.

If the caliber of financial statements and investment efficiency are positively correlated, efficient investment activity can be raised (Lai et al., 2014). According to Ahuja & Novelli (2017), demonstrate how effective financial statements can lessen overinvestment circumstances. Overinvestment is a situation when too much money is invested, but the company only makes a small profit. The conceptual framework developed to test the link between independent and dependent variables is shown in the figure below.

H_1: *There is a significant effect on changes in account receivables and total investment.*

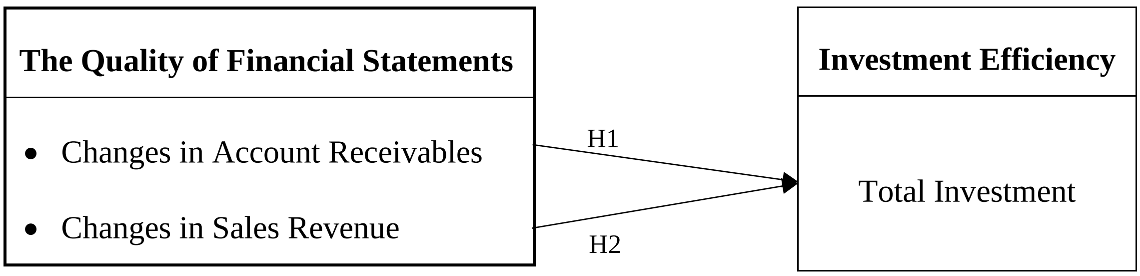
H_2: *There is a significant effect on changes in sales revenue and total investment.*

2.6 Conceptual Framework

According to Azam et al. (2021), the conceptual framework is a useful structure that helps explain how the phenomenon under investigation is likely to develop. The way the researcher approaches the problem while conducting the investigation is represented in the conceptual framework. This framework provides an understanding of the relationships, connections, and links between the variables as well as how they can be logically, explicitly, empirically, and theoretically justified. Based on the analysis on the theoretical basis and previous research that examined the factors that influence investment efficiency above, a framework of thinking can be described as follows:

Figure 2.1 Conceptual Framework

Independent Variable **Dependent Variable**



2.7 Summary

This study adds to the body of knowledge on investment efficiency and the quality of financial statement. The summary of this chapter contains information about empirical review, underpinning theories, research framework and hypotheses. As a result, the reader will find it simpler to understand the justification for this study.