

The Impact of Accrual-Based Earnings Management on the Cost of Equity Capital of Companies Listed on the Tehran Stock Exchange with Control for Firm Size, Financial Leverage, and Growth Opportunities

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ABSTRACT

The objective of this study was to investigate the effect of accrual-based discretionary earnings management on the cost of equity capital of companies listed on the Tehran Stock Exchange while controlling for firm size, financial leverage, and growth opportunities. This applied quantitative study employed an explanatory–correlational design using panel data analysis. The statistical population consisted of companies listed on the Tehran Stock Exchange, from which 142 firms were selected through systematic elimination sampling based on data availability, fiscal year uniformity, continuous market presence, and exclusion of financial intermediaries. The study period covered ten fiscal years from 2014 to 2023, generating 1,420 firm–year observations. Financial data were collected from audited financial statements and official market databases. Accrual-based earnings management was measured using discretionary accruals estimated through the Modified Jones Model. The cost of equity capital was calculated using a market-based implied cost of capital approach. Control variables included firm size measured by the natural logarithm of total assets, financial leverage measured as total liabilities to total assets ratio, and growth opportunities proxied by the market-to-book ratio. Data were analyzed using panel regression techniques following diagnostic tests including the Chow and Hausman tests to determine the appropriate estimation model. Panel regression results indicated a positive and statistically significant relationship between discretionary accruals and the cost of equity capital, suggesting that higher levels of accrual-based earnings management increase shareholders' required returns. Firm size exhibited a significant negative association with the cost of equity capital, implying that larger firms experience lower financing costs. Financial leverage showed a positive and significant effect, indicating that higher debt levels increase perceived risk and equity financing costs. Growth opportunities were also positively related to the cost of equity capital, reflecting greater uncertainty associated with future performance expectations. The overall regression model demonstrated strong explanatory power and statistical significance. The findings demonstrate that accrual-based earnings management increases information risk and leads investors to demand higher expected

returns, while firm size mitigates financing costs and leverage and growth prospects intensify equity risk perceptions. The study highlights the critical role of financial reporting quality in capital market efficiency and emphasizes the importance of transparent accounting practices for reducing equity financing costs in emerging markets.

Keywords: *Earnings Management; Discretionary Accruals; Cost of Equity Capital; Firm Size; Financial Leverage; Growth Opportunities; Tehran Stock Exchange; Financial Reporting Quality*

1. Introduction

Financial reporting quality and capital market efficiency represent two central pillars of modern corporate finance and accounting research. In capital markets characterized by information asymmetry between managers and investors, financial statements serve as the primary mechanism through which firms communicate economic performance, risk exposure, and future prospects. Investors rely heavily on accounting information to estimate expected returns and evaluate firm risk, which directly influences the cost of equity capital. Consequently, managerial discretion in financial reporting—particularly through accrual-based earnings management—has become a critical issue in understanding how accounting choices affect financing costs and market valuation. The growing complexity of financial markets has intensified scholarly interest in examining whether discretionary accounting behavior increases uncertainty perceived by investors and ultimately raises firms' required rates of return (Nguyen et al., 2025; Saputra, 2025).

Earnings management refers to managerial intervention in financial reporting aimed at influencing reported earnings through accounting judgments rather than underlying economic activities. Accrual-based earnings management, in particular, allows managers to adjust accounting estimates, revenue recognition timing, and expense allocation without necessarily altering cash flows. While such flexibility may be justified within accounting standards, excessive discretion can reduce earnings quality and weaken investor confidence. Empirical evidence demonstrates that firms engaging in higher levels of accrual manipulation often experience deteriorating information transparency, increased perceived risk, and adverse capital market reactions (Nguyen et al., 2025; Valášková & Gajdosikova, 2022). Studies across emerging and developed markets consistently indicate that earnings management is closely linked to agency conflicts arising from the separation between ownership and control, reinforcing agency theory

explanations of managerial opportunism (Hamad, 2025; Kontuš, 2021).

The cost of equity capital represents the return required by shareholders to compensate for investment risk, information uncertainty, and opportunity costs. Unlike debt financing, equity capital reflects investors' expectations regarding long-term profitability, corporate governance quality, and reporting credibility. When investors suspect earnings manipulation or reduced reporting reliability, they demand higher expected returns as compensation for increased uncertainty. Empirical findings confirm that accounting transparency, voluntary disclosure, and reliable financial reporting significantly reduce the cost of equity by mitigating information asymmetry between firms and capital providers (Alia et al., 2022; Raimo et al., 2020). Conversely, accounting manipulation tends to increase perceived firm risk, thereby elevating financing costs and weakening capital market efficiency (Baloch, 2023).

Recent international research highlights the growing interaction between earnings quality and market-based financing decisions. Evidence from Vietnam demonstrates that accrual-based earnings management significantly influences firm performance evaluation and investor behavior within stock markets (Nguyen et al., 2025). Similar findings suggest that discretionary accounting practices distort performance signals and alter investor expectations regarding future cash flows. Research conducted in Poland emphasizes that stronger earnings quality improves market credibility and reduces uncertainty associated with corporate valuation (Gryko et al., 2024). These findings collectively support the argument that earnings management not only affects accounting outcomes but also shapes financial market pricing mechanisms.

The relationship between earnings management and cost of equity capital is further explained through agency theory and signaling theory perspectives. Agency theory posits that managers may manipulate accounting numbers to pursue personal incentives such as compensation maximization or job security, thereby increasing monitoring costs borne by investors (Kontuš, 2021). Signaling theory, on the other

hand, suggests that transparent reporting serves as a positive signal of firm quality, reducing required investor returns. Empirical evidence indicates that improved corporate governance structures can moderate the adverse effects of earnings management on capital costs, highlighting the importance of institutional mechanisms in maintaining reporting integrity (Almusattar & Teker, 2023; Arianpoor & Farzaneh, 2023).

Corporate financing decisions also play an essential role in determining firms' cost of capital. Capital structure theory emphasizes the balance between debt and equity financing in shaping firm risk and valuation. Financial leverage increases financial risk exposure and may amplify the consequences of earnings manipulation, as investors become more sensitive to accounting quality when firms rely heavily on external financing (Godakanda & Manawaduge, 2022; Hamad, 2025). Studies demonstrate that leverage, profitability, and operational efficiency jointly influence investor expectations and capital costs, particularly in emerging markets characterized by higher uncertainty levels (Saputra, 2025; Ullah et al., 2020). Therefore, examining earnings management without considering leverage effects may produce incomplete conclusions regarding financing outcomes.

Firm size constitutes another critical determinant influencing the cost of equity capital. Larger firms generally enjoy greater analyst coverage, stronger internal controls, diversified operations, and improved disclosure practices, which collectively reduce information asymmetry. Empirical studies show that firm size is negatively associated with financing costs because investors perceive large organizations as more stable and less risky (Awaliyah et al., 2021; Fasua & Olatunji, 2020). Additionally, larger firms often adopt advanced financial technologies and analytical systems, improving forecasting accuracy and valuation reliability (Malmir, 2025). Consequently, controlling for firm size is essential when analyzing the economic consequences of earnings management behavior.

Growth opportunities further complicate the relationship between financial reporting practices and capital costs. Firms experiencing rapid expansion or high market-to-book ratios often operate under greater uncertainty regarding future cash flows. While growth prospects attract investors, they simultaneously increase estimation risk and dependence on managerial projections. Research indicates that companies with higher growth expectations may face elevated cost of equity capital due to uncertainty surrounding long-term performance sustainability (Kamisanti, 2025;

Wilda et al., 2023). Growth-oriented firms may also possess stronger incentives to engage in earnings management to meet market expectations, reinforcing the need to incorporate growth variables into empirical models.

The broader corporate environment—including sustainability performance, corporate social responsibility, and innovation activities—also influences equity financing costs. Evidence from Korean markets shows that corporate social responsibility initiatives enhance financial performance and investor trust, thereby reducing perceived investment risk (Yoon et al., 2024). Similarly, research on integrated reporting adoption demonstrates that improved disclosure environments contribute to lower equity financing costs by enhancing transparency and legal accountability (Zaro et al., 2022). Green innovation activities and strategic investments further signal long-term value creation potential, influencing shareholder expectations regarding risk-adjusted returns (Alkebsee et al., 2023). These findings highlight the multifaceted nature of factors shaping the cost of equity capital beyond traditional financial indicators.

Financial health and organizational performance also influence investor perceptions. Firms exhibiting stronger financial stability and operational efficiency tend to experience lower financing costs due to reduced default risk and improved long-term performance expectations (Arofah et al., 2025; Mom & Linh, 2025). Organizational capital, managerial capability, and digital transformation initiatives increasingly shape firm competitiveness and investment attractiveness within modern capital markets (Mechael et al., 2023; Trisnawati & Maulana, 2023). As capital markets evolve toward information-driven environments, accounting quality becomes even more critical in guiding investor decisions.

Empirical research across multiple international contexts reinforces the connection between financing decisions, earnings quality, and firm performance outcomes. Studies examining Islamic banking systems, multinational firms, and developing economies reveal that capital structure choices significantly affect cost of capital and profitability dynamics (Sayed Hashem Abdul Razzak, 2020; Silwal, 2022; Vitriya & Marciano, 2020). Share repurchase decisions, disclosure strategies, and financial inclusion initiatives further influence market valuation processes and shareholder return expectations (Sophia et al., 2023; Wang & Chen, 2023). These findings emphasize that equity financing costs emerge from an integrated interaction

between accounting behavior, corporate governance, market structure, and macroeconomic conditions.

Despite extensive international evidence, research examining accrual-based earnings management and cost of equity capital within emerging capital markets remains limited. Emerging markets often exhibit higher information asymmetry, weaker enforcement mechanisms, and greater reliance on accounting numbers for investment decisions. Evidence from Nigeria indicates that adoption of international financial reporting standards affects accrual manipulation practices, suggesting institutional environments significantly shape managerial reporting behavior (Adedokun et al., 2022). Likewise, cross-country studies highlight that financial reporting credibility plays an essential role in attracting investment and reducing financing costs in developing economies (Ravindran & Kengatharan, 2021; Salinger, 2022). These insights underline the importance of examining accounting quality effects within specific institutional contexts.

The Tehran Stock Exchange represents a particularly relevant setting for investigating this relationship. As one of the largest emerging capital markets in the Middle East, it is characterized by rapid market development, evolving regulatory frameworks, and increasing participation of institutional and individual investors. Firms operating in such environments face strong incentives to manage earnings to maintain market expectations, while investors rely heavily on accounting information due to limited alternative information channels. Consequently, understanding how discretionary accrual-based earnings management influences the cost of equity capital provides valuable insights for regulators, investors, and corporate managers seeking to improve market transparency and capital allocation efficiency.

Given the theoretical arguments of agency theory, signaling theory, and capital structure theory, along with growing empirical evidence linking reporting quality to financing outcomes, investigating the economic consequences of earnings management becomes essential for advancing accounting and finance research. Integrating firm size, financial leverage, and growth opportunities as control variables allows a more comprehensive evaluation of how accounting discretion interacts with firm characteristics to influence shareholder required returns.

Therefore, the aim of this study is to examine the impact of accrual-based discretionary earnings management on the cost of equity capital of companies listed on the Tehran

Stock Exchange while controlling for firm size, financial leverage, and growth opportunities.

2. Methods and Materials

This study was conducted using a quantitative, applied research design with an explanatory–correlational approach based on archival financial data. The research adopted a longitudinal panel data framework to examine the relationship between accrual-based earnings management and the cost of equity capital while controlling for firm size, financial leverage, and growth opportunities. The statistical population consisted of all companies listed on the Tehran Stock Exchange (TSE). The study focused specifically on firms operating continuously in Tehran’s capital market environment to ensure consistency in regulatory, accounting, and disclosure conditions. After applying screening criteria—including continuous listing during the study period, availability of audited financial statements, identical fiscal year ending in March, absence of financial intermediaries such as banks and insurance companies due to their distinct reporting structures, and complete accessibility of required variables—a final sample of 142 companies listed on the Tehran Stock Exchange in Tehran was selected. The observation period covered ten consecutive fiscal years from 2014 to 2023, producing a balanced panel dataset appropriate for econometric estimation. The sampling method was systematic elimination sampling, ensuring that only firms meeting all analytical requirements were retained, thereby enhancing internal validity and comparability across observations.

Data collection relied exclusively on secondary financial information extracted from verified institutional databases. Required financial statement data—including balance sheets, income statements, cash flow statements, and accompanying notes—were obtained from the official databases of the Tehran Stock Exchange, the Comprehensive Database of All Listed Companies (CODAL), and Rahavard Novin financial software. The measurement of accrual-based earnings management was operationalized using discretionary accruals derived from the Modified Jones Model, which is widely recognized in accounting research for separating discretionary accrual components from nondiscretionary accruals. Total accruals were calculated as the difference between accounting earnings and operating cash flows, after which regression-based estimation procedures were applied annually within each industry to obtain expected accruals. The residual component of

accruals represented discretionary accruals and served as the proxy for earnings management intensity. The dependent variable, cost of equity capital, was estimated using an implied cost of capital approach derived from market valuation models that incorporate stock price, earnings forecasts, and book value information to approximate shareholders' expected rate of return. Control variables were defined in accordance with established financial theory. Firm size was measured using the natural logarithm of total assets to capture scale effects and information asymmetry differences among firms. Financial leverage was calculated as the ratio of total liabilities to total assets, reflecting capital structure risk. Growth opportunities were proxied by the market-to-book ratio, representing investors' expectations regarding future expansion potential and profitability prospects. All financial variables were standardized and winsorized where necessary to reduce the influence of extreme observations and improve statistical robustness.

Data analysis was performed using econometric techniques suitable for panel data structures. After organizing and preprocessing the dataset, descriptive statistics were calculated to evaluate central tendency, dispersion, and distributional properties of the variables. Prior to hypothesis testing, diagnostic procedures were conducted to ensure compliance with classical regression assumptions, including tests for normality, multicollinearity, heteroskedasticity, and serial correlation. Panel data estimation began with the Chow (F-Limer) test to determine the appropriateness of pooled versus panel estimation, followed by the Hausman specification test to select between fixed-effects and random-effects models. Based on these diagnostic results, the appropriate panel regression model was estimated to assess the impact of discretionary accruals on the cost of equity capital while controlling for firm size, financial leverage, and growth opportunities. The regression coefficients were interpreted in terms of both statistical

significance and economic magnitude. Statistical analyses were conducted using EViews version 12 and supplementary calculations were verified using Excel to ensure computational accuracy. Significance levels were evaluated at conventional confidence thresholds, and robustness checks were performed to confirm stability of findings across alternative specifications. This analytical framework enabled rigorous examination of whether managerial discretion in accrual reporting influences shareholders' required returns within the institutional context of companies listed on the Tehran Stock Exchange.

3. Findings and Results

The research sample consisted of 142 companies listed on the Tehran Stock Exchange observed over a ten-year period from 2014 to 2023, resulting in 1,420 firm-year observations. The firms represented diverse industrial sectors including manufacturing, petrochemical, pharmaceutical, automotive, metal industries, construction, food products, and technology-related industries. Examination of firm characteristics indicated substantial heterogeneity across companies in terms of operational scale, financing structure, and market valuation. The average firm size, measured by the natural logarithm of total assets, reflected medium-to-large publicly traded companies operating within Tehran's capital market. Financial leverage ratios revealed that most firms relied considerably on debt financing, consistent with capital structure patterns typical of emerging markets. Growth opportunity indicators suggested that a significant proportion of firms operated in expansionary stages characterized by active investment expectations. Overall, the demographic structure of the dataset confirmed adequate variability among firms, which is essential for reliable panel regression estimation.

Table 1

Descriptive Statistics of Research Variables

Variable	Mean	Median	Standard Deviation	Minimum	Maximum
Cost of Equity Capital	0.214	0.209	0.071	0.082	0.498
Discretionary Accruals	0.036	0.031	0.094	-0.287	0.312
Firm Size (Ln Assets)	14.872	14.901	1.284	11.203	18.445
Financial Leverage	0.593	0.601	0.167	0.121	0.891
Growth Opportunities	1.764	1.542	0.836	0.421	5.733

The descriptive statistics presented in Table 1 provide an overview of the central tendencies and dispersion

characteristics of the study variables. The average cost of equity capital was 0.214, indicating that shareholders

required approximately a 21.4 percent expected return, reflecting relatively high risk premiums consistent with emerging financial markets. Discretionary accruals exhibited both positive and negative values, suggesting that firms engaged in income-increasing as well as income-decreasing earnings management strategies. The standard deviation of discretionary accruals demonstrates notable variation in managerial reporting behavior across firms. Firm size displayed moderate dispersion, confirming the

presence of companies with significantly different operational scales. Financial leverage levels indicated a considerable reliance on debt financing structures, while growth opportunity measures revealed substantial variation in market expectations regarding future performance. Overall, the distributional properties suggested sufficient variability and absence of extreme concentration, supporting the suitability of the dataset for subsequent econometric analysis.

Table 2

Correlation Matrix of Study Variables

Variable	1	2	3	4	5
1. Cost of Equity Capital	1				
2. Discretionary Accruals	0.412**	1			
3. Firm Size	-0.356**	-0.118*	1		
4. Financial Leverage	0.298**	0.204**	-0.221**	1	
5. Growth Opportunities	0.267**	0.173**	0.192**	0.116*	1

*Significant at 0.05 level

**Significant at 0.01 level

The correlation matrix in Table 2 illustrates the bivariate relationships among the research variables prior to regression modeling. Discretionary accruals demonstrated a positive and statistically significant association with the cost of equity capital, indicating that higher levels of earnings management are linked to increased shareholder required returns. Firm size showed a negative correlation with the cost of equity capital, suggesting that larger firms benefit from reduced information asymmetry and lower perceived investment risk. Financial leverage exhibited a positive

relationship with the cost of equity capital, implying that increased debt obligations elevate financial risk and consequently raise investors' expected returns. Growth opportunities were also positively correlated with the cost of equity capital, reflecting higher uncertainty associated with expansion-oriented firms. Importantly, correlation coefficients remained below conventional multicollinearity thresholds, indicating that independent variables could be simultaneously included in regression estimation without statistical distortion.

Table 3

Panel Data Model Selection Tests

Test	Statistic	Probability	Decision
Chow (F-Limer) Test	9.842	0.000	Panel model preferred
Hausman Test	21.617	0.001	Fixed effects selected

The results of panel data specification tests are presented in Table 3. The Chow test rejected the null hypothesis of pooled regression, confirming the necessity of panel estimation to account for firm-specific heterogeneity. Subsequently, the Hausman test indicated statistical significance, supporting the fixed-effects model as the appropriate estimation technique. This outcome implies that

unobservable firm characteristics are correlated with explanatory variables, making fixed-effects estimation more reliable than random-effects modeling. Adoption of the fixed-effects framework allowed the analysis to control for time-invariant firm attributes such as managerial culture, governance structures, and industry positioning, thereby improving causal interpretation of results.

Table 4

Fixed Effects Panel Regression Results

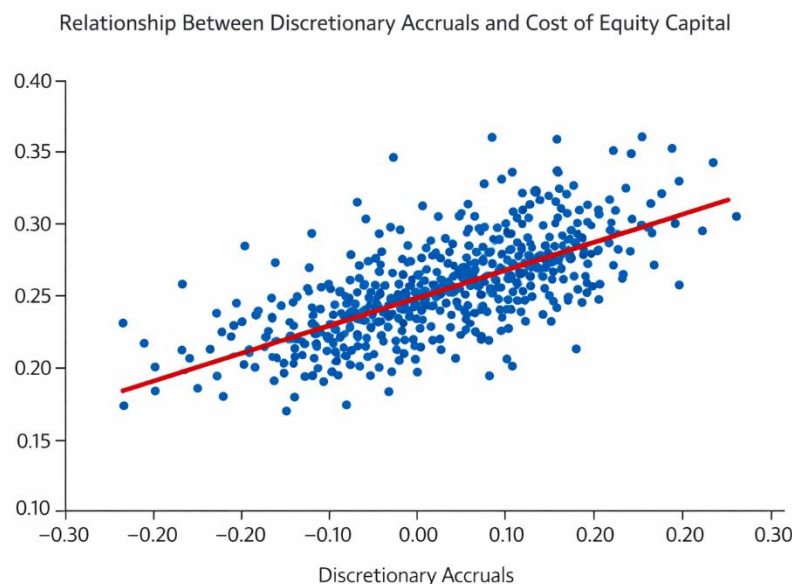
Variable	Coefficient	Std. Error	t-Statistic	Probability
Intercept	0.487	0.052	9.365	0.000
Discretionary Accruals	0.284	0.041	6.927	0.000
Firm Size	-0.021	0.006	-3.483	0.001
Financial Leverage	0.163	0.034	4.791	0.000
Growth Opportunities	0.057	0.014	4.071	0.000
R ²	0.61			
Adjusted R ²	0.58			
F-Statistic	48.23			0.000

Table 4 reports the main regression results examining the relationship between accrual-based earnings management and the cost of equity capital. The coefficient associated with discretionary accruals is positive and highly significant, demonstrating that increased earnings management leads to a higher cost of equity capital. This finding indicates that investors interpret discretionary accounting adjustments as signals of lower earnings quality and higher information risk, requiring greater expected returns as compensation. Firm size displayed a statistically significant negative coefficient, confirming that larger firms benefit from lower financing costs due to enhanced transparency, diversified

operations, and improved access to capital markets. Financial leverage showed a strong positive effect on the cost of equity capital, suggesting that higher debt exposure increases perceived financial risk from shareholders' perspective. Growth opportunities also exerted a positive and significant influence, indicating that firms with stronger expansion prospects face higher required returns due to uncertainty surrounding future cash flows. The model's explanatory power was substantial, with an adjusted R² of 0.58, indicating that more than half of the variation in the cost of equity capital is explained by the independent variables included in the model.

Figure 1

Relationship Between Discretionary Accruals and Cost of Equity Capital



The graphical representation illustrates the upward trend between discretionary accruals and the cost of equity capital across firm-year observations, demonstrating that firms exhibiting higher levels of accrual-based earnings

management consistently experience increased shareholder required returns. The positive slope confirms the econometric results obtained from panel regression analysis and visually highlights the economic magnitude of the

relationship. The dispersion of observations around the fitted line indicates variability across firms; however, the overall pattern remains strongly positive, reinforcing the interpretation that earnings management contributes to higher perceived investment risk. The figure further suggests that investors in the Tehran Stock Exchange actively incorporate accounting quality considerations into pricing decisions, thereby linking financial reporting behavior directly to firms' financing costs.

4. Discussion and Conclusion

The present study examined the impact of accrual-based discretionary earnings management on the cost of equity capital among companies listed on the Tehran Stock Exchange while controlling for firm size, financial leverage, and growth opportunities. The empirical findings revealed a statistically significant positive relationship between discretionary accruals and the cost of equity capital, indicating that firms engaging more intensively in accrual-based earnings management experience higher shareholder required returns. This result supports the central argument of information asymmetry theory, suggesting that when investors perceive accounting numbers as less reliable, they demand additional compensation for increased uncertainty. The findings align closely with evidence showing that earnings manipulation weakens earnings quality and reduces investor confidence, thereby increasing capital costs (Nguyen et al., 2025; Valášková & Gajdosikova, 2022). Investors in emerging markets appear particularly sensitive to discretionary accounting practices because financial statements constitute one of the primary sources of valuation information.

The positive association identified between earnings management and equity financing costs confirms predictions derived from agency theory. Managers possess informational advantages over shareholders and may exploit accounting flexibility to achieve private objectives, such as meeting performance benchmarks or stabilizing earnings volatility. However, capital markets eventually price such opportunistic behavior through higher expected returns. Similar conclusions were reported in studies demonstrating that accounting manipulation elevates weighted average cost of capital and increases risk premiums demanded by investors (Baloch, 2023). Furthermore, empirical research emphasizes that weak monitoring mechanisms intensify agency conflicts, thereby amplifying the economic consequences of earnings management (Hamad, 2025;

Kontuš, 2021). The results of the current study therefore reinforce the notion that accounting transparency functions as a critical governance mechanism influencing financing efficiency.

Another important finding of this study concerns the negative and significant effect of firm size on the cost of equity capital. Larger firms exhibited lower financing costs, suggesting that scale advantages, diversified operations, and improved disclosure environments reduce information asymmetry and perceived investment risk. This outcome is consistent with empirical literature demonstrating that firm size enhances financial stability and market credibility, allowing large organizations to access capital at lower costs (Awaliyah et al., 2021; Fasua & Olatunji, 2020). Large firms typically benefit from broader analyst coverage, stronger internal control systems, and greater institutional ownership, all of which contribute to improved reporting reliability. Advanced analytical technologies and predictive financial models increasingly adopted by larger firms also strengthen investor confidence by enhancing forecasting accuracy and valuation transparency (Malmir, 2025). Consequently, firm size operates as an important moderating factor in the relationship between earnings management and capital market outcomes.

The findings also indicate that financial leverage positively influences the cost of equity capital. Firms with higher debt ratios faced increased shareholder return expectations, reflecting heightened financial risk and potential solvency concerns. This result aligns with capital structure theory, which predicts that higher leverage magnifies earnings volatility and increases sensitivity to economic fluctuations. Previous empirical studies confirm that debt financing intensifies risk perception among investors, particularly when combined with questionable reporting quality (Godakanda & Manawaduge, 2022; Ullah et al., 2020). Agency theory further explains this relationship by suggesting that leveraged firms may face stronger incentives to manipulate earnings to comply with debt covenants, which investors anticipate and price accordingly (Ravindran & Kengatharan, 2021). The findings therefore highlight the interconnected nature of financing decisions and accounting behavior in shaping equity costs.

Growth opportunities were also found to exert a significant positive effect on the cost of equity capital. Firms with higher market-to-book ratios experienced higher required returns, suggesting that growth-oriented firms are associated with increased uncertainty regarding future cash flows. While growth prospects signal expansion potential,

they simultaneously introduce estimation risk and dependence on managerial projections. Similar conclusions have been reported in studies showing that investors require higher returns when future performance relies heavily on expectations rather than realized outcomes (Kamisanti, 2025; Wilda et al., 2023). Growth firms may also engage more actively in earnings management to maintain optimistic market perceptions, reinforcing the importance of controlling for growth opportunities when examining earnings quality effects.

The overall explanatory power of the regression model indicates that accounting quality, firm characteristics, and financing structure collectively explain a substantial proportion of variations in equity capital costs. These findings are consistent with research demonstrating that the cost of equity capital emerges from a multidimensional interaction between financial reporting credibility, governance mechanisms, and corporate performance indicators (Mom & Linh, 2025; Saputra, 2025). Financial health and operational efficiency serve as signals of long-term sustainability, reducing uncertainty surrounding investment decisions and influencing investor expectations.

The present results also correspond with disclosure-based perspectives emphasizing the role of transparency in reducing financing costs. Studies examining voluntary disclosure and integrated reporting adoption reveal that enhanced information environments lower equity costs by improving investor trust and reducing perceived risk (Alia et al., 2022; Zaro et al., 2022). Likewise, non-financial disclosures and sustainability initiatives have been shown to improve financial performance and capital market reputation, thereby influencing shareholder required returns (Raimo et al., 2020; Yoon et al., 2024). The positive relationship between earnings management and cost of equity capital observed in this study therefore underscores the economic importance of high-quality reporting practices in maintaining efficient capital allocation.

Corporate governance structures represent another relevant explanatory dimension. Evidence suggests that governance quality moderates the adverse effects of earnings management by strengthening oversight and limiting managerial opportunism (Almusattar & Teker, 2023; Arianpoor & Farzaneh, 2023). Although governance variables were not directly modeled in this study, the observed results indirectly support governance theory by demonstrating that markets penalize firms when reporting credibility deteriorates. Investors appear capable of

identifying signals associated with earnings manipulation and incorporate them into pricing decisions.

The findings further resonate with research exploring innovation, organizational capital, and strategic investment behavior. Firms investing in innovation or organizational development often experience improved market valuation and enhanced investor confidence (Alkebsee et al., 2023; Trisnawati & Maulana, 2023). Conversely, earnings manipulation may obscure genuine performance signals, preventing investors from accurately assessing firm value. Digital transformation initiatives and information systems integration also contribute to transparency improvements, reinforcing the importance of reliable accounting practices in modern data-driven capital markets (Mechael et al., 2023).

From an international perspective, the results align with cross-country evidence demonstrating that institutional environments influence the relationship between accounting quality and financing outcomes. Adoption of international reporting standards has been shown to affect accrual management practices and investor perceptions across emerging economies (Adedokun et al., 2022). Capital market development, legal systems, and disclosure regulations jointly shape how investors interpret financial statements and evaluate risk. Studies conducted across Islamic banking systems and multinational firms confirm that capital structure decisions, disclosure quality, and reporting credibility remain central determinants of capital costs worldwide (Sayed Hashem Abdul Razzak, 2020; Silwal, 2022; Vitriya & Marciano, 2020).

The evidence generated in this study also complements research examining broader determinants of capital costs, including share repurchase policies, organizational performance, and financial inclusion initiatives (Sophia et al., 2023; Wang & Chen, 2023). These studies collectively demonstrate that investors incorporate diverse financial and strategic indicators when evaluating risk and determining required returns. Earnings management therefore represents only one component within a broader informational ecosystem influencing market valuation.

Overall, the results confirm that accrual-based earnings management increases the cost of equity capital by intensifying information risk, while firm size reduces financing costs and financial leverage and growth opportunities increase investor-required returns. These findings provide empirical support for agency theory, signaling theory, and capital structure theory within the institutional context of the Tehran Stock Exchange. The

study contributes to the literature by integrating accounting behavior with firm characteristics to explain variations in equity financing costs in an emerging market environment.

Despite providing meaningful empirical insights, this study has several limitations that should be acknowledged. First, the measurement of earnings management relied solely on discretionary accrual models, which may not fully capture real activities manipulation or other non-accrual-based managerial behaviors. Second, the research focused exclusively on companies listed on the Tehran Stock Exchange, which may limit generalizability of findings to other institutional or regulatory environments. Third, macroeconomic fluctuations, political uncertainty, and market-specific shocks during the observation period may have influenced investor expectations independently of accounting behavior. Additionally, the study utilized secondary archival data, restricting the ability to incorporate qualitative dimensions such as managerial incentives or governance culture. Finally, although several control variables were included, other potentially relevant factors such as ownership structure, board independence, or audit quality were not explicitly modeled.

Future studies may extend this research by incorporating real earnings management measures alongside accrual-based indicators to provide a more comprehensive evaluation of managerial reporting behavior. Researchers could also examine moderating roles of corporate governance mechanisms, institutional ownership, or audit quality in mitigating the impact of earnings management on financing costs. Comparative cross-country analyses between emerging and developed markets may further clarify how institutional environments influence investor reactions to accounting discretion. Longitudinal studies covering crisis and post-crisis periods could offer deeper understanding of how economic instability alters the earnings management–cost of capital relationship. Additionally, integrating behavioral finance perspectives and investor sentiment indicators may enrich future models by capturing psychological responses to financial reporting quality.

Managers should prioritize transparent financial reporting and minimize opportunistic accounting practices to reduce equity financing costs and enhance investor trust. Regulatory authorities and stock exchange supervisors should strengthen disclosure requirements and monitoring mechanisms to discourage earnings manipulation and promote market efficiency. Investors and financial analysts are encouraged to incorporate earnings quality indicators into valuation models when assessing firm risk and expected

returns. Corporate boards should enhance oversight functions and reinforce internal control systems to ensure reliability of financial reporting processes. Finally, professional accounting bodies and educational institutions should emphasize ethical financial reporting standards to support sustainable capital market development and long-term corporate value creation.

Authors' Contributions

Authors contributed equally to this article.

Declaration

In order to correct and improve the academic writing of our paper, we have used the language model ChatGPT.

Transparency Statement

Data are available for research purposes upon reasonable request to the corresponding author.

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Declaration of Interest

The authors report no conflict of interest.

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Ethics Considerations

In this research, ethical standards including obtaining informed consent, ensuring privacy and confidentiality were considered.

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