

# Literature Review on the Influence of Internal Control Quality and Innovation Investment

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## Abstract

**Enterprise innovation is an important support for China's future economic development, and internal control management is an important factor influencing China's improving enterprise innovation. Therefore, systematic research on the influence of internal control quality on China's enterprise innovation has important significance for China's sustainable economic development. In order to comprehensively analyze the impact of internal control quality on enterprise innovation, this paper combs and analyzes relevant literature at home and abroad, points out the main shortcomings of existing research, and forecasts the future research trend of this direction, so as to provide theoretical basis for enterprises to make reasonable Internal control system.**

## Keywords

**Internal control quality; Innovation input; Corporate governance.**

## 1. Introduction

The 19th National Congress of the COMMUNIST Party of China (CPC) reported that innovation is the first to promote the development of the national power, and the strategic support of construction of modern economic system. As the main body of technological innovation, enterprises play a decisive role in technological innovation. Research and development is an important driving force for an enterprise to maintain its technological innovation ability, competitive advantage and sustainable development ability. Therefore, how to promote enterprises to carry out innovative activities has become an urgent problem to be solved. The factors influencing the innovation ability of enterprises include environment, structure, organization and individual. As an important part of enterprise management, the internal control in the influence factor of "organization" plays an important role in enterprise innovation. Especially in recent years, China's internal control related policies and regulations, the status of internal control to a new height. Based on the summary of relevant literature at home and abroad, this paper puts forward a new understanding of the relationship between internal control and enterprise innovation, and combined with the current situation of enterprise internal control management in China, puts forward some Suggestions, in order to provide reference for listed companies to improve the competitiveness of innovation.

## 2. Literature Review

Scholars at home and abroad have two views on the relationship between internal control and enterprise innovation. One is the "internal control promotion theory", that the internal control quality has a positive role in promoting enterprise innovation, the higher the internal control quality is conducive to enterprise innovation. Zhan Zhengqun et al. conducted an empirical analysis of high-tech enterprises listed on China's GEM and found that the higher the internal management ability of enterprises, the higher the internal control quality, and the stronger the innovation ability of enterprises [1]. Jia Chunxiang et al. used the method of combining grey

number and DEMATEL to analyze the correlation of influencing factors of enterprise innovation performance, selected 11 indicators with high influence, such as internal control, from 26 indicators, and put forward Suggestions on enterprise innovation management based on their influence indexes [2]. Li Ming et al. conducted empirical test analysis on listed companies in China and found that internal control quality was positively correlated with corporate performance. Moreover, by comparing listed companies with different property rights, they found that the internal control quality of listed companies in state-owned enterprises had a greater impact on corporate performance than that of listed companies in non-state-owned enterprises [3]. Feng Qian of agriculture listed company government subsidies, the relationship between internal control and corporate performance study, found that enterprises improve quality of internal control can significantly improve preferential tax policies of investment projects to expand investment scale of the enterprise incentive effect, and once enterprises to expand investment scale decision, so enterprises to expand investment scale to promote agricultural class the business performance of listed companies [4]. Skaife et al. found that compared with companies with effective internal control, companies that disclose major defects of internal control are more likely to have insider trading, thus affecting enterprise innovation performance [5]. For listed companies, the higher the quality of internal control, the higher the corporate bond rating and the lower the financing cost [6]. On the contrary, low-quality internal control will increase the cost of debt financing [7,8], thus affecting the quality of business decisions [9]. By examining the relationship between the company's investment level and the disclosure of internal control defects, Sun et al. found that the investment level of enterprises with non-standard internal control audit opinions significantly decreased [10]. The higher the quality of internal control, the higher the efficiency of innovation investment [11,12]. Another is the paradox of internal control, which shows that the internal control as the standard of enterprise management system, has the characteristics of standardization, while innovation with high uncertainty, will produce certain contradictions between the two if the company focus on internal control, enterprise innovation are limited, and make the company's management unwillingly try innovative activities, that hinder the company's innovation and development [13]. Jensen believes that institutionalized internal control will bring about a certain degree of management rigidity, and there is an irreconcilable conflict between such rigidity of management and the flexibility required by enterprise innovation, so internal control will inhibit enterprise innovation activities [14]. Zhang pointed out that strict internal control will reduce the hidden income of senior executives due to the increase of their risk exposure and greatly reduce their willingness to invest in risky projects such as technological innovation, thus inhibiting enterprise innovation [15]. From the perspective of employee behavior, Ribstein proposed that strict internal control would make employees feel trapped and oppressed, inhibit their work passion and innovative spirit, and have a negative impact on enterprise innovation [16]. Based on the empirical study of listed companies in the main board manufacturing industry from 2007 to 2013, Zhang Juan proposed that most companies were at an average level of innovation and that increasing internal control would inhibit enterprises' investment in innovation [17].

### 3. Summary and Suggestions

By summarizing the views of domestic and foreign scholars on the relationship between internal control quality and enterprise innovation, it can be seen that there are disputes between domestic and foreign scholars on the relationship between internal control quality and enterprise innovation. Some scholars believe that internal control will inhibit enterprise innovation, while others believe that internal control will promote enterprise innovation. Different from foreign scholars, both views have more literature reference, domestic scholars

are more inclined to internal control will promote enterprise innovation, which may be due to the rise of internal control system of domestic enterprises later than developed countries in Europe and the United States, internal control system is not mature, and the differences caused by different national conditions. Although the average innovation activities of listed companies in China are developing rapidly, the overall innovation development time is still short, and the average innovation investment level is still lower than that of mature companies in western countries. Therefore, the research and development system with the western developed country mature manufacturing company, listed companies in China to the reform and development of innovative, innovation is an urgent need to improve internal control standards to curb possible lack of money management, and other various because of agent cost caused by moral hazard and adverse selection problem. In the future development of China, with the continuous improvement of enterprise internal control system and more mature supervision system, there may be more views from different directions.

Innovation requires enterprises to continuously increase R&D investment, however, innovation investment is characterized by high risk, long cycle, slow effectiveness and uncertain returns [18]. As an important mechanism for enterprises to prevent, discover and correct risks, internal control not only affects the business decisions of enterprises themselves, but also the investment decisions of external information users, which is closely related to enterprise innovation. This paper proposes the following Suggestions:

- (1) Enterprises should improve the internal control system with defects to ensure its rationality, promote the improvement of internal control quality, and thus improve the performance of enterprises. Therefore, a reasonable internal control system can promote the development of enterprises and bring more opportunities to enterprises.
- (2) Enterprises should attach importance to the responsibility of internal control in enterprise innovation, and at the same time try to avoid the contradiction between the standardization of internal control and the flexibility required by enterprise innovation, which will lead to serious impact on enterprise innovation activities and damage enterprise innovation performance.
- (3) In practice, the internal control system is not static, for different industries, the scale of the enterprise, the applicable internal control system is different, the enterprise to develop the most suitable plan and for the continuous development of the enterprise, the internal control system should also be constantly improved.

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