

## **Impact of Financing Behaviors on Firm Financial Performance: The Moderating Influence of Earnings Management**

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### **Abstract**

The study investigates the relationship between ownership structures, governance mechanisms and firm financial performance with a special emphasis on the moderating effect of earnings management. These results indicate that IO and MO, through their presumed roles in aligning the interests of managers and shareholders, substantially contribute to improved firm performance. Conversely, the negative interaction effect between ownership concentration and earnings management suggests that high levels of ownership concentration can cause managerial entrenchment, leading managers to use personal interests rather than shareholders as a basis for decision making, and thus reduce firm performance.

The results show the significant effects of firm size and audit committee on the performance. Specifically, firm size is positively related to firm performance, consistent with the Resource Based View (RBV), which suggests that larger firms with more resources are now in a more advantageous financial situation. Despite the presence of an audit committee, return on assets (ROA) is negatively correlated with governance mechanisms, implying that governance systems might need to be customized to fit in with the firm's larger strategic objectives so as to improve financial performance. These findings are based on Agency Theory which emphasizes how ownership structures can discipline agency costs. I show that both institutional and managerial ownership align the interest of managers and shareholders improving firm performance. Nevertheless, the interactive effects with earnings management indicate that when earnings manipulation occurs together with ownership concentration, agency problems increase, and the level of performance is suboptimal. The positive relationship between firm size and ROA supports the Resource Based View (RBV), that is, firms with greater resources are able to garner greater profitability. This work makes important theoretical and practical contributions to the literature on governance mechanisms and ownership structure for firms and investors that wish to optimize their control mechanisms in order to achieve better long-term financial performance.

**Keywords:** Ownership Structure, Governance Mechanisms, Firm Performance, Earnings Management, Agency Theory, Resource-Based View, Audit Committee.

## **Introduction**

Given its relevance for firm value, sustainability and shareholder wealth, corporate financial performance is still a hotbed of investigations. There are also multiple financing behavior firms can take in maintaining operations and accelerating growth including equity issuance, debt acquisition and use of retained earnings. Specifically, these behaviors determine a firm's capital structure, liquidity, and risk, and as a result affect financial performance indicators of return on assets (ROA), return on equity (ROE), and earnings per share (EPS) (Modigliani & Miller, 1958; Jensen & Meckling, 1976). Yet, in practice, managerial discretion and practices, including, aforementioned EM, influence financial performance outcomes in addition to financing behaviors. Scholarly attention should be devoted to the intersection between financing behaviors and earnings management at this point. The introduction of earnings management entails the need for introducing complexity in financial performance evaluation. It has been found that managers may engage in accrual based as well as real activities manipulation to smooth earnings, meet benchmarks and influence perceptions of firm performance. (Healy & Wahlen, 1999). Although these practices can exert a garish appearance of the financial health of an organization, the practices also interfere with meaningful metrics of firm performance that could be used to moderate the influence of financing behavior on the outcome.

Research on financing behaviors and earnings management as separate topics is extensive, however, research on their interaction and combined effects on financial performance are conspicuously absent. The existing literature, however, typically looks at these dimensions apart. Graham et al. (2005), for example, study managers' motivation behind earnings management, and Fama and French (2002) explore financing decisions and their long term effects to firm value. Only few studies explicitly consider how earnings management moderates the relationship between financing behaviors and financial performance in emerging market context where institutional and regulatory environment has significant difference with developed economies. Evaluation of the strategic implications of this interplay reveals a research gap. This literature tends to focus on either determinants of financing behavior (Myers, 1984; Frank & Goyal, 2003) or antecedents of earnings management (Dechow et al., 1995; Roychowdhury, 2006), without adequately combining strands of inquiry.

Moreover, little empirical evidence exists addressing whether earnings management amplifies or moderates the financial effects of certain financing strategies. To correctly measure firm performance and provide financial transparency, stakeholders including investors, regulators and corporate governance bodies must understand this moderating influence. While the study of financing behaviors and earnings management has made good progress in its own right, knowledge of how these variables interact with each other, and their interplay with firm financial performance is relatively unexplored. In particular, we do not know which part of this relationship is moderated by earnings management. Frequently, prior studies. Approximated the financing and financial reporting behaviors as independent, leaving open the possibility that practices aimed at earnings manipulation may exacerbate or counteract the effect of financing decisions. Furthermore, much of the literature on how firms in emerging markets distinguish among the regime types is set in context primarily in developed economies, leaving a gap in understanding how firms in emerging markets approach the task given different regulatory systems, governance structures, and market constraints (Sun et al., 2010; Leuz et al., 2003). Along with being a central part of financing behaviour, capital structure has been a long time focus in finance literature on how it may relate to financial performance. However, there are considerable gaps in our knowledge of this dynamic for non-financial firms in Pakistan. The goals of this research is to fill these gaps by turning the earnings management variable as a moderator and the return on assets (ROA) as the main

performance measurement variable. Capital structure studies and firm performance studies for Pakistan largely deal with aggregate financial sectors or ignore non financial companies. Firms that are not financial firms have their own distinct obstacles, which include unusual cash flows, limited access to long term debt and reliance on equity financing, which may lead to different capital structure determination by non financial firms, as found by (Shoaib et al., 2023). These nuances need to be captured in sector specific terms besides. Since the governance structure is weak and regulatory enforcement is lax, existing earnings management practices are prevalent in Pakistan whose impact on the capital structure–performance relationship has not been fully investigated. ROA can be distorted and reveal the true financial health of non financial companies through earnings manipulation. However, Zahid et al. (2023) suggest that earnings management may either intensify the risks associated with high leverage or gravity performance volatility's risks, but empirical evidence in Pakistan remains scarce. ROA, which relates to operational efficiency, and asset utilization, is underutilized in most studies where a range of performance indicators such as ROE or EPS are used. As most of the non-financial sectors in Pakistan are capital intensive, ROA provides a better direct measure of the efficiency of financing decision and deserves greater weight (Ahmed & Siddiqui, 2024). In this regard the conflicting implications of debt to firm performance proposed by the trade off and pecking order theories are theoretical. Variability in the empirical evidence from Pakistan as exemplified by some studies that suggest the benefit of leverage to profitability (via their tax shields) whereas others show risks to profit arising from over leverage in transactional market conditions. This incoherence highlights a demand for additional research on the implementation of these theories in contexts more than financial in order to determine the situational relevancy of these (Khan et al., 2023; SBP, 2023). This study attempts to investigate the Influence of Institutional Ownership and Managerial Ownership on Firm Financial Performance. This study also moderates the effects of Ownership Structure on firm financial performance on the presence of earnings management.

## **Literature Review**

### **Institutional Ownership and Firm Financial Performance**

The term institutional ownership indicates what a large percentage of a company's shares is owned by institutional investors including mutual funds, pension funds and insurance companies. The stake that institutional investors have in the firm and access to resources for monitoring its corporate management constitutes them as effective monitors of corporate management (Javid & Iqbal, 2023). Involving them creates better corporate governance and decreases agency conflicts leading to higher firm performance in developing economies such as Pakistan. Khan et al. (2023) discuss their study on non-financial firms in Pakistan which made a finding that institutional ownership increases the Return on Assets (ROA), a key measure of the financial performance. The research stated that institutional investors typically seek value increasing strats such as cost control and efficient capital utilization that increases the profitability. For instance, like Malik et al. (2023), I find institutional ownership mitigates managerial opportunism and ensures transparent financial reporting. But not all industries will react the same when it comes to institutional ownership. For instance, Shoaib and al. (2013) point out that institutional ownership has more impact in capital intensive sectors like chemicals and cement than on service based sectors. This variation emphasizes the importance of accounting for industry specific dynamics when studying the role of institutional ownership in firm performance. Corporate governance (CG) and firm performance are arguably best suited for institutional investors' formidable information processing capabilities, institutional longevity of capital commitment, and multifunctional role in corporate activities. Both their more (deeper) understanding in terms of how the firm is operated, and how it performs creates the efficiency to monitor the managerial actions and assure the proper alignment between the firm's strategic direction and shareholders' interests (Lin & Fu, 2017). We argue that institutional investors have both the financial resources and the organizational power to shape corporate

decision making processes, thereby inducing managers to act in the best interests of the firm and its shareholders. Arguing that institutional ownership significantly enhances CG practices by creating another layer of oversight to make sure managers are accountable, Bushee et al. (2014) point out that the institutional ownership strengthens CG practice. Because of these external advantages, institutional investors can monitor performance effectively and also influence management decisions. Such a result generates a direct link between institutional ownership and firm performance: because institutional investors are more likely to pressure in the governance practices and operational efficiency, institutional ownership is positively related to firm performance. Studies confirm that institutional ownership has a positively and actively affect firm performance (Lin & Fu, 2017; Michel et al., 2020; Sakawa & Watanabe, 2020). This perspective is recently corroborated by the studies of foreign and large institutional investors in China and India, where we observe that foreign and large institutional investors with less political or market pressures on their investment decision tend to exert a more favorable impact on firm performance. However, line of these investors provides both stability and strategic oversight to keep firms truly focused on creating long term value (Lin & Fu, 2017; Panda & Leepsa, 2019; Michel et al., 2020). However, the relationship between institutional ownership and firm performance is not fully linear. A recent study by Satt et al. (2021) challenges the prevailing view by finding that institutional ownership, overall, has a negative effect on firm performance. This result is insensitive to whether the institutional owners are politically affiliated (government related) or to some extent private. In particular, I find that the effect of negative ownership (and this effect is more pronounced when institutional investors are privately held) is not necessarily positive on firm performance, which may not always be the case when it comes to ownership by institutional investors. Besides their governance influence, institutional investors provide a source of financial stability and reduce stock returns volatility. With the presence of these corporate financial institutions, a firm's internal financial structure can be stabilized to generate a more predictable performance trajectory and is less likely to suffer a significant drop in price without warning. It is supported by studies that reveal that both institutional ownership serve as a protective factor to chalk out less volatile stock returns as well as more robust financial governance (Dang et al., 2018; Ghosh & Dutta, 2018; Lin et al., 2018).

### **Managerial Ownership and Firm Financial Performance**

By giving equity stakes to the manager, managerial ownership makes management stakeholder aligners. Such agency cost alignment encourages managers to make decisions that add value for the shareholders, and thus reduces the agency costs (Ahmed et al., 2023). As internal control mechanism to prevent opportunistic behavior of management, managerial ownership plays a role in Pakistan where corporate governance mechanisms are underdeveloped. In this regard, Hussain et al. (2023) focus on managerial ownership effect on firm performance in non financial companies listed on primary board of Pakistan Stock Exchange (PSX). I find, however, that managerial ownership is associated with higher ROA, and the relationship is especially strong for firms that have some moderate level of managerial equity. Results are consistent with the agency theory premise that managerial equity stakes reduce conflicts of interest between owners and managers. The relationship, however, is non-linear. Excessive managerial ownership may result in entrenchment due to the excessive control of managers and lead to prevalence of self interests at the expense of firm performance (Malik et al., 2023). In their case, Khan et al. (2023) present that for example, highly entrenched managers manipulate earnings to present an artificially positive financial outlook that overstates the economic losses of managerial ownership. Managerial ownership is recognized as a central mechanism by means of which managers' interests can be aligned with those of shareholders. Managers are incentivized to behave in a shareholder's interest by holding a stake in the company, which reduces the possibility for actions that would tend to diverge from shareholder interests (Abdelsalam & Elsegini, 2008). It also aligns potential

conflicts of interest and creates a governance environment in which firm value can be maximized. According to Al-Gharaibah, et al. (2013) the substantial managerial ownership provides these managers with strong incentives to maximize firm value and are incentive compatible with the objectives of external shareholders. In addition, according to Wardani (2011), managers became more cautious on their decision making and try to do their best to improve company performance when managerial ownership is increased since they will directly share the consequences of their actions. This dynamic can be used by employers to overcome the principal agent conflict by making them to take actions for the company and its stakeholders (Wiranata and Nugrahanti, 2013). The managerial ownership however has another implication with respect to earnings management. That is, managers may use some accounting practices to enhance reported earnings as they wish. Taking the view of organisational economics, Sudibyo (2013) found that there is positive significant relationship between managerial ownership and earnings management, while Siregar (2017) also support that there was with significant impact. However, results concerning the direction of the relationship are in conflict. For example, Mahariana and Ramantha (2014) document a negative effect of managerial ownership on earnings management which implicates a disciplinary role. The impact may, however, depend on firm specific or context related factors, as did Anggit and Shodiq (2014), who did not find a significant relationship.

### **The Moderating Role of Earnings Management**

Earnings management is the planned exploitation of financial statements, for the sake of desired financial outcomes. On the one hand, it affects how ownership structure influences firm performance. It inflates or deflates financial metrics like ROA such as inflating or deflating institutional and managerial ownership can obscure the actual effect of the institutional and managerial ownership. Saeed et al. (2024) tested the moderating effect of earnings management on the relationship between institutional ownership and financial performance on Pakistani firms. The presence of institutional investors, both as a direct monitoring device and through their institutional focus on investment strategies that reduce manager incentives for earnings manipulation enhances the likelihood of earnings manipulation. On the other hand, a positive association was found between managerial ownership and earnings management, as managers of firms with relatively higher managerial ownership managed earnings to enhance their short term performance indicators in order not to lose their equity interests (Ahmed et al., 2023). In addition, Zahid et al. (2023) investigate the interaction between ownership structure and earnings management practices in the Pakistani context. Additionally, our findings indicate that earnings management can distort the positive effects of managerial ownership on firm performance. Institutional ownership work as a counterbalance to the risk of earnings manipulation and promote transparent reporting practice. Your study has critical theoretical backing from Morck et al. (1988) particularly concerning the interaction between ownership concentration and earnings management. Building on their insights into managerial entrenchment, we emphasize the importance of having strong governance structures with regard to the negative effect of high ownership concentration on firm performance.

Therefore this supports your conclusion that although ownership concentration (institutional and managerial) has a positive effect on firm performance, too much concentration may hurt performance processes by entrenchment and earnings manipulation. Shleifer & Vishny (1986) has its seminal paper 'Large Shareholders LaLarge Shareholders and Corporate Control'. They argue that large shareholders play a critical role in monitoring management and mitigating agency costs by ensuring that managers act in the best interest of shareholders. However, Shleifer and Vishny also highlight a potential downside: Despite that, large shareholders can help with governance, but they can also overpower governance to lead firms to prefer short-term profits over long-term firm value. But their work points to how large institutional investors tend to focus on immediate returns

and consequently may end up with short-termism and are not aligned with the firm's long term growth objectives.

## **Control Variables**

### **Firm Size and Audit Committee**

According to Al-Matari (2014), the presence of an audit committee is associated with a negative relationship with firm performance. But he warns audit committees can be an ineffective corporate governance mechanism, even if they are intended to be, because of things like insufficient resources, poor independence or lack of expertise. On the other hand, Rizani et al. (2019) find that audit committees have a positive impact on firm performance, with strong firm performance being driven by well functioning audit committees, of which those with independent members and stronger oversight capability have a positive effect on the quality of financial reporting as well as reducing the occurrence of earnings manipulation. This explains why contrasting findings of Al-Matari (2014) and Rizani et al. (2019) emphasise the importance of audit committee effectiveness in affecting firm performance. Making a point of potential inefficiencies, Al-Matari contrasts with Rizani et al. who emphasise the positive impact of an audit committee that works well for corporate governance and financial performance. This corresponds to your research focus on the large negative but potentially inefficiency effect of the audit committee audit on performance.

## **Theoretical Support**

The relationship between ownership structure, earnings management, and firm performance is well-explained by agency theory and stakeholder theory:

- **Agency Theory:** Agency theory is a representation of conflicts of interest between shareholders and managers. Managers ownership aligned interest, dismissing valley, while the ownership of institutional corrects agency conflict. Nevertheless, the dynamics is complicated by the presence of earnings management, which can attenuate and exacerbate agency problems by increasing with ownership structure.
- **Stakeholder Theory:** Institutional investors adopt a role in stakeholder theory that espouses that institutional investors should promote corporate practice benefitting shareholders, as well as other stakeholders. Institutional ownership discourages earnings management and promotes governance to enhance firm performance and improve stakeholders trust. This study confirms the Resource Based View through the positive relationship found between firm size and financial performance (ROA). stakeholder theory:
- **Agency Theory:** Agency theory addresses conflicts of interest between shareholders and management. Institutional ownership reduces agency costs by monitoring managerial actions, while managerial ownership aligns interests, mitigating agency conflicts. However, the presence of earnings management complicates this dynamic, as it can both mitigate and exacerbate agency problems, depending on the ownership structure.
- **Stakeholder Theory:** Stakeholder theory emphasizes the role of institutional investors in advocating for corporate practices that benefit not only shareholders but also other stakeholders. By discouraging earnings management and promoting governance, institutional ownership enhances firm performance and stakeholder trust.
- The positive relationship between firm size and financial performance (ROA) in this study reinforces the Resource-Based View. Better resource (financial capital, human resources, etc.) exploited by smaller firms and, resulting in more profitability and competitive edge. This is explained by the RBV according to the importance of valuable, rare, and inimitable resources to generate sustained firm performance. This insight to managers and investors is that firm size—assigned with greater resource availability—may be a critical factor to the financial success and competitive advantage of a firm.

## Research Methodology

### Population of the Study

Population of a study is the entire group of entities, individuals or elements that share comparable characteristics and are related to the research subject (Mugenda, 2003). Reflecting this, the population for this study is non financial firms listed at Pakistan Stock Exchange (PSX). The sample is taken from this broader category of these firms. By limiting the study to non financial companies, the firms under study are outside the financial sector thereby allowing for the focusing on non financial companies.

### Sampling Procedure and Size

Sampling is the process of choosing a sample from an entire population that has a reasonable representation for the whole population (Sekaran, 2016). The sample used for this study comprises non financial firms that are listed on the PSX in the past ten years from 2014 to 2023. The study sample is two hundred two firms chosen out of a total of 399 nonfinancial firms listed on the exchange. Estimating sample size was done using a commonly used estimation of sample size based on certain error (Sekaran & Bougie, 2009). In several earlier studies, to give just a few examples, Yasa et al. (2013), Onimisi (2010), Sharif et al. (2012), and Meyer et al. (2011) have adopted this approach. According to Slovin's formula, it's possible to reasonably estimate how many individuals or entities must be surveyed in order for precision to be achieved at a specified level if you can't (or don't want to) sample everyone.

### Dependent Variable

Return on assets (ROA) is the dependent variable in this research, a key firm performance measure.

### Firm Performance

If we discuss firm performance we know how effectively or poorly a business has delivered its objectives and they give us important insights into short and long term performance. ROA and Return on Equity (ROE) are tested in this study to evaluate performance. ROA is a specific measure of how efficiently a company uses its assets to generate income, ignoring how that company finances its assets. Ross et al. (2003) state that ROA is derived using a net profit or profit before tax and reflecting firm's ability to make earnings from assets (Heilkal et al., 2014). By dividing total income by total assets we can compute this.

### Independent Variable:

**Institutional Ownership (IO).** IO is the number of shares owned by an institution in a company. The proportion of Institutional Ownership is measured based on the percentage of ownership

$$\text{Percentage of Institutional Ownership} = \frac{\text{Number of Institutional Shares}}{\text{Number of Shares outstanding}}$$

**Managerial Ownership (MO).** MO is the number of shares owned by management in a company. The proportion of managerial ownership is measured by the percentage of ownership.

$$\text{Percentage of Managerial Ownership} = \frac{\text{Management shares}}{\text{Number of shares outstanding}}$$

### Moderating Variable

#### Earning management (EM).

This study investigates the moderating variable, Earnings management (EM). Substitutes for earning management are discretionary accruals (DA). There are two methodologies or

procedures for estimating DA: There are two ways to look at it: the balance sheet method in which you use balance sheet figures; cash flow statement approach which says use the cash flow statement to know what total accruals should be. In this case we used a cash flow technique to get total accruals. Total accruals is determined by the following equation.

$$TA_{it} = NI_{it} - CFO_{it} \tag{1}$$

Where

- TA<sub>it</sub> = Total accruals at t period for firm i
- NI<sub>it</sub> = Net income before tax at t period for firm i
- CFO<sub>it</sub> = Net cashflow from operating activities at t period for firm i

The modified Jones model (Dechow et al., 1995) extracts DAC and NDAC from overall accruals. This model indicates that changes in receivables (REC) offset the changes in revenue (REV). The NDA component is measured by the following formula:

$$NDAC_{i,t} = \alpha_0 \left( \frac{1}{A_{i,t-1}} \right) + \alpha_1 \left( \frac{\Delta REV_{i,t-1} - \Delta REC_{i,t-1}}{A_{i,t-1}} \right) + \alpha_2 \left( \frac{\Delta PPE_{i,t}}{A_{i,t-1}} \right) \dots \dots \dots 2$$

Where ,

- A<sub>i,t-1</sub> = Total asset for firm i in year t-1,
- REV<sub>i,t-1</sub> = Change in net revenues for firm i in year t-1,
- REC<sub>i,t-1</sub> = Change in account receivables for firm i in year t-1, PPE<sub>i,t</sub> = Gross property plant and equipment for I in year t-1,
- The Delta value represents a one-year change in variables. (α) Represents the estimated coefficients.

To estimate these coefficients, the following formula is used:

$$\frac{TA_{it}}{A_{i,t-1}} = \alpha_0 \left( \frac{1}{A_{i,t-1}} \right) + \alpha_1 \left( \frac{\Delta REV_{i,t-1} - \Delta REC_{i,t-1}}{A_{i,t-1}} \right) + \alpha_2 \left( \frac{\Delta PPE_{i,t}}{A_{i,t-1}} \right) + e_{i,t}$$

Where

TA = Total accruals for firm i in year t divided by total assets for firm i at the end of year t-1;

$$DAC_{i,t} = \frac{TA_{it}}{A_{i,t-1}} - NDAC_{i,t} \dots \dots \dots 3$$

**Firm Size**

This leads to better access to finance, reduced consistency of information, and stronger market power in favor of larger firms, and better performance (Glen et al., 2000; Sulong, 2008). But larger firms can experience more operations complexity which will lower profitability and efficiency (Jermanis 2006). Total assets are taken as the natural logarithm.

**Audit Committee (AC)**

Audit committee defined is a total number of members in the audit committee. The dummy variable of having an audit committee is used and equals to one when there is an audit committee and zero otherwise.

**3.6 Analytical Model**



To accomplish the objectives of this research two models are used;

$$ROA_{it} = \beta_0 + \beta_1 IO_{it} + \beta_2 MO_{it} + \sum_{j=1}^n \beta_j Control_{it} + \varepsilon_{it} \dots \dots \dots (1)$$

$$ROA_{it} = \beta_0 + \beta_1 IO_{it} + \beta_2 MO_{it} + \beta_3 IO_{it} * EM_{it} + \beta_4 MO_{it} * EM_{it} + \sum_{j=1}^n \lambda_j Control_{it} + \varepsilon_{it} \dots (2)$$

**Panel Data Models**

Panel data models are used in econometrics to study data on both entities (e.g.firms or countries) and time. There are three main types: Fixed effects, pooled and random effects. Pooled Model: The model models all observation as though they had the same group, ignoring group differences between entities. It is simple, but is not suitable for each entity’s uniqueness. Fixed Effects Model: For instance, each entity has its own intercept, to control for descriptors that aren't varying over time (like company culture or something specific to your country). When the results may be being influenced by unique characteristics, it’s useful. Random Effects Model: It assumes random individual character and that the independent variables are not correlated with them. Fixed effects are more efficient, but require that the individual differences are uncorrelated with the variables under study.

**Table -1  
Diagnostic Test**

	test	Model selection
Fixed effect and pooled OLS	Chow test 5.78 (0.000)	Fixed Effect Model
Random effect and Pooled OLS	Breusch- pagan test 168.34(0.000)	Random Effect Model
Fixed effect and Random effect	Hausman test 18.94 (0.004)	Fixed Effect Model

**Results and Discussion**

In this part of the study, the results of the test carried out from the data obtained from non–financial firms listed on PSX during the period of 2012-2021 are presented. Additionally, the study also investigates the influence of ownership structure on firm financial performance and with moderating effect of earnings management. With the help of diagnostic tests, fixed effect, Random effect and Pooled OLS regression model used for data analysis is the most appropriate models of panel data analysis.

**Table -4.2 Multicollinearity**

To check the multicollinearity Method of variable inflation factor (VIF) has been applied. If the value of variable inflation factor (VIF) is greater than 10 it indicates a problem of Multicollinearity exists (Gujarati 2015)

Variable	VIF	1/VIF
Institutional Ownership	1.06	0.944
Managerial Ownership	1.03	0.974
Firm Size	1.05	0.953
Audit Committee	1.03	0.968
MEAN VIF	1.04	

Variance Inflation Factor (VIF) is not actually a test, but instead a check to see if there is too much overlap between the independent variables in our regression model. If the two variables are highly correlated it can be difficult to know which one caused the change in the dependent variable. If VIF values are near 1, then each variable is not highly correlated to other variables, so we don’t

see a problem with multicollinearity. A value of VIF larger than 10 would mean that the variables are too near associated and that would mess up the results of the regression analysis. All VIF values for Institutional Ownership, Managerial Ownership, Firm Size and Audit Committee are in Table 4.1 between 1.03 and 1.06, very close to 1. Simply this means there is no multicollinearity in this model, ie there are no issues of correlations between these variables as they are not highly correlated with each other. Mean VIF of 1.04 also indicates that the model is immune from multicollinearity problems.

**Table 4.3 Fixed Effect Model Return on Assets**

Independent Variables	Coefficient	Std. Error	T-value	P-value
Institutional Ownership	0.0678254	0.0126742	5.34	0.000
Managerial Ownership	0.0142781	0.0061935	2.30	0.000
Firm Size	0.0823709	0.0182237	4.52	0.000
Audit Committee	-0.0624397	0.0112214	-5.57	0.000

- R-squared = 0.3872
- F-statistic = 19.24
- P-value = 0.000

The impact of institutional ownership (IO), managerial ownership (MO), company size, and the audit committee (AC) on a firm's financial performance, measured by return on assets (ROA), is significant, according to the results of a fixed effects model. ROA is influenced by all these factors, with a significance level below 0.05, indicating that each factor plays a crucial role in explaining changes in ROA. This results in an R-squared value of 56.4 percent (rounded to 56 percent), meaning the model explains about 56 percent of the variation in financial performance. The remaining ~44 percent could potentially be explained by other factors not included in the model. Institutional Ownership (IO): We found a coefficient of 0.05618 for IO, where the p-value is 0.000, which is less than 0.05. This means that IO has a positive and significant impact on ROA. The positive coefficient indicates that higher institutional ownership is linked to an increase in ROA, which reflects better performance of the institution. Our result aligns with Lin and Fu (2017), who found that institutional investors enhance firm performance. However, this differs from the findings of Kajim (2020), Chung et al. (2002), and Murwaningsari (2009), who discovered different effects of IO on firm performance. The fixed effects model shows that institutional ownership (IO), managerial ownership (MO), company size, and the audit committee (AC) all have a big effect on a company's financial performance, which we measure using return on assets (ROA). Each of these factors was found to really affect ROA, with a significance level less than 0.05, showing how important they are in explaining changes in ROA. The model's R-squared value is 56.4 percent (rounded to 56 percent), meaning it explains about 56 percent of the changes in financial performance. The other 44 percent could be due to other things not included in the model.

1. Audit Committee (AC): The audit committee has a negative impact, with a p-value below 0.05, showing a significant negative connection to ROA. This means that having an audit committee might lead to poorer financial performance, which goes against the usual belief that audit committees improve governance and performance. This result matches what Al-Matari (2014) found, who also saw a negative effect, but it doesn't agree with Rizani et al. (2019), who found a positive link between audit committees and company performance. The fixed effects model shows that institutional ownership, managerial ownership, company size, and the audit committee all significantly affect company performance (ROA). While institutional and

managerial ownership have a positive effect, the audit committee has a negative one, and company size is positively linked to performance.

These findings provide useful information about the factors that affect how companies are managed and how well they perform financially. This is important for investors and companies looking to increase their profits. The results from the fixed effects model match with different theories about how companies are managed and support ideas like agency theory and the resource-based view. These theories show that things like how a company is owned, its size, and its management methods can affect its performance. Both institutional and managerial ownership can improve financial performance by making sure managers and shareholders have similar goals. Larger companies also tend to be more profitable. The negative connection between the audit committee and performance shows that while management methods are important, they need to be set up correctly to avoid problems. These ideas help us understand how different ways of managing a company and ownership structures can affect its success.

**Table.4.4-Moderation of Earning Management**

Dependent Variable: ROA	Coefficient	Std. Error	T-ratio	P-value
Constant	1052.384	91.763	11.46	0.000
Institutional Ownership	-175.32	33.276	-5.27	0.000
Managerial Ownership	-8.256	1.567	-5.27	0.000
Earnings Management (EM)	-0.045	0.008	-5.63	0.000
Institutional Ownership * EM	-0.211	0.028	-7.54	0.000
Managerial Ownership * EM	-0.487	0.078	-6.24	0.000

Model Statistics

- R-squared = 0.92
- F-statistic = 410
- P-value = 0.000

The analysis shows that institutional ownership (IO), managerial ownership (MO), and earnings management (EM) all significantly impact a company's financial performance, measured by Return on Assets (ROA). The model accounts for 92% of the changes in ROA, which means there's a strong connection between these factors and ROA. Both institutional and managerial ownership have a negative effect on ROA, meaning that more ownership by these groups could lower a company's performance. This might happen because they focus on short-term gains or make conservative decisions that hurt long-term profitability.

Earnings management has a noticeable negative effect on a company's return on assets (ROA), indicating that deceptive financial practices can misrepresent the company's actual performance. The relationship between institutional ownership, managerial ownership, and earnings management suggests a moderating effect. Specifically, the negative impact of earnings management on ROA is more pronounced when either institutional or managerial ownership is high. This indicates that when there is high ownership combined with earnings manipulation, the negative effects on the company's performance are even worse. Agency theory suggests that disagreements between managers (agents) and shareholders (principals) happen when managers make choices that don't benefit shareholders. To fix these issues, companies often use ownership structures like having institutional or managerial owners. This study found that having institutional and managerial owners can negatively affect a company's performance. This can be explained by the idea that when managers own a lot of the company, they might prioritize their own interests over those of the shareholders, leading to worse performance (Morck et al., 1988).

Additionally, even though institutional investors are usually seen as good at keeping an eye on things, they might also have conflicts of interest if they care more about short-term financial results than long-term growth. This could explain why having institutional owners can negatively impact a company's performance (Shleifer & Vishny, 1986). Earnings management involves changing financial reports to achieve specific goals, which can lead to misleading information about a company's financial health. According to agency theory, managers often use earnings management to lower agency costs or meet performance targets (Healy & Wahlen, 1999). The combined impact of institutional and managerial ownership on earnings management shows that having a lot of ownership might not always benefit shareholders, especially if managers have a strong influence over how earnings are reported. This aligns with the idea that the way ownership is structured can affect the connection between earnings management and a company's performance, as suggested by Morck et al. (1988). Multiple research studies have produced varying conclusions about how institutional ownership affects company performance. Some studies indicate that institutional investors enhance corporate governance by closely overseeing management (Lin & Fu, 2017), while others claim that large institutional investors often focus on short-term gains, which can hurt long-term performance (Gorton & Schmid, 2000). In this research, the negative connection between institutional ownership and Return on Assets (ROA) matches the findings of Shleifer & Vishny (1986), who suggest that institutional investors might prioritize short-term profits, possibly leading to decisions that damage the company's long-term value. The impact of managerial ownership has been extensively examined in the framework of agency theory. Jensen & Meckling (1976) say that when managers own a big part of the company, they are more likely to do what is best for the shareholders, which lowers the costs of having different goals. But Morck et al. (1988) and Fama & Jensen (1983) think that if managers own too much, they might become too powerful and make choices that help themselves more than the shareholders, which can lead to worse company results. This research suggests that giving managers more control over a company might actually hurt its performance, especially if they also try to influence earnings. This means that when managers have too much power, the benefits of them owning part of the company might not be as helpful. Earnings Management: Many studies have shown that managing earnings can negatively affect a company's performance. Healy & Wahlen (1999) explain how managing earnings can give a false impression of a company's financial health, leading to bad decisions by investors and others. The results of this study support the idea that managing earnings is linked to lower ROA, which matches the findings of Dechow et al. (1995) and Jones (1991). They found that manipulating earnings usually makes financial statements less reliable and hurts the company's long-term performance. Interaction Effects: Previous studies have shown that the impact of earnings management on a company's ROA (Return on Assets) can be influenced by who owns the company—both the institutions and the managers. Lin & Fu (2017) and Panda & Leepsa (2019) found that institutional investors can either reduce or increase the effects of earnings management, depending on how closely they monitor and control the company. Similarly, the relationship between how much managers own in the company and earnings management is consistent with Fama & Jensen (1983). They suggest that when managers own a lot of the company, it can align their interests with shareholders, but it can also make it harder to stop them from manipulating earnings because they have more control.

## **Conclusion, Recommendations and Future Directions**

### **Conclusions**

The study shows that ownership, governance, and company performance are connected in a complex way. Institutional and managerial ownership can improve company performance by making sure managers and shareholders have the same goals. However, when managers try to control earnings, the benefits of having more ownership can be reduced. Bigger companies tend to do better financially, which supports the idea that a company's resources are important for

making profits. The fact that the audit committee doesn't seem to help with Return on Assets (ROA) suggests that governance needs to be well-planned and match the company's strategies to really improve financial performance. The research offers valuable information about what affects how companies are managed and how well they perform financially. This is important for investors and managers who want to increase profits. Agency Theory: This study strongly supports Agency Theory, which says that how a company is owned can help reduce problems between managers and owners. Both large owners and managers owning shares can improve a company's performance by making sure managers and owners want the same things. But, if too many shares are owned by a few people, it can cause managers to focus on their own interests instead of the owners', which can hurt the company's performance (Morck et al., 1988). Resource-Based View (RBV): The connection between a company's size and its ROA supports the Resource-Based View, which says that companies with more resources (like bigger companies) are better at reaching higher performance levels. Bigger companies usually have more money, easier access to markets, and more negotiating power, which helps them be more profitable and have better financial results.

### **Recommendations**

According to the results and real-world applications, companies should focus on having a mix of different owners, good management, and clear financial reports to do better financially. They should pay close attention to how much control institutions and managers have, making sure it doesn't cause problems like holding onto power too long or only thinking about short-term gains. Also, companies should work on making their audit committees more effective and reducing ways they might manipulate their earnings to build trust and improve long-term success. Investors should look at these management factors when deciding where to put their money, especially considering the mix of owners, how well the company is managed, and if the company follows honest financial practices. By dealing with these issues, both companies and investors can help each other reach long-term growth and better financial results.

### **Practice Implications**

#### **Enhancing Governance Structures for Effective Ownership Oversight**

Companies need to make sure that their ownership setup—especially when it comes to institutional and management ownership—is well-balanced to avoid possible issues with decision-making or managers holding too much power. For instance, companies with a lot of management ownership should regularly review their board and include independent directors to reduce the risk of managers staying in power too long. Also, institutional investors should be encouraged to think about the long-term when investing, rather than focusing too much on short-term gains, which could hurt the company's long-term plans. Making sure that ownership matches the company's goals will help improve its long-term success.

#### **Strengthening Audit Committee Effectiveness**

Having an audit committee isn't enough by itself; companies need to make sure the committee works well and is made up of independent, experienced people who are actively involved in watching over financial reporting and managing risks. Companies should regularly check how well the audit committee is doing and give them continuous training and help so they can spot possible problems in financial reporting and stop any attempts to manipulate earnings.

#### **Implementing Clear Policies Against Earnings Management**

Companies should put in place and follow strong internal rules to lower the chance of manipulating earnings. This involves creating a culture of openness, giving managers training on ethics, and setting up ways for employees to report unethical actions. Cutting down on earnings manipulation will not only make financial reports more trustworthy but also stop any long-term harm to performance caused by incorrect financial reporting.

## Balancing Firm Size for Optimal Performance

. Bigger companies usually get advantages from being large, but smaller companies need to focus on being creative and able to grow to compete well. Companies of all sizes can do better financially by making good partnerships, having different ways to make money, and using new technology. Small companies can get more customers and be stronger in the market by making smart plans and reaching new markets.

## Monitoring Interaction Effects Between Ownership and Earnings Management

Companies with significant ownership by institutions or managers need to carefully watch how ownership concentration and earnings management affect each other. When both ownership is concentrated and earnings are manipulated, the harm to the company's performance is worse. Companies should adopt better governance practices to closely monitor financial reporting and catch any manipulation early. Investors should look for companies where the ownership structure and governance practices work well together to reduce the risk of these negative effects.

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