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# **Ownership Structure and Leverage as Precursors to Financial Distress in an Emerging Economy: A Mediating Model**

**(Articles-in-Press)**

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## **Abstract**

**Purpose**—This study investigates the mediating role of leverage structure in the relationship between corporate ownership composition and financial distress within an emerging economy. Given that stakeholders' influence on leverage decisions can significantly alter a firm's risk profile, we examine the specific pathways through which different ownership categories, via their leverage choices, affect the likelihood of financial distress.

**Design/methodology/approach** – The study examines the impact of leverage structure on the relationship between ownership structure and financial distress. A panel dataset from 2017 to 2021 in Pakistan is analyzed using the Preacher-Hayes (Preacher & Hayes, 2004) method to identify both direct and indirect pathways. Additional sensitivity analysis involves testing different methodological approaches and alternative proxies for mediating variables. Pooled OLS regression serves as the main estimation method, with PCSE (panel-corrected standard error) regression used for robustness checks.

**Findings** – Results show that total leverage mediates the impact of institutional ownership, insider ownership, and foreign ownership on financial distress in Pakistan. Regarding debt maturity, findings confirm that the effects of institutional and foreign ownership on financial distress are mediated by long-term leverage. Additionally, the influence of insider ownership, foreign ownership, and state ownership on financial distress is mediated by short-term leverage.

**Research limitations/implications** – This study focuses on an emerging economy and highlights implications of the tradeoff theory, which limits the extensive use of leverage, whether short-term or long-term.

**Originality/value** – This research explores the less-examined mediating role of leverage structure, which integrates both capital and debt maturity structures. Moreover, there is limited literature linking ownership structure with financial distress in both developed and developing countries. The findings provide a quantitative framework that enhances managerial decision-making by clarifying how different ownership structures, through the mechanism of leverage, impact financial risk, thereby making a significant contribution to the corporate finance literature on risk management and governance. The findings offer a granular framework for decision-makers to understand and mitigate financial risk originating from the interplay of ownership and leverage.

**Keywords:** Ownership structure, leverage structure, financial distress, mediation, Pooled OLS, PCSE

**JEL Classifications:** C51, C54, C58, G32, G34

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