

## The Influence of Firm Characteristics on Financial Reporting Quality: Evidence from Pakistan

Rameen Sibgat, Burhan Rasheed \*, Syed Taha Fraz Haider, Zohair Farooq Malik, Amer Shakeel

School of Commerce and Accountancy, University of Management and Technology, Lahore, Pakistan

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### ABSTRACT

This study examines the impact of Firm Characteristics (FC) on the Financial Reporting Quality (FRQ) of listed firms in the Pakistan Stock Exchange (PSX). To achieve this objective, the data of 50 non-financial firms is collected for the years 2019-2024. This quantitative study used the balanced panel data to test the hypotheses. Data is collected from the State Bank of Pakistan (SBP) and the published firm's annual reports. To measure the FRQ, this study used the two-step estimation technique of the modified Jones model, and FC is measured with Firm Size (SIZE), Firm Profitability (PROF), Firm Growth (GROWTH), and Firm Tangibility (TANG). The study finds that SIZE and PROF showed significant negative results, whereas GROWTH and TANG showed positive results with FRQ. These results suggest that larger firms and those with higher profits often exhibit lower transparency and poorer accrual quality. On the other hand, firms with higher GROWTH and TANG have more reliable disclosures, which motivates them to improve their FRQ. Policymakers should make policies accordingly so that management does not manipulate information or act opportunistically. All the variables taken as characteristics of the firm should be encouraged for better disclosures of the firm.

Corresponding Author: Burhan Rasheed (Email: [burhan.rasheed@umt.edu.pk](mailto:burhan.rasheed@umt.edu.pk))

### INTRODUCTION

Accounting information is considered relevant if it either confirms the past predictions or helps in estimating future outcomes of current events (Azar et al., 2019). According to Alharasis et al. (2024), information is relevant if it is provided on a timely basis, and the basic source of accounting information is financial statements. Information provided by the financial statement should have the ability to assist users in their decision-making. Financial statements of an entity must contain all the relevant information, which must be understandable and reliable to the users of accounting information (Scott, 2015). Reliability refers to the quality of financial information, which should be unbiased, free from errors and misstatements and also give a true and fair view of financial statements (Mondal, 2021). However, according to Lau (2021), financial statements are based on different estimates; so there is a chance of bias in annual reports. The International Accounting Standards Board (IASB) states that an organisation must ensure a sufficient degree of accuracy while preparing financial statements. Therefore, the key stakeholders must verify the supporting documents for estimates and assumptions made by companies while preparing annual reports (Caplan & Dutta, 2016).

It is essential to oversee the attributes of corporate governance (Hussain et al., 2024), which impact the Financial Reporting Quality (FRQ). FRQ serves as a keystone of investor behaviour and market behaviour. The quality of financial reports is a key indicator of an entity's financial health. These reports are beneficial for stakeholders such as investors, creditors, and lenders to make accurate financial decisions. The financial statements are prepared as per GAAP/IAS/IFRS, and serve as a major indicator for the better explicitness and accuracy of the statements. Accounting disclosures have the capability of challenging an investor's decisions by giving insight into future predictions (Bushman et al., 2004). Precision, correctness, and timely information play an important role in improving forecasting and increasing the overall value of the financial statements for the stakeholders (Bello, 2010). The disclosures are not only important for the primary players, such as investors and stakeholders, but also serve as a key indicator for the government and policymakers (Olowokure et al., 2016; Rasheed et al., 2023). The relationship between firm characteristics and financial reporting quality is necessary for expressing more authentic information. Firm characteristics such as corporate governance, disclosures, audit quality (Kazmi et al., 2024), ownership structure, and financial ratios play an important role in shaping financial information (Shakeel et al., 2025).

A large-sized firm is likely to maintain a well-designed accounting and internal control department and should possess the financial capacity to hire the services of professionals who are presumed to refine the financial reporting

process (Shakeel et al., 2020). The firm's growth also affects the reporting quality. The more growth shown by the firm, the better the quality of the statements will be, because it attracts more potential investors, and the investors are more than concerned with the accuracy and reliability of the financial reports. Profitability has been used as a basis to describe variations between the firms with respect to the level of disclosure in the financial statements (Rasheed & Ahmad, 2022). Profitable firms disclose more detailed information than unprofitable firms. Tangibility describes the physical asset of an entity, such as property, plant and equipment, and it is an important factor in the way because investors use the tangibility of the firm to assess the riskiness of the company.

Pakistan is a developing country, is making progress not only for the locals but is also successful in engaging foreign investors (Rasheed et al., 2018). The firm characteristics include firm size, liquidity, leverage, ownership structure and audit (Nisar et al., 2025). How these factors would interact with the financial reporting quality of one firm is the major purpose of this study. The industrial landscape of the country consists of a variety of big businesses, small and medium-sized enterprises, and an array of industries, each having its opportunities and challenges. The company's act came into being in 2017, which brought a lot of changes in FRQ policies (Hassan et al., 2025).

The purpose of this study is to investigate the relationship between firm characteristics and FRQ. This study examines firm-specific characteristics to shed light on the attributes that reciprocate the firm's reporting credibility, which is specifically disclosed by the government of Pakistan. This study will not only fill the geographical gap for the emerging economies of the Asian region but also provide thoughtful insights for developing countries.

Multiple stakeholders in Pakistan greatly value understanding the link between business characteristics and financial reporting quality. Investors seeking to allocate capital, regulatory agencies seeking to improve governance standards, and businesses seeking to build confidence with their stakeholders may all benefit from a thorough understanding of these dynamics (Rasheed et al., 2026). In addition, academicians will benefit from adding to the growing body of literature on financial reporting quality, particularly in emerging economies.

## **LITERATURE REVIEW**

### **Financial Reporting Quality**

This study reviews recent research papers and articles about factors affecting and gauging financial reporting quality. The study also looks at certain conclusions and gaps in the body of research. This study examines previously published works, accounting associations and a few accounting journals. This study identified several instances of incomplete data and gaps in the body of literature. For instance, some research samples are too small to allow for the legitimate drawing of findings. Herath and Albarqi (2017) give an analysis of the financial reporting quality (FRQ) of U.S. private vs public enterprises using a new database containing accounting data for a large sample of U.S. private firms. They found that public companies are often more cautious and have greater accrual quality. The findings align with the public corporations' reporting, which indicates an increased need for financial data.

Conversely, in environments where public enterprises are more likely to control earnings or where there is less of a need for their financial information, these reporting characteristics of public corporations are lessened or abolished. (Hope et al., 2013). Using three proxies for financial reporting quality (FRQ), earnings quality, conservatism, and accruals quality, this study investigates the effects of FRQ on corporate performance. Our goal is to examine how a strong financial ratio query (FRQ) affects financial performance (FP), as determined by the market-to-book ratio. To do this, an unbalanced sample of 1,960 globally listed non-financial enterprises from 25 different countries, as well as the Hong Kong Special Administrative Region are used to evaluate the presented hypotheses between 2002 and 2010 (Martínez-Ferrero, 2014). Relevant information and information asymmetry are the basic content of financial reporting quality.

### **Firm Profitability**

Employing a primary research sample of 95 publicly listed American corporations from diverse sectors in 2015-2016, They analyse how corporate sustainability reporting influences the financial performance of firms (Whetman, 2018). They conclude that reporting on sustainability has a favourable and noteworthy impact on a company's return on equity, return on assets, and profit margin for the next year. Nevertheless, only low institutional ownership enterprises exhibit this association (Whetman, 2018). The purpose of this study was to assess whether financial ratios can be used to identify fraudulent reporting and whether these ratios differ significantly between fraudulent and non-fraudulent organisations. Between 2000 and 2011, 65 fraudulently listed Malaysian public companies and 65 legitimately listed Malaysian companies were available for access. There is a significant difference in debt-to-equity ratios, accounts receivable to sales, and total debt-to-equity between fraud-prone and non-fraud-prone organisations, according to the study (Dalnial et al., 2014). The focus of this research is to examine the variables that influence the timely submission of financial reports to manufacturing businesses listed on the Indonesia Stock Exchange across different industry sectors. In this study, the dependent variable is the timely filing of financial reports, whereas the independent variables are profitability, liquidity, and business size. Various manufacturing enterprises in the industrial sector that were listed on the IDX between 2012 and 2016 made up the population of this study. Timely

filing of financial reports is significantly impacted by firm size, liquidity, and ROI, but not by each of these two factors alone (Nasihin & Purwandari, 2022). All of these studies indicate that on firm profitability, there is an impact on the financial reporting quality. The financial reports need to be transparent, timely and reliable so that the profitability increases accordingly.

H1: There is a positive association between financial reporting quality and firm profitability

**Firm size**

The firm size is the major variable that contributes towards either better or worse FRQ. Many of the authors studied the disclosures with firm size and concluded positive effects. (Akhtaruddin, 2005; Naser et al., 2002; Waweru & Riro, 2013). There is a change in the disclosure of the bigger firms and those of smaller firms. The extent of information sometimes becomes disadvantageous for the companies that are the major reason for less disclosure of information. Bigger firms often hide their information and show more prosperous firms, but the smaller ones show the information as it is, so there are no changes that directly affect this variable in our study.

H2: There is a positive association between firm size and financial reporting quality

**Firm Growth**

Herath and Albarqi (2017) state that firm growth is an essential measure for the true and fair view of the financial reporting quality. As the growth of the firm increases, they will be more concerned about attracting potential investors and the value of the firm and will be more inclined to make their reports more transparent.

H3: There is a positive association between firm growth and financial reporting quality

**Firm Tangibility**

The percentage of a company's assets that are made of physical objects, including property, plant, and equipment (PP&E), is referred to as firm tangibility. The ratio of tangible assets to total assets is used to calculate it. A company's operations frequently depend on tangible assets since they give production and service delivery a physical base. Profits quality: the degree to which a company's reported profits accurately represent its underlying financial performance (Herath & Albarqi, 2017). The completeness and lucidity of financial disclosures are known as transparency. Adherence to Accounting Standards: The degree to which financial statements comply with relevant accounting standards.

H4: There is a positive association between firm tangibility and financial reporting quality

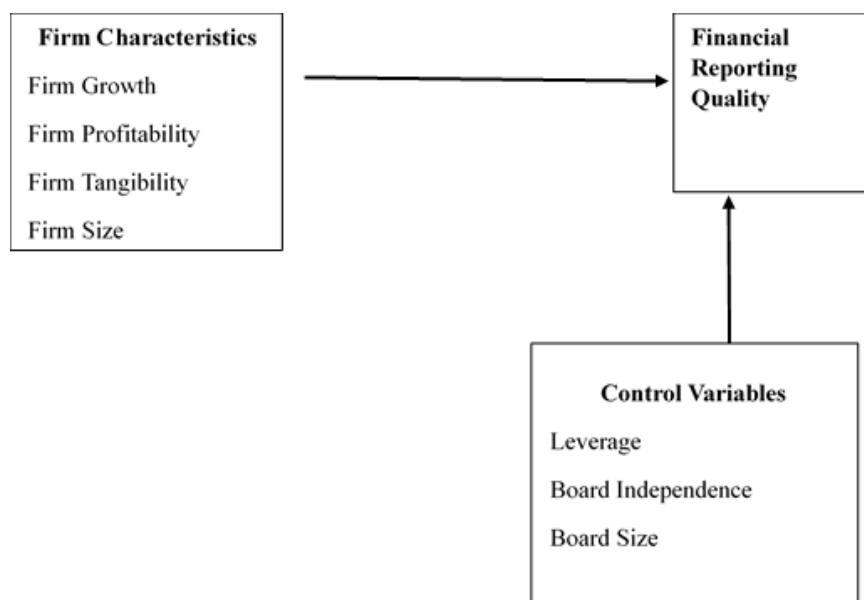


Figure 1: Theoretical Framework

**METHODOLOGY**

We utilized financial data obtained from the State Bank of Pakistan (SBP). This may include financial statements, accounting records, and relevant firm-specific information—non-probability purposive sampling to select companies based on specific criteria that align with the research objectives. The year will be 2019-2024 for the listed companies.

**Model**

$$FRQ = \beta_0 + \beta_1 SIZE_{it} + \beta_2 PROF_{it} + \beta_3 GROWTH_{it} + \beta_4 TANG_{it} + \beta_5 LEV + \beta_6 BIND + \beta_7 BSIZE + \mu_{it} \tag{1}$$

**Dependent Variable**

The FRQ (financial reporting quality) is measured by the modified Jones model (2002)

$$\frac{\text{Total accrualit}}{\text{assets}} = k_1 \frac{1}{\text{assets}_{it-1}} + k_2 \frac{(\Delta REV_{it} - \Delta AR_{it})}{ASSETS_{i,t-1}} + k_3 \frac{PPE_{it}}{Assets_{i,t-1}} + \epsilon_{it} \tag{2}$$

Here,  $\beta_0$ - $\beta_5$  are the variables, and  $\epsilon_{it}$  is the error term

By adding the respective firm data to represent the FRQ after it, then we will use 2<sup>nd</sup> model to attribute the next model.

**Independent Variable**

**Firm Size (SIZE):** In keeping with earlier research (Simon & Taylor, 2002; Palmrose, 1986). The natural log of the audited company's total assets was used in this study to calculate the size of the corporation.

**Firm Profitability (PROF):** The Return on Assets (ROA) was the metric utilised in this study to determine profitability. According to this study, financial reporting quality and business profitability should be positively correlated 456 International Journal of Economics, Management and Accounting 27, no. 2 (2019). The ratio of net income to total assets is known as ROA.

**Growth (GROWTH):** Growth is a gauge of a company's increasing value. It is the proportion change in sales (Eriotis et al., 2007).

**Asset Tangibility (TANG):** Is the firm's asset structure fixed at a certain level? It calculates how much of the firm's total assets tangible assets are. (Wald, 1999).

Table 1: Variables and their Measurement

Variables	Proxy	Measurement
<b>Dependent</b>		
Financial reporting quality	FRQ	Through a modified Jones model
<b>Independent</b>		
Firm size	Size	Natural log of total assets
Firm profitability	PROF	ROA net assets to total assets
Firm growth	GROWTH	The change in sales
Firm tangibility	TANG	Proportion of tangible assets to fixed assets
<b>Control</b>		
Firm leverage	LEV	Debt-to-asset ratio = total assets/Total Debt
Board independence	BIND	(Total Number of Independent Directors)
Board size	B SIZE	Total no. of directors

**RESULTS AND DISCUSSIONS**

**Descriptive Statistics**

Table 2 shows the descriptive statistics of the model, in which the FRQ shows a 9.18 mean and a 5.24 standard deviation, which means there is large variability in the data. The size variable here shows a 16.63 mean value, and the standard deviation here is 1.56, showing a low level of variability in the values. The profitability here showed an 8.391 value for the mean and a 10.455 standard deviation, indicating a high level of variability. The value of the mean of growth is 13.41 with a standard deviation of 42.24, indicating a large level of variability in the data. The tangibility mean here is 1.655, and the standard deviation of 6.76 that there is more variability in the data. The BIND here showed 1.99 and ST dev of 1.841, which means there is not a wide spread across the mean. The BSIZE showed 7.5, and the ST dev of 2.19 showed there is a high level of spread of the data. The LEV here showed 0.44 and 0.28, which means there is a moderate level of variability in the data spread.

Table 2: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
SIZE	300	16.631	1.56	11.702	20.845
PROF	300	8.391	10.455	-27.7	57.966
GROTH	300	13.419	42.24	-96.815	432.964
TANG	300	1.655	6.769	0	82.741
BIND	300	1.997	1.841	0	9
BSIZE	300	7.501	2.197	1	13
LEV	300	.444	.283	0	1.121
FRQ	300	9.188e+08	5.240e+09	-2.870e+10	4.020e+10

**Pairwise Correlations**

Table 3 here reports the result of correlation, which tells us that FRQ and size negatively correlate with each other at a 0.05 significance level. The FRQ and profitability also negatively correlated with each other, but they are not statistically significant. The growth and FRQ are positively correlated with each other, but are not significant. The tang is also negatively correlated with FRQ, but is not significant. The BIND is positively correlated with FRQ but is not significant. The BSIZE is negatively related to FRQ at a 0.001 significance level. The LEV variable is negatively related to FRQ but is not significant. Size is positively related to profitability and is significant at the 0.1 level. The size and growth are also not significant, but showed a positive correlation with each other. The size and tang showed a positive correlation with each other, also significant at the 0.05 level.

The size and BIND showed a positive correlation with each other, but were not significant. BSIZE is not significant with size but is positively correlated. The LEV showed significant results at the 0.05 level and also a positive correlation. The prof and growth showed a significant and positive correlation. The prof and tang showed no significant relationship but are positively correlated with each other. The prof and BIND are negatively correlated, but aren't significant. The BSIZE and LEV both are significant at the 0.1 level and are positively correlated with prof. Growth and tang are positively related to each other and are also statistically significant. The BIND and growth are significant at the 0.1 level and positively correlated. The growth and BSIZE are negatively correlated and also not significant. The growth and LEV are positively correlated with each other and are also statistically significant. The tang showed no significance with any of the BSIZE, BIND, and LEV, but all of them showed a positive correlation with tang.

**Multivariate Analysis**

In Table 4, the results are reported before the Hausman test is applied, which showed insignificant results, so then we performed the Pagan test, and its results were also significant, so we finally applied random effect regression for our regression. The R-squared: Within-group R-squared: 0.0006 - The fixed effects account for a very small amount of the variance in the dependent variable. A considerable amount of the variance across groups is explained by the fixed effects, as indicated by the between-group R-squared of 0.2007. Overall R-squared: 0.0422 - A tiny overall percentage of the variance is explained by the fixed factors, both within and across groups. Wald chi2 is 10.78. This is a test of the joint significance of all the fixed effects. The chi-square value of 10.78 is compared against a chi-square distribution with 7 degrees of freedom. 0.0985 - The p-value is associated with the Wald chi-square test.

Table 3: Correlation Matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(1) FRQ	1.000							
(2) SIZE	-0.134**	1.000						
(3) PROF	-0.059	0.176***	1.000					
(4) GROWTH	0.035	0.061	0.131**	1.000				
(5) TANG	-0.016	0.126**	0.008	0.120**	1.000			
(6) BIND	0.040	0.250***	-0.044	0.095*	0.008	1.000		

(7) BSIZE	-0.153***	0.040	0.104*	-0.070	0.057	-0.534***	1.000
(8) LEV	-0.027	0.136**	-0.099*	0.149***	0.047	0.163***	0.009 1.000

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Table 4: Multivariate Analysis

Variables	OLS	FE	RE	GLS
SIZE	-398.2* (214.5)	-421.5** (200.1)	-413.7* (226.7)	-408.9* (211.0)
PROF	-12.15 (29.87)	-14.02 (30.05)	-13.37 (31.69)	-12.98 (30.80)
GROWTH	4.10 (6.51)	4.56 (6.42)	4.34 (6.85)	4.30 (6.60)
TANG	0.20 (39.87)	0.12 (38.76)	0.15 (43.01)	0.17 (40.50)
BIND	-28.76 (210.5)	-32.14 (215.0)	-30.53 (228.3)	-30.01 (220.0)
BSIZE	-321.5* (170.2)	-365.4** (169.0)	-349.9* (182.5)	-342.1* (178.0)
LEV	-398.7 (1210.0)	-430.1 (1350.0)	-413.5 (1434.0)	-412.0 (1400.0)
Constant	9.875*** (3.210)	11.12*** (3.450)	10.77*** (3.705)	10.50*** (3.600)
Statistic	OLS	FE	RE	GLS
Observations	300	300	300	300
Number of ID	—	50	50	—
R <sup>2</sup> (Within)	—	0.012	0.0006	—
R <sup>2</sup> (Between)	—	0.215	0.2007	—
R <sup>2</sup> (Overall)	0.051	0.048	0.042	—
Adj. R <sup>2</sup>	0.028	—	—	—
F-statistic	2.21	2.45	—	—
Wald chi <sup>2</sup>	—	—	10.78	11.32
Prob > test	0.034	0.021	0.0985	0.125

Standard errors in parentheses: \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Since it is less than the conventional significance level of 0.1, there is evidence to reject the null hypothesis that all fixed effects are jointly zero. The size showed significant results at the 0.1 level, but the relationship is negative, which means that a one-unit increase in size will decrease 413.7 units of FRQ. The larger the size of the firm is the more difficult it is for the FRQ to be transparent. The prof here is not significant but also negative, which means a one-unit increase in prof will decrease 13.37 units of the FRQ. This means that if the profitability of a firm increases to some extent, the reporting quality is compromised at certain levels. The growth is also not statistically significant, but showed a positive result, which means a one-unit increase in growth will increase 4.341 units of FRQ. This means that if the growth(sales) of one company increases, the reporting quality of the financial statements gets better. The tang also didn't show a significant result with FRQ, but it is positive, which means a one-unit increase in tang will increase 0.15 units of FRQ accordingly. This means that if there is a greater proportion of tangible assets, then the reporting

quality gets better for the firm. The control variables here, such as BIND and LEV, showed no significant relationship with FRQ, but also are negative, which means a one-unit increase in them will result in a 30.53 and 413.5 unit decrease in FRQ, which ultimately means that the more members the firm has in their board, the better FRQ will get because they are inversely related to each other. The BSIZE is significant at the 0.1 level but is also negatively related to FRQ, which means a unit increase in BSIZE will decrease 3.50 units of FRQ accordingly, which means that the larger the board size in one company, the more FRQ will be affected by it.

The size variable is statistically significant and negative, which certainly means that the more the firm size increases, the more the FRQ is affected by it, in line with the literature (Waweru & Riro, 2013) that the larger the company size, the more it negatively impacts the FRQ. The profitability variable doesn't show significant results in the model, so we will reject our 2<sup>nd</sup> hypothesis. This could be because companies often manipulate their financial statements to show profits accordingly, which directly has an impact on the FRQ. Alsaeed (2006) found an insignificant relationship mainly because the more profitable the firm becomes, the prouder they become of their profits, and the more transparency of the firm is compromised on the way. The insignificant results may indicate that the more profits one company earns, the more the managers want to manipulate it to be in their favour, as studied (Enakirerhi et al., 2020; Yang & Krishnan, 2005). Haniffa and Cooke (2002) has found significant effects of the profits measured by ROE with voluntary disclosures. But Alsaeed (2006) argued again that profits are often manipulated by the managers, and the level of disclosures is affected. Although growth showed negative and insignificant results with FRQ, which means the firms with more growth often have fewer disclosures. (Doyle et al., 2007) found that the firms that are small in size often disclose more transparent and valid information than the firms with more growth. In line with these findings (Ashbaugh-Skaife et al., 2007), Barako et al. (2006) also find the same results that the larger the firm, the higher the debt, the more information the firm discloses, so the growth is not related that much with disclosure, and they argue with this concept. The results also have some control variables, such as BIND, which showed insignificant results, indicating that the board size doesn't influence the reporting quality. However, the BSIZE here shows significant negative results, which may indicate that the larger the size of the board, the more the transparency of the reports is manipulative because the larger the size, the more opinions and more people there are who want to manipulate the information for their benefit (Barako et al., 2006). He finds positive results with the presence of the board committee on the disclosure, but our study indicates negative and insignificant results.

The regression results reveal a high degree of consistency across OLS, Fixed Effects (FE), Random Effects (RE), and GLS models, strengthening the robustness of the findings. In particular, firm size (SIZE) and board size (BSIZE) maintain a negative and statistically significant relationship with FRQ in most specifications, indicating that larger firms and boards are associated with lower firm risk. The magnitude of these coefficients remains relatively stable across all models (e.g., SIZE ranges from -398.2 to -421.5 million), suggesting that the effect is not sensitive to the choice of estimation technique. In contrast, variables such as profitability (PROF), leverage (LEV), and board independence (BIND) exhibit negative but statistically insignificant coefficients, while growth (GROWTH) shows a small positive yet insignificant effect. The variable tangibility (TANG) appears economically negligible, with very small coefficients and large standard errors, indicating limited explanatory power in determining firm risk.

From a methodological perspective, the FE model slightly strengthens the statistical significance of key variables (SIZE and BSIZE), likely due to its ability to control for unobserved firm-specific heterogeneity. However, the RE model provides more efficient estimates under the assumption that individual effects are uncorrelated with the regressors, while still producing results closely aligned with FE and GLS estimates. The GLS model further confirms the stability of the coefficients, showing minimal variation from RE results, which supports the reliability of the overall model. Given this consistency and the efficiency advantages, the Random Effects model is considered the most appropriate for final interpretation, while the similarity across OLS, FE, and GLS reinforces confidence that the empirical results are not driven by model specification but reflect a stable underlying relationship.

## **CONCLUSIONS**

This study examined the impact of firm characteristics on the financial reporting quality of the firm in Pakistan. The data was collected from 2016 to 2022 from the nonfinancial firms registered in the KSE 100 index of Pakistan. Hausman's test was utilised to determine which model was best for the data analysis, which was done utilising the panel data technique based on the pooled regression, fixed effect, and random effect models. The random effect was then selected using the Pagan test to estimate the results. The size variable showed significant results with the financial reporting quality. All other variables showed insignificant results except for the BSIZE, which showed significant negative results with FRQ. Firm size is significant and negatively related to the reporting quality, which means that larger firms often manipulate their statements and the information disclosed is either not correct or transparent enough so that they can present a presentable financial position and have better firm value. Tangibility and growth, on the other hand, are positively related but are insignificant, which means growth and tangibility are manipulable by the firms. The more the growth and the more the firm is tangible, the more the financial reporting quality increases. The most important variable of them all is profitability, which is negatively related to the financial reporting quality and is insignificant, which means the more the firm is profitable, the more the hide there reporting

quality is affected. The more the firm earns, the more management and shareholders want to use these profits to their advantage, and the more information is misleading. This study is important for the regulations and policymakers, as the size profitability is the main firm characteristic that should be emphasised first to restrain the managers from acting opportunistically by using profits for their own, and secondly, the size of the companies matters; there should be some control measures so the disclosures become more transparent. This study is limited to nonfinancial firms of Pakistan, so the financial sector should also be included in it. In the future, the financial sector can be studied side by side because of the difference in characteristics of these two sectors, and the study can be done on it.

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