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# The Effect of Bank Ownership on Loan Maturity

## ABSTRACT

*This paper empirically tests the determinants of corporate debt maturity suggested in the framework of the contracting costs hypothesis. Using data on new debt issues of Finnish listed firms, we concentrate on examining the effect of bank ownership on the determinants of maturity structure. We hypothesize that significant bank ownership mitigates the contracting problem, and thus firms with many growth opportunities are also able to use long-term debt. Furthermore, we expect that bank-owned firms are better able to match their asset and liability maturities. We regress the debt maturity on the market-to-book ratio and asset maturity. Additionally, we use control variables representing alternative approaches to maturity determination. The results show that when the lender bank is an owner of the borrowing firm, asset maturity and the term spread of interest rates are the determinants of maturity selection. Our additional tests show that this is the case even after controlling for loan type (bank loan vs. other loan).*

## 1. INTRODUCTION

Myers's (1977) theory on the determinants of corporate borrowing states that the total value of a firm can be broken down into the value of assets already in place and the present value of future growth opportunities. According to this theory, the managers of a firm with many growth opportunities have a disincentive to exercise the growth options when the firm holds long-

term risky debt in its balance sheet. This is because the owners must share the benefits of new projects with the holders of old debt. Therefore, Myers's theory predicts that the optimal present value of a company's debt is inversely related to the ratio of the value of growth options to the total market value of the firm.

Shortening loan maturity is one solution to the contracting problem between the borrower and the lender. Other solutions include e.g. decreasing the amount of debt and/or using protective covenants. Especially, Myers (1977) argues that firms attempt to match the maturities of their assets and liabilities to schedule debt repayments to correspond to the decline in value of assets already in place.<sup>1</sup>

A few empirical studies examine the determinants of maturity structure. Consistently with Myers (1977), Barclay and Smith (1995) find that large firms with few growth options have more long-term debt in their capital structure. Similar results are provided by Stohs and Mauer (1996) and Guedes and Opler (1996).

The results concerning the practice to match the maturities of assets and liabilities are mixed, however. Stohs and Mauer's (1996) results support the hypothesis of matching. Guedes and Opler (1996) find some support for matching the maturities of assets and liabilities, while Mitchell (1991) finds no evidence of such behavior.

This paper empirically tests the maturity determinants suggested by Myers (1977) using data on Finnish listed firms. We concentrate on examining whether bank monitoring based on ownership in the borrowing firms affects loan maturity. In Finland, financial institutions such as banks, insurance companies and foundations are the largest owner group of industrial and commercial firms. Another distinctive feature of the Finnish loan markets is that corporate bonds have a minor role, i.e. loans from financial institutions are the most important source of debt capital. A third issue is that debt covenants are rarely used to mitigate the contracting problem, neither in private loans, nor in public bond issues.<sup>2</sup>

Several formal models concerning the monitoring role of banks have been developed. Diamond (1984) and Ramakrishnan and Thakor (1984) state that banks have a gross cost advantage in collecting information. They argue that financial institutions exist because of their ability to lower information production costs. If there are scale economies in information production, and information is durable and not easily transferred, these theories say that a firm

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**1** Barclay and Smith (1995) point out that Myers must implicitly assume that rolling short-term debt is more expensive than long-term financing, because otherwise all firms would prefer short-term debt under the contracting cost hypothesis.

**2** Niskanen and Niskanen (1999) investigate the use of covenants in Finnish firms loans and find that only 11 percent of the loans contain at least one covenant. The small share of loans with covenants may partly be due to the large ownership share of financial institutions, who may protect themselves through their ownership status. It can also be partly due to the fact that even the firms that do not have bank owners have in most cases established lengthy banking relationships which presumably enhance the banks' information concerning the firm.

with close ties to financial institutions should have a lower cost of capital and greater availability of funds relative to a firm without such ties. Mayer (1988) and Petersen and Rajan (1994, 1995) further suggest that banks would be more willing to transfer the benefits of long-term relationships to their clients if they were allowed to hold equity in the borrowing firms on an ongoing basis.

Based on the theoretical models, we hypothesize that bank ownership should mitigate the contracting problem between the bank and the borrowing firm. Under such circumstances, firms with large growth opportunities could also benefit from using longer-term debt, and the differences between loan maturities of growth firms and non-growth firms should be smaller. For the same reason, we also hypothesize that when the lender banks are also owners, firms are better able to match the maturities of their assets and liabilities.

Similar to Guedes and Opler (1996), we examine the determinants of the maturity of new debt issues, whereas Barclay and Smith (1995) and Stohs and Mauer (1996) use balance sheet data covering all outstanding debt at a given time. We believe that new debt issues are more useful for the purposes of this study, because the role of bank ownership accentuates when new debt contracts are negotiated.

The next section provides a description of the research method, loan data, and variables suggested to explain the maturity structure. Section 3 reports the empirical results, and the paper concludes with a summary in section 4.

## 2. DATA AND HYPOTHESES

### 2.1. Loan Data

Our loan (maturity) data cover the new debt issues of 44 listed Finnish firms (either Helsinki Stock Exchange, OTC-, or Stockbrokers' list) during the period 1985 through 1991. We received the data on the loans through a private questionnaire to the firms. The intended sample included all 67 manufacturing and commercial firms that had a listing for at least three consecutive years during the research period.<sup>3</sup>

Initially, the gathered data set consisted of 349 loan observations. However, 66 observations were lost due to unavailability of the stock market value (needed to compute the explanatory variable measuring growth options). This was because some of the firms were not listed throughout the research period.<sup>4</sup> Consequently, we have 283 observations left for our analysis. The average firm in the sample took 8 loans during the time period. Some smallest compa-

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<sup>3</sup> Ten firms were excluded because they had not taken in any non-government regulated or non-subsidized debt during the period investigated. Another ten firms refused to reply, and three firms provided insufficient data.

<sup>4</sup> They may either have become listed firms during 1985–1991, or their listing may have been interrupted.

nies only took one new loan, whereas some large companies raised up to 33 loans. The mean book value of assets for all 44 firms in the sample is 3621 million FIM. On average, the largest owner bank holds 5.8 percent of the company's total voting power, the minimum being 0 percent and the maximum 72 percent.

## 2.2 Explanatory variables

The data on explanatory variables were available from public sources, such as the stock exchange files and the sample firms' annual reports. Interest rate data were provided by courtesy of the Bank of Finland.

Our explanatory variables may be divided into two groups. The variables of primary interest, growth options and asset maturity, represent the contracting cost approach. However, these are not the only variables suggested in the literature to explain debt maturity structure. For instance, Barclay and Smith (1995) form three categories of hypotheses previously expressed to explain the selection of debt maturity: contracting cost hypotheses (as described above), information asymmetry hypotheses and tax hypotheses. To control for the potential effect of maturity determinants expressed in the two last mentioned frameworks, we add a second group of variables representing these competitive hypotheses in our empirical model.

### 2.2.1 Contracting cost variables

*Market-to-book -ratio.* There is no direct measure for the growth options of a firm. Perhaps the most commonly used variable in the literature is the market-to-book ratio, which is computed as the market value of a firm's assets divided by the book value of the same assets. The book value of assets comes from the last annual report and the market value of equity is taken from the same date. We compute the market value of assets in the usual way by first subtracting the book value of equity from the book value of total assets, and then adding back the market value of equity. Dividing this number by the book value of assets, we obtain our empirical measure for the market-to-book ratio. The contracting cost hypothesis suggests that firms with high growth opportunities have an incentive to borrow short term, because the contracting costs are supposedly higher for long term debt. In our sample, we expect to find that when firms borrow from owner banks, firms with high growth opportunities can also use longer-term debt. Therefore, growth opportunities should not be associated with debt maturity in the group of firms that borrow from owner banks.

*Asset maturity.* Several alternative ways have been used in the literature to measure asset maturity. Petersen and Rajan (1997) use the ratio of current assets to total assets. The weakness of this measure is that it tells little about the expected life of the firms assets. Since our study deals with the maturities of the firms' long-term loans we select a measure for asset ma-

turity that attempts to estimate the maturity of the firms fixed assets. As Guedes and Opler (1996), we compute our proxy for asset maturity by dividing the balance sheet value of productive assets by the annual straight-line depreciation expense. Myers (1977) suggests that firms use maturity matching to lower the agency costs of debt because firms with more long-term assets can support more long term debt. Based on this line of thought we expect the coefficient on asset maturity to take a positive sign in the entire sample. Especially, we expect the result to be more pronounced for the firms that borrow from owner banks because of less severe information asymmetries.

### 2.2.2 Control variables

*Term spread.* Brick and Ravid (1985) suggest that when the term structure of interest rates is not flat, corporate taxation may have an effect on the debt maturity choice. According to their hypothesis, when the yield curve is upward sloping, long-term debt is preferred because the tax benefit of interest payments is then larger. In the inverse case, rolling short-term debt produces larger tax benefits. As Barclay and Smith (1995), we measure the term structure related to the tax hypothesis by the difference between short and long interest rates. Our measure of the *term spread* is constructed by subtracting the three-month interbank yield from the ten-year government bond yield. This variable is calculated separately for each loan and for the day the loan is taken. The predicted sign for this variable is thus positive.

*Firm size.* Barclay and Smith (1995) argue that large firms – as opposed to small firms – can benefit from “scale economies of borrowing” because of the large fixed costs of public debt issues. Therefore, smaller firms are more likely to use shorter-term bank debt. To control for these effects, we use the *natural log of the market value* of the firm as a size proxy (see above for computation of the variable).

*Unexpected EPS.* Flannery (1986) and Barclay and Smith (1995) test the effect of *firm quality* on the maturity decision. Following Barclay and Smith, we measure firm quality by the change (from the previous year to the year that the loan is taken) in earnings per share (EPS) scaled by the market value of the firm, i.e. unexpected EPS. Barclay and Smith (1995) assume that undervalued firms have positive and overvalued firms have negative future unexpected EPS. This assumption leads them to predict that the sign of this variable is negative, since undervalued firms with larger growth opportunities hold shorter-term debt. In cases where the lender is also an owner, we predict that borrowers have no motive to signal. If so, unexpected EPS should have an insignificant regression coefficient for firms that borrow from owner banks.

### 3. EMPIRICAL RESULTS

#### 3.1 Descriptive Statistics

TABLE 1 provides summary statistics separately for the loans taken from owner banks and for the rest of the sample. We note that the maturity differences between the loan groups are small and statistically insignificant.

**TABLE 1. Summary statistics.**

Panel A: Loans where the lender bank is an owner						
Variable	Mean	Standard deviation	25th percentile	Median	75th percentile	
Maturity	6.33	2.88	5.00	5.00	8.00	
Market-to-book	1.25	0.32	1.03	1.14	1.38	
Asset maturity	13.74	11.99	8.66	10.66	14.98	
Ln(Market value of assets)	7.66	1.34	6.52	7.93	8.58	
Term spread	-0.29	1.54	-0.81	0.05	0.64	
Unexpected EPS	-0.26	0.82	-0.20	-0.05	0.02	
Panel B: Loans where the lender bank is not an owner						
Variable	Mean	Standard deviation	25th percentile	Median	75th percentile	t-value <sup>1</sup>
Maturity	6.32	2.58	5.00	6.00	8.00	0.02
Market-to-book	1.18	0.25	1.00	1.13	1.35	1.68*
Asset maturity	13.83	8.41	10.04	12.50	15.83	-0.08
Ln(Market value of assets)	8.06	1.45	7.03	8.43	9.25	-2.07**
Term spread	-0.03	1.42	-0.72	0.14	0.94	-1.43
Unexpected EPS	-0.16	0.40	-0.23	-0.05	0.03	-1.44

<sup>1</sup> Positive t-values in the rightmost column of Panel B indicate that the variable mean is larger in Panel A, while negative t-values indicate that the variable mean is larger in Panel B.

\* significant at the 5% level

\*\* significant at the 1% level

In the group of explanatory variables, TABLE 1 shows that the market-to-book ratio representing growth options is statistically significantly larger (1.25) for firms that borrow from owner banks than for the rest of the sample (1.18). For firms that borrow from owner banks, the average asset maturity (13.74 years) does not differ from that for the rest of the sample (13.83 years).

The statistics on the size variable (log of market value) clearly show that the firms which do not borrow from owner banks are larger. Term spread and average unexpected EPS are larger for firms that do not borrow from owner banks, but the differences are not statistically significant.

### 3.2 Regression results

Column 1 of TABLE 2 presents the Ordinary Least Squares (OLS) regression results for the group of loans that are taken from owner banks. Column 2 presents the results for an other group of loans taken from other sources such as non-owner banks, insurance companies or the bond market. The model in column 3 of TABLE 2 is estimated to investigate whether the coefficients in columns 1 and 2 are in fact statistically significantly different from each other. Column 3 presents the Ordinary Least Squares (OLS) results from regressing loan maturity on the five explanatory variables, a dummy indicating that the loan has been taken from an owner bank and multiplicative variables to indicate whether the explanatory variables have different slopes when the loan has been taken from an owner bank.

*Market-to-book ratio.* The coefficients of the market-to-book ratio are insignificant in both columns 1 and 2 of TABLE 2, suggesting that growth opportunities do not affect loan maturity. The results in column 3 also suggest that the coefficients for the two subgroups are not statistically significantly different from each other, although TABLE 1 shows that the growth opportunities of firms that borrow from owner banks firms are clearly larger than those of the firms that borrow from other sources. According to theory, firms with larger growth opportunities should be rolling shorter-term debt. Thus, the result may indicate that in the presence of significant bank-ownership firms with large growth opportunities are able to utilize long-term debt financing equally well as firms with fewer growth opportunities. Interpreted this way the result is consistent with our hypothesis.

*Asset maturity.* Consistently with our hypothesis, we note that the regression coefficient of asset maturity is positive and highly significant when the lender bank is also an owner (column 1). On the contrary, asset maturity is not a significant determinant of loan maturity for the firms that do not borrow from owner banks. Because the multiplicative dummy is highly significant, column 3 of TABLE 2 confirms that firms which borrow from owner banks are better able to match the maturities of their assets and loans than firms borrowing from other sources.

*Term spread.* Term spread takes a statistically significant correct-signed coefficient when the loan has been taken from an owner bank but it is insignificant for the loans that have been taken from other than owner bank sources. The statistically significant coefficient on the multiplicative dummy in column 3 further indicates that firms under bank-ownership are better able to utilize the tax-advantage of long-term borrowing than the other sample firms.

*Size and Unexpected EPS.* Size and unexpected EPS are statistically significant both for loans from owner banks and loans from other sources. Both coefficients, however, have unexpected signs, and the results concerning these two variables remain uninterpreted.

In summary, the results are consistent with our hypotheses for the loans that are taken

**TABLE 2. Determinants of Loan Maturity with Bank Ownership. Estimated coefficients from regressing loan maturity on a set of explanatory variables. Column 1 includes loans from owner banks. Column 2 includes loans from other than owner bank sources. In column 3 the whole sample is used to provide a comparison between the two loan groups.**

Variable	Expected sign	Sample		
		Loans from owner banks	Other than owner bank loans	Combined sample
		1	2	3
Intercept		9.31*** (0.000)	7.43*** (0.000)	7.43*** (0.000)
Loan from owner bank (0,1)				1.88 (0.408)
Market-to-book	-	-0.11 (0.899)	0.75 (0.328)	0.74 (0.317)
Asset maturity	+	0.12*** (0.000)	-0.02 (0.424)	-0.02 (0.413)
Ln (market value of assets)	+	-0.54** (0.014)	-0.20 (0.101)	-0.20* (0.093)
Term spread	+	0.37** (0.041)	-0.06 (0.641)	-0.06 (0.633)
Unexpected EPS	-	0.66* (0.066)	0.93** (0.039)	0.93** (0.034)
Owner bank loan * Market-to-book	-			-0.86 (0.482)
Owner bank loan * Asset maturity	+			0.14*** (0.000)
Owner bank loan * Ln(market value of assets)	+			-0.34 (0.197)
Owner bank loan * Term spread	+			0.43* (0.063)
Owner bank loan * Unexpected EPS	-			-0.26 (0.652)
N		70	211	283
Adjusted R <sup>2</sup>		0.34	0.03	0.11
F		8.165 (0.000)	2.12 (0.065)	4.17 (0.000)

\* significant at the 5% level  
 \*\* significant at the 1% level  
 \*\*\* significant at the 0.1% level

from the largest owner bank. Growth opportunities are not a significant determinant of loan maturity in this group of loans. Matching of asset and loan maturities and taking advantage of the term spread on the other hand seems to be easier for the firms that borrow from owner banks.

### 3.3. Additional Tests

One distinctive feature of the Finnish loan markets is their bank dominance – not only in the form of bank ownership. In our sample, banks account for 76 percent of all loans, the fraction of domestic banks being 56 percent and that of foreign banks being 20 percent. Corporate bonds, on the other hand are used much less frequently in Finland than in Anglo-saxon countries. Therefore, the share of bond financing has been much larger in the data sets used in previous studies. It is possible that the maturity determinants of bank loans and bonds, and potentially the determinants of other loan types, are different. This could be one explanation to the striking differences between the results of previous empirical studies. To examine this issue, we re-divide our data into three groups in TABLE 3. We first investigate *all 208 bank loans*, irrespective of whether the lender bank is an owner or not. These results are reported in column 1 of TABLE 3.

The regression results for all bank loans are very similar to the results in TABLE 2 concerning loans from owner banks. The results for other than bank loans in column 3 of TABLE 3 show that only term spread is significant, but it has the unexpected sign. It must be noted, however, that the group of other loans is heterogenous, because we have very few observations from other homogenous loan groups than bank loans (e.g., bonds). The regression model in column 4 compares the results for all bank loans to those for other loans, and suggests that only the coefficients of term spread are statistically significantly different from each other. Next, we re-run the regression in the group of bank loans after having deleted the observations where the bank is an owner. This is done to check whether our results are specific to bank loans as a group, or whether they are driven by the loans from owner banks. These results are presented in column 2 of TABLE 3. It appears that only firm size and unexpected EPS take statistically significant coefficients, but they both have unexpected signs.

Finally, column 5 of TABLE 3 compares the group of non-owner bank loans to the rest of the sample. The results again suggest that only the coefficient on term spread is statistically significantly different in the two samples. These results give us further confidence that bank ownership is the reason to the differences between the results in TABLE 2 for the loans from the owner bank and the for loans from other sources.

## 4. SUMMARY AND CONCLUSIONS

Under the contracting cost hypothesis, firms with larger growth opportunities should hold shorter-term debt than firms with few growth opportunities. Also, firms are expected to match the maturities of their assets and liabilities to schedule debt repayments to correspond to the decline in the value of assets already in place.

**TABLE 3. Additional tests. Estimated coefficients from regressing loan maturity on a set of explanatory variables. Column 1 includes all bank loans. Column 2 includes bank loans except those from owner banks. Column 3 includes loans from other than bank sources. Column 4 presents a comparison between all bank loans and non bank loans. Column 5 compares bank loans, when loans by owner banks have been excluded, to the non bank loans.**

Variable	Expected sign	Sample				
		All bank loans	Bank loans except those from owner banks	Other than bank loans	All bank loans versus non bank loans	All except owner bank loans versus non bank loans
		1	2	3	4	5
Intercept		8.92*** (0.000)	9.68*** (0.000)	5.06** (0.011)	5.06** (0.020)	5.37** (0.019)
Loan from bank (0,1)					3.85 (0.141)	4.30 (0.173)
Market-to-book	-	0.08 (0.912)	-0.31 (0.790)	1.38 (0.189)	1.38 (0.116)	1.52 (0.204)
Asset maturity	+	0.07*** (0.003)	-0.01 (0.731)	-0.02 (0.465)	-0.02 (0.535)	-0.02 (0.471)
Ln (market value of assets)	+	-0.43*** (0.001)	-0.32* (0.055)	-0.002 (0.991)	-0.002 (0.992)	-0.06 (0.777)
Term spread	+	0.25* (0.051)	0.13 (0.451)	-0.362* (0.058)	-0.36 (0.182)	-0.44** (0.050)
Unexpected EPS	-	0.94*** (0.009)	1.88** (0.033)	0.57 (0.232)	0.57 (0.160)	0.57 (0.296)
Bank loan * Market-to-book					-1.30 (0.227)	-1.83 (0.259)
Bank loan * Asset maturity					0.08 (0.142)	0.006 (0.888)
Bank loan * Ln(market value of assets)					-0.43 (0.116)	-0.26 (0.362)
Bank loan * Term spread					0.61** (0.038)	0.56** (0.040)
Bank loan * Unexpected EPS					0.37 (0.452)	1.32 (0.184)
N		208	140	73	283	211
Adjusted R <sup>2</sup>		0.11	0.03	0.02	0.09	0.03
F		6.077 (0.000)	2.12 (0.065)	1.35 (0.252)	3.53 (0.000)	1.63 (0.092)

\* significant at the 5% level  
 \*\* significant at the 1% level  
 \*\*\* significant at the 0.1% level

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Several empirical studies examine debt maturity determinants derived from different approaches. The results from those studies are mixed. This paper empirically tests the maturity determinants suggested in the framework of the contracting costs hypothesis using data on new loans of Finnish listed firms. The Finnish capital markets are bank based and they are also characterized by significant ownership share of manufacturing and commercial firms by financial institutions such as banks. This study concentrates on examining the effect of bank ownership on the determinants of corporate debt maturity structure. We hypothesize that significant bank ownership mitigates the contracting problem, and thus firms with many growth opportunities are also able to use long-term debt. Furthermore, we expect that under such circumstances, firms are better able to match their asset and liability maturities.

Sample statistics indicate that the market-to-book ratio which measures growth opportunities is statistically significantly larger for bank-owned firms than for other firms. Regression results show that the market-to-book ratio is an insignificant explanatory variable for debt maturity irrespective of whether the loan is from the owner bank or from some other source. One way to interpret this result is that bank ownership makes it possible also for firms with large growth opportunities to use longer term debt.

Consistently with our hypothesis, asset maturity is positively related to debt maturity when the lender bank is also an owner. Also term spread takes a statistically significant correct-signed coefficient when the loan has been taken from an owner. This indicates that firms under bank ownership are better able to utilize the tax-advantage of long-term borrowing than the other sample firms. However, neither asset maturity nor term spread is significantly related to loan maturity for the firms that do not borrow from owner banks. In general, the results speak for bank ownership being an important determinant of debt maturity. ■

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