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THE IMPACT OF CAPITAL STRUCTURE ON COMPANY VALUE AND THE MODERATING ROLE OF THE BOARD

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Abstract: *This study examines the effect of leverage, board size, firm size, growth, asset structure, profitability, and firm age on firm value, using Tobin's Q as a proxy. Furthermore, this study explores the role of board size as a moderating variable in the relationship between leverage and firm value. Control variables such as company size, growth, fixed asset ratio, Return on Total Assets, and company age are added in this study. Based on 128 financial report data of public companies listed on the Indonesia Stock Exchange from 2021 to 2024, and using panel data regression with a Fixed Effects Model, the results show that leverage has a significant negative impact on firm value. Although board size does not directly affect firm value, board size serves as a key moderating variable that reduces the negative impact of leverage on firm value. These findings highlight the important role of corporate governance in mitigating financial risks associated with capital structure.*

Keywords: Capital Structure, Leverage, Tobin's Q, Board Size

JEL Classification: G32, G32, L25

INTRODUCTION

Investors rely on a company's value as a key factor when evaluating investment opportunities. This shows greater investor confidence in the company, which is reflected in its rising valuation. When allocating resources, investors generally prefer companies with higher values.

This variation in company value is caused by several factors, including the amount of debt a company holds. Increasing corporate debt levels generate significant sentiment among investors (McLean & Zhao, 2014). Increasing debt levels can also benefit company value (Bui et al., 2023). Consequently, it indicates that the company is performing very well, making it easier for the organization to obtain financing from

external sources. Karaca et al. (2025) state that increasing liabilities is detrimental to company value. Companies with greater liabilities are more likely to experience financial distress than those with fewer commitments. The risk of default is considered a potential risk. This condition raises concerns among investors, leading to a decline in company value.

Within the corporate governance function, the volatility of a company's debt is closely related. Company management can increase or decrease the amount of debt. There is a correlation between the number of directors and the level of oversight exercised within the organization. Whenever a debt policy poses a risk to the organization, the board of directors has the authority to take action. Furthermore, Lv et al. (2025) and Khaoula & Moez (2019) found that good governance increases firm value. It can be concluded that rising debt, if managed well, can boost investor confidence. However, a large number of directors can create coordination problems and agency costs. Therefore, their interaction needs to be examined.

Many researchers have examined the relationship between capital structure and firm value. However, previous research has been limited to factors that directly influence firm value. Therefore, the purpose of this study is to investigate the role of corporate governance to fill this gap. Furthermore, this study uses the most recent data from 2021 to 2024, with a particular focus on the manufacturing sector of public companies in Indonesia.

LITERATURE OVERVIEW

Conceptually, capital structure, as measured by leverage, is expected to decrease firm value due to increased financial risk. In contrast, board size is considered a governance mechanism that can mitigate this risk. The interaction between leverage and board size is expected to moderate the relationship. Control variables are included to isolate the impact of a firm's operational characteristics on firm value. The following is an overview of the conceptual framework:

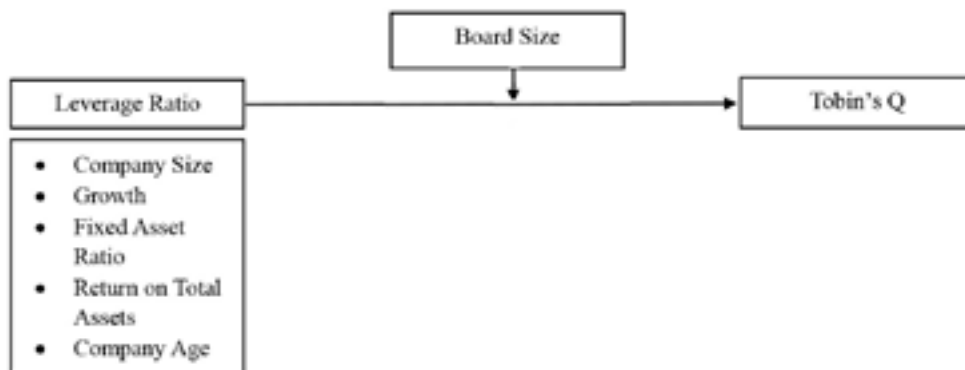


Figure 1. Conceptual Framework

Trade-off Theory

Source: Processed by the author

This theory states that increasing debt can decrease a company's value when the tax benefits of debt are no longer enough to outweigh the costs of bankruptcy

(Modigliani & Miller, 1958) . Conversely, when debt levels are optimal, they can provide tax benefits for the company.

Agency Theory

This theory suggests that effective governance can minimize conflicts of interest and boost company value. High levels of debt can lead to conflicts between shareholders and creditors. Management acting on behalf of shareholders often engages in overly risky projects (risk-shifting) or avoids beneficial investments if most of the profits will go to creditors (underinvestment). These risks are viewed negatively by the market (Jensen & Meckling, 1976).

Capital Structure and Firm Value

Karaca et al. (2025) and Bui et al. (2023) found an influence between capital structure and firm value. The research findings specifically indicate that lower borrowing levels can increase firm value, whereas excessive borrowing above a threshold decreases firm value. In line with these findings, Uddin et al. (2022) also found an influence between leverage and firm value. These results also support the trade-off theory, which states that tax savings achieved by firms through interest expense deductions result in a lower total cost of capital and ultimately increase firm value. More specifically, leverage hurts firm value (Alabdulkarim et al., 2024; Chandro Sarkar, 2022; Demiraj et al., 2023; Misrah & Arifin, 2024) . The higher a firm's debt level, the higher the risk of default or bankruptcy, thus lowering future cash flow expectations and market valuation. Therefore, firm value can decline due to increased debt. Based on this explanation, the hypothesis proposed is as follows:

H1: Leverage has a negative and significant effect on firm value.

Capital Structure, Board Size and Firm Value

Rodríguez Valencia (2025) found a moderating effect of board size on the influence of leverage on firm value. An optimal or large board size acts as a governance mechanism that reduces the agency costs of debt and the market's perceived risk. Board effectiveness becomes particularly important when financial risk or leverage is high. Under these conditions, the board of directors can increase oversight of the use of debt-sourced funds. This, in turn, prevents management from taking actions that harm creditors and signals to the market that the risk of financial distress can be well managed. These actions by the board of directors have been shown to increase firm value (Bayyurt & Basti, 2019; Omenihu & Nwafor, 2025) . Based on this explanation, the following hypothesis is proposed:

H2: Board size positively moderates the negative relationship between leverage and firm value.

METHODOLOGY

This study aims to examine the effect of capital structure and the moderating influence of board size on firm value. Control variables included in the analysis are firm size, growth, fixed asset ratio, profitability, and firm age. The definitions for each variable are as follows:

Table 1. Variable Definition

Variable Types	Variable Name	Variable Symbols	Definition	Source
Dependent Variable	Company Values	Tobin's Q	The ratio between a company's market value and the replacement value of its assets. Measures management's effectiveness in creating value.	Lv et al. (2025)
Independent Variables	Leverage Ratio	LEV	Debt to equity or asset ratio. Measures a company's level of financial risk.	Lv et al. (2025)
Moderating Variables	Board of Directors Size	BOARD SIZE	Number of members on the board of commissioners or directors. Measures the capacity of corporate governance oversight.	(Wang & Liang, 2025)
Control Variables	Company Size	SIZE	Company size is measured by the logarithm of total assets.	Lv et al. (2025)
	Growth	GROWTH	Company revenue growth	(Karaca et al., 2025)
	Fixed Asset Ratio	FAR	Net fixed assets at the end of the year/ total assets at the end of the period	Lv et al. (2025)
	Return on Total Assets	ROA	Net profit after tax/total assets at the end of the period	(Bui et al., 2023)
	Company Age	AGE	Age of the company since its founding up to the research period.	Lv et al. (2025)

Source: Processed by the author

This study uses data from the annual reports of manufacturing holding companies listed on the Indonesia Stock Exchange (IDX). The yearly reports used in this study were from 2021 to 2024, sourced from the IDX website and the company websites. A total of 128 annual reports from 32 manufacturing companies were used in this study. The analysis uses panel data regression with a fixed-effects model (FEM).

EMPIRICAL EVIDENCE

Table 2. Statistics Descriptive

Variable	Obs	Mean	Std. Dev.	Min	Max
Tobin's Q	128	1.4095	1.5953	0.0875	8.7492
LEV	128	0.8144	1.0856	0.0672	6.4659
BOARD SIZE	128	10.6797	3.3271	5.0000	19.0000
SIZE	128	29.9835	1.3611	27.6288	32.9379
GROWTH	128	0.3405	1.6445	-11.8444	7.0693
FAR	128	0.4922	0.2611	-0.1957	0.9935
ROA	128	0.0919	0.0676	-0.0341	0.3319
AGE	128	19.3672	12.9139	1.0000	43.0000

Source: Processed by the author using the STATA application

Table 2 summarizes the characteristics of the research data, which comprises 128 observations of publicly traded manufacturing companies listed on the Indonesia

Stock Exchange. The dependent variable in this study is Tobin's Q, a proxy for firm value. In contrast, the independent and control variables include leverage, board size, firm size, firm growth, fixed-asset ratio, profitability, and firm age. The average Tobin's Q value is 1.4095, with a minimum value of 0.0875 and a maximum value of 8.7492. This indicates that, in general, the companies in the study sample have a higher market value than their book value, suggesting a positive market perception of their prospects. However, the relatively large standard deviation of 1.5953 indicates significant variation across companies in market valuation, with some exhibiting very high market performance while others have low firm value.

The leverage variable has an average of 0.8144 and a maximum of 6.4659. High leverage values in some companies indicate a significant dependence on debt-based funding. The relatively high standard deviation of leverage, at 1.0856, indicates substantial differences in funding structures between companies, thus varying the potential for financial risk in this study's sample. The average board size was 10.67, with a range of 5 to 19 members. This finding suggests that most companies have relatively large governance structures, which may be associated with the complexity of their operations. Variation in board size also indicates differences in oversight mechanisms and strategic decision-making within each company.

Company size, measured using the natural logarithm of total assets, had an average value of 29.98 with a relatively small standard deviation of 1.3611. This indicates that the companies in the study sample have relatively homogeneous asset sizes, so differences in operational scale are not extreme. The company growth variable showed an average value of 0.3405, with a wide range of values from -11.84 to 7.06 and a standard deviation of 1.6445. This indicates that although companies generally experienced positive growth, some experienced a sharp decline, while others showed very high growth rates. Thus, the growth dynamics of companies in the sample are heterogeneous.

The fixed asset ratio (FAR) averaged 0.4922, indicating that almost half of the company's total assets are fixed assets. This shows that companies in the sample tend to be capital-intensive. However, the minimum negative FAR value indicates possible data anomalies or specific accounting adjustments, requiring further examination for outliers before further analysis. Profitability, measured by Return on Assets (ROA), averaged 0.0919, indicating that companies generated, on average, 9.19 percent of profit from their total assets. Although some companies had negative ROA values, indicating losses, the overall level of profitability in the sample can be categorized as relatively good. The average company age was 19.37 years, with a minimum value of 1 year and a maximum of 43 years. This indicates that the research sample spans companies from relatively new to long-established, enabling a more comprehensive analysis of the influence of corporate maturity on firm value.

Overall, the descriptive statistics show significant variation in some key variables, particularly Tobin's Q, leverage, and firm growth. This variation suggests that the relationship between financial structure, corporate governance, and market performance merits further analysis using the regression model used in this study.

Table 3. Baseline Regression

Variable	(1)	(2)
	Tobin's Q	Tobin's Q
LEV	0.081*	0.040**
	(-.6367728)	(-.544971)
SIZE		0.017**
		(1.922362)
GROWTH		0.601
		(0.0150229)
FAR		0.349
		(0.8989684)
ROA		0.174
		(3.160947)
AGE		0.005***
		(-.1399541)
Obs.	128	128
Adj. R ²	0.0931	0.1235
Cons	1.928084	-53.81348

Note(s): ***p < 0.01, **p < 0.05, *p < 0.1

Source: Processed by the author using the STATA application

Table 3 above presents the results of a panel data regression using a fixed effects model that examines the influence of leverage and firm characteristics on firm value, represented by Tobin's Q. Column 1 shows a direct relationship between leverage and firm value. At the same time, column 2 includes control variables to obtain a more robust estimate. In column 1, leverage (LEV) produces a negative coefficient of 0.6367, significant at the 10% level (0.081). This result indicates that increasing leverage decreases firm value. Furthermore, when control variables are included, as seen in column 2, the effect of leverage remains negative and statistically significant at the 5% level, with a coefficient of -0.5449. This indicates that the relationship between leverage and firm value is consistent and not distorted by other internal company factors. These results support Hypothesis 1.

Furthermore, firm size (SIZE) exhibits a positive coefficient of 1.9223, significant at the 5% level, indicating that larger firms tend to have higher market valuations, likely due to economies of scale, greater access to funding, and stronger market credibility. Meanwhile, the variables for growth (GROWTH), fixed asset structure (FAR), and profitability (ROA) exhibit positive but insignificant coefficients. This insignificance implies that these variables do not contribute significantly to the variation in firm value in this model. In contrast, firm age (AGE) exerts a substantial and significant effect at the 1% level with a coefficient of -0.1399. From a model fit perspective, the adjusted R-squared value increases from 0.0931 in Column 1 to 0.1235 in Column 2, indicating that the addition of control variables improves the model's ability to explain variation in Tobin's Q.

Overall, the empirical results indicate that leverage, firm size, and firm age consistently contribute to changes in firm value. In contrast, firm growth, fixed asset intensity, and profitability did not show significant effects in this baseline model. These

findings provide empirical evidence that a firm's capital structure and fundamental characteristics play a more dominant role in shaping market perceptions of its value.

Table 4. Moderating Testing

Variable	(3)
	Tobin's Q
LEV	0.000*** (-2.018304)
BOARDSIZE	0.147 (-.0698576)
LEVERAGE X BOARDSIZE	0.000*** (0.1972078)
SIZE	0.023** (1,891,758)
GROWTH	0.884 (0.0031743)
FAR	0.059* (1.550522)
ROA	0.212 (2.642608)
AGE	0.009*** (-0.1314328)
Obs.	128
Adj. R ²	0.0084
Cons	-53.07134

Note(s): ***p < 0.01, **p < 0.05, *p < 0.1

Source: Processed by the author using the STATA application

The regression results in Table 4 above demonstrate the testing of the moderating role of board size in the relationship between leverage and firm value (Tobin's Q). Specifically, the LEV variable has a negative and significant coefficient at the 1% level, indicating that leverage influences firm value. The BOARDSIZE variable shows a positive but insignificant coefficient, indicating that board size does not directly affect firm value. The main finding in this model is the significant interaction variable LEVERAGE × BOARDSIZE, which is essential at the 1% level. These results confirm that board size acts as a moderating variable, strengthening the effect of leverage on firm value. This means that companies with larger boards tend to manage leverage-related financial risks more effectively, so that leverage can contribute more positively to firm value. Based on these test results, Hypothesis 2 is supported.

Table 5. Robustness Test

Variable	(4)	(5)
	Tobin's Q	Tobin's Q
DER	0.059* (-0.0005429)	0.041** (-0.0005201)

SIZE		0.040** (1.763833)
GROWTH		0.870 (0.0041278)
FAR		0.965 (-0.0576391)
ROA		0.151 (3.463341)
AGE		0.004*** (-0.1420403)
Obs.	128	128
Adj. R ²	0.0940	0.1122
Cons	2.020982	-48.43107

Note(s): ***p < 0.01, **p < 0.05, *p < 0.1

Source: Processed by the author using the STATA application

Robustness testing was conducted to confirm previous results. Robustness testing was performed by replacing the dependent variable with an alternative proxy. In this study, the chosen proxy is the debt-to-equity ratio (DER). DER has the same characteristics as the previous variable. The test results in columns 4 (without control variables) and 5 (with control variables) illustrate the effects of DER and control variables on firm value, proxied by Tobin's Q. In both models, the DER variable shows a significant negative coefficient at the 10% level in column 4 and at the 5% level in column 5. These results indicate that an increase in equity-based DER can reduce firm value. This result is consistent with the results of previous tests. Therefore, the robustness test is valid.

RESULT AND DISCUSSION

The results of panel data regression testing using the Fixed Effects Model approach indicate that capital structure hurts firm value. These results are shown both with and without control variables, indicating that the effect remains negative and significant. The test results have also been confirmed in robustness testing. These findings suggest that a company's increase in debt tends to reduce firm value, especially after accounting for firm characteristics. Previous studies also support these findings. Karaca et al. (2025) and Bui et al. (2023) also found similar results, finding an effect of capital structure on firm value. A capital structure dominated by debt negatively impacts firm value (Alabdulkarim et al., 2024; Chandro Sarkar, 2022; Demiraj et al., 2023; Misrah & Arifin, 2024). Furthermore, these findings theoretically support the trade-off theory of Modigliani & Miller (1958), which posits that although debt provides tax benefits, excessive use of debt increases bankruptcy and agency costs, thereby reducing firm value.

The findings of this study are also consistent with the agency theory of Jensen & Meckling (1976), which states that a highly debt-based capital structure can increase conflict between shareholders and creditors. This conflict increases monitoring costs and risk-shifting behavior, leading to a negative market response. Several previous studies support a negative relationship between leverage and firm value. For example,

Alabdulkarim et al. (2024) found that companies with high debt levels tend to have lower market valuations, particularly in countries with developing financial systems. Misrah & Arifin (2024) also showed that leverage is negatively related to firm value when the firm is above its optimal debt level. In developing countries, capital structures are more sensitive to bankruptcy risk and economic uncertainty, so increasing leverage is often associated with a decrease in firm value.

The adverse effect of leverage on firm value can be reduced by incorporating the role of the board. The board has been shown to moderate the relationship between leverage and firm value in a positive way. This indicates that although leverage directly reduces firm value, the presence of a larger board of directors can mitigate this negative impact. In other words, stronger monitoring and governance mechanisms, enabled by a larger board size, can reduce the risks and agency costs arising from high debt usage. This moderation finding is consistent with agency theory, which emphasizes the board of directors' role as an internal monitoring mechanism to limit managers' opportunistic behavior, particularly in high-risk financing decisions. A larger board allows for a diversity of expertise, experience, and perspectives in strategic decision-making, thereby improving the quality of oversight of capital structure policies. This finding is also consistent with research by Rodríguez Valencia (2025), which found a moderating effect of corporate governance, as measured by board size, on the relationship between leverage and firm value. The board can also prevent management from taking actions that are detrimental to creditors and signal to the market that the risk of financial distress is well managed. Board actions have been shown to increase firm value (Bayyurt & Basti, 2019; Omenihu & Nwafor, 2025). Overall, these moderating results indicate that board size acts as a governance mechanism that weakens the negative relationship between leverage and firm value. These findings confirm that the impact of capital structure on firm value is not universal but is highly dependent on the quality of corporate governance. Therefore, highly leveraged companies need to strengthen their board structure to effectively manage agency and financial risks, thereby maintaining firm value in the eyes of investors.

Based on the finding that leverage has a negative and significant impact on firm value, management is advised to adopt a more conservative capital structure policy and avoid excessive debt use. Companies need to actively evaluate optimal debt levels by considering cash flow capacity, bankruptcy risk, and capital market conditions. Increasing leverage should focus on financing projects with clear, measurable returns, so that increased risk and agency costs do not outweigh the benefits of debt. Furthermore, moderation results indicate that board size can mitigate the negative impact of leverage on firm value. Therefore, companies with relatively high leverage are advised to strengthen their board structure, both in terms of the number of members and the quality of those members. The addition of board members should consider diverse expertise, particularly in finance, risk management, and corporate governance, to ensure more effective oversight of financing policies.

CONCLUSION

Companies are advised to consider board size as part of their financial risk management mechanism. A larger and more competent board of directors can improve monitoring, reduce opportunistic behavior by managers, and ensure that debt decisions

align with shareholder interests. In this context, supporting board committees, such as the audit committee and risk committee, need to be optimally empowered to oversee capital structure policies and debt risk exposure. Capital market regulators and supervisory authorities are also advised to encourage stronger governance practices, particularly for highly leveraged companies. Guidelines on board composition and size can be strengthened by emphasizing the importance of financial expertise and independence, so that the board can effectively manage capital structure risk.

For investors, the results of this study imply that a company's leverage level needs to be analyzed in conjunction with the quality of corporate governance, particularly the size of the board of directors. Investors are advised to assess debt risk not only through financial ratios but also to consider whether the company has adequate oversight mechanisms to manage such risks. Companies with high leverage but supported by strong and effective boards of directors tend to have a lower risk of impairment than companies with weak governance. Future researchers are advised to develop models that incorporate additional governance dimensions, such as board independence, CEO duality, or audit committee effectiveness, to gain a more comprehensive understanding of the role of corporate governance in the relationship between capital structure and firm value. In addition, future research may consider non-linear approaches or threshold effects to identify optimal leverage levels more accurately.

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