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Sustainability Implications of Earnings Management and Tax Aggressiveness on Shareholder Wealth and Stock Price Crash Risk: Evidence From Zimbabwean Companies

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Abstract:

This study investigates the sustainability implications of earnings management and tax aggressiveness on shareholder wealth and stock price crash risk among Zimbabwean listed companies. Using a quantitative research design, the study integrates secondary financial data from 2015–2025 and survey responses from finance managers, auditors, and investors. Earnings management was measured through discretionary accruals, while tax aggressiveness was assessed via effective tax rates and book-tax differences. Sustainable shareholder wealth was proxied by stock returns, and stock price crash risk was evaluated using negative return skewness and down-to-up volatility ratios. Descriptive statistics, correlation analysis, panel regressions, and GARCH(1,1) models were employed to examine the relationships among the variables. Findings indicate that both earnings management and tax aggressiveness undermine sustainable shareholder wealth and increase stock price crash risk. The results highlight the sustainability risks and persistent volatility induced by these managerial practices and underscore the need for improved corporate governance, transparency, ESG-oriented reporting, and regulatory oversight in Zimbabwe's emerging capital markets.

Keywords:

Earnings Management, Tax Aggressiveness, Stock Price Crash Risk, Discretionary Accruals, Book-Tax Differences

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Introduction

The relationship between earnings management, tax aggressiveness, and capital market outcomes has become a central concern in financial economics, particularly in emerging and frontier markets characterised by weak institutional frameworks and high economic uncertainty. Earnings management, defined as the discretionary manipulation of accounting choices to influence reported earnings, and tax aggressiveness, which involves strategic actions to minimise corporate tax liabilities, are widely documented managerial practices (Healy & Wahlen, 1999; Frank et al., 2009). While these practices may enhance short-term reported performance and cash flows, growing empirical evidence suggests that they undermine financial reporting quality, increase information asymmetry, and expose shareholders to significant downside risks (John, 2025; Kim et al., 2011). In capital markets, distorted financial disclosures can mislead investors, inflate firm valuations, and ultimately destabilise share prices.

Empirical studies indicate that earnings management is prevalent across both developed and developing economies, with estimates suggesting that between 20% and 30% of listed firms globally engage in income-increasing earnings manipulation in any given year (Dechow et al., 2010). Similarly, tax aggressiveness has intensified, with multinational and domestic firms in emerging markets reportedly reducing effective tax rates by as much as 5–15 percentage points through aggressive tax planning strategies (Hanlon & Heitzman, 2010; Smith, 2024). These practices have direct implications for shareholder wealth, as inflated earnings and lower tax expenses may temporarily boost stock prices and dividends, yet mask underlying operational weaknesses. When negative information accumulates and is eventually disclosed, firms become exposed to stock price crash risk — defined as the probability of extreme negative stock returns — which has been shown to increase by up to 30% in firms with aggressive financial reporting behaviour (Kim & Zhang, 2016; John, 2025).

In Zimbabwe, these concerns are amplified by persistent macroeconomic instability, characterised by recurring inflationary episodes, exchange rate volatility, and constrained access to long-term capital. Inflation in Zimbabwe exceeded 175% in 2019 and remained above 90% in 2023, exerting intense pressure on corporate performance and financial reporting credibility (Reserve Bank of Zimbabwe, 2024). The Zimbabwe Stock Exchange (ZSE), though one of the oldest in Africa, remains relatively shallow, with market capitalisation fluctuating between 15% and 25% of GDP and low trading liquidity compared to regional peers (World Bank, 2023). These structural weaknesses heighten the incentives for managers to manipulate earnings and engage in aggressive tax strategies to preserve firm valuations and investor confidence in an uncertain economic environment (Moyo, 2024).

The problem, however, lies in the potential misalignment between managerial actions and shareholder interests. While earnings management and tax aggressiveness may create short-term shareholder

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gains, they often conceal firm-specific bad news, increase agency conflicts, and weaken corporate transparency. In the Zimbabwean context, limited disclosure enforcement and uneven corporate governance compliance exacerbate these risks, increasing the likelihood of sudden and severe stock price corrections when suppressed information becomes public. Despite these realities, there is a notable lack of empirical evidence examining how these managerial practices jointly affect shareholder wealth and stock price crash risk in Zimbabwean listed companies. Existing studies largely focus on developed markets, limiting their relevance to Zimbabwe's unique institutional and economic environment (John, 2025; Ncube, 2023).

Against this backdrop, the main objective of this study is to examine the effect of earnings management and tax aggressiveness on shareholder wealth and stock price crash risk among Zimbabwean listed firms. Specifically, the study seeks to assess the extent to which earnings management practices influence shareholder wealth, evaluate the impact of tax aggressiveness on firm value, and determine whether these practices increase the likelihood of stock price crashes in the Zimbabwean capital market. By addressing these objectives, the study aims to provide evidence-based insights that contribute to the literature on financial reporting quality, risk, and market stability in frontier economies, while offering practical implications for investors, regulators, and policymakers concerned with strengthening market discipline and investor protection in Zimbabwe.

Literature Review

Introduction

The literature on financial reporting practices and corporate risk management highlights the complex interaction between managerial discretion, firm performance, and investor outcomes. In particular, earnings management and tax aggressiveness have emerged as critical areas of study because of their dual effects: while they may improve short-term performance indicators, they can also undermine transparency, erode investor confidence, and increase stock price crash risk (Healy & Wahlen, 1999; Frank et al., 2009). Earnings management refers to the deliberate manipulation of accounting information within the bounds of accounting standards to influence reported earnings, often to meet market expectations, avoid covenant violations, or secure managerial incentives (Dechow et al., 2010). Tax aggressiveness, on the other hand, involves strategies aimed at minimising tax liabilities through legal but often ethically ambiguous methods, which may include shifting profits across jurisdictions, exploiting tax incentives, or utilising complex financial instruments (Hanlon & Heitzman, 2010). Both practices are particularly relevant in emerging economies like Zimbabwe, where institutional weaknesses, macroeconomic instability, and underdeveloped capital markets amplify the consequences of managerial opportunism (John, 2025).

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This literature review synthesises global and regional research on earnings management and tax aggressiveness, their effects on shareholder wealth, and their influence on stock price crash risk. It identifies gaps in the Zimbabwean context and establishes a theoretical and empirical foundation for the present study.

Earnings Management

Conceptualisation

Earnings management has been extensively studied as a form of managerial discretion over financial reporting (Healy & Wahlen, 1999). Managers may manipulate revenues, expenses, provisions, or accruals to achieve predetermined financial targets. Two main types of earnings management are identified in the literature: accrual-based and real activities manipulation. Accrual-based management adjusts accounting entries without affecting actual cash flows, whereas real activities manipulation changes the timing or magnitude of business operations to influence reported earnings (Roychowdhury, 2006).

Motivations

Research identifies multiple motivations for earnings management. Meeting or beating analysts' forecasts is one of the most frequently cited reasons, particularly in public firms where market perceptions influence stock prices and managerial compensation (Beneish, 1999). Other motivations include avoiding debt covenant violations, masking poor performance, and influencing political or regulatory scrutiny (Jones, 1991; John, 2025). In emerging markets, firms often face additional pressures from macroeconomic volatility and liquidity constraints, which can intensify the reliance on earnings management as a tool to stabilise perceived performance (Moyo, 2024).

Implications for Shareholder Wealth

Earnings management can have mixed effects on shareholder wealth. Short-term benefits include inflated stock prices, higher dividend payouts, and enhanced managerial reputation (Burgstahler & Dichev, 1997). However, studies consistently show that aggressive earnings management can lead to long-term value erosion when real economic performance fails to meet inflated expectations (Dechow et al., 2010). Empirical studies indicate that firms engaging in persistent earnings manipulation are more likely to experience sudden negative corrections in stock prices, consistent with the bad-news hoarding hypothesis (Kim & Zhang, 2016).

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Tax Aggressiveness

Conceptualisation

Tax aggressiveness involves legal strategies to reduce corporate tax obligations, often through profit shifting, utilisation of tax credits, and financial engineering (Hanlon & Heitzman, 2010). While reducing tax burdens can increase cash flows available for reinvestment or distribution to shareholders, it also raises transparency and governance concerns, particularly if these strategies border on illegality or conflict with ethical norms (Frank et al., 2009).

Drivers and Determinants

The literature identifies managerial incentives, corporate governance quality, and macroeconomic conditions as key determinants of tax aggressiveness. Managers may pursue aggressive tax strategies to boost reported after-tax profits, secure bonus-linked compensation, or maintain liquidity during economic downturns (Desai & Dharmapala, 2006). Firms with weak boards, low institutional ownership, and concentrated control are more likely to engage in aggressive tax behaviour due to reduced oversight (Dyreng et al., 2010).

Impact on Shareholder Wealth

Empirical evidence suggests a nuanced relationship between tax aggressiveness and shareholder wealth. On one hand, lower effective tax rates increase cash flows available for investment or dividend distribution, potentially enhancing shareholder value (Chen et al., 2010). On the other hand, aggressive tax planning may increase the likelihood of regulatory scrutiny, penalties, or reputational damage, which can negatively affect long-term stock performance (John, 2025). In volatile economic environments, such as Zimbabwe, the risk of sudden policy changes and enforcement actions can amplify the negative consequences of tax aggressiveness.

Stock Price Crash Risk

Conceptual Framework

Stock price crash risk refers to the probability of extreme negative stock returns within a short time frame, typically triggered by the sudden release of accumulated negative firm-specific information (Kim et al., 2011). The literature identifies earnings management and tax aggressiveness as significant contributors to crash risk because managers may deliberately withhold bad news to meet market expectations or mask tax exposures. When such information is eventually disclosed, the market reacts sharply, resulting in abrupt declines in share prices.

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Evidence from Emerging Markets

Studies in emerging markets have shown that concentrated ownership, weak disclosure standards, and institutional voids amplify crash risk (Chen et al., 2001; John, 2025). For instance, research in Sub-Saharan Africa indicates that firms with high accrual-based earnings management are 25–30% more likely to experience severe stock price corrections than firms with transparent reporting. Similarly, tax aggressiveness has been linked to heightened crash risk due to the accumulation of unreported liabilities or exposure to policy reversals.

Interactions Between Earnings Management and Tax Aggressiveness

Recent literature suggests that earnings management and tax aggressiveness are often complementary strategies used by managers to maximise short-term performance indicators. Managers engaging in earnings manipulation may simultaneously pursue aggressive tax strategies to enhance after-tax earnings, thereby inflating perceived profitability (Chen et al., 2010; John, 2025). This interaction increases complexity for investors and regulators, as it obscures firm risk profiles and can amplify stock price crash potential. Studies in developing economies suggest that firms employing both strategies exhibit higher volatility in stock returns and are more likely to experience governance-related shocks.

Evidence From Zimbabwe

Empirical research on Zimbabwean firms remains limited but growing. Moyo (2024) finds that earnings management is prevalent among listed companies, with over 40% of firms showing signs of discretionary accrual manipulation during high-inflation periods. Similarly, John (2025) reports that effective tax rates among Zimbabwean listed firms are on average 18% lower than statutory rates, suggesting significant tax planning activity. These practices, coupled with market illiquidity and macroeconomic shocks, increase shareholder vulnerability to sudden price crashes. The scarcity of context-specific studies underscores the need for research linking earnings management, tax aggressiveness, and crash risk in Zimbabwe.

Theoretical Foundations

This study is grounded in agency theory, which posits that managers may act in their own interest rather than maximizing shareholder wealth, particularly when monitoring mechanisms are weak (Jensen & Meckling, 1976). It also draws on the bad-news hoarding hypothesis, which explains how managers delay the disclosure of negative information, increasing crash risk (Kim & Zhang, 2016). Finally, signalling theory informs the study by highlighting how financial reporting and tax strategies convey information to the market, influencing investor perceptions and valuations.

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Research Gaps

Despite extensive international literature, several gaps persist: (i) limited empirical evidence on the joint effect of earnings management and tax aggressiveness on shareholder wealth in Zimbabwe, (ii) scarce research linking these practices to stock price crash risk in frontier markets, and (iii) insufficient attention to contextual factors such as inflation, exchange rate volatility, and regulatory enforcement that may amplify the consequences of managerial discretion.

Methods and Data

Research Design

This study adopted a quantitative research design, utilising secondary financial data from Zimbabwean listed companies alongside survey data from finance managers, auditors, and investors. The design was chosen to allow for the statistical evaluation of relationships between earnings management, tax aggressiveness, shareholder wealth, and stock price crash risk. A cross-sectional dataset spanning the period 2015–2025 was constructed, capturing financial reporting metrics, corporate governance indicators, and market performance measures. This approach allows for rigorous econometric analysis while controlling for firm-specific and macroeconomic factors.

The study employed a mixed-method approach for data collection. Secondary data were obtained from audited financial statements of companies listed on the Zimbabwe Stock Exchange (ZSE), as well as regulatory filings from the Reserve Bank of Zimbabwe (RBZ) and Zimbabwe National Statistics Agency (ZIMSTAT). Survey data were collected using structured questionnaires to obtain qualitative insights on managerial practices related to earnings management and tax planning. The combination of objective financial data and subjective managerial responses enables robust triangulation of findings.

Sampling Procedure and Response Rates

A purposive sampling technique was applied to select companies and respondents that are directly involved in financial reporting and tax planning. This includes companies across key sectors: manufacturing, agriculture, banking, and services, ensuring coverage of firms with diverse financial structures and exposure to macroeconomic shocks. A total of 120 questionnaires were distributed to finance managers, internal auditors, and investors, and 102 valid responses were received, representing an 85% response rate.

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Category	Questionnaires Distributed	Responses Received	Response Rate (%)
Finance Managers	50	44	88%
Internal Auditors	30	26	87%
Investors	40	32	80%
Total	120	102	85%

Table 1: Sample Size and Response Rates

The high response rate enhances the reliability of the survey findings and reduces non-response bias.

Representativeness of the Sample

To assess the representativeness of the s111ample, the demographic characteristics of respondents and firms were compared to population statistics from the ZSE and RBZ reports. Firms included in the study represent approximately 70% of the total market capitalisation on the ZSE, while respondents' professional experience and sectoral distribution closely match the national profile.

Variable	Population Proportion	Sample Proportion	Representation Adequate?
Manufacturing Firms	35%	33%	Yes
Banking & Finance	25%	27%	Yes
Agriculture	20%	21%	Yes
Services	20%	19%	Yes
Respondent Experience (>5 years)	60%	62%	Yes

Table 2: Representativeness of the Sample

The table confirms that the sample is sufficiently representative of both the population of firms and relevant managerial respondents.

Data Collection and Variable Measurement

The study focused on four primary constructs: earnings management (EM), tax aggressiveness (TA), shareholder wealth (SW), and stock price crash risk (SPCR).

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- Earnings management was measured using discretionary accruals, calculated via the Modified Jones Model (Jones, 1991; Dechow et al., 1995).
- Tax aggressiveness was assessed through effective tax rate (ETR) deviations from statutory tax rates, as well as book-tax differences (Frank et al., 2009).
- Shareholder wealth was proxied by stock returns, adjusted for market and risk factors.
- Stock price crash risk was measured using negative skewness in stock returns and down-to-up volatility ratios (Kim et al., 2011).

Survey responses were scored on a 5-point Likert scale for qualitative assessment of managerial practices, internal controls, and reporting incentives.

Model Specification

To examine the relationships among the variables, the study adopted the following econometric specifications:

Base model:

$SW_it = \beta_0 + \beta_1 EM_it + \beta_2 TA_it + \beta_3 Controls_it + \varepsilon_it$

Stock price crash risk model:

$SPCR_it = \alpha_0 + \alpha_1 EM_it + \alpha_2 TA_it + \alpha_3 Controls_it + \mu_it$

Where:

- **SW_it** = Shareholder wealth for firm *i* at time *t*
- **SPCR_it** = Stock price crash risk for firm *i* at time *t*
- **EM_it** = Earnings management measure
- **TA_it** = Tax aggressiveness measure
- **Controls_it** = Control variables, including firm size, leverage, industry, and market volatility
- **ε_it, μ_it** = Error terms

Additionally, the study employed GARCH(1,1) models to estimate volatility in stock returns and panel regression techniques, including fixed and random effects models, to account for unobserved heterogeneity across firms. These models allow the study to capture both time-varying risk patterns and firm-specific characteristics that may influence shareholder wealth and stock price crash risk.

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Reliability and Validity

The reliability of survey items was assessed using Cronbach's alpha, while construct validity was verified through expert review. The overall Cronbach's alpha was 0.84, exceeding the 0.70 threshold, indicating strong internal consistency.

Construct	No. of Items	Cronbach's Alpha
Earnings Management	6	0.81
Tax Aggressiveness	5	0.83
Shareholder Wealth	4	0.85
Stock Price Crash Risk	5	0.86

Table 3: Reliability Test

The validity of secondary data was confirmed by cross-referencing multiple sources, including ZSE filings, RBZ reports, and audited financial statements, ensuring accuracy and credibility.

The study employs a mixed-methods approach integrating secondary financial data and survey responses, with a carefully designed sample representative of the Zimbabwean corporate landscape. Sample size, response rates, and representativeness have been documented and confirmed. Econometric models, including panel regressions and GARCH specifications, were employed to examine the relationships among earnings management, tax aggressiveness, shareholder wealth, and stock price crash risk. Reliability tests confirm the internal consistency of survey instruments, supporting the robustness of empirical findings presented in the subsequent section.

Results

Descriptive Statistics

Table 4 presents the descriptive statistics for the main variables: earnings management (EM), tax aggressiveness (TA), shareholder wealth (SW), and stock price crash risk (SPCR). The mean, standard deviation, minimum, and maximum values provide insights into the variability and central tendencies of the data.

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Variable	Mean	Std. Dev	Min	Max	Observations
EM	0.052	0.027	-0.011	0.121	150
TA	0.184	0.075	0.032	0.310	150
SW	0.068	0.044	-0.021	0.153	150
SPCR	0.091	0.056	0.012	0.212	150

Table 4: Descriptive Statistics

The data indicate moderate variability in earnings management and tax aggressiveness, with some firms exhibiting unusually high or low values, reflecting heterogeneous managerial behaviour in the Zimbabwean market. Shareholder wealth and stock price crash risk also show significant dispersion, suggesting differences in firm size, industry exposure, and financial transparency.

Correlation Analysis

Pearson correlation analysis was conducted to examine initial relationships among the variables.

Variable	EM	TA	SW	SPCR
EM	1	0.42**	-0.35**	0.48**
TA	0.42**	1	-0.29**	0.41**
SW	-0.35**	-0.29**	1	-0.38**
SPCR	0.48**	0.41**	-0.38**	1

Table 5: Correlation Matrix

Note: **p < 0.01

The results indicate that earnings management and tax aggressiveness are positively correlated with stock price crash risk, confirming the hypothesis that aggressive financial reporting practices increase the likelihood of sudden negative stock price movements. Both EM and TA are negatively associated with shareholder wealth, suggesting that these strategies may undermine long-term investor value.

Unit Root and Stationarity Tests

To ensure validity of regression results, all time series were tested for stationarity using the Augmented Dickey-Fuller (ADF) test.

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Variable	Level (t-stat)	1st Difference (t-stat)	Stationary?
EM	-2.11	-5.43**	Yes
TA	-1.97	-4.88**	Yes
SW	-1.45	-6.12**	Yes
SPCR	-1.63	-5.77**	Yes

Table 6: Unit Root Test Results

Note: **p < 0.01

All variables were found to be stationary after first differencing, supporting the use of panel regression and GARCH modeling.

ARCH Effect Test

To capture time-varying volatility in stock returns, an ARCH-LM test was conducted.

Variable	Chi-Square	df	Prob.
SW	15.72	1	0.0001
SPCR	18.33	1	0.0000

Table 7: ARCH-LM Test

The significant Chi-square statistics indicate the presence of autoregressive conditional heteroskedasticity, justifying the use of GARCH models for volatility estimation.

GARCH(1,1) Model Estimation

The GARCH(1,1) model was used to estimate volatility clustering in shareholder wealth and stock price crash risk.

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Parameter	SW	SPCR
Ω	0.0012**	0.0021**
α (ARCH term)	0.35**	0.41**
β (GARCH term)	0.58**	0.52**
Log-Likelihood	312.45	298.17

Table 8: GARCH(1,1) Estimation Results

Note: **p < 0.01

Results indicate significant persistence in volatility for both shareholder wealth and crash risk, confirming that negative shocks have lasting effects on Zimbabwean firms' stock prices.

Panel Regression Results

Panel regression with fixed and random effects was conducted to examine the impact of EM and TA on SW and SPCR.

Dependent Variable	SW	SPCR
EM	-0.287**	0.314**
TA	-0.195**	0.228**
Controls	Mixed	Mixed
R^2	0.42	0.39
F-stat	15.32**	13.78**

Table 9: Panel Regression Results

Note: **p < 0.01

The results confirm that both earnings management and tax aggressiveness negatively affect shareholder wealth and increase stock price crash risk. Control variables such as firm size and leverage exhibit mixed but consistent patterns with prior research.

Discussion

The findings provide strong evidence that earnings management and tax aggressiveness in Zimbabwean companies increase stock price crash risk while undermining long-term shareholder

wealth. The positive correlations between EM, TA, and SPCR suggest that managers engage in "bad-news hoarding," suppressing adverse information until market correction occurs, consistent with prior studies in emerging markets (Kim & Zhang, 2016; John, 2025). The negative effect on shareholder wealth confirms that short-term financial engineering can harm long-term investor returns, especially in markets with weak corporate governance and regulatory enforcement.

GARCH results highlight the persistence of volatility, showing that shocks in earnings or tax behaviour have prolonged effects on stock prices. Scenario analysis further indicates that firms with aggressive EM and TA strategies experience larger negative corrections during periods of macroeconomic stress, such as high inflation or exchange rate volatility in Zimbabwe. This reinforces the notion that both managerial discretion and structural market vulnerabilities amplify crash risk.

Overall, the study confirms that earnings management and tax aggressiveness are not merely accounting choices; they are strategic decisions with measurable impacts on firm value and market stability. The findings have implications for investors, regulators, and policymakers, suggesting a need for stricter disclosure standards, improved corporate governance, and enhanced monitoring of financial reporting practices in Zimbabwe.

Conclusion

This study examined the effect of earnings management and tax aggressiveness on shareholder wealth and stock price crash risk among Zimbabwean listed companies. The findings demonstrate that both earnings manipulation and aggressive tax strategies have significant and measurable implications for firm performance and market stability. Specifically, earnings management was found to negatively impact shareholder wealth while increasing the probability of stock price crashes, supporting the bad-news hoarding hypothesis and confirming that managers' discretionary reporting behaviour can distort firm value. Similarly, tax aggressiveness, though often employed to increase short-term after-tax cash flows, was associated with reduced shareholder wealth and heightened crash risk, highlighting the trade-off between tax efficiency and transparency. The panel regression and GARCH(1,1) results further reveal that volatility induced by these managerial practices is persistent, with negative shocks exerting lasting effects on market valuation. Scenario analysis underscores that firms exhibiting high levels of earnings manipulation and tax aggressiveness are particularly vulnerable during periods of macroeconomic instability, such as high inflation, exchange rate fluctuations, and low market liquidity, conditions that have characterised the Zimbabwean economy over the past decade. The study thus provides robust empirical evidence that managerial discretion in financial reporting and tax planning is not benign; rather, it has profound implications for investors, regulators, and policymakers. From a policy perspective, the findings call for stronger corporate governance frameworks, enhanced disclosure standards, and regulatory mechanisms to monitor and constrain aggressive financial reporting and tax

practices. For investors, the results highlight the importance of due diligence and risk assessment when evaluating Zimbabwean firms. Overall, the study contributes to the literature on corporate financial behaviour in emerging markets by demonstrating the joint influence of earnings management and tax aggressiveness on shareholder value and market stability, providing context-specific insights for Zimbabwe and similar frontier economies.

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