Original Research Article

Impact of Conditional Conservatism and Agency Cost on Investment Cash Flow Sensitivity

Usman Ali Awan*, Ahmed Imran Hunjra, Waqas Zaman and Muhammad Tariq Mahmood

University Institute of Management Science-PMAS- Arid Agriculture University Rawalpindi, Pakistan,

*Corresponding Author's E-mail:
usman_awan210@hotmail.com

Abstract

Purpose of this research is to give the factual confirmation about the impact of conditional conservatism over the company investment cash flow sensitivity and its impact is more on those firms with higher agency cost as compared to lower agency cost firm. Researcher used the dividend payout ratio to estimate the cost of the agency, as the study uses Pakistan as a research condition in which organizations in Pakistan focus concentrated ownership and financing through debt, in this case the conflict of the agency which seems to be the most commanding is the agency's dispute. This study used secondary data which is collected from the listed manufacturing company's annual reports available on their website on Pakistan Stock Exchange. Study used sample of 147 companies of manufacturing sector listed and traded on the Pakistan Stock Exchange during the period 2008 to 2017, out of them 73 companies were high agency cost firms and 74 were low agency cost firms. Study used ordinary least squares regression. The results indicate that timely recognition of losses (application of conditional conservatism), firm sensitivity of investment to its cash flows reduces. Conditional conservatism reduces investment cash flow sensitivity in higher agency cost firms however expands the sensitivity in lower agency cost firms. Actually, prior to execution of conditional conservatism, high agency cost firms have lower investment cash flow sensitivity.

Keywords: Conditional Conservatism, Investment – Cash flow Sensitivity, Agency Cost, Dividend Payout Ratio

INTRODUCTION

Conservatism in accounting can be defined as "on average understated residual value of net operating assets comparative to their market value". Accounting conservatism classified in two generalized but well-defined ways in books of accounting studies. First category of conservatism is unconditional (news-independent). This mean accounting cycle is determined at the starting point of liabilities and assets expected and un-booked yield. Unconditional conservatism examples includes the immediate expenses / records of the costs of most of the established intangibles internally, the amortization and depreciation of fixed assets like land, building, machinery and computer equipment which is more speedup compared to the economic depreciation. A

longstanding literature describes unconditional conservatism focus on how accounting numbers are bias dependent.

Second category of conservatism is conditional (news-dependent). This means residual value is depreciated under specifically negative situation but never over valued under specifically favorable situation. Conditional conservatism examples include low cost or market or market esteem accounting for stock and for long term fixed tangible and intangible resources. The primary research that begins with Basu (1995) highlight that the conditional conservatism implications. Which approach to how and why do it imply that incomes more significantly correlated with current stock returns? This primary investigation also investigates asymmetry with respect to its accrual components and cash flow, time-series properties of earning and lagged returns. These two categories of conservatism have the same purpose, including the capture of asymmetric loss functions perceived by investors and others, minimizing the costs of litigation, taxes or company regulations. It also allows industry and regulators of accounting to reduce economic turbulence to stay away from criticism. The previous studies on conditional conservatism places more focus on enhancing the effectiveness of given managers' given the incentives to managers to report biased upward numbers that tend to rise. Without being affected by long history and continued use, a debate is underway on whether conservatism is appropriate or not.

Previous schooling in the domain of accounting described in a way that the standard / quality of accounting facts / figures effect the worth of the company (Healy and Bushman, 2001; Easley and Hara, 2004; Lambert et al., 2007 and Lara et al., 2009). This announcement sparks the science of reasoning about what sort of standard / caliber can expand the worth of the company. The standard / caliber of accounting facts, which are highlighted in the annual financial statements, are presented via many kinds of reporting. There are many choices in how to practice accounting standards. One is the philosophy behind the mechanism for doing so. An accounting philosophy that is believed to have a huge impact on accounting approach is conservatism. Conservatism in accounting measure is a philosophy in which higher the value of assets or income is not simply recognizable. Conservatism could be explained as a trend adopted by an accountant who stand in need of high-profile verification to acknowledge the benefits (good announcement on profits) than losses (bad news on profits) (Basu, 1997).

Guay et al. (2007) explained that conditional conservatism could escalate the worth of the company, escalating the capacity to obtain a low cost of external financing. Furthermore, conditional conservatism also opens up the door for supervision function of the firm which helped a firm with conditional conservatism to have

the extra edge in its management function. Jensen (1986) argues about the conservatism which is a process that ex ante control in management investment decisions and ex post allows the supervisory function of such management decision. Before making investment decision, fund manager will try to keep away from a negative Net Present Value project, even though the loss on that investment can be recorded through conservatism. After executing the investment project, conservative accounting numbers make more effective evaluation of the management performance.

While ascertaining the value / worth of the investment activity, the organization will look in advance the availability of retain earnings / internal funds (represented by the amount of cash generated through operations over the years). If internal funds are not sufficient, the organization then takes into consideration of additional funds from outside stakeholders (Weiss and Stiglitz, 1981 and Myers and Majluf, 1984). An " easy " availability of external funds make the firmness of the investment activities of the company less resting on its internal funds; in that case they can easily make the investment activities more effective and efficient. In school of corporate finance literature, the level of dependency of investment activity on the availability of an internal fund known as the sensitivity of investments for internal funds (between investments and cash flow). This sensitivity demonstrates the organization's capability to have external funding (Kaplan and Zingales, 1997; Hubbard, 1998; Imhof, 2014 and Wibawa and Wardhani, 2018). The lesser the sensitivity, the business investment activities can be financed with retain earnings / internal source of finance, but also with external source of finance (Fazzari, Hubbard and Peterson, 1988).

Many elements correlate with the enormity of sensitivity, in which of them is the organizations cost of agency. When the asymmetry information is high then the sensitivity is higher, highlighted by a higher agency cost. When the asymmetry information is low then the sensitivity is lower, indicated by a lower agency cost Jensen(1986).Imhof(2014) and Wibawa and Wardhani (2018) also explained that whenever the agency cost is apparently high, the organization face extra difficulty to acquire outer source of financing due to the high external cost of capital fixed by the creditors, therefore, the availability of internal source of finance is considered very high Influent to forecast the activities related to company investments (higher sensitivity of investment).

Conditional conservatism can easily minimize the cost of the organizations capital obtained through externally (Guay and Verrecchia, 2007;Suijs, 2008;Imhof, 2014 and Wibawa and Wardhani, 2018). The cheaper external financing will allow the management to acquire much more easily to invest in a project instead of internal financing. On this prospective a study proclaims that conditional conservatism minimize a degree of sensitivity

2

at cash flow of investments. Moreover, the certainty of the stakeholders who provide capital is affected from value of the agency cost (Arugasian, Mello &Saini, 2014;Imhof, 2014 and Wibawa and Wardhani, 2018).

A study incorporates the agency cost that derives an association between the owners of the fund (shareholders vs. creditor / investors) in view of the fact that this enquiry is the sensitivity of cash-flow of investments, which is highly associated with the financing decisions. Accordingly, to estimate agency cost, we uses the dividend payment ratio as the results report the dispute among creditors and shareholders. This magnitude of the cost of agency highlights the degree asymmetry information that the company seeks to lighten. So the higher the cost of agency (lower), the higher the risk assumed and return presumed from the providers of capital. The higher (lower) the uncertainty and expected return, the higher (lower) the cost of external debt that a company has to pay. The cost of the external capital, that is most of the time quite expensive (cheap), makes it difficult for the organization to acquire extra financing from outside creditors when it invests. Consequently, amount needed by the organization for the investment is totally relying (not relying) on availability of retain earnings / internal funds, even as investigated / highlighted by Imhof (2014) greater (lesser) company investment-cash flow sensitivity. This investigation also proclaims that companies with higher agency cost have the greater level of sensitivity for investment cashflow as compared with the companies with lower agency cost.

Quality of corporate governance can be improved with greater conditional conservatism (Lafond and Watts, 2008; Imhof, 2014 and Wibawa and Wardhani, 2018).On the basis of above narration, we can quoted the impact of conditional conservatism is reducing the sensitivity of cash flow of investments that's powerful organization which are governance issues (a company with high agency costs) and weaker organization that they had a batter governance structure (low-cost agency companies).

Conditional conservatism is a growing and fundamental area of financial reporting that could affect firm cash flow from operations. Role played by specific accounting mechanism, accounting conservatism over the firm cash flow are the main driving forces of firm investment level. Firm investment depends on availability of firm'sinternal and external source of finance. Conditional Conservatism reduces investment cash flow sensitivity.
A conflict of interest between the shareholder and management has existed in developing countries because of asymmetric information and market characteristics. The agency problem is more severe for the companies who have lower availability of internal funds.

Work on the dimensions/direction of Conditional Conservatism and Agency cost at Investment Cash Flow Sensitivity is not fully explored over the manufacturing companies listed on Pakistan Stock Exchange. Most of the researches done by Lafond and Watts (2008); Imhof (2014) and Wibawa and Wardhani (2018) over the developed countries like USA, Europe and Malaysia. Considering it as an opportunity for the researcher to explore the impact of conditional conservatism and of other control variables, like firm size Gurgler et al. (2000) Prior annual stock return Lamont (2000) & Richardson (2006) and firm previous year investment value Richardson (2006) will contribute in literature.

In Pakistan, the majority of the organization has a concentrated ownership structure, distinctive market elements and attributes, used debt as the main source of funding and most of the businesses are family owned business. So the agency's issues are straightforward to the question in between minority or dominant part investors (who are typically relatives) in addition to the organization and conflict among investors and creditors. Investment cash flow sensitivity is high in non-financial firms which need to be investigated. Therefore, this study is conducted to measure the impact of conditional conservatism and agency cost on investment cash flows sensitivity of manufacturing listed companies.
This research has following objectives:
1. To examine the effect of conditional conservatism on firm's investment cash flow sensitivity.
2. To analyze high agency cost firms have higher investment cash flow sensitivity.
3. To investigate the negative effects of conditional conservatism on firm investment cash flow sensitivity is higher for firms with higher agency cost firms as compared to lower agency cost firms.

The result of a research may be beneficial for the advancement of science, administrative systems and money related experts especially in Pakistan. For the evolution of science, this investigation explained the influence of conditional conservatism on the sensitivity of cash flow investment in Pakistani organizations, which are more bank-based, will be very not quite the same as the effect on US and Malaysian organizations, Likewise, this examination adds to rundown on research of the agency cost in Pakistan. The estimation of the organization reflected in the flexibility of the source of investment financing. For regulators, the investigation ought to show the advantages of applying conditional conservatism to expand the value of the company with the goal that it tends to be a valuable commitment identified with the advancement of quality accounting standards in Pakistan. For money related experts, this investigation ought to give an entire comprehension understanding of conditional conservatism and its effect on the organization's adaptability to decide the source of funding when it is invested.

3

Review of Literature

We investigate the positive link between cost of capital and conditional conservatism. This is known as earnings timelines asymmetric (Basu, 1997). Contemporary systematic worked by Guay and Verrecchia (2007) and Suijs (2008) has concluded that asymmetric information can influence firm's market worth and its capital cost. According to the researcher analytically highlight accurate and adverse signals reduce the discount factor that directly hit on value of the firm at the time of uncertainty and the future share prices. Guay and Verrecchia (2007) explain the fundamental mechanism and anticipated connection between conditional conservatism and cost of capital. They demonstrate organizations are obligation to report low realized income with full honesty along with lower cost of capital. As per conceptual mechanism, uneven information are directly increase risk premiums as financial speculator put less load on uncertain data signals (Merton, 1987; Easley & O'Hara, 2004; Lambert et al., 2008) and complete showing of information with full honesty decreases the uncertainty about expected future cash flows, bringing down cost of capital. Complete showing of information with full honesty is accomplished by means of convenient acknowledgment of the consolidated financial statements along with disclosure of information, which are assist to flourish within the sight of conservative reporting (LaFond and Watts, 2008).Findings of Guay and Verrecchia (2007) and Suijs (2008) explains that conditional conservatism could maximize the worth of the company, increasing the ability to obtain a decreased external cost of capital. The obligation to highlight / recognize bad news on opportune way (conditional conservatism) makes managers impart the information in more depth. Reduces uncertainty in financial relationships, reduces the company's risk in front of capital providers and creditors and facilitates availability of external financing at a comparatively low cost (Dye, 2001).

Li (2015) explained that countries lower cost of capital and equity is using more conservative financial reporting systems. The researcher also highlighted that link between cost of capital and conditional conservatism is more noticeable in countries with better legal application and where financial reporting accounting protocols are widely used. Lara, Osma and Penalva (2011) and Imhof (2014) described that conservative reporting improves information accuracy, increase firm value, decline the cost of external sources by diminishing "vulnerability of amount and circulation of upcoming cash flows, the instability of future stock costs".

Wibawa and Wardhani (2018) also revealed that impact of conditional conservatism reduces the cost of external source of finance. Appropriately lower the level of cost of outside source of funds able to organization for acquire fixed assets as a source of funding opportunity.

That situation is clarified by the clearly lower sensitivity of cash stream affect ability after usage of conditional conservatism.

The impact of free cash flow on spending at a firm has been reported long ago in 1950s and 1960s by (Meyer and Kuh, 1957 and Donaldson, 1961). Notwithstanding, the original addition in this literature is given by (Fazzari, Hubbard and Petersen, 1988 and 2000).Researchers exhibited that cash flow has a significant impact on a firm spending on investment activities and that cash flow sensitivity is higher in financially constrained firms than less financially constrained firms. This has been supported by different authors, who have steadily reported a similar positive and significant outcome (Hoshi, Kashyap and Scharfstein, 1991; Oliner and Rudebusch, 1992; Vogt, 1994; Gilchrist and Himmelberg, 1995; Hadlock, 1998; Degryse and De Jong, 2006). Interestingly, Kaplan and Zingales (1997 and 2000) documented that less constrained firms showing higher free cash flow sensitivity to investment than higher constrained firms. In Literature, the primary clarification for an association between cash flow and firm spending on investment in the presence of asymmetric information. Myers and Majluf (1984) elaborate this properly. They explain that firm insiders (administrators and shareholders) plan to exchange wealth from outside suppliers to existing shareholders. To accomplish this objective, they kept information about the estimation of the firm value from participants of capital market. Within the sight of such information asymmetry, external capital suppliers add a premium to the fund they give to firms. This raises the amount of external finance in respect to internal funds and allows firms to depend on internally generated cash flows to fund investment. The absence of external funds makes a financing gap and therefore firms most of the time forgo numerous profitable projects (for example they under-contribute). Asymmetric information prompts financing limitations and its clarification for the positive impact of internal finance.

Cash flow sensitivity also impact on the financial structure of the country, this structure elaborate how the consequences of asymmetric information is handled. The possibility that the financial framework has a critical role to carry out in monetary fluctuations and investments specifically is an old one (Gertler, 1988). Money market related frameworks offer finance via commercial paper, right share and equity markets are bound to demonstrate more prominent sensitivity to cash flow. Relationship situated frameworks are probably going to cultivate nearer and progressively straightforward arrangements of action that enable them to practice more noteworthy investigation over borrowers, and thus financial specialists will be less conscious to internal sources of finances. Size of the firm has also been used as a tool to indicate availability of external financing (Gertler and Gilchrist, 1994). In additions to this, small firms are

4

normally younger in age and having a high level of industry risk, less insurance, no credit worthiness which are not able to attract external source of finance. The literature also suggested that younger firms are most likely to be sensitive of monetary policy tightening than large firms.

Firm investment decision in the availability of free cash flows can investigate as investment cashflow sensitivity. In principle, firm investment level must not be connected cash flows internally generated (Modigliani and Miller, 1958). However, previous studies have elaborated a significance relation between investment cash flow and expenditure. There are two explanations for this significant positive relation. In the first place, the positive essentials connection is a trait of an agency issue, where managers in association with free cashflow are occupied with non-gainful consumption (Jensen, 1986 and Stulz, 1990). Second, the significant positive connection elaborate imperfections of capital market, where external financing which is costly generate the potential need of generated internally cash streams to access the investment opportunity feasible (Fazzari, Hubbard and Petersen, 1988 and Hubbard, 1998).

An implication of the doctrine by Modigliani and Miller (1958) explains future investment decisions of the companies are not related to their financing decision in which the external and internal finances are considered alternate of each other. Nonetheless, theory was formulated under the condition of perfect capital markets in which companies don't have to face restrictions to obtain financing from outside. In reality, obtaining external financing is expensive for companies and therefore not easily swaps with government financing. In simple words, companies will have financial restrictions and will depend on internal financing. The first publications of (Donaldson, 1961 and Pinegar and Wilbricht, 1989) demonstrate that domestic source is the fundamental source for companies. The proposal by Modigliani and Miller (1958) has additionally been addressed with the perspective of the contentions that exhibit the presence of information asymmetric and agency costs. Fazzari et al. (1988) have also highlighted that the presence of asymmetric information and agency cost influence the cash flow sensitivity of investments in a particular way. Their outcomes were commonly endorsed by numerous other investigations (Bond, Harhof&Reenen,1999; Carpenter, Fazzari and Petersen, 1994 and Nickell and Nicolitsas, 1999).

The firm investment cash flow sensitivity highlights level of reliance (sensitivity) for future investment projects on the internal funds availability. An exposition of immensity of this sensitivity can describe the organization's ability to acquire external source of finance when it invests. The lower level sensitivity makes a company able to obtain external financing for investment projects (Wibawa and Wardhani, 2018; Imhof, 2014;

Bushman, Smith and Zhang, 2011; Moyen, 2004; Hubbard, 1998). Fazzari, Hubbard and Peterson (1988) and Moyen (2004) supervised a study on the operating cash flow sensitivity of and investment companies classified according to their financial restrictions. The level of the financial restriction is based on the amount of the external capital cost. The higher the external capital cost set by creditors, the higher the resistance. The findings explains that the organizations with the classification of the most limited obstacles (apparently greater funding hurdle) are more sensitive to the company's cash flow investment transactions in the less restrictive category of constraints (relatively lower funding constraints)

Agency theory moves around the conflicts and its solution (Jensen and Meckling, 1976 and Ross, 1973). The historical backdrop of agency problem goes back to when human civilization conducts business and endeavored to maximize their interest. Agency problem is one of the deep rooted problems that persists since the advancement of the business entities. It can't be disregarded since each company conceivably experienced this problem in various forms. With the advancement in the time, the agency problem has taken diverse shapes and the literature has proof about it. The literature of agency theory is especially in need to comprehend the agency problem its different structures and the different costs associated with it to minimize the problem. The existence of agency related issues were widely documented in many academic fields. These proofs has been found in different academic fields like finance (Fama, 1980; Fama& Jensen, 1983 and Jensen, 1986), accounting (Ronen and Balachandran, 1995 and Watts and Zimmerman, 1983), political science (Hammond and Knott, 1996 and Weingast and Moran, 1983), sociology (Adams, 1996 and Kiser and Tong, 1992), organizational behavior (Kosnik and Bittenhausen, 1992), economics (Jensen and Meckling, 1976; Ross, 1973 and Spence and Zeckhauser, 1971) and marketing (Bergen, Dutta and Walker, 1992; Logan, 2000 and Tate et al., 2010). The expanded presence of agency problem in different kinds of organizations allowed this theory as the most important theory in the literature of economics and finance.

The agency relationship can be defined as understanding in which more than one person who acts on behalf of the principal, which implies delegation of power on some decision-making authorities to know as agent. The principle diverges from their interest by setting up an appropriate incentive for the agent to limit the aberrant agent's activities. Moreover, in a few circumstances, you will pay the agent to spend assets (surety costs) to guarantee that you won't embrace certain activities that they could hurt the principal or assure that the capital will be compensated on the off chance that you take such activities. However it is

commonly impossible for the operator to ensure that you settle on ideal choices from the executive's perspective. In most agency connections, the director and the operator acquires positive observing and association costs (non-monetary and financial), and there will likewise be a few divergences between the specialist's / agents choices and those that would augment the executive's prosperity. The agency costs may arise in any kind of situation involving of the combined efforts of two or more people, even though there is no clear relationship between the principal and the agent.

Based on the post literature, the agency's issue is distributed into three categories (Godfrey et al., 2010). The first category describes the dispute between the shareholders and the administration. The second category explains the dispute among the majority shareholder and the administration against the minority, and the third category described the dispute between shareholders and debtors. Firms in Pakistan have different characteristics than companies in the United Kingdom or the United States. Most of the companies in Pakistan have a concentrated property and use financing through debt. Because of this, most of the time, the dispute arises between the major shareholder (and the administration) and the minority shareholders (category two dispute) and the dispute in between creditors and shareholders (category three conflict). Considering this situation, the dividend is more effective and reliable mechanism for estimating agency cost problems (Imhof, 2014 and Wibawa and Wardhani, 2018). Fearing that minor shareholders might sell their shares at a lower price as occurred as a sign of expropriation or just to meet their routine expenses, the controlling shareholders and management be apt to give greater dividends as way to advance (Rozeff, 1982 and Gugler and Yurtoglu, 2001).On other side, the majority shareholder, the management of the organization with a comparatively lower agency problem is not panic for minor shareholders, so that dividends are apt to be lower (Gugler and Yurtoglu, 2001; Imhof, 2014 and Wibawa and Wardhani, 2018).

Considering the three dimensions of agency dispute, the dividend is a tool for reducing the agency cost between debtors and shareholders. In liabilities settlement, creditors normally restrict the payment of dividends in the debt contract. The organization has no longer has sufficient internal funds that may be used to sustain future growth.

It is a philosophy adopted by a bookkeeper who is profoundly cautious in recording income and timelier in perceiving cost. This philosophical approached made administration to present information more completely and dependably, so the bookkeeping data is increasingly precise and authenticated. It minimizes the vulnerability in accounting reporting; decreasing the danger of the organization according to speculators and creditors and

encourages access to external source of financing at apparently minimal cost. As per the announcement, Guay and Verrecchia (2007) and Suijs (2008) express that conditional conservatism reduce external capital cost. The generally minimal effort of external source of finance enables the organization to acquire funds from outside as a funding for investment projects. That structure able organization to less relay on accessibility of non-current assets to contribute (Imhof, 2014).This circumstance is represented by the moderately affected to the cash flow sensitivity of firms after the usage of conditional conservatism. Based on the literature, we draw the testable statement that is given below:

H1: Investment cash flow sensitivity negatively affected by conditional conservatism

Investment Cash Flow Sensitivity and Agency Cost

We identified different factor that can be to measure the sensitivity. These factors are being referred to as the organization agency cost Imhof (2014).The risk evaluation by the equity provider is influence by the measure of the cost of the agency of the organization (Arugasian and Saini, 2014). Imhof (2014) states that measure the cost of the agency demonstrates the dimension of asymmetry of the data that the organization tries to mitigate. The higher (low) the agency cost of the organization, the higher (lower) the evaluated risk and the expected return from the capital suppliers. The higher (lower) the risk and the expected return, the higher (lower) the cost of capital that the organization will pay. The expense of external capital, which is very costly (cheap), makes it troublesome for the organization to get extra funds from outside sources at the time of investment projects. Thus, the measure of the speculation made by the organization depends more (does not depend) on the measure of the inward assets, as demonstrated by the sensitivity to the cash flow of the investment that is generally huge (small). In light of these clarifications, the hypothesis:

H2: Organizations with higher agency cost have high cash flow sensitivity then the companies that have lower agency cost

Organizations with generally high agency issues have issues with their administration. The absence of good administration made the information asymmetry high, so the organization was progressively defenseless against unfriendly choice and moral hazard. This circumstance has constrained the directors to issue a greater cost as a means for relieving information asymmetry, which is reflected in the measure of the agency cost. For this

situation, conditional conservatism is thought to end up an answer for this circumstance since it very well may be adjusted to a powerful supervisory capacity in corporate administration (Lafond and Watts, 2008).

Imhof (2014) states that organizations with poor administration issues, described by the greatness of the cost of agency, the effect of conditional conservatism will be more grounded to decrease affectability. Due to this when selection of conditional conservatism in an organization with a high agency cost could likewise lessen the cost of capital, it additionally enhances administration capacity. This implies the owners to offer a more prominent return when organizations a poor government (high cost service organizations) execute conditional conservatism as for the use of a similar thing in an organization that as of now has great administration (agency enterprise).The form of gratefulness is the simplicity of getting external finances when organizations need to contribute or, at the end of the day, less sensitivity to the flow of investments. From above mentioned arguments, hypothesis is constructed as:

H3: Negative impact of conditional conservatism on firm investment cashflow sensitivity is greater for firms with higher agency cost then firms with lower agency cost.

METHODOLOGY

The data in this study we used secondary and acquire through annual reports of manufacturing companies of Pakistan Stock Exchange during the period 2008 to 2017.We used convenient sampling technique for the selection of firms. Initially sample is expected to be 200 companies from different sectors like Sugar Industry, Cement Industry, Chemical Industry, Fertilizer and Textile Industry etc. A criterion used in sample selection is asunder:

1. Companies listed and traded on the Pakistani Stock Exchange during the period 2008 to 2017.
2. The Company is engaged in the manufacturing industry.
As per criteria mentioned above, measurement of variables will be as follows:

In this study the researcher analyze the impact of conditional conservatism in minimizing the sensitivity of investment cash flow in Pakistan. This study also direct to investigate whether the effect is greater / higher to firms apparently high agency cost or might be weaker with companies with apparently lower agency cost. Following techniques are used to predict / examine above mentioned predictions.

Descriptive statistics explores the general behavior of all dependent and independent variables. The descriptive statistic investigates the estimation of mean, least qualities, greatest qualities and estimations of standard deviations of all factors utilized as test that demonstrates how much information is veered off from its inside.

Pearson's connection examination is utilized to research multicollinearity issues between test factors. The outcomes demonstrate the connection between two factors, Signs mirroring the negative and positive, indicates heading of the connection between two arrangements. On the off chance that the connection esteem is "1" it demonstrates that there exists an ideal relationship between the two factors, when the estimation of relationship is "0" at that point there is no relationship between two factors. As indicated by Kennedy (1998) presumes that when connection surpasses the limit of 0.70, at that point it demonstrates that the accompanying two factors are exceedingly associated, because of which an issue of multicollinearity might be emerge.

This study used least square regression supported and based by (Imhof, 2014 and Wibawa and Wardhani, 2018). Researcher also tested the assumptions of BLUE (Best Linear Unbiased Estimation) which shows that the model must meet the assumption of no multicollinearity, normally distribution and no heteroscedasticity.
Based on the above mentioned explanations, following below mentioned regression equations are applied to analyze the hypothesis.
Equation I: Investment cash flow sensitivity negatively affected by conditional conservatism (Hypotheses 1)
$(INV)_{i,t} = \alpha it + \beta_1 (CFO)_{i,t} + \beta_2 (CONS)_{i,t} + \beta_3(Q)_{i,t} + B_4 (SIZE)_{i,t} + \beta_5 (RET)_{i,t-1} + \beta_6 (INV)_{i,t-1} + \beta_7(CFO * CONS)_{i,t} + \varepsilon_{i,t}$
Equation II: Companies with higher agency cost have high investment cash flow sensitivity then the companies that have lower agency cost (Hypotheses 2)

$(INV)_{i,t} = \alpha it + \beta_1 (CFO)_{i,t} + \beta_2 (AGENCY)_{i,t} + \beta_3(Q)_{i,t} + \beta_4 (SIZE)_{i,t} + B_5 (RET)_{i,t-1} + \beta_6 (INV)_{i,t-1} + \beta_7 (AGENCY * CFO)_{i,t} + \varepsilon_{i,t}$

Equation III: Negative impact of conditional conservatism on investment cash flow sensitivity ishigher for organizations with high agency cost then organizations with lower agency cost(Hypotheses 3)

$(INV)_{i,t} = \alpha it + \beta_1(CFO)_{i,t} + \beta_2(CONS)_{i,t} + \beta_3(AGENCY)_{i,t} + \beta_4(Q)_{i,t} + \beta_5(SIZE)_{i,t} + \beta_6(RET)_{i,t-1} + \beta_7(INV)_{i,t-1} + \beta_8 (CFO * CONS)_{i,t} + \beta_9(CFO * AGENCY)_{i,t} + \beta_{10} (CFO * CONS * AGENCY)_{i,t} + \varepsilon_{i,t}$
Where:
INV is firm investment value, CFO isFirm operating cash flows, CONS is Conditional conservatism, Q is Firm investment opportunity, SIZE is firm size, RET is Firm annual stock return, INV is The firm previous year investment value, AGENCY is Agency cost.

7

Table 1. Measurement of Variables and proxies

Variable	Abbreviation	Measurement of Variables	References
Firm-Investment (INV)it	$(INV)_{i,t}$	Capital expenditures divided by overall assets	Wibawa&Wardhani (2018)
Investment Cash Flow Sensitivity	(CFO*CONS)	CFO = cash flow from operation divided by beginning period of total assets	Imhof (2014), Wibawa&Wardhani (2018)
Conditional conservatism (CONS)it	CONS	Firm's accruals calculated as (net income minus cash flows from operations) divided by the average total asset	Givoly&Hayn (2000) and Wibawa&Wardhani (2018)
Agency Cost	(CFO * AGENCY)	Dividend payout ratio (Dividend divided by net income)	Yurtoglu (2003) and (Godfrey et al., 2010)
Company Size (SIZE)it	$(SIZE)_{i,t}$	SIZE is natural logarithm of the average total assets	Gurgler et al. (2000)
Operating Cash flow (CFO)it	CFO	cash flow from operation divided by beginning period of total assets	Wibawa&Wardhani (2018)
Firm Investment Opportunity (Tobin's Q) (Q)it	$(Q)_{i,t}$	Market value of shares outstanding plus long term debt plus short term debt divided by total assets	Tobin's Q (1969)
Annual Stock Return (RET) it-1	$(RET)_{i,t-1}$	Annual stock return of firm i in period $_{t-1}$	Lamont (2000) and Richardson (2006)
Previous Year Investment Value	$(INV)_{i,t-1}$	Firm i investment value in period t-1	Richardson (2006)

Table 2. Sample details

Particulars	Total	Percentage
Sample	147	-
High Agency Costs Firm	73	49.65%
Low Agency Costs Firm	74	50.35%
Total	**147**	**100%**

RESULTS

In this part effort has been made to show the outcomes clearly and briefly and have been brace by true and fair introduction of the tables. Results have been talked about in detail as far as the examination point and targets. The basic aim of the investigation is to access the effect of conditional conservatism and agency cost of investment cash flow sensitivity of association through various variables. A few tests have been connected to examine the gathered information. The aftereffects of various variables and the level of appropriateness and essentialness as per the respondents and the connection between these variables are tested by different measurements and regression procedure and results are elaborated beneath:

In this investigation, the primary elements affecting the organization investment cash flow sensitivity of public sector manufacturing organizations in Pakistan have been broke down based on the gathered and accumulated information. Frequency of factual testicles has been connected to examine the information relating to the statistic highlights, and the outcomes are summarized. Additionally, the outcomes showing the level of agreeableness or disagreeableness to the different variables by the respondents have likewise been broke down by illustrative measurement and have been exhibited in organized shape.

This examination used sample of manufacturing companies listed in Pakistan Stock Exchange aiming for the period 2008-2017. The number count of organizations that are utilized as test totaling 147 organizations with 1470 firm years, which 73 of the examples is named high agency cost firms and 74 test as low agency cost firms. Attributes of the example can be seen from Table 2.

From Table 3 it can be clearly seen that the normal

Table 3. Descriptive statistics

Variables	N	Mean	Median	Maximum	Minimum	S. D
INV	1323	0.054	0.034	0.444	0.000	0.061
CFO	1323	0.110	0.091	0.607	-0.371	0.128
CONS	1323	-0.038	-0.030	0.440	-0.960	0.115
AGENCY	1323	0.114	0.000	1.767	0.000	0.243
Tobin's Q	1323	0.504	0.510	1.660	0.000	0.203
SIZE	1323	15.45	15.35	18.378	11.908	1.204
RET_{t-1}	1323	0.371	0.150	10.260	-0.790	0.974
INV_{t-1}	1323	0.055	0.034	0.598	0.000	0.066

Table 4. Correlation analysis

	INV	CFO	CONS	AGEN	Tobin's Q	SIZE	RET_{t-1}	INV_{t-1}
INV	1							
CFO	0.089	1						
CONS	-0.024	-0.539	1					
AGEN	-0.001	0.048	-0.046	1				
Tobin's Q	0.053	-0.079	0.021	-0.084	1			
SIZE	-0.094	-0.088	0.027	-0.093	-0.056	1		
RET_{t-1}	-0.067	0.122	-0.094	-0.086	-0.044	0.034	1	
INV_{t-1}	0.300	0.130	-0.010	0.027	0.046	-0.082	-0.038	1

estimation of the variable conditional conservatism (CONS) is - 0.038 with a normal most extreme to least esteem are (0.440 and –0.960). It demonstrates that the organizations in Pakistan manufacturing industry are more conservative. The variable investment (INV) has a normal estimation of 0.054 with a normal INV most extreme and least extreme qualities are (0.444 and 0.000). The maximum extreme0.444 demonstrates that the Pakistani manufacturing industry with high agency cost put more in capital expenses through inward source of finance when contrasted with external source of funds/ finance. Moreover, the normal estimation of variable AGENCY is 0.114. It demonstrates that there are practically 11.4% firms with high agency cost when contrasted with low.

From Table 4, it can be viewed that there is a positive relationship amongst (INV and CFO) firm investment ratio / values and cash flow from operational activities which implies firm investment values absolutely relies on just its internal current assets like cash / highly liquid assets. There is negative connection amongst (INV and CONs) firm investment value and conditional conservatism. It shows that conservative behavior negatively affects the firm investment values. There is a marginally inverse connection amongst (INV and AGENCY) firm investment value and high agency cost firms. It demonstrates that in context of Pakistan Manufacturing Industry, firms with high agency cost must have sufficient internal assets for investment as contrast with low agency cost firms. There is somewhat week positive connection amongst (INV and

Tobin's Q) firm investment value and firm investment opportunity. It demonstrates that firm's investment values are also increased as if there is positive investment opportunity.

There is somewhat powerful negative connection amongst (INV and SIZE) firm investment value and firm size. It demonstrates that firm size did not helps greater organizations for gathering source of funds internally and remotely for investment openings. There is somewhat negative relationship amongst (INV and RET) firm investment value and firm yearly stock return. Yearly stock return demonstrates firm performance of the previous year compare with current year. There is solid positive connection amongst (INV and INV_{t-1}) firm investment value and firm earlier year investment value.

Redundant fixed effects likelihood test is used for the selection purpose that either common effect model or fixed effect model which one is better. Selection criteria for this test are the P-value. If the likelihood test is significance, then common effect model will be rejected. In the current situation, P-value is significant; therefore common effect model is rejected.

As per the results in Table 5, the P-Value is highly significant, now researcher have two choices either fixed effect model or random effect model may be used. Hausman test will be used for decision making.

Hausman (1978) proposed a test to facilitate the choice of an appropriate technique among the two approaches named the fixed effects and the random effects. This test tells us that difference between the

Table 5. Likelihood test

Test Summary	Statistics	D.f	P-Value
Cross-section F	5.630	(145,1138)	0.0000

Table 6. Hausman test

Test Summary	Chi-square statistic	Chi-sq. d.f	P-Value
Cross-section random	84.89868	10	0.0000

Table 7. Regression results for equation I

Variable	Sig. Pred.	Coef.	Std. Error	t-Stat	Prob.
CFO	-	-0.067	0.028	-2.388	0.017
CONS	+/-	-0.024	0.022	-1.107	0.268
Tobin's Q	+	-4.760	0.000	-0.143	0.886
SIZE	+/-	-0.016	0.008	-2.081	0.037
RET_{t-1}	+	-0.001	0.001	-0.905	0.365
INV_{t-1}	+	0.074	0.027	2.735	0.006
CFO*CONS	-	-0.092	0.054	-1.701	0.089
C		0.306	0.122	2.508	0.012
R-squared		0.35375			
Adjusted R-squared		0.26204			
F-statistic		3.85705			

fixed effect and the random effect estimators is significant or not.

As per the results in Table 6, Chi-square value of cross section is 84.89 having p-value of 0.0000. Hence the Hausman test recommends fixed effects model to be used in order to obtain consistent and efficient estimates.The Fixed effect model is similar to pooled regression but it allows for the constant to vary across individuals. It is also called Least Square Dummy Variable (LSDV) estimator, because it uses dummy variables for taking different cross sections to account (Gujrati 2006).

Regression Analysis

INV, Capital expenditures divided by overall assets.CFO, is the ratio of cash flows from operations calculated by the beginning period of total assets. CONS, Firm's accruals, (net income minus cash flows from operations) divided by the average total asset. Q, proxy for calculating the investment opportunity, which is the market value of shares outstanding plus long term debt plus short term debt divided by total assets (Kroes, 2013). SIZE, is natural logarithm of the average total assets. $RETURN_{t-1}$ is the stock return with respect to previous year. INV_{t-1} is investment value of company previous year.

To anticipate and test the impact on organization investment sensitivity which is affected by conditional conservatism, hypothesis is tested using regression equation 1. Results can be clearly viewed in Table 7. It can be seen that value of R Square for regression equation 1 is 0.3537. These outcomes demonstrate that 35.37% of variation measured by the independent variables clarified over investment value of organization and rest is clarified by different other factors. On the other hand the value of F test demonstrates that general autonomous factors in model altogether impact on dependent variable. In view of this equation I, it can be viewed that variable CFO with a likelihood estimation of t-measurement of 0.017 (noteworthy at 1%) having a coefficient of-0.067 or β1 <0. This infers the investment sensitivity of cash flow is bringing down when organizations have higher conditional conservatism.

The coefficient of CONS is -0.024 or β2 < 0. This

Table 8. Regression results for equation II

Variable	Sign Pred	Coeff	Std. Error	t-Stat	Prob.
CFO	-	-0.054	0.025	-2.133	0.033
AGENCY	+/-	-0.005	0.017	-0.339	0.734
Tobin's Q	+	0.008	0.015	0.568	0.569
SIZE	+	-0.019	0.008	-2.355	0.018
RET	+	-0.001	0.001	-0.912	0.361
INV_{t-1}	+	0.066	0.026	2.468	0.013
AGENCY*CFO	+/-	0.048	0.086	0.558	0.576
C		0.337	0.124	2.704	0.006
R-squared		0.3517			
Adjusted R-squared		0.2599			
F-statistic		3.8304			

shows that the impact of conditional conservatism negatively effects the cash flow sensitivity but it P value is insignificant. This shows that the effect is negative which is consistent with the accepted literature but the insignificant values shows the in the context of Pakistan its effect is not proved. The overall combine effect of CFO *CONS having a coefficient value of -0.092 or β7 < 0 (noteworthy at 8%). This refers that the investment sensitivity of cash flow is bringing down when organizations have higher conditional conservatism. As such, coefficient of CFO which demonstrates the sensitivity of investment-cash flow will be bring down in the wake of being interacted with CONS.

Tobin's Q insignificant negative impact on the dimensions of firm's investment values demonstrates that organization's investment activities over here in Pakistan's manufacturing industry affected by components other than the organization's chance to invest (as estimated by Tobin's Q).. Size as the one of attributes of the organization has a critical beneficial outcome on the size of the investment organization. These outcomes are in accordance with the announcement Gurgler et al. (2000) that the extent / size of the organization influence its availability to outer financing, and afterward influences the investment-cash flow sensitivity (Imhof, 2014).

Earlier annual stock return has insignificant negative effect on the measure of the investment organization. This isn't like Lamont (2000) and Richardson (2006) which expresses that the estimation / values of the earlier stock return influence the future estimation of an investment organization as the results identified with the organization's development prospects are not clarified in Q. The projection of the investment that organization will do later on isn't will be far from his past investment values. This makes the variable INV_{t-1} has an extensive positive outcome (0.074) and critical at the 1% level to variable INV.

Clarification for these results can be communicated as conditional Conservatism could be explained as a trend adopted by an accountant who stand in need of high-profile verification to acknowledge the benefits (good announcement on profits) than losses (bad news on profits). This trend allows the board members to uncover all financial information completely and dependably, with the goal that the bookkeeping data to be progressively qualified. It removes the exposure in money related detailing, bringing down the danger of the organization according to investors and creditors, and encourages access to the external cost of capital with moderately ease (Guay and Verrecchia, 2007 and Suijs, 2008). Reasonable minimal effort of outer capital will empower the organization to get outside subsidized funds as a source of financing for investment activity, along these lines, the organization turns out to be less dependent to internal finances when investing (Imhof, 2014).This circumstance is presented by the moderately low dimension of investment cash flow sensitivity.

INV, Capital expenditures ratio calculated by beginning period overall assets. CFO, is the ratio of cash flows from operations calculated by the beginning period of total assets. Q, proxy for calculating the investment opportunity, which is the market value of shares outstanding plus long term debt plus short term debt divided by total assets (Kroes, 2013). SIZE, is natural logarithm of the average total assets. $RETURN_{t-1}$ is the stock return with respect to previous year. INV_{t-1} is investment value of company previous year. AGENCY, Dividend Payout Ratio calculated as dividend divided by net income.

Besides conservatism, to investigate and check out the connection of agency cost with investment-cash flow sensitivity level, this investigation regress equation II and the outcomes can be found in Table 8. In view of Table 8 the R Square for equation II is 0.3517. These outcomes show that 35.17% of the variation measured on the

Table 9. Regression results for equation III

Variable	Sign Pred.	Coeff.	Std. Error	t-Stat	Prob.
CFO	-	0.003	0.039	0.080	0.936
CONS	+/-	-0.019	0.030	-0.650	0.515
AGENCY	+/-	-0.001	0.013	-0.096	0.923
Tobin's Q	+	0.005	0.015	0.325	0.745
SIZE	+	-0.004	0.010	-0.382	0.702
RET	+	-0.004	0.002	-1.957	0.051
INVt-1	+	0.0317	0.045	0.698	0.485
CFO*CONS	-	0.127	0.092	1.385	0.166
AGENCY*CFO	+	-0.042	0.042	-1.002	0.316
CFO*CONS*AGENCY	-	-0.408	0.178	-2.292	0.022
C		0.116	0.159	0.729	0.466
R-squared		0.3368			
Adjusted R-squared		0.1817			
F-statistic		2.1723			

investment organization can be clarified by the independent variables in the equation, and the rest is clarified by different factors. On the other hand the F test demonstrates that general independent variables in the equation significantly impact the dependent variable.

From the aftereffects of the t test in this equation II, CFO has a likelihood estimation of 3.3% having a coefficient of -0.054 or $\beta_1 < 0$. That means CFO variable have a marginal negative impact on INV that is the dependent variable.The AGENCY variable has an extent coefficient of -0.005 and very insignificant. This is demonstrating that the negative impact of AGENCY insignificantly affect the value of investment organizations in this examination.To test equation 2, this examination is tested whether the coefficient (β_6) AGENCY * CFO is significant.

The outcomes in Table 8 demonstrate that variable coefficient AGENCY*CFO is 0.048 and is at insignificant level. These outcomes demonstrate that this variable is insignificant and the coefficient is positive. Coefficient having positive value and insignificant level demonstrates that the higher agency cost firms have a lower investment-cash flow sensitivity contrast with lower agency cost firms. The outcomes demonstrate that hypothesis 2 is rejected. The consequences of Equation II in Table 7 demonstrates that the organization which has bigger agency cost, their investment action are not dependent from their external source of funds. As it were, the investment-cash flow sensitivity in high agency cost organizations will in general be lower. Any expansions (decline) of CFOs in organizations with a substantial higher agency cost will higher (raise) the measure of their investment exercises. The translation is conflicting with

Imhof (2014) and Wibawa and Wardhani (2018) but these results are consistent with Kaplan and Zingales (1997) and Moyen (2014).

The reasons of these results can be elaborated by Moyen (2004) that country with lower agency cost organizations move to be more flexible in choosing where to allot their finances both on capital investment, dividends payments or both. On the other hand higher agency cost firms must choose the one option. In addition to this Moyen (2004) also highlighted that cash received from issue of debt, firms with lower agency cost are most flexible as compared to firms with higher agency cost to increase the size of firm investment along with the payment of dividend. This is due to reasons that there is no requirement to provide a high dividend. Finally cash flows from operational activity followed by increase in firm investment value in a same direction, so we can say that company sensitivity in this category seems to be high. This current trend also adds to the explanation that why cash flow sensitivity on higher agency cost firms seems to be lower.

For the control factors / variables, annual stock return has insignificant negative impact on the size of the investment organization. Which expresses that the high agency cost firms stock return adversely influences the future estimation of an investment organization. For alternate factors like Tobin's Q and SIZE, there is no real material change in results as SIZE is significant and negative, Tobin's Q is insignificant and slightly positive. This proposes these control factors in the equation have steady capacity, without partiality to the nearness of directing new factors.

INV, capital expenditures ratio calculated by beginning

period overall assets. CFO, is the ratio of cash flows from operations calculated by the beginning period of total assets. CONS, Firm's accruals, (net income minus cash flows from operations) divided by the average total asset. Tobin's Q, proxy for calculating the investment opportunity, which is the market value of shares outstanding plus long term debt plus short term debt divided by total assets (Kroes, 2013). SIZE, is natural logarithm of the average total assets. $RETURN_{t-1}$ is the stock return with respect to previous year. INV_{t-1} is investment value of company previous year. AGENCY, Dividend Payout Ratio calculated as dividend divided by net income.

Besides to look at the moderating impact of agency cost on the impact of conditional conservatism negative effects on investment cash flow sensitivity, equation III tried. The outcomes can be notice in Table 9. In light of Table 9 it tends to be perceived that R Square for equation III is 0.3368. These outcomes demonstrate that 33.68% of the variation is explained by the independent factors / variables on the value of organization investment in the equation and the rest is clarified by different factors. On the other hand the F test demonstrates that general independent factors in the equation significantly impact the dependent variable. From the results of regression equation III, variable CFO*CONS demonstrates the coefficient is 0.127 with insignificance at the 10% level.

AGENCY factors demonstrated a slightly negative coefficient of -0.001 and highly insignificant. This demonstrates that the existence of agency cost dummy factor / variable in the equation III influence the size of the organization's investment activity. CFO*AGENCY which indicates sensitivity of the high agency cost organization has a coefficient estimation of -0.042 and furthermore insignificant Pvalue 0.316. With respect to the CFO*AGENCY*CONS, it has a coefficient of -0.408 and significant at the likelihood value 2 %. This recommends in high agency cost firm, the connection between conditional conservatism and investment-cash flow sensitivity is lower. At the end of the day, the investment-cash flow sensitivity in high agency cost firms decreases after the execution of conditional conservatism.

This demonstrates the hypothesis 3 is rejected. This circumstance is not consistent with the findings of Imhof (2014)and Wibawa and Wardhani (2018) who found that the negative impact of conditional conservatism on the investment-cash flow sensitivity is extra stronger in high agency cost firms. Control factors like INVt-1has a positive coefficient but insignificant in this equation. RETt-1has a negative coefficient but significant. This demonstrate that the annual stock return did not affect the firm investment vale in the presence of AGENCY variable in the equation. Other control factors utilized in the equation III is as yet having a comparable direct test

results on the coefficients and criticalness, as the outcomes in equation I and II.

Conditional conservatism drives organization to not surge (be watchful) when recording incomes/profits, however more timely in the recording of losses / expenses. This rule of thumb tends to be bringing down income, in spite of the fact that it enhances the quality of profit / earnings. Whenever done by a firm with high agency cost in the United States, shareholders / owners of capital considered about it as a good tendency to be most cautious in recording profit. Accordingly, the cost of external capital required turns out to be less expensive.

Moreover, the usage of higher conditional conservatism on high agency cost firms fixes its knowledge over the administration / management function. These two things influence the organization to end up significantly and more easier to get external low cost financing when investing, and that makes the investment-cash flow sensitivity ends up smaller (Guay and Verrecchia, 2007; Suijs, 2008; Lafond and Watts, 2008 and Imhof, 2014).

Notwithstanding, when performed by firms in Indonesian having high agency cost attributes, capital owners think of it as bad on the grounds that fundamentally high agency cost firms must had a lot to allocate funds for the dividend (Kaplan and Zingales, 1997 and Moyen, 2004).At the point when organizations apply higher conditional conservatism, capital providers / shareholders are not concentrating on the state of reasonability connected by the organization. Shareholders / capital providers are more centers around the assumption that there is no more profit left for them. As a result, the cost of outside capital required turns out to be more costly. Moreover, marginal increase in cost influences the organization to appear to be more bad administration since it can't make profitable administrative decisions. Two things that make Indonesian high agency cost firms (which execute higher conditional conservatism) turns out to be increasingly hard to acquire outside / external subsidized capital when investing, along these lines, the dependence (sensitivity) on its internal reserve ends up higher.

This investigation intends to give experimental proof that conditional conservatism negatively affects investment-cash flow sensitivity and this is even greater and noteworthy impact on organizations having higher agency cost as contrasted to lower agency cost. Apart from this, this examination also needs to demonstrate that before the use of conditional conservatism, organizations with high agency cost of investment cash flow sensitivity is higher than the low agency cost. Not quite the same as past investigations, this examination utilizes the dividend payout proportion to gauge the measure of agency cost.

The outcomes demonstrate that conditional conservatism has a noteworthy / significant negative

impact on firm investment activity dependence on the accessibility of internal assets / funds. This demonstrates that utilization / application of conditional conservatism can reduce the organization's reliance on the accessibility of internal funds when contributing investment. Control factors were appeared to influence value of the investment is the magnitude / size of the organization, prior year stock return, and the firm investment value in the past period. These outcomes are consistent with the research of Imhof (2014) and Wibawa and Wardhani (2018) who directed a comparative report with an example of organizations in the United States and Indonesia.

Besides, this examination demonstrates that high agency cost firms has lower investment cashflow sensitivity than the low agency cost ones. Low agency cost firms will in general be increasingly flexible in picking where to allocate their assets / funds both on investment, dividend payments or both. While high agency cost firm should pick one of them. High agency cost firm isn't centered on investment since they need to organize assets / funds to the arrangement of generally large dividends. This makes the sensitivity is bring down for high agency cost firms. (Kaplan and Zingales, 1997 and Moyen, 2004). These outcomes are not consistent with the finding of Imhof (2014) and Wibawa and Wardhani (2018) but in line with Kaplan and Zingales (1997) and Moyen (2004).

This investigation additionally revealed that in the presence of conditional conservatism sensitivity of cash flow investment is lower for high agency cost firm. As such, investment cash flow sensitivity in high agency cost firms reduces after the application of conditional conservatism. These outcomes are steady and in line with Moyen (2004) and Kaplan and Zingales (1997) however conflicting with Imhof (2014) and Wibawa and Wardhani (2018).

To explain the variation for these results from the findings of Imhof (2014) and Wibawa and Wardhani (2018). Those investigations were conducted in the United States of America and Indonesia simultaneously where the culture is totally different and the people have different characteristics as compared with the people of Pakistan. These differences in characteristic include decision making process, criteria for risk assessment and the required rate of return expected by the shareholders / capital providers. Risk assessment change by the capital providers due to implementation of conditional conservatism on the high agency cost firm is higher than the change in the risk assessment firm low agency cost, but reversed. Main root cause can only be understood by the characteristics of conditional conservatism.

CONCLUSION

This investigation means to give exact proof that condi-

tional conservatism negatively affects investment-cash flow sensitivity in the Pakistani setting. The exploration was primarily centered on investment cash flow sensitivity which measure firm investment value and how these qualities influence by the firm conditional conservatism. Researcher additionally examined the effect of firm (SIZE), firm yearly stock return (RET), firm investment opportunity (Tobin's Q) and firm agency cost. While experiencing the writing, it was noticed that diverse measures for firm investment cash flow sensitivity value have been utilized in past. Obliging a large portion of the analysts, firm investment value was utilized as a measuring component of firm cash flow sensitivity in this investigation. The information was gathered from annual reports of organizations in manufacturing sector registered and operating in Pakistan Stock Exchange. Consequences of our investigation demonstrate that conditional conservatism decreases firm cash flow sensitivity and firms with a high agency cost have lower cash flow sensitivity when contrasted with low agency cost.

The investigation about effect of conditional conservatism and agency cost on investment cash flow sensitivity can demonstrate an extraordinary headway in understanding of its importance for the executives and managers before making the investment decision. More determinants may also be incorporated into the examination to expand the vision about this cash flow sensitivity idea. Findings of this investigation are beneficial for financial managers and accountants that conservatism helps in arranging funding sources when investing. Like different investigations, this examination additionally experiences certain restrictions. To begin with, test information was gathered of 148 companies from 2008 to 2017 just for a long time. With information involving more periods and a bigger sample, the investigation would have appeared better outcomes. Second, the discoveries of this examination are not founded on an expansive population, since just recorded organizations in manufacturing sectors were considered. The discoveries therefore just apply to manufacturing sector. Third, this investigation use dividend payout ratio as measure of agency cost as proxy. Potential problem of using this ratio is that dividend is not the only indicator of agency cost. Fourth, the examination was done in general example. There is also an option for the separate investigation may be done for high and low agency cost organizations, and for various sectors of economy. Researcher achieved dynamically quick results and understanding of the firm development through investment value.

REFERENCES

Alchian AA, Demsetz H (1972).Production, information costs, and economic organization. *The American economic review*, *62*(5), 777-795

3

Ball R, Kothari SP, Robin A (2000).The effect of international institutional factors on properties of accounting earnings. *J. Account. Econ. 29*(1), 1-51.

Basu S (1997).The conservatism principle and the asymmetric timeliness of earnings1. *J. Account. Econ. 24*(1), 3-37.

Bergen M., Dutta, S., & Walker Jr, O. C. (1992). Agency relationships in marketing: A review of the implications and applications of agency and related theories. *The Journal of Marketing,* 1-24.

Bond S, Harhoff D, Van Reenen J (1999). Investment, R & D and financial constraints in Britain and Germany (No.W99/05).*London: Institute for Fiscal Studies.*

Bushman RM, AJ Smith (2001). Financial accounting information and corporate governance.*Journal of Accounting and Economics 32*, 237-333.

Bushman RM, Piotroski JD (2006). Financial reporting incentives for conservative accounting: The influence of legal and political institutions. *J. Account. Econ. 42*(1-2), 107-148.

Carpenter, R. E., Fazzari, S. M., Petersen, B. C., Kashyap, A. K., & Friedman, B. M. (1994). Inventory investment, internal-finance fluctuations, and the business cycle. *Brookings Papers on Economic Activity*, *1994*(2), 75-138.

Degryse, H., & De Jong, A. (2006). Investment and internal finance: Asymmetric information or managerial discretion?. *International Journal of Industrial Organization*, *24*(1), 125-147.

Devereux, M., Schiantarelli, F., & Hubbard, R. G. (1990).Asymmetric Information, Corporate Finance, and Investment. *Investment, Financial Factors, and Cash Flow: Evidence from UK Panel Data. University of Chicago Press, Chicago*, 279-306.

Dye, R. A. (2001).An evaluation of "essays on disclosure" and the disclosure literature in accounting. *Journal of accounting and economics*, *32*(1-3), 181-235.

Easley, D., &O'hara, M. (2004).Information and the cost of capital. *The journal of finance*, *59*(4), 1553-1583.

Fazzari, S., Hubbard, R. G., & Petersen, B. C. (1987).Financing constraints and corporate investment. *Brookings Paper on Economic Activity 1*, 141—195.

Francis, J., LaFond, R., Olsson, P. M., and Schipper, K. (2004).Costs of equity and earnings attributes. *The accounting review, 79*(4), 967-1010.

Gertler, M. (1988). Financial structure and aggregate economic activity: an overview.

Givoly, D., &Hayn, C. (2000). The changing time-series properties of earnings, cash flows and accruals: Has financial reporting become more conservative?. *Journal of accounting and economics*, *29*(3), 287-320.

Godfrey, J., Hodgson, A., Tarca, A., Hamilton, J., & Holmes, S. (2010). *Accounting theory*.

Gray, R., Owen, D., & Adams, C. (1996). Accounting & accountability: changes and challenges in corporate social and environmental reporting. Prentice Hall.

Guay, W., & R. Verrecchia.(2007). Conservative disclosure, *Working paper*, University of Pennsylvania.

Gugler, K., &Yurtoglu, B. B. (2003). Corporate governance and dividend pay-out policy in Germany. *European economic review*, *47*(4), 731-758.

Hadlock, C. J. (1998). Ownership, liquidity, and investment. *The Rand Journal of Economics*, 487-508.

Hammond, T. H., & Knott, J. H. (1996). Who controls the bureaucracy?Presidential power, congressional dominance, legal constraints, and bureaucratic autonomy in a model of multi-institutional policy-making.*The Journal of Law, Economics, and Organization, 12*(1), 119-166.

Hausman, J. A. (1978). Specification tests in econometrics. Econometrica: *J. Econ. Soc.* 1251-1271.

Healy, P. M., &Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of accounting and economics*, *31*(1-3), 405-440.

Hoshi, T., Kashyap, A., &Scharfstein, D. (1991). Corporate structure, liquidity, and investment: Evidence from Japanese industrial groups. *The Quarterly J. Econ. 106*(1), 33-60.

Hu, X., &Schiantarelli, F. (1998). Investment and capital market imperfections: A switching regression approach using US firm panel data. *Review of Economics and Statistics, 80*(3), 466-479.

Hubbard, G. R., Kashyap, A., & Whited, T. M. (1995).International Finance and Firm Investment," *Journal of Money Credit and Banking, 27,* forthcoming.

Hubbard, R.(1998). Capital-market imperfections and investment. *J. Econ. Literature 36*, 193-225.

Imhof, M. J. (2014). Conditional conservatism, agency cost, and the cash flow sensitivity of firm investment. *Journal of Accounting and Financial Studies18*(3), 45-61.

Jensen, M. C. (1986). Agency costs of free cash flow, corporate finance, and takeovers. *The American economic review*, *76*(2), 323-329.

Kaplan, S. N., &Zingales, L. (1997). Do investment-cash flow sensitivities provide useful measures of financing constraints?. *The quarterly journal of economics*, *112*(1), 169-215.

Kennedy, G. A. (1998). Comparative rhetoric: An historical and cross-cultural introduction (p. 157). *New York: Oxford University Press*.

LaFond, R., & Watts, R. L. (2008).The information role of conservatism. *The Accounting Review*, *83*(2), 447-478.

Lambert, R., Leuz, C., &Verrecchia, R. E. (2007).Accounting information, disclosure, and the cost of capital. *Journal of accounting research*, *45*(2), 385-420.

Lara, J. M. G., Osma, B. G., &Penalva, F. (2011).Conditional conservatism and cost of capital. *Review of accounting studies*, *16*(2), 247-271.

Li, X. (2015).Accounting conservatism and the cost of capital: An international analysis. *J. Bus. Fin. Account. .42*(5-6), 555-582

Meyer, J. R., &Kuh, E. (1957). The investment decision: An empirical study (Vol. 102). Cambridge, MA: Harvard University Press.

Modigliani, F., & Miller, M. H. (1958).The cost of capital, corporation finance and the theory of investment.*The American economic review, 48*(3), 261-297.

Moyen, N. (2004). Investment–cash flow sensitivities: Constrained versus unconstrained firms. *The Journal of finance*, *59*(5), 2061-2092.

Myers, S. C., &Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of financial economics*, *13*(2), 187-221.

Nickell, S., &Nicolitsas, D. (1999). How does financial pressure affect firms?. *European Economic Review*, *43*(8), 1435-1456.

Oliner, S. D., &Rudebusch, G. D. (1992).Sources of the financing hierarchy for business investment. *The Review of Economics and Statistics*, 643-654.

Pinegar, J. M., &Wilbricht, L. (1989). What managers think of capital structure theory: a survey. *Financial Management*, 82-91.

Richardson, S. (2006). Over-investment of free cash flow. *Review of accounting studies*, *11*(2-3), 159-189.

Ronen, J., Kashi, R., and Balachandran. (1995). Agency theory: an approach to incentive problems in management accounting. *Asian Review of Accounting, 3*(1), 127-151.

Ross, S. A. (1973). The economic theory of agency: The principal's problem. *The American Economic Review, 63*(2), 134-139.

Rozeff, M. S. (1982). Growth, beta and agency costs as determinants of dividend payout ratios. *J. Finan. Res. 5*(3), 249-259.

Sterling, R. R. (1967). Conservatism: The fundamental principle of valuation in traditional accounting. Abacus, 3(2), 109-132.

Stiglitz, J. E., & Weiss, A. (1981).Credit rationing in markets with imperfect information. *The American economic review*, *71*(3), 393-410.

Stulz, R. (1990). Managerial discretion and optimal financing policies. *Journal of financial Economics*, *26*(1), 3-27.

Suijs, J. (2008). On the value relevance of asymmetric financial reporting policies. *J. Account. Res. 46*(5), 1297-1321.

Tobin, J. (1969). A general equilibrium approach to monetary theory. *Journal of money, credit and banking*, *1*(1), 15-29.

Vogt SC (1994). The cash flow/investment relationship: evidence from US manufacturing firms. *Financial management*, 3-20.

Watts, R. L. (2003). Conservatism in accounting part I: Explanations and implications. *Accounting horizons, 17*(3), 207-221.

Weingast, B. R., & Moran, M. J. (1983).Bureaucratic discretion or congressional control?Regulatory policymaking by the Federal Trade Commission. *Journal of Political Economy, 91*(5), 765-800.

Wibawa, B. A., &Wardhani, R. (2018).The Effect of Conditional Conservatism and Agency Cost on Investment-Cashflow Sensitivity. *International Research Journal of Business Studies*, *10*(2), 69-88.

Yurtoglu, B. (2003). Corporate governance and implications for minority shareholders in Turkey (No. 2003/7).*Discussion Paper, Turkish Economic Association.*