



Analyzing the role of financial development and governance quality on industrial growth strategy in selected countries*

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Abstract

Economic development and growth are considered an integral part of sustainable development goals. Financial development is one of the effective factors in growth strategies that encourages investment and reduces financing cost. The governance quality is another important factor in growth strategies that ensures optimal allocation of financial resources and strengthens the impact of financial development on growth strategies. This study examines the role of financial development and governance quality on industrial growth strategies in selected Factor-driven, Efficiency-driven and Innovation-driven countries using panel data and the GMM method over the period 2002-2022. The results show that financial development has a positive effect on growth strategies in Factor-driven and Innovation-driven countries, and has no significant effect in Efficiency-driven countries. Governance quality has a positive and significant effect on growth strategies in Factor-driven countries, and has no significant effect on growth strategies in Efficiency-driven and Innovation-driven countries. The interactive effect of governance quality and financial development on industrial growth strategy is negative and significant in Factor-driven and Innovation-driven countries, so that the lower the level of financial development, the greater the impact of governance on strategy. This indicator has no significant effect in Efficiency-driven countries.

Keywords: Industrial growth strategy, Financial development, Panel data, Governance quality, Comparative advantage.

JEL Classification: O16, G38, O47.

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1. Introduction

Many countries are experiencing a growing trend in financial development and governance quality indicators, but observations show that growth has been underperforming in some countries, which can raise important questions regarding the role of finance and governance in industrial growth strategy. Is it important to increase financial development in formulating growth strategy and what are the outcomes of financial sector reforms and development policies? How does the quality of governance affect growth strategy? Can governance quality enhance the impact of financial development on industrial growth strategy choice? What are the determinants of growth strategies? Therefore, it is important to examine financial development and governance quality to determine the policies used in growth strategy and identify the influencing factors.

2. Theoretical Framework

Financial development is one of the effective factors in the industrial growth strategy, playing an important role in supporting economic development through investment and technological innovation. Governance quality contributes to financial development. Good governance provides a suitable environment for productive sectors in the economy by creating a stable political environment and effective institutions. On the other hand, financial development can help improve governance. Access to financial services and financial markets can help businesses to have a greater participation in production. Financial development can provide the resources needed to finance public and infrastructure projects that help improve governance. In general, these two concepts affect each other and improving one can lead to improving the other. The purpose of this research is to examine the impact of governance and financial development on industrial growth strategy.

3. Methodology

The model of this research is panel data because the dependent variable depends on its historical path, which leads to the problem of endogeneity and dynamics in the model. To solve this problem, it is necessary to use the lags of the dependent variable as explanatory variables in the model, which is consistent with the view of Gujarati (2004). Panel data is usually estimated based on dynamic patterns. One of the characteristics of panel data is that the dynamics between variables can be interpreted by introducing the time factor. The dynamic pattern in panel data is as follows:

$$Y_{it} = \alpha_i Y_{(it-1)} + \beta X_{it} + \mu_t + \vartheta_{it}$$

In this model, Y_{it} is the dependent variable vector, X_{it} is the independent variable vector, μ_t is the error coefficient related to the sections, and ϑ_{it} is the error coefficient of section i at time t . The generalized Moment Model (GMM) is a method for

estimating model parameters in dynamic panel data, which is used for time series, cross-sectional, and panel data. This method takes into account the effects of dynamic adjustment of the dependent variable. When the dependent variable appears as an interruption on the right side in the pooled data model, the OLS estimators do not have this intercept. Therefore, Arellano and Bond (1991) proposed the GMM. The financial development and governance quality indicators are used as explanatory variables. The industrial growth strategy index is endogenous and dynamic because it is influenced by past values. To empirically determine the role of financial development and governance quality on industrial growth strategy, the panel data model is used in the form of the following relationship:

$$TCI_{it} = \alpha_i + \sum_{it=1}^{NT} \beta TCI_{it-1} + \sum_{it=1}^{NT} \gamma FD_{it} + \sum_{it=1}^{NT} \sigma INS_{it} + \delta FD_{it} * INS_{it} + \sum_{it=1}^{NT} \theta CV_{it} + L_c + L_t + \varepsilon_{it}$$

TCI_{it} is the technology choice index, FD_{it} is the financial development indicators, INS_{it} is the governance quality index, $FD_{it} * INS_{it}$ is the interaction effect of governance quality and financial development, and CV_{it} is control variables including the workforce with basic education, government spending relative to GDP, fuel exports, and net foreign direct investment flows.

4. Discussion

The stock market value index is considered an indicator of financial development. The research findings showed that financial development has a positive effect on industrial growth strategy in Factor-driven and Innovation- driven countries, meaning that stock market value increases industrial growth strategy in these two groups of countries and financial development has no significant effect in Efficiency- driven countries.

The estimation shows that governance quality has a positive and significant impact on growth strategy in Factor-driven countries. Although this indicators ranks high in Efficiency- driven and Innovation- driven countries, it does not have a positive impact on industrial growth strategy. Countries with strong governance Usually have stricter laws and regulations, which can slow down innovation processes.

5. Conclusion and Suggestions

This study examined the impact of two variables: financial development and governance quality on industrial growth strategy in Factor-driven, Efficiency- driven, and Innovation- driven countries during the period 2002-2022. According to the empirical findings of the study, the following suggestions were made:

- In Efficiency- driven countries, there are factors such as lack of transparency of financial markets and legal risks, limited access to financial resources, market fluctuations, diversity in economic structure, etc., which make financial development

to have less impact on growth strategy. Therefore, it is suggested that financial infrastructure be developed in this group of countries.

- Governance quality is of great importance in economic growth and development, Efficiency- driven countries must take fundamental steps in institutional reforms. Good governance can lead to increased public participation in decision-making, which can help develop financial markets. When public trust increases, people are more likely to invest and participate in economic activities.

- The negative interaction effect shows that policies to improve the quality of governance are better when they lead to increased financial development. Therefore, it is recommended that government and legal institutions be strengthened in all three groups of countries.

6. Ethical Considerations

5.1. Compliance with ethical guidelines

All ethical guidelines have been followed in writing this article.

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5.3. Authors' Contribution

The authors, while adhering to publication ethics, declare that they have contributed equally.

5.4. Conflict of Interest

The authors declare that there are no conflicts of interest in this research.

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