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The Effect of Financial Reporting Quality on Firm Financial Performance: The Moderating Role of Ownership Structure

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***Abstract:** The purpose of the study is to analyze the effect of financial reporting quality on firm financial performance and the moderating role of ownership structure between financial reporting quality and firm financial performance. This study conducted the analysis of 20 cement firms listed on Pakistan stock exchange from the period 2011 to 2016. Furthermore, this study utilizes the OLS regression model to estimate the dependent and independent variable. The study used statistics-based models to examine the independent variables. The result indicates that there is a positive relation between financial reporting quality and firm financial performance. It is confirmed that an increase in the quality of financial reporting can affect positively the firm financial performance. Also, the institutional have a positive impact on firm financial performance and financial reporting quality. On the other hand, the Result shows that there is a negative effect on the moderating role of the managerial ownership on the relationship between the firm financial reporting quality and firm performance quality. Investors judge the company positively which dedicated to the correct information about firm financial reporting and show a high quality to their investors. Hence all hypothesis of the study was accepted.*

***Keywords:** Financial Reporting Quality, Return on Assets, Return on Equity, Earning Per Share, Managerial Ownership, Institutional Ownership.*

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1. INTRODUCTION

The firm financial performance is reported or communicated to the suppliers of capital and other stakeholders through the financial reports. Financial reporting plays a vital role in decision making for a firm as it makes a context for the examiners of the performance of the firm. Investors demand information to measure the efficiency and uncertainty of current and future financial reports that they may evaluate the firms and make other investment decisions (Dechow et al., 2010). Financial reporting quality is defined as the accuracy of financial reports stating that managers should fully inform their shareholders and investors about the information of trend of cash flow and operation of the company (Warfield et al., 1995).

A firm's financial performance showed that reporting quality is efficient when it maximizes the firm's value. Financial reports help shareholder and owners to know how their funds are being utilized (Tang et al., 2012). Investors judge the company positively which dedicated to the correct information about firm financial reporting and show a high quality to their investors (Edward Lee et al., 2013). Mustapha and Ahmad (2011) reported that the relation of managerial ownership structure and a firm financial performance is positive. They found that this satisfactory effect is because of the valued information controlled by managers compared to that possessed by outsider shareholder (institutional ownership). Thus, the managerial ownership and firm performance are relatively positive. However, the main problem that in case of managerial ownership concentration it can interrupt shareholder from internal and external affairs of the firm. Thus, it can reduce firm value.

Firm financial performance had been effected by financial reporting quality, for firm performance reporting quality must be acknowledged. Thus the aim of this paper is to find the relation of financial reporting quality and firm performance and also study the moderation of ownership structure between firm performance and financial reporting quality. Henceforth, reporting quality arise the problem as its subsequent effect on financial performance of a firm and moderate the relationship by the structure of ownership between the firm's financial reporting and a company financial performance. The objective of this paper are to examine the impact of financial reporting quality on firm financial performance, To examine the moderating role of the institutional ownership on the relationship between the firm financial reporting quality and firm performance and to examine the moderating role of the managerial ownership on the relationship between the firm financial reporting quality and firm performance. This paper has provided the guide line to investors as what will be a firm performance if institutional and managerial ownership increase or decrease and also study the effect on financial reporting quality.

1.2 Problem Statement

Firm financial performance had been affected by financial reporting quality, for firm performance reporting quality must be acknowledged. The ownership structure of a company plays vital role if the concentrated ownership is increases (institutional or managerial ownership) this may affect the firm financial performance and financial reporting quality. Thus, there is need to know the relation of financial reporting quality and firm performance

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and to study the moderating role of ownership structure between firm performance and financial reporting quality.

1.3 Research Question

This research is based on the following research question that is clearly defines the research criterion.

1. Is there any impact of financial reporting quality on the firm financial performance?
2. Whether institutional ownership moderate the relationship between the quality of the Firm's financial reporting and firm financial performance?
3. Whether managerial ownership moderate the relationship between the quality of the firm's financial reporting and firm financial performance?

1.4 Research Objectives

The main objectives of this study are below,

1. To examine the impact of financial reporting quality on firm financial performance.
2. To examine the moderating role of the institutional ownership on the relationship between the firm financial reporting quality and firm performance.
3. To examine the moderating role of the managerial ownership on the relationship between the firm financial reporting quality and firm performance.

2. RELATED WORKS

Literature related to firm financial performance, financial reporting quality, is presented by this section including institutional and managerial ownership structure. The real owners of firm or corporation are shareholder and those who have invested in that firm. Accounting Standards Board proposed a definition for financial reporting quality; the main objectives of financial reporting this board declares is to notify those motivated investors who make reasonable decisions and evaluate financial reporting quality of the firm. Bjugren (2007) explored the full definition of institutional ownership with his theory he define that institutional ownership are corporation to invest and reduce transection costs and make the transection of investment easy for user and with their professional way they can manage fund and stock for the investors. While managerial ownership is measure by the total and average proportion of the reward awards given to the members of the Board. With large managerial ownership, firms must have lower agency clashes and lower agency cost disputes.

financial reporting quality indicating it is good for the firm, they define reporting quality as the means used by managers to improve the financial position of the firm (Healy and Wahlen 1999). Bruce Pounder (2013) documented that financial reporting quality is an important model that is used to quantify the excellence of financial reporting quality. Therefore, Shehu Usman Hassan (2013) studied that Investors and consumers of the financial information of the firm are involved in attaining a high reporting quality information, and this quality can be possible from having a high quality financial reports indicates the actual position of the company that's why financial reporting quality should be high.

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Kwang Sing Ngui et al. (2008) explore that managerial ownership have is a positive effect on firm financial performance. They studied that this effect is due to the financial information controlled by managers compared to that possessed by institutional ownership. Another researcher named Terry D Warfield et al. (1995) found that a conflict to the preparation of argument, an adverse relation can be imagined between managerial ownership, financial reporting quality and firm performance. When managerial ownership is high they are less focus on reporting quality of information. Thus, without the exclusive costs of quality managers will decrease the quality of revealing, since the fewer managers disclose the quality, the fewer competitor and suppliers know about the firm's actual financial situation and managerial ownership cheers managerial quality of reports. Fudenberg and Tirole (1995) studied managerial ownership and firm financial reporting quality both have an inverse relation, his study finds that if manger work for a company interest and report smoothly there could be high chance of good reporting quality,

Controlling the ability of managers to efficiently manage firm performance and financial reporting quality. The effective monitoring of managers by institutional investor suggests that institutional ownership structure, have inverse association with the relationship between firm financial performance and financial reporting quality. Institutional investor sample forms into two groups based on the investment prospect. Short-term performance is not a goal of institutions ownership that hold large share, their goal is long term and for that they monitor managers to achieve that goal for them. Comparing institutional investor with individuals Institutional investors are e considered as well informed investors who can easily access, obtaining and processing financial information. Brian and Bushee (1998) explore institutional investors have the chance, resources, and capability to monitor managers. Thus, the well-organized monitoring suggests that institutional ownership is related to a better monitoring of management activities. These arguments show that institutional investors may not bounds managers' financial reporting quality and may increase managerial incentives to participate in manipulating financial reporting quality.

2.1 Hypotheses of the Study

H1 Financial Reporting Quality has a positive effect on financial firm performance.
H2 Managerial ownership has a positive impact on the relationship between firm financial performance and financial reporting quality.
H3 Institutional ownership has a negative impact on the relationship between financial reporting quality and firm financial performance.

2.2 Conceptual Framework

In this study financial firm performance is an independent variable while the dependent variable is financial reporting quality and this study also find the role of moderation of ownership structure among financial reporting quality and firm performance. For that the conceptual framework is below,

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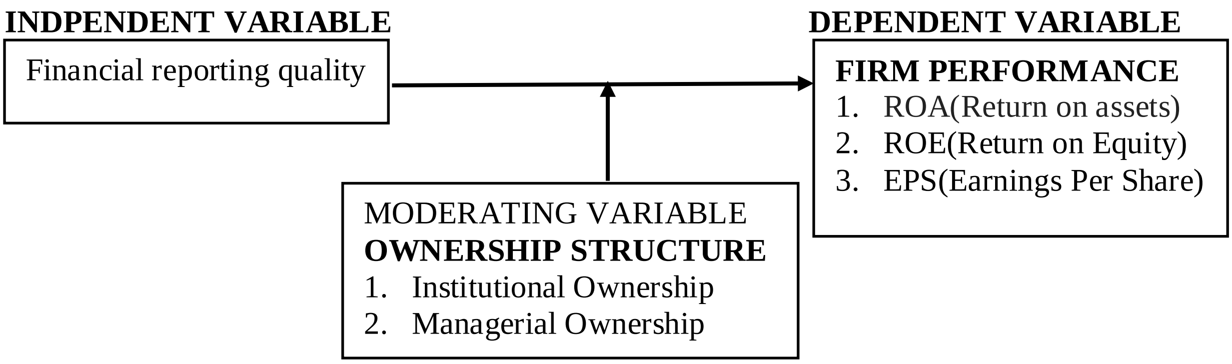

Figure 1: Conceptual Framework of the Study

3. METHODOLOGY

Pakistan is one of the rising in export of cement to all over the world according to annual report of All Pakistan Cement Manufacturer (APCM 2016). This study will be selecting the data of 20 cement firm during 2011 to 2016. This study is using the census sampling technique. To find the relation between independent and dependent variables this study used Ordinary Least Square (OLS). Financial reporting quality is measured through total accruals by modified Jones model of (Patricia M Dechow et al., 1995). To examine the firm financial performance this study, employ ratio ROA, ROE, and EPS. However, for ownership structure this study employed institutional and managerial share holder pattern form annual reports.

4. RESULTS AND FINDINGS

Results based on ROA

Table 4.1: Financial Reporting Quality on Firm Financial Performance based on ROA

Variable ROA	**Coefficient**	**t-ratio**	**P-value**
FRQ	0.071	9.15	0.00
	F-value	83.72	
	P-value	0.00	
	R-square	0.413	

This table (4.1) represent the financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as ROA and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for hetroscedasticity.

Table 4.2: The Moderation Effect of the Institutional Ownership on the Relationship between the Firm Financial Reporting Quality and Firm Performance based on ROA

Variable ROA	**Coefficient**	**t-ratio**	**P-value**
FRQ	0.097	10.52	0.00
IO	.136	4.82	0.00

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IOFRQ	-0.635	-4.76	0.00
	F-value	40.97	
	P-value	0.00	
	R-square	0.512	

This table (4.2) represent the moderating effect of ownership structure between financial reporting quality and firm performances based on OLS regression model. The dependent variable is firm financial performance as ROA and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for hetroscedasticity.

Table 4.3: The Moderation Effect of the Managerial Ownership on the Relationship between the Firm Financial Reporting Quality and Firm Performance based on ROA

Variable ROA	**Coefficient**	**t-ratio**	**P-value**
FRQ	0.039	5.49	0.00
MO	.168	6.68	0.00
MOFRQ	-0.324	-2.32	0.022
	F-value	67.7	
	P-value	0.00	
	R-square	0.634	

This table (4.3) represent the moderating effect of ownership structure between financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as ROA and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for heteroscedasticity.
Results based on ROE

Table 4.4: Financial Reporting Quality on Firm Financial Performance based on ROE

Variable ROE	**Coefficient**	**t-ratio**	**P-value**
FRQ	0. 7801	3.67	0.00
	F-value	13.48	
	P-value	0.00	
	R-square	0.101	

This table (4.4) represent the financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as ROE and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for hetroscedasticity.

Table 4.5: The Moderation Effect of the Institutional Ownership on the Relationship Between the Firm Financial Reporting Quality and Firm Performance based on ROE

Variable ROE	**Coefficient**	**t-ratio**	**P-value**
FRQ	0. 7801	3.67	0.00
	F-value	13.48	
	P-value	0.00	

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R-square	0.101

This table (4.5) represent the moderating effect of ownership structure between financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as ROE and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for heteroscedasticity.

Table 4.6: The Moderation Effect of The Managerial Ownership on the Relationship between the Firm Financial Reporting Quality and Firm Performance based on ROE

Variable ROE	Coefficient	t-ratio	P-value
FRQ	1.09	1.89	0.02
MO	6.037	8.93	0.00
MOFRQ	-22.25811	-5.93	0.00
	F-value	67.7	
	P-value	0.01	
	R-square	0.477	

This table (4.6) represent the moderating effect of ownership structure between financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as ROE and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for heteroscedasticity.

Result Based On EPS

Table 4.7: Financial Reporting Quality On Firm Financial Performance Based On EPS

Variable EPS	Coefficient	t-ratio	P-value
FRQ	35.71326	5.80	0.00
	F-value	33.64	
	P-value	0.00	
	R-square	0.2204	

This table (4.7) represent the financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as EPS and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for heteroscedasticity.

Table 4.8: The Moderation Effect of the Institutional Ownership on the Relationship between the Firm Financial Reporting Quality and Firm Performance Based on EPS

Variable EPS	Coefficient	t-ratio	P-value
FRQ	50.62505	6.67	0.00
IO	83.74462	3.59	0.00
IOFRQ	-979.9814	-3.46	0.00
	F-value	18.25	
	P-value	0.00	

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R-square	0.3187

This table (4.8) represent the moderating effect of ownership structure between financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as EPS and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for heteroscedasticity.

Table 4.9: The Moderation Effect of the Managerial Ownership on the Relationship between the Firm Financial Reporting Quality and Firm Performance Based on EPS

Variable EPS	**Coefficient**	**t-ratio**	**P-value**
FRQ	19.350	2.87	0.005
MO	93.488	3.97	0.000
MOFRQ	-219.845	-1.68	0.095
F-value	20.49		
P-value	0.03		
R-square	0.3444		

This table (4.9) represent the moderating effect of ownership structure between financial reporting quality and firm performance based on OLS regression model. The dependent variable is firm financial performance as EPS and independent variable is financial reporting quality. All the coefficient are adjusted by standard error for heteroscedasticity.

5. CONCLUSION AND DISCUSSION

This study conducted the analysis of 20 cement firms listed on Pakistan stock exchange from the period 2011 to 2016. This study found that firm financial performance has significantly influence by financial reporting quality. Findings of the study found that there is a positive effect of financial reporting quality and firm financial performance. The financial reporting quality is significant factor that influence the firm financial performance. The study found that the moderating role of institutional ownership has negative between financial reporting quality and firm financial performance. The moderation effect of the institutional ownership is significant factor that influence the financial reporting quality and firm financial performance. As such these variable are statistically significant 'fails to reject' the hypothesis. And in last this study found that the moderating role of managerial ownership has negative between financial reporting quality and firm financial performance. Over all the result indicates that financial reporting quality effect the firm financial performance and will never denied the moderating role of ownership structure as it drives these two factors, financial reporting quality and firm performance.

5.1 Limitations of the Study

Several limitation to this study need to be acknowledged that may extend prospectus for future research .The most important limitation lies in the fact that this research has include only cement industry which is a non-financial sector of the industry in Pakistan and the study

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exclude all other financial sector of the sector of Pakistan. This study take only cement industry which are listed on Karachi stock exchange known as Pakistan stock exchange. The foremost limitation of this study is data limitation. This study considered cement industry which are operate from 2011 to 2016. Moreover, study exclude the firm for which completely data is not available .likewise due to limited number of cement firm in Pakistan. Therefore this study mainly focused on the analysis based on the overall sample.

5.2 Recommendations and Direction for Further Study

There is a prolific room for further research as more data available in future, in line with importance of firm owner should be aware of their management doing financial reporting or manipulation. The financial sector is still in tapped of these issue it could be open for future research in Pakistan. Likewise, the availability of data is important. Therefore the future research recommendation are to examine the overall sector of Pakistan or could be examine financial sector of Pakistan.

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