



## Financial Failure Risk and Sustainable Growth: Evidence from the Palestine Exchange with Organizational Behavior Insights

Etedal Robeen Siaj<sup>1,2\*</sup>, Sana Masmoudi<sup>3</sup>

<sup>1</sup>Department of Accounting, Faculty of Economics and Management, University of Sfax, Sfax, Tunisia.

<sup>2</sup>Department of Accounting, Hebron University, Hebron, Palestine.

<sup>3</sup>Department of Accounting, Higher Business School, University of Sfax, Sfax, Tunisia.

**\*Corresponding Author**

**E-mail:** [etedals@hebron.edu](mailto:etedals@hebron.edu)

### ABSTRACT

*Firms operating in politically and economically constrained environments face significant challenges in maintaining sustainable growth. This study examines the impact of financial failure risk on sustainable growth policies in non-financial firms listed on the Palestine Exchange (PEX) from 2010 to 2023. Using a comprehensive panel data analysis of 32 firms (393 firm-year observations), we employed rigorous diagnostic tests for normality, multicollinearity, cross-sectional dependence, and heteroskedasticity, followed by Hausman specification tests and robust regression analysis with Period SUR (PCSE) estimation. The findings demonstrate a significant impact of financial failure risk on sustainable growth. Among the five models tested, the Taffler (1983) T-score emerged as the most effective predictor in the Palestinian context, followed by the Fulmer H-score. Return on Assets (ROA) was identified as the strongest economic driver of sustainable growth. From an organizational behavior perspective, these findings highlight how managerial risk perception and decision-making under uncertainty shape corporate financial policies and sustainable growth trajectories. The results provide valuable insights for managers, investors, and policymakers, underscoring the need to develop context-specific financial risk management and sustainable growth strategies in constrained economic environments. The study advocates prioritizing short-term financial health monitoring, as captured by the Taffler model, to bolster resilience and guide strategic growth decisions.*

**Keywords:** Financial failure risk, Sustainable growth, Organizational behavior, Economic growth, Socio-economic factors, Palestine exchange.

### Introduction

Today, businesses face difficulties as climate change impacts, resource shortages, and evolving social conditions compel them to change their Corporate Social Responsibility practices (Shih *et al.*, 2023). Organizations now shift focus from short-term profit goals toward comprehensive sustainable development, committing to Environmental, Social, and Governance (ESG) frameworks. Companies that proactively integrate ESG principles into their core strategies unlock strategic advantages, including better risk management, increased operational productivity, and improved brand image (Dmuchowski *et al.*, 2023). The success of business sustainability initiatives is linked to organizational dynamics, a relationship that necessitates further investigation by both academic researchers and industry professionals.

The Palestinian economy faces major financial constraints due to restricted access to international capital markets, heavy reliance on donor support (IMF, 2023), banking sector weaknesses that hinder private sector sustainable growth (UNCTAD, 2023), and persistent fiscal challenges (World Bank, 2024). Recent studies confirm that political instability and institutional constraints significantly impact corporate financial stability and performance in Palestine (Barakat & Al-Zyoud, 2021; Khatib & Nour, 2021; Mousa & Elamir, 2022; Abu Jebbeh, 2023).

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Sustainable growth rate (SGR) represents the maximum growth a firm can achieve without altering its financial policies or seeking external equity financing (Higgins, 1977). This metric evaluates the degree to which strategic growth plans match the financial situation (Fonseka *et al.*, 2020). The SGR approach, rooted in Agency Theory (Jensen & Meckling, 1976), shows that managers serving as shareholder agents will work to prevent financial losses because they need to protect their job security, resulting in excessive risk avoidance that decreases shareholder wealth. The Pecking Order Theory explains how companies make financing decisions: businesses use internal funding as their primary source, turning to debt and equity only as a last resort, which may hinder sustainable growth (Myers & Majluf, 1984; Raza *et al.*, 2020). Cross-country evidence from emerging markets shows that sustainable growth is influenced by capital structure decisions, ownership structure (Ghazali & Zulkafli, 2021), and firm-specific characteristics. As demonstrated in the comprehensive evaluation by Cheraghali and Molnár (2025), which analyzed over 6,100 model combinations for SME default prediction, the choice of estimation methodology significantly impacts predictive accuracy, with machine learning approaches such as LightGBM and XGBoost outperforming traditional methods (Dang & Nguyen, 2021).

Managers establish sustainable growth through their decisions about resource allocation, risk assessment, and strategic goal selection. When firms enter financial distress, their managers begin using conservative growth strategies, which protect the company from bankruptcy by delivering short-term financial benefits that hinder future growth (Ashraf *et al.*, 2021). Executive personal traits, including overconfidence and risk-taking behavior, determine how companies experience financial distress and make capital investment choices (Al-Najjar & Clark, 2021; Li & Lu, 2022; Chen & Lee, 2023). According to prospect theory (Kahneman & Tversky, 1979) and upper echelons theory (Hambrick & Mason, 1984), managers under uncertainty exhibit heightened risk perception when encountering new situations, as their desire to avoid losses shapes decision-making. Financial failure risk serves as a measurable indicator guides managers in their decisions about risk management and their strategic planning processes (Platt *et al.*, 1995; Al-Shami *et al.*, 2022).

Financial failure risk refers to the probability that a firm will encounter financial distress or bankruptcy, typically measured through various prediction models combining multiple financial ratios. The development of these models started with univariate techniques and later developed into multivariate systems assessing various aspects of financial health (Altman *et al.*, 2022). The predictive power of failure models used in emerging markets shows different results according to established institutional contexts, thus requiring validation through specific contextual testing (Mansour & Al-Zoubi, 2020; Nguyen & Nguyen, 2021; Charalambakis & Garrett, 2022). Recent advancements continue to refine these models, such as the prognostic approach by Wu *et al.* (2025). The research employs five established financial failure prediction models, each utilizing distinct indicators to assess profitability, leverage, liquidity, and cash flow trends, thereby capturing multiple dimensions of financial distress. The comparative method enables researchers to determine which financial health factors provide maximum assistance to sustainable growth under conditions of restricted resources (Gülener *et al.*, 2023; Yaman & Gür, 2023).

The existing studies about how financial failure risk interacts with sustainable growth show limited findings for emerging markets. Raza *et al.* (2020) found that financial distress significantly constrains sustainable growth in Pakistani firms, while Yaman and Gür (2023) demonstrated that effective risk management enhances sustainable growth in Turkish companies. However, these studies did not evaluate all financial failure models, resulting in an incomplete analysis of the specific difficulties that exist within Palestine. The research demonstrates that financial distress affects corporate sustainability in different ways according to the specific context of each situation (Khan *et al.*, 2022; Abdulla & Al-Ajmi, 2023). Recent studies show that corporate governance mechanisms act as moderators between financial distress and sustainable growth, a relationship that remains unstudied in Palestine (Gupta & Gupta, 2023; Ullah & Wang, 2023). This aligns with evidence from other emerging markets where governance quality has been shown to mitigate the adverse effects of financial distress (El-Sayed Ebaid, 2022). With over USD 4.5 trillion in bond debt maturing by 2027, the OECD (2025) notes that emerging market and developing economies face increased borrowing costs and refinancing risks. This underscores the urgency of creating robust local currency bond markets and sound debt management practices.

The purpose of this study is to fill this research gap through econometric analysis, which investigates how financial failure risk affects sustainable growth policies of non-financial companies at the Palestine Exchange. The study



addresses two pivotal research questions: (1) Is financial failure risk a critical determinant in sustainable growth policies for Palestinian listed firms? (2) Which financial failure risk model holds the utmost significance for fostering sustainable growth in the unique Palestinian economic environment? The research extends financial distress theory to sustainable growth literature through the examination of five established failure prediction models. The study examines how financial analysis interacts with organizational behavior to show how managers' risk perceptions and cognitive patterns affect financial decision-making, creating knowledge about corporate sustainability in resource-limited settings.

Based on the theoretical framework and literature review, the following hypotheses are formulated to empirically test the relationship between financial failure risk and sustainable growth:

**H1:** Financial failure risk has a significant effect on the sustainable growth (SGR) of non-financial firms listed on the Palestine Exchange (Razhaeva *et al.*, 2022; Sri *et al.*, 2022; Al Abadie *et al.*, 2023; Guzek *et al.*, 2023; Lee *et al.*, 2023; Ncube *et al.*, 2023; Oran & Azer, 2023).

To provide a more nuanced understanding, this main hypothesis is subdivided into five sub-hypotheses, each testing a specific financial failure prediction model. Following standard statistical methodology, these are formulated as null hypotheses:

**H1a:** The Altman Z'-score has no significant effect on sustainable growth (SGR).

**H1b:** The Springate S-score has no significant effect on sustainable growth (SGR).

**H1c:** The Taffler T-score has no significant effect on sustainable growth (SGR).

**H1d:** The Fulmer H-score has no significant effect on sustainable growth (SGR).

**H1e:** The Legault CA-score has no significant effect on sustainable growth (SGR).

## Materials and Methods

### Sample and Data Collection

This study uses panel data from 32 non-financial firms listed on the Palestine Exchange (PEX) during 2010–2023, yielding 393 firm-year observations after excluding financial sector entities. All financial data for SGR, failure risk measures, and controls were obtained from the audited financial statements of PEX-listed firms.



### Variable Measurement

The dependent variable is the Higgins Sustainable Growth Rate (HSGR; Higgins, 1977):

$$\text{HSGR} = [P(1 - d)(1 + L)] / [T - P(1 - d)(1 + L)] \quad (1)$$

where:

P = profit margin after tax,

d = dividend payout ratio,

L = total debt/equity,

T = total assets / net sales.

The independent variables are five established financial failure prediction models:

1. **Altman (1983) Z'-score:**

$$Z' = 0.717X_1 + 0.847X_2 + 3.107X_3 + 0.420X_4 + 0.998X_5 \quad (2)$$

( $X_1$  = net working capital/total assets,  $X_2$  = retained earnings/total assets,  $X_3$  = EBIT/total assets,  $X_4$  = book value of equity/total debt,  $X_5$  = sales/total assets)

2. **Springate (1978) S-score:**

$$S = 1.03X_1 + 3.07X_2 + 0.66X_3 + 0.4X_4 \quad (3)$$

( $X_1$  = working capital/total assets,  $X_2$  = EBIT/total assets,  $X_3$  = profit before tax/short-term liabilities,  $X_4$  = sales/total assets)

3. **Taffler (1983) T-score:**

$$T = 3.20 + 12.18X_1 + 2.5X_2 - 10.68X_3 + 0.03X_4 \quad (4)$$

( $X_1$  = earnings before tax/average short-term liabilities,  $X_2$  = current assets/total liabilities,  $X_3$  = short-term liabilities/total assets,  $X_4$  = (current assets – inventories – short-term liabilities)/(net sales – earnings before tax + depreciation))

4. **Fulmer et al. (1984) H-score:**

$$H = 5.528X_1 + 0.212X_2 + 0.073X_3 + 1.270X_4 - 0.120X_5 + 2.335X_6 + 0.575X_7 + 1.083X_8 + 0.894X_9 - 6.075 \quad (5)$$

5. **Legault (1987) CA-score:**

$$CA = 4.59X_1 + 4.51X_2 + 0.3936X_3 - 2.76 \quad (6)$$

( $X_1$  = shares/total assets<sub>t-1</sub>,  $X_2$  = (operating profit/loss + finance expense<sub>t-1</sub>)/total assets<sub>t-1</sub>,  $X_3$  = sales<sub>t-2</sub>/total assets<sub>t-2</sub>)

Control variables: leverage (LEV = total debt/total assets), return on assets (ROA = net income/total assets), and growth in assets (GIA = percentage growth in total assets).

#### *Econometric Approach*

We conducted comprehensive panel diagnostics (normality, multicollinearity, cross-sectional dependence, serial correlation, heteroscedasticity) followed by the Hausman specification test. Based on results, we applied pooled OLS with Period SUR (PCSE) robust estimation to address cross-sectional dependence, heteroscedasticity, and serial correlation. All variables except H-score were asinh-transformed. The regression model is:

$$HSGR_{it} = \alpha + \beta_1 FailureRisk_{it} + \beta_2 LEV_{it} + \beta_3 ROA_{it} + \beta_4 GIA_{it} + \varepsilon_{it} \quad (7)$$

where Failure Risk represents the five measures (Z-asinh, S-asinh, T-asinh, H, CA-asinh) tested separately (Models 1–5) and jointly (Model 6).

## Results and Discussion

### *Descriptive Statistics and Data Characteristics*

**Table 1** presents descriptive statistics. HSGR shows a positive mean (0.018), indicating overall sample growth. Altman Z-score has the highest mean (3.209) among failure measures. CA exhibits the largest standard deviation (46.06), revealing substantial liquidity variation across firms. JarqueBera tests ( $p < 0.01$ ) reject normality for all variables, justifying robust methods and the asinh transformation.

**Table 1.** Descriptive Statistics and Normality Test Results

Variable	Mean	Median	Max	Min	Std. Dev.	Skewness	Kurtosis	Jarque-Bera
<b>HSGR</b>	0.018	0.021	0.270	-0.274	0.092	-0.600	4.336	53.75***
<b>Z</b>	3.209	1.686	34.366	-0.598	5.782	3.920	18.727	5146.80***
<b>S</b>	0.754	0.574	5.451	-0.971	1.018	1.947	9.313	917.00***
<b>T</b>	9.874	5.254	105.855	-13.015	16.965	3.446	17.705	4395.33***
<b>H</b>	6.752	6.532	24.615	-8.495	5.773	0.673	4.629	74.41***



<b>Breusch-Pagan LM</b>	5.850**	-	-	-	-	-	-	-
<b>Hausman <math>\chi^2</math></b>	77.57***	-	-	-	-	-	-	-

Note: \*\*\* and \*\* indicate 1% and 5% significance levels. CD test null: No cross-sectional dependence. The Hausman test supports the fixed effects specification for Model 6.

The diagnostic tests reveal significant serial correlation (Baltagi-Li LM and Born-Breitung LM\*), heteroscedasticity (Breusch-Pagan LM), and the Hausman test confirms fixed effects as the appropriate specification for Model 6 ( $\chi^2 = 77.57$ ,  $p < 0.01$ ). The complete results lead us to select a fixed effects estimator that uses robust standard errors, adjusted for cross-sectional dependence, serial correlation, and heteroscedasticity.

### Regression Analysis

**Table 4** presents pooled OLS regression results with Period SUR (PCSE) estimation. All models are significant at 1% (F-statistics), with  $R^2$  values ranging from 0.791 to 0.818. Model 6 provides the most comprehensive assessment by including all failure measures simultaneously.

**Table 4.** Pooled OLS Regression Results with Period SUR (PCSE) Estimation

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
<b>Z-asinh</b>	0.011*** (3.31)					0.020*** (5.52)
<b>S-asinh</b>		0.000 (0.04)				-0.016** (-2.39)
<b>T-asinh</b>			0.006*** (2.79)			0.011*** (4.69)
<b>H</b>				-0.001** (-2.09)		-0.002*** (-4.39)
<b>CA-asinh</b>					-0.002** (-2.10)	-0.004*** (-3.34)
<b>LEV</b>	0.052*** (3.68)	0.023** (2.01)	0.051*** (3.40)	0.014 (1.14)	0.025** (2.26)	0.108*** (5.90)
<b>ROA</b>	1.105*** (30.92)	1.149*** (21.27)	1.059*** (22.75)	1.194*** (30.32)	1.165*** (34.25)	1.147*** (20.50)
<b>GIA</b>	0.000*** (3.46)	0.000*** (3.32)	0.000*** (3.03)	0.000*** (3.49)	0.000*** (3.25)	0.000*** (3.32)
<b>Constant</b>	-0.050*** (-5.81)	-0.026*** (-4.86)	-0.046*** (-5.42)	-0.017*** (-2.76)	-0.030*** (-5.89)	-0.083*** (-7.28)
<b>R<sup>2</sup></b>	0.797	0.791	0.795	0.794	0.794	0.818
<b>Adjusted R<sup>2</sup></b>	0.795	0.789	0.793	0.792	0.792	0.814
<b>F-statistic</b>	387.78***	374.65***	384.00***	379.90***	379.92***	218.94***
<b>Durbin-Watson</b>	0.989	0.939	0.952	0.924	0.943	1.035

Note: t-statistics in parentheses. \*\*\*, \*\*, and \* indicate 1%, 5%, and 10% significance levels. Dependent variable: HSGR.

All models are significant at 1% (F-statistics), with  $R^2$  from 0.791 to 0.818. Model 6 provides the most comprehensive assessment by including all failure measures simultaneously.

### Hypothesis Testing

**Table 5** summarizes hypothesis testing results. **H1 is supported** (all models significant at  $p < 0.001$ ; four of five individual predictors significant). **H1a rejected**: Altman Z' is significant in Models 1 ( $\beta = 0.011$ ,  $p < 0.001$ ) and 6 ( $\beta = 0.020$ ,  $p < 0.001$ ). **H1b shows conditional effects**: insignificant in Model 2 ( $p = 0.968$ ) but significant in Model 6

( $\beta = -0.016$ ,  $p < 0.05$ ). **H1c rejected:** Taffler T is significant in Models 3 ( $\beta = 0.006$ ,  $p < 0.001$ ) and 6 ( $\beta = 0.011$ ,  $p < 0.001$ ). **H1d rejected:** Fulmer H is significant in Models 4 ( $\beta = -0.001$ ,  $p < 0.05$ ) and 6 ( $\beta = -0.002$ ,  $p < 0.001$ ). **H1e rejected:** Legault CA is significant in Models 5 ( $\beta = -0.002$ ,  $p < 0.05$ ) and 6 ( $\beta = -0.004$ ,  $p < 0.001$ ).

**Table 5.** Summary of Hypothesis Testing Results

Hypothesis	Statement	Result	Evidence
<b>H1</b>	Financial failure risk has a significant effect on sustainable growth	Supported	All models are significant at $p < 0.001$ ; four of five individual predictors are significant.
<b>H1a</b>	Altman Z'-score has no significant effect on SGR	Rejected	Significant in Models 1 and 6 ( $p < 0.001$ )
<b>H1b</b>	Springate S-score has no significant effect on SGR	Not Rejected	Insignificant in Model 2 ( $p = 0.968$ ); significant in Model 6 ( $p < 0.05$ )
<b>H1c</b>	Taffler T-score has no significant effect on SGR	Rejected	Significant in Models 3 and 6 ( $p < 0.001$ )
<b>H1d</b>	Fulmer H-score has no significant effect on SGR	Rejected	Significant in Models 4 ( $p < 0.05$ ) and 6 ( $p < 0.001$ )
<b>H1e</b>	Legault CA-score has no significant effect on SGR	Rejected	Significant in Models 5 ( $p < 0.05$ ) and 6 ( $p < 0.001$ )

#### Robustness Checks

Robustness tests (cluster robust SE, outlier removal, sub-sample analysis, alternative estimator) confirm the stability of results (**Table 6**).

**Table 6.** Robustness Test Results

Test Type	Specification	Result	Conclusion
<b>Cluster Robust SE</b>	Firm-level clustering	Coefficients remain significant at 1% level	Results robust to within-firm correlation
<b>Outlier Removal</b>	5% trimming both tails	Similar coefficients and significance levels	No sensitivity to extreme values
<b>Sub-sample Analysis</b>	Pre-2015 vs. Post-2015 split	Stable coefficients across periods	Findings are generalizable over time
<b>Alternative Estimator</b>	Fixed effects with Driscoll-Kraay SE	Consistent results with PCSE estimation	Methodologically sound

#### Economic Significance

Marginal effects from Model 6 (**Table 7**) show that one standard deviation increase in ROA raises HSGR by 8.03%, in LEV by 2.14%, and in Z-asinh by 1.85%.

**Table 7.** Economic Significance – Marginal Effects

Variable	Coefficient	Std. Dev.	Marginal Effect	Interpretation
<b>ROA</b>	1.147***	0.070	+8.03%	One SD increase in ROA → 8.03% increase in HSGR
<b>LEV</b>	0.108***	0.198	+2.14%	One SD increase in LEV → 2.14% increase in HSGR
<b>Z-asinh</b>	0.020***	0.925	+1.85%	One SD increase in Z-score → 1.85% increase in HSGR

Results strongly support **H1**: financial failure risk significantly affects sustainable growth in Palestinian firms, confirming Platt *et al.* (1995) and extending Raza *et al.* (2020) to the Palestinian context, consistent with Yaman and Gür (2023).

**H1a is rejected:** Altman Z' is positive and significant, indicating that distress risk reduction enhances sustainable growth. This aligns with Boso *et al.* (2022) on institutional environments shaping model applicability, and Hoang



and Nguyen (2023) on political uncertainty amplifying predictive power (Constantin *et al.*, 2022; Mojsak *et al.*, 2022; Frost *et al.*, 2024; Rosellini *et al.*, 2024; Umarova *et al.*, 2024).

**H1b reveals conditional effects:** insignificant in Model 2 but significant negative in Model 6 ( $\beta = -0.016$ ), indicating Springate components overlap with other variables. This contrasts with Khan *et al.* (2022) and highlights the value of comparative model testing (Adeleke, 2022; Balaji *et al.*, 2022; Sri *et al.*, 2022; Simonyan *et al.*, 2023; Delcea *et al.*, 2024; Essah *et al.*, 2024; Frost *et al.*, 2024; Ribeiro *et al.*, 2024; Sanlier & Yasan, 2024; Uneno *et al.*, 2024)

**H1c is strongly rejected:** the Taffler T-score exhibits the strongest positive impact, underscoring the critical role of short-term financial flexibility in Palestinian firms. This aligns with Qian and Wen (2025), who demonstrate how top management team diversity influences investment decisions through social learning. Prospect theory (Kahneman & Tversky, 1979) and upper echelons theory (Hambrick & Mason, 1984) suggest managers prioritize liquidity over long-term investments, a pattern amplified in Palestine by political instability and capital constraints. Effective working capital management (Hasan & Alam, 2022) and ESG performance (Rahman & Khan, 2023) further mitigate financial distress, while heightened external vulnerabilities (Salem & Salem, 2022) necessitate robust liquidity buffers (Sugimori *et al.*, 2022; Kajanova & Badrov, 2024; Lee & Ferreira, 2024).

**H1d and H1e are rejected** because Fulmer H and Legault CA demonstrate unexpected negative relationships. The models do not accurately depict Palestinian financial systems because they exhibit excessive conservative tendencies. Environmental uncertainty distorts managerial incentives: risk-averse managers choose conservative systems that block value-creating investments, yielding temporary stability but long-term limitations (Adeleke, 2022; Razhaeva *et al.*, 2022; Rojas *et al.*, 2022; Sri *et al.*, 2022; Al Abadie *et al.*, 2023; Guzek *et al.*, 2023; Lee *et al.*, 2023; Ncube *et al.*, 2023; Oran & Azer, 2023; Simonyan *et al.*, 2023). These negative relationships suggest model misspecification in the Palestinian context, supporting Charalambakis and Garrett's (2022) call for recalibrating failure models for emerging markets and Mansour and Al-Zoubi's (2020) advocacy for hybrid approaches

Return on Assets (ROA) produces stable results across all models, confirming that operational efficiency is the core foundation of corporate sustainability (Şahin & Ergün, 2018).

## Conclusion

The study shows that financial failure risk creates major obstacles that prevent sustainable development in resource-constrained environments. The Taffler T score serves as the most precise forecasting tool for firms in the Palestinian context. From an organizational behavior perspective, managerial risk perception and decision-making under uncertainty mediate the link between financial health and sustainable growth.

### *Theoretical Implications*

Financial distress effects on sustainable growth vary across modeling methods and contexts. It establishes multiple dimensions of failure risk and how prediction models assess sustainability differently in limited markets. Organizational behavior research enhances understanding of how financial conditions shape strategic decisions through managerial cognition. Environmental uncertainty distorts incentives, leading firms to deviate from agency theory predictions.

### *Practical Implications*

Organizations should prioritize short-term flexibility using the Taffler T-score for monitoring working capital and liquidity. Managers must recognize risk tendencies to avoid excessive caution. Investors should integrate the Taffler model into due diligence, and regulators can require disclosure of Taffler-relevant indicators.

### *Limitations and Dimensions for Future Research*

This study is limited to non-financial Palestinian firms; future research should test the Taffler model in other emerging markets with similar constraints. Future models should integrate governance variables, ownership factors, and macroeconomic elements because they impact existing relationships. The research needs to use qualitative



methods for studying organizational behavior, focusing on key aspects such as leadership styles, corporate culture, and team dynamics. Cross-cultural and longitudinal studies could track how financial distress responses evolve, and the impact of digital transformation and sustainable finance on failure risk perceptions deserves investigation. Future research should investigate how corporate governance quality functions as a moderating factor, as suggested by Gupta and Gupta (2023) and Ullah and Wang (2023), while employing meta-analytic methods similar to those used by Nguyen and Nguyen (2021) to create evidence summaries across emerging markets.

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