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The Effect of Bank Ownership on Loan Maturity

Financial theory suggests that the managersof 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, 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. Based on this reasoning, it has been suggested that 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.

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.

This paper empirically tests the maturity determinants suggested in the theoretical literature using data on Finnish listed firms. We concentrate on examining whether bank monitoring based on ownership in the borrowing firms affects loan maturity. 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. 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. Consequently, we have 283 observations left for our analysis.

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. Other categories of hypotheses previously expressed to explain the selection of debt are the 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. These are the term spread, firm size and the unexpected change in the earnings per share.

The results suggest that bank ownership makes it possible also for firms with large growth opportunities to use longer term debt. The results also suggest 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.