



The Effect of Financial Flexibility on Firms' Risk Taking with the Moderating Role of Institutional Ownership

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Abstract

In the unstable economic and financial landscape of developing markets such as Iran, where firms face financial constraints and environmental uncertainties, understanding how financial flexibility affects the risk-taking behavior of firms is essential for improving the strategic management of financial resources. This is the primary objective of the present study. Additionally, by examining the moderating role of institutional ownership in this relationship, deeper insights into the various influencing conditions are sought. This research employs a quantitative approach and multivariate regression analysis, utilizing data collected from 153 firms listed on the Tehran Stock Exchange over the years 2013 to 2023, analyzed using dynamic panel econometric techniques and EViews software. The results indicate that an increase in financial flexibility leads to a rise in firms' risk-taking, suggesting that financial flexibility can act as a strategic resource that enables firms to make riskier decisions by providing sufficient financial resources. Furthermore, it was found that institutional ownership significantly strengthens this relationship, indicating the effective supervisory role of institutional owners in the Iranian environment for optimal resource allocation to enhance risk-taking. This study provides novel insights into the role of financial flexibility and institutional ownership in risk management and offers valuable policy recommendations for stakeholders engaged in directing high-risk investments.

Keywords: Financial flexibility, firm risk-taking, institutional ownership.

JEL Classification: G32, G38, Q56.

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INTRODUCTION

In today's rapidly changing and highly uncertain economic environment, particularly in developing countries such as Iran, firms encounter a unique mix of financial constraints and market volatilities. These conditions heighten the necessity for intelligent financial resource management as a strategic pillar, supporting growth, resilience, and competitiveness. The recent global shocks, such as the Covid-19 pandemic, have further underlined the need for optimizing financial management to mitigate risk and exploit emerging opportunities. Within this dynamic landscape, attention has increasingly turned to the concept of financial flexibility—the capacity of firms to adjust their financial policies, access capital under favorable terms, and ultimately respond swiftly to unforeseen shocks or investment prospects. Despite its critical importance, the relationship between financial flexibility and risk-taking, especially in emerging markets facing structural constraints like Iran, remains under-researched. Previous studies in other contexts ([Gamba & Triantis, 2008](#); [Bagh et al., 2025](#)) emphasize the strategic value of financial flexibility in fostering competitive advantage and enabling companies to engage in higher-risk, higher-reward projects. However, the mechanisms and outcomes of this relationship within the context of Iranian listed firms, which face pervasive uncertainty and limited access to external finance, have not been systematically explored. Furthermore, emerging literature highlights that the impact of financial flexibility on corporate risk-taking may be significantly influenced by institutional ownership—the shareholding of entities such as mutual funds, pension funds, insurance companies, and other institutional investors. These institutions, through their enhanced monitoring and governance capabilities, can alter managerial risk preferences and resource allocation decisions, moderating the effect of financial flexibility on risk behavior. By examining both the direct and moderating roles of institutional ownership, this study aims to provide a more nuanced understanding of the antecedents to firm risk-taking in a volatile institutional and market environment.

METHODOLOGY

The overarching objective of this study is to investigate how financial flexibility affects firms' risk-taking, and how this relationship is moderated by the presence of institutional owners, relying on evidence from companies listed on the Tehran Stock Exchange over a recent decade (2013–2023). Concretely, the study seeks to answer:

1. Does increased financial flexibility translate into greater corporate risk-taking?
2. Does institutional ownership strengthen or weaken this relationship in the Iranian context?

Drawing on theoretical frameworks and empirical precedents, the following hypotheses are articulated:

- Hypothesis 1: Financial flexibility has a significant effect on firms' risk-taking.
- Hypothesis 2: Institutional ownership moderates the effect of financial flexibility on risk-taking, amplifying or dampening it depending on ownership structure.

To address these questions, the study adopts a quantitative, empirical approach. Data were collected from 153 non-financial firms listed on the Tehran Stock Exchange across 11 years (2013–2023). The study utilizes a dynamic panel data methodology with multivariate regression models estimated via the Generalized Method of Moments (GMM), implemented in EViews 12. This econometric approach helps mitigate concerns about endogeneity, a common problem in studies of dynamic relationships and panel datasets.

RESULTS

These findings have multifaceted theoretical and practical implications:

Strategic Financial Management: The results validate the notion of financial flexibility as a strategic asset, especially vital in emerging markets where resource constraints and shocks are common. Flexible firms can better respond to opportunities for growth and innovation by selectively engaging in higher-risk projects.

The Role of Institutional Investors: While institutional investors typically promote conservative governance to mitigate agency problems, in conjunction with financial flexibility, they not only safeguard against imprudent risk but also enable management to pursue high-risk, high-return projects when well-justified. This dual role highlights the sophistication of institutional investors in both monitoring and enabling value-creating risk-taking.

Dynamic Risk Behavior: The lagged, negative coefficient of prior risk-taking underscores behavioral persistence and conservatism—firms that engaged in high risk in the previous period show a tendency to moderate risk subsequently, reflecting learning or risk aversion over time.

CONCLUSION

In summary, this study provides robust evidence that financial flexibility facilitates risk-taking among Iranian listed firms, and that the presence of strong institutional ownership magnifies this strategic effect. The findings contribute novel insights to both the financial management literature and the practice of corporate governance in volatile, developing market environments. The results underscore the need for an integrated approach to financial policy and ownership structure to support effective and value-enhancing corporate risk management.

Contribution of Authors

All authors participated in the process of writing the article, collecting data, and analyzing it.

Ethical Approval

All stages of the research were conducted with the informed consent of the participants, and their information will remain confidential.

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Conflict of Interest

No conflict of interest has been declared by the authors

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