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**THE IMPACT OF ORGANIZATIONAL TRUST
ON A FIRM'S MARKET VALUE.
THE EFFECTS OF FIRM SIZE**

The paper investigates the relationship between organizational trust and a firm's market value through the perspective of company size. The paper addresses the theoretical and empirical gap regarding the effects of organizational trust on a firm's value by embarking on stewardship and agency theories. This provides a theoretical framework to extend the understanding of an organizational trust's influence on a firm's market value based on company size considering the extent to which a firm's size plays a role in determining the market value effect. Furthermore, the effects of firm size on an organizational trust's impact on market value were tested empirically through a moderation analysis drawing on a sample of 198 firms listed on the Warsaw Stock Exchange. It has been found that there is no significant association between organizational trust climate and a firm's market value. However, what materialized from this investigation, as predicted, is that the aggregate impact of the internal trust climate on market value depends on company size. Specifically, it is reported that high trust diminishes the value of big firms, but at the same time contributes to a firm's value in the case of small firms. Although these results might seem surprising, they are supported by arguments derived from the stewardship and agency theories distinguishing the possible positive and negative outcomes of organizational trust under different conditions.

Keywords: firm market value, company size, stewardship theory, agency theory, organizational trust, organizational performance, financial performance, economic performance

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1. INTRODUCTION

There seems to be a broad agreement that trust has salient positive effects (McGregor 1967; McEvily et al. 2003; Dirks and Ferrin 2001). The extensive amount of literature has documented the impact of trust on different aspects of organizational performance including job satisfaction, citizenship behaviours, productivity (Cardona and Morely 2013; Shockley-Zalabak, Morreale et al. 2010; McAllister 1995), organizational commitment (Livet and Reynaud 1998; Busacca and Castaldo 2005; Darrough 2008), customer satisfaction (Lam and Lau 2008), team effectiveness (Costa, Roe et

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al. 2001; Kiffin-Peterson 2004) and alliance performance (Suseno and Ratten 2007).

In view of these substantial positive effects of trust, numerous researchers predict that there must also be a positive influence of trust on financial results (Davis, Schoorman et al. 2000; Chow 2008; Shockley-Zalabak, Morreale et al. 2010). In spite of this recognition, only one study undertook an empirical investigation between trust and financial performance. It reported the significant relationships between trust in the general manager and financial indicators such as sales and profits in the restaurant industry (Davis, et al. 2000), which are imperfect proxies for ultimate performance evaluation (Bruce et al 1985). In fact, companies can achieve superior financial results (e.g. accounting earnings) and still underperform in terms of economic performance (i.e. the stock market). Some studies even report that there is a negative relationship between profitability indicators such as ROE (return on equity), ROA (return on assets), ROI (return of investment) and market-based performance (Keats and Hitt 1988). So the current analysis of trust effects should be expanded in terms of the dominant economic goal of a firm, which is the creation of shareholder wealth (Bruce et. Al 1985). Unfortunately this perspective is not prevailing in the subject literature on trust. The literature does not look at the consequences of internal trust through the perspective of a firm's market value, which refers to a firm's performance in the stock market.

This study aims to fill this gap and explore the effects of internal trust on a firm's market value. This perspective is promising as it does not take into account only one or few effects of trust (such as the impact on employee satisfaction, retention, market sales, innovation and so on), but rather considers the total benefits and costs of trust connected with investment in the maintenance of a climate of organizational trust. Since market value reflects both current and future cash flows, it is an appropriate overall performance criterion.

Importantly, only few studies depart from the tradition to search for the positive effects of trust. This approach may lead to a substantial underestimation of the negative effects of trust as well as the total return from trust, especially in light of the existing inconclusive results on whether trust has a major effect on performance or not (Dirks 1999). After all, the reason might to a certain extent lie in the fact that the negative effects of trust have been omitted. Scant literature exists that suggests that trust is not always good (Molina-Morales et al 2011; Bierly III and Gallagher 2007; de Man and Roijackers 2009) and examines the so called "dark side of trust" (Gulati, Sytch 2008). As Gulati and Sytch (2008, p. 278) advocate "shedding

light on the dark side of trust by highlighting that benefits trust generates may have associated costs and risks will be of great value to scholars and practitioners". Only when the benefits of trust exceed the costs of imposing the mechanism the performance will be enhanced. However this might not be the only possible reality, as no single lever such as trust is directly connected to any outcome (Sherwood 2002). With this in mind, it is worth to consider the possibility that the final outcomes of trust might be adverse, i.e. that the costs of trust might outweigh its merits as they usually coexist concurrently. Alternatively, in another scenario the costs/detriments and benefits accruing with trust might just balance out. In order to solve this puzzle, the influence of trust should be assessed on some overall final performance criterion such as a firm's market value (stock market capitalization).

As an empirical answer to the question of what the total effects of organizational trust on a firm are remains an open issue, in this study our objective is to test a theoretically driven assumption that internal trust affects the market value. However, we adopt a contingency perspective claiming that trust affects the ultimate outcome of a firm's value only under some conditions. Our theoretical reasoning, drawn on the agency (Ross 1973; Jensen & Meckling 1976; Eisenhardt 1989) and stewardship theories (Donaldson 1990; Donaldson and Davies 199; Davis et al. 1997), provide arguments for the contingent nature of this relationship. We propose to acknowledge that a firm's size moderates the relationship between an organizational trust climate and a firm's market value.

We organize the rest of this paper as follows. First we introduce the theoretical grounds for the relationship between the variables of intra-organizational trust and the market value. Next we focus on the moderators, company size, the influence on the relationship between the internal trust and market value. We do so by referring to the agency and stewardship theories that put the issue of trust in the centre. Then we describe the data and present the findings. We conclude with the discussion and provide the study's limitations.

2. THE CLIMATE OF INTRA-ORGANIZATIONAL TRUST

Just as most research on trust focuses on interpersonal trust, most of the definitions of trust in the subject literature focus on the interpersonal relations between individuals, especially the willingness to be vulnerable (Mayer et al. 1995; Rousseau et al. 1998; McAllister 1995; Schoorman et al.

2007; Castelfranchi and Falcone 2010). It is far less common to investigate the trust incorporated (institutionalized) into values, strategies, procedures, and practices within an organization (Kroeger 2013). In this paper we will refer to these two types of trust as internal trust and organizational trust respectively.

Organizational trust is believed to be shaped by the perceived trustworthiness (Pirson 2008) based on such dimensions as ability, benevolence and integrity (Mayer et al. 1995). Yet organizational trust is not trustworthiness per se. It also entails the willingness to engage in relations and take the involved risk with a positive expectation about the results. This is a distinct construct from trust in supervisors, peers and leaders (Tan and Tan 2000). Since it is believed that organizational trust affects the organizational climate, it is often interpreted as a synonym for an organizational climate (Bruhn 2001; Mishra and Morrissey 1990; Huff and Kelley 2003; Levin, Cross et al. 2003) or for one of its dimensions (Spitzer 2007). Thus we can state that organizational trust is a kind of organizational climate coupled with the willingness to be vulnerable, and organizational trustworthiness.

3. TRUST AND A FIRM'S MARKET VALUATION

Financial (accounting) performance is often demonstrated to be a poor indicator of overall performance (Bruce et al. 1985). That is why we look at organizational trust's consequences through a firm's market value creation perspective and the ultimate metric of shareholder value, which is a firm's value expressed by market capitalization (Srinivasan and Hanssens 2009; Rappaport 1987). The direct linkage between organizational trust climate and a firm's market value has not been previously investigated. The importance of the aforementioned variables suggest the potential value of such an exploration. Yet there is some indirect evidence of such linkage in the literature. Empirical evidence suggests that there is some relationship between internal trust in large publicly-listed companies and market valuation. It is documented that the market perceptions of "a good work environment" impacts on the market price of a firm, based on the Great Place to Work Trust Index announcement (Filbeck and Preece 2003). But this pertains rather to the positive market reaction to new information about companies pricing the net benefits of "good companies" than the actual effect of an internal trust atmosphere within a firm on its overall performance estimated finally by the market value of a firm.

In this paper we are not interested in the stock market response to new information about labour practices within organizations, but rather whether internal trust translates into market value and what the possible explanation for that is. However if in efficient stock markets, share prices at a particular point in time fully reflect all available information on a company up to this point (Nicolau and Santa-Maria 2013), it follows from the studies cited above that it might be expected that internal trust exerts some influence on the market value. So according to the literature we can formulate the following hypothesis:

Hypothesis 1: *Organizational trust is related to a firm's market value.*

However, we believe that internal trust alone is not enough to guarantee a high level of either performance or market value. There are situational aspects that must be considered, too. Hence we argue that the influence of the organizational climate of trust on the market value varies depending on company size. The arguments for this assertion will be presented in the following section.

4. THE EFFECTS OF COMPANY SIZE

Unfortunately, the existing literature does not couple the effects of internal trust on organizational performance with company size, although in organizational and management literature company size is regarded as one of the most relevant contingent variables playing the role of a moderator (Aramburu and Saenz 2011). We expect company size to play a role in the trust's influence on a firm's market value by means of different (and sometimes counterbalancing) processes. There are several rationales for that assumption. In smaller companies, employees usually experience higher task interdependencies, which leads them to interact "face to face" and develop personal knowledge about others. This kind of close interaction is lost in big companies (Stepanova 2013). This changes the nature of trust and its sources. Personal knowledge and interaction are generally better means to building trust than second-hand information. As a firm's size increases it becomes more difficult to interact with people on a daily basis, and, as a result, trust becomes more impersonal and fragile. That is why internal trust within small companies is more based on real experience and less likely to suffer from an asymmetry of information.

In part, the claim that small firms enjoy more benefits from internal trust than big companies do, can be explained by the fact that the latter (because of effects of scale) have better access to distribution channels, higher

legitimization and reputation, so exploitation (March 1991) strongly impacts their valuation. In order to be more competitive, small companies must produce or deliver high quality products and services, and innovations, which require a certain amount of trust. As a result, exploration (March 1991) is often crucial for the survival of a firm. The innovativeness of small firm serves as the main mechanism for their competitiveness and thus market value, which, after all, depends on trust. What is more, the limited resources available to smaller firms result in their lower acceptance of the unproductive usage of them. Consequently, smaller firms require a more integrative type of capital that achieves its potency under a climate of trust and autonomy.

The underlying rationale for the effects of company size can be traced back to the stewardship theory (Davis et al. 1997) that demonstrates the strong association between family businesses and trust (Davis et al. 2010). Usually, because of the smaller size of a firm, the owner can serve the role of a steward in a firm. As a result, in a small family business, steward-owners hire steward-subordinates that make productive use of the climate trust in a firm. With the lack of direct interaction and recruitment due to the increase of company size and the organizational levels, a firm can lose this perfect fit between steward owners and employees due to the increasingly experienced asymmetry of information resulting from the unobservability (or at least the strongly limited observability) of the motivations of managers as well as employees (Christman et al. 2007), which leads more often to the abuse of trust. For example, each manager in a big company can exhibit short-term opportunism and self-interest in recruiting and maintaining a specific applicant far beyond or secondary to the interests of the organization, particularly in cases when the manager's external (i.e. not connected with the company itself) social network is dense (Dineen, Ling et al. 2011).

Due to the separation of the owner and manager roles, big companies are more likely to have "agents", whose actions are aimed at securing their own interests rather than those of the company. That is why we argue that smaller companies are likely to outperform bigger companies, which, under conditions of trust, provide more "free-rider" opportunities. In contrast, if the choice of the owner of a small company is to be a steward, and, consequently, he/she chooses stewards to work for him/her, we encounter a "*stewardship world*" with minimal opportunism and corruption (Segal and Lehrer 2012). This high-trust stewardship model creates some advantages in small companies, providing them with higher strategic flexibility (Eddleston 2008) which is important for market performance. So in the case of small and high-trust organizations, strategic flexibility can be enhanced. Thus,

employees can be more responsive to new opportunities and innovation-seeking ideas. In the case of big companies, this factor is not of paramount importance and owing to the many levels of organizational hierarchy in big companies, does not provide such strong effects on a firm's results as in the case of small companies.

As noted, an important effect of a high organizational trust climate in small companies is that it creates an environment for creativity and innovation. There is strong evidence in the literature that organizational trust fosters creativity and innovation (Sankowska 2013; Tsai and Ghosal 1998), and that small companies can benefit from this effect. As investors value highly any single event in small firms (Sood and Gerald 2009), the impact of trust, transferred to innovations, will result in an increase in market value. What is more, for market valuation, innovation is far more critical for small companies than for big companies. The reason for this is that it signals the ability to grow over time, and innovations help predict growth to a far greater extent than profitability (Cho and Pucik 2005). In contrast, high stock prices of big companies mostly result from their current assets' size such as land, capital, and labour. Some big companies can achieve better results even without being innovative, just by exploring existing products/services and access to the market. That is not to say that innovation does not account for big companies' market value, rather it matters more for small ones. As a firm grows, it is more likely to expand its current market share and enjoy economies of scale which increase their market power and reputation (Bourgeois, 1980). For theoretical clarity, Figure 1 summarizes the effect of internal trust on market value creation based on the factor of company size. However, big company size can act as a two-edged sword. On the one hand, it increases the market valuation of the company, but at the same time it creates opportunities for free-riding (in cases of a high trust climate). If employees choose to take the position of agents, it is likely to lead to higher opportunistic temptations and the exploitation of organizational vulnerabilities. High institutional trust rooted in strategies and processes can leave room for corruption, theft, and free riding (Van Slyke 2007). Segal and Lehrer (2012) use the term "*fox in the henhouse*" to denote such situations. If highly institutionalized stewardship is combined with the employees' choice to be agents, the consequence is likely to be unchecked opportunism and petty corruption motivated by greed. This very situation (opportunity) created within the company is in itself a temptation for employees and managers to take advantage of it (Brower et al. 2000). We therefore contend that the big size of a firm can perhaps explain the higher level of threat of opportunism, thus the costs and risks of creating high trust are significant.

This opportunism threat contributes to the negative effects of trust on the firm's market value. So what matters for market valuation in the case of big companies with high levels of internal trust is the net benefit of trust outcomes, both positive and negative. In the case of small companies, free riding or human opportunism is not such a huge concern. As a steward, an owner, having all the firsthand information about subordinates, can not only choose the right subordinates but also monitor their performance so that it fits the organization best.

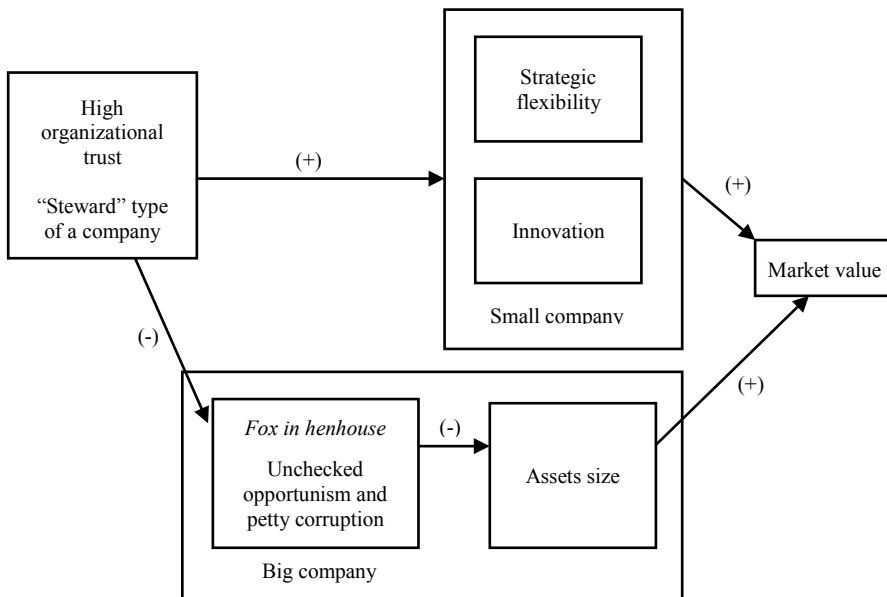


Figure 1. Theoretical framework explaining the effect of internal trust on market value creation based on a company size factor

Source: authors' own

From this picture we can expect that high trust is better suited for small companies as it enhances their overall stock market performance, which is not always the case with big companies. Put differently, a firm's size functions as a mediator that accounts for the relation between the organizational trust climate and market value (Baron and Kenny 1986). Thus we can postulate the extended hypothesis:

Hypothesis 2. The relationship between organizational trust and a firm's market value depends on the company's size.

We will empirically test the above hypotheses in the next section.

5. RESEARCH METHODOLOGY

Data

Our sample consists of 198 Polish companies listed on the Warsaw Stock Exchange. Data was collected through telephone interviewing in the first half of 2010 in the CATI technique based on a previously prepared questionnaire. The formulated hypotheses were tested using the moderation analysis based on the regression approach as a moderator is a continuous variable.

Independent variable: Trust

Although a number of trust scales exists, we are not able to find one that reflects overall trust climate within an organization. Aramburu and Saenz (2011) used the following sentence “There is a climate of trust” measured by means of the seven-point Likert scale. We used the multiple indicators of multi-item organizational trust scale developed by Hacker consisting of 38 items. We also used one global item that describes trust climate as “There is a climate of trust in the organization”, which was compared to the multi-item organizational scale of high reliability ($\alpha=0.982$) that is highly correlated with an organizational trust climate one-item scale (0.891; $p=0.000$), so we reported high convergent validity (Hair et al. 2006) of the used measure. The seven-point Likert scale was applied to assess the degree of organizational trust (1=completely disagree to 7 completely agree). Since items of originating multi-item scale are highly homogeneous as Cronbach's alpha is above the threshold value of 0.9, according to literature guidelines, we used a single item measure for further analysis (Diamantopoulos et al. 2012). The data on trust climate were collected at the beginning of 2010.

Dependent variable: market value

With respect to market value, we used market capitalization, which is a product of the stock price of a company in a given year and the number of common stock shares. Data on stock performance were acquired at the end of 2010, so there is a time lag between organizational trust climate and market value measurement.

Moderating variable

A firm's size was measured as the logarithm of the book value of assets, which is a commonly applied approach in literature (Sorescu and Spanjol

2008). The log transformation was performed as a remedy for skewness to more closely approximate a normal distribution (Chrisman et al. 2007).

Results

Table 1 presents Pearson's correlations for all the pairs of variables. Only a company's size is significantly correlated with a firm's market value ($r=0.404$, $p<0.01$), which is consistent with the expectations that the size of assets impacts on company valuation. Somewhat surprisingly perhaps in the light of literature predictions, there is no evidence of an association between internal organizational trust climate and market value. However, it does not contradict our predictions about the different effects of organizational trust climate on a firm's market value depending on a firm's size. This is because an association between a predictor and an outcome is not required for a predictor's effect to be moderated (Hayes 2013).

Table 1
Correlations and descriptive statistics

Variables	1. Organizational trust climate	2. Market value	3. Firm size	Mean	Standard deviation
1. Organizational trust climate	1			5.17	1.433
2. Market value	-0.060	1		1,152,019,107	4,639,883,321
3. Firm size (log)	-0.041	0.404**	1	8.2606	0.86524

Note: Pearson's correlation is significant at level: * $p<0.05$; ** $p<0.01$

Source: authors' own

Before performing hierarchical regression to assess the effects of a continuous moderating variable (firm size) on a firm's market value single predictor variables were centred (Aiken and West 1991) by subtracting a mean from every variable (Hayes 2013), although in the current literature this is said to be an unnecessary remedy (Hayes 2013). Organizational trust climate was centred in the first step, firm size (moderator) in the second step, and the interaction term in the third step. Table 2 presents the obtained moderated regression results. The first step shows that there is no significant main effect for organizational trust. Thus, the direct relationship between organizational trust and market value is not confirmed. In the second step a firm's size significantly predicts a firm's market value. This is consistent with the financial theory of market value which describes this relation. In the third step, as expected, the interaction term is significant and increases the

Table 2

The results of a hierarchical regression predicting a firm's market value

Variable	Step 1	Step 2	Step 3
Organizational trust	-0.060	-0.043	-0.038
Firm size		0.402**	0.538**
Organizational trust climate × Firm size			-0.344**
R²	0.004	0.165	0.265

Note: standardized regression coefficients “ $p < 0.05$; ** $p < 0.01$ ”

Source: autors' own

variance explained in market value. This supports the formulated hypothesis that organizational trust climate has an effect on market value depending on a firm's size. With the evidence of a significant moderation between organizational trust and a firm's size, we further examined the nature of this interaction by plotting them. In doing so we used the procedure advised by Aiken and West (1991) to plot significant interactions, by using high and low values for company size. Simple slope analysis reported their significance ($p < 0.01$). The simple slope for the high value of moderating variables is negative (-10243088), while for the low value of moderating variables it is positive (77789601).

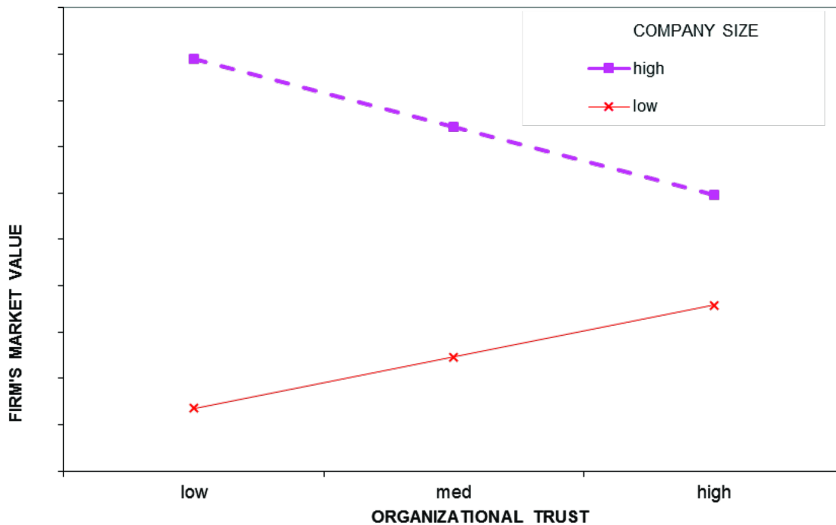


Figure 2. Moderating effects of a firm's size on the relationship between organizational trust and market value

Source: autors' own

When inspecting figure 2 we can notice that the big company line is the steepest. The pattern indicates that the relationship between organizational trust and market value is stronger for big companies, and the relationship is the weakest for small firms.

Consistent with our expectations, we found that the relationship between internal trust and market value depends on a firm's size. Moreover, our findings suggest that the relationship for big companies is negative.

From the findings with respect to big companies, we can posit that the costs of trust outstrip the gains from it when looking at it though the perspective of a firm's market value. This finding is in accordance with the agency paradigm that advises higher control over bigger companies. On the other hand, our findings suggest that this is not the case of small companies, where higher trust increases the amount of firm's market value per se.

6. DISCUSSION AND CONCLUSION

In considering how internal organizational trust affects a firm's market value, the findings of our research go far beyond the simplistic view that sees trust in either one of the two extremes, that is as creative or destructive for value, i.e. beyond the behavioural assumption of opportunism or altruism. The acknowledged theory suggests that, in general, trust leads to better outcomes, with the underlying premise that trust reveals the best in people. However, in the light of the findings, it appears that organizational trust climate should be differently perceived in terms of the overall competitive advantage creation evaluated by the stock market. A company's size is a certain situational mechanism that impacts on the effect of the actual trust on market value performance. The paper reconciles the aforementioned effect with respect to this contingency. It has been demonstrated that the impact of organizational trust on the ultimate outcome of market value is conditioned by a company's size. Small companies – in contrast to big companies – enjoy the greater net benefits of a high-trust atmosphere. Big companies experience diseconomies of scale with regard to increasing organizational trust. This entails that agency problems occur in big companies to the extent that high trust organizational climate is not economically feasible in the sense that it adversely affects company performance, bringing more losses than gains to a firm's value. As a result of higher opportunities of free riding in big high-trust companies, for which they do not have a defense mechanism, more focus is required to control them, which in high-trust climate organizations is by their very nature

foregone. It seems appropriate to suggest, albeit tentatively, that small companies are inclined to be stewards more than big companies, whose agency control measures can discourage trust abuse. Consequently, in small companies the existence of direct social control is possible, because the network of relations is more dense and self-coercive, so it is functional for trust. Moreover, the costs of imposing such a mechanism are lower than the benefits contributing to the sufficient evidence of trust suitability for small companies. Thus, trust might be interpreted as an important source of competitive advantage for small firms. Although empirical results at first might seem counterintuitive, they have explanations in the underlying theories of stewardship and agency. The results provide additional support for the fit of the stewardship theory for small companies and suggest that institutionalized stewardship is too idealistic for big companies, or at least it is unwise to make it a central organizing principle. Consistent with this conclusion is the belief that agency problems sprang up because of opportunism (Williamson 1975) that arose in big organizations. But at the same time, under some conditions provided by small firms, the imposition of trust might yield more benefits than losses. Importantly, our results challenge the cooperative view assertion that a firm would be better off over the longer-term operating without the assumption of opportunism (Madhok 1995) as it was proved that in bigger firms increasing organizational trust can result in a lower firm value. In fact, our findings question partly the opportunistic view (Williamson 1975) of organizations, pointing out that in the case of small firms, high trust can be actually beneficial for the ultimate outcome of firm value. The paper reconciles these theoretical inconsistencies, providing an argument to examine trust through the perspective of a firm's size. This is a valuable theoretical input of the paper in the face of the contradicting theories.

In the light of the above-mentioned findings, the manager of a company should be advised about the possible impact of internal trust on market value. In the case of big companies, too much trust means taking too much risk detrimental to market value. The results of the study have important implications for strategy formulation, suggesting that the benefits of trust should be considered through the viewpoint of company size and company practices regarding the recruitment of employees. Just like high-trust big organizations can easily fall prey to non-stewards, high-trust big firms require corruption control and that is essential for their market value. In general terms, we can posit that organizational trust does not seem to have a universally positive impact on firm's value. Importantly, this opens avenues

for future research that will cope with contingency factors of trust impact on different organizational factors and thus reveal the nature of variation in trust outcomes. So far, particularly organizational trust climate level has been left substantially unattended.

7. LIMITATIONS AND FUTURE RESEARCH

The presented empirical analysis is subject to several limitations to be pointed out. When trying to interpret the results of the study, we should not generalize the findings to the dyadic relationship such as subordinate–manager or peer to peer. Those relationships could be productive both in small and big companies under high trust conditions. What we have looked at was the general trust climate inside an organization that expects the overall net benefits of trust being a result of many dyadic relationships, but also of impersonal ones.

Caution should be exercised about the generalization of the study results to other cultures as the proposition of the study was tested on a Polish sample. It might be the case that some prevailing cultural assumptions can have impact on how people behave and whether they are more prone to steward or agent behaviour, so it will be advisable to replicate this study in samples of other countries. In this regard Davis et al. (1997) suggested that there is a substantial relationship between cultural dimensions and a steward and agent type of conduct. For example, Scandinavian countries, which have a higher level of feminist orientation and long-term orientation (Hofstede et al. 2010), are examples of the higher propensity to stewardship behaviour among employees and managers that may offset the negative consequences of trust for bigger companies. At this point it is hard to estimate the country effect in the proposed model of the overall effect of trust on market value. In this respect, new research endeavours will be welcome.

Furthermore, the validity of the subjective respondents' judgment of internal trust by company managers could be questioned, so the accuracy of the data depends on the quality of their assessments of a trust climate.

Last but not least, this study is observational by nature. An experimental design, however, would be very hard to conduct with the variables we investigated. This naturally imposes certain restraints in the design of the study.

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