

## **Why do the urgency of stakeholders matter more in the firm performance?**

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### **Abstract**

This study is an attempt to scrutinize the importance of different stakeholders with respect to financial performance (FP hereafter) in emerging countries context. Unlike developed countries, every element of the corporate social responsibility (CSR hereafter) is not supposed to generate similar corporate payback in the context of developing countries. Enterprises take considerable care to categorize these stakeholders in proper sequence for better corporate results. It was found empirically that CSR disclosure (CSR D hereafter) relevant to employees and communities have direct relationship with the firm's performance in term of earning per share (EPS). The results of this study will portray a comprehensive picture for corporate decision makers to realize the priorities and urgency of different beneficiaries for corporate benefits, existence and prosperity in the context of developing countries like Pakistan.

### **1. Introduction**

The term "CSR" consists of three unrelated words i.e. "corporate" "social" and "responsibility" however, this concept is beyond societal needs and corporate goals. This concept lies at "mandatory" and "optional" extremes or somewhere in the middle of both in different parts of the world. The action of CSR initiates from the corporate financial gain and merges in the broader spheres of a society through the complex legal system and religious institutions to local norms and international regulations. CSR is one of the interesting topics due to its dual nature, i.e. beneficial for the business community and the general public simultaneously.

Western countries have rich knowledge and strong awareness about CSR as compared to developing countries. The 3Ps model was proposed by Elkington (1997) which is also called triple bottom line (TBL) consists of three dimensions. These three dimensions (3Ps) are People (social responsibility), Planet (environmental Responsibility) and Profit (economic responsibility). It is true that some enterprises are engaged in only one or few CSR dimensions, while on the other hand, there are many enterprises working on various aspects of CSR as their core daily business strategy. The broad concept of CSR is a process to safeguard human rights,

and address other stakeholder's issues. Such activities are included but not restricted to only working for the welfare of society, eliminating corruption, obeying public policies, encouraging corporate competition, complying with the law and so on.

In developing countries, the local community has more expectations from the business community to provide what is lacking (Cash, 2012; George et al, 2016). Sheikh and Beise-Zee (2011) emphasized that the corporate resources ought to be aligned to the domestic needs and then communicated accordingly. Due to this communication, Corporations can gain respect and reputation in the marketplace that adds value to the company (Sheikh and Beise-Zee, 2011). Initially, it was considered that CSR is a one-way benefit tool (i.e. taking resources from business to outer community) because there was no visible benefit of CSR in the short term. This argument proved inappropriate in research by scrutinizing the combination of financial and non-financial benefits in "cost & benefits" effects which were incurred and received by corporation respectively. Numbers of researchers (e.g. Kurucz et al, 2008; Mullerat, 2010; Perry and Towers, 2013; Porter and Kramer, 2006) have already been confirmed the firm performance in their respective CSR studies. Even though, the contribution of corporation in CSR activities is fruitful for business and stakeholders, however, the practical execution and procedures are not necessarily easy to implement. In this regard, it is very important for corporations to restructure their corporate approach and identify the corporate actions which are sensitive towards the domestic needs, social norms & values, religious ideologies, corporate framework and so on. Merely involvement in CSR activities is not enough if it is not aligned with the needs of the stakeholders and properly communicated to the stakeholders. The corporations should have enough knowledge to classify various stakeholders and prioritize their needs which can ultimately lead to FP.

The aim of this study is to reunite the diverse CSR dynamics relevant to stakeholders in the context of developing country i.e. Pakistan. This study highlights that CSR is not a universal phenomenon. This concept varies geographically according to the needs and requirements of the surroundings and thus beyond the 'time & space'. Therefore, corporations should behave to dress up according to the local needs and traditions. In the light of the above arguments, this study is conducted to investigate the CSR practices of listed companies operating in Pakistan. The exact meaning of the study is to discourse the questions:

1. Whether all the stakeholders equally affect the firm performance (FP)?
2. What is the classification of different stakeholders relevant to firm performance (FP)?

## **2. Theoretical framework and hypotheses development**

### **2.1. CSR Theories**

CSR is a widespread terminology and has the flavor of every field, ranging from management to politics. Following are the few CSR's theories relevant to this study:

According to Shareholder's theory, the only purpose of the corporation is to generate profit, and enhance the corporate value for the owners. Friedman (1970) was one of the most defenders of shareholder theory, by stating that, "The only liability of the corporation is to enhance economic value for the owner within the legal circle". According to this theory, the main concern of the business is to be answerable to their shareholders. Besides, a corporation should be engaged

in good quality products and services, creating employment opportunities, and circulating the money in society.

Different from the shareholder theory, the stakeholder theory defends the welfares of all stakeholders including shareholders. The managers have to consider the stakes of every stakeholder while performing corporate action. Freeman (1984) introduced the stakeholder theory on the basis of stakeholder definition of Stanford Research Institute (SRI). This theory safeguards the rights of all the stakeholders' groups and claims that these groups are as important as profit generation for a business extension.

Legitimacy theory states that there is an invisible contract between the corporation and society. The corporations behave in such a manner to maintain a good image among the stakeholders, while encouraging stakeholders to raise their voice against every action of the corporation. According to Suchman (1995), it is a universal insight that a specific action performed by a person is acceptable and suitable according to social norms, values and beliefs within a given society. This assumption postulates that the enterprise should have the capacity to act in the "middle way" between the business profit and societal needs to get a license from the surrounding with a commitment of "no harm policy". The dynamics of legitimacy theory varies from society to society due to the difference in social norms and values in different cultures.

## **2.2 Stakeholders classification:**

One distinctive feature of CSR concept is that it is clustered by a number of beneficiaries (stakeholders), ranging from regulators, peer groups, shareholders and non-profitable organizations, society, customers and workforce (Dawkins 2004). The stakes and interest of these groups varies with time and group. All stakeholders, especially the internal stakeholders regulate the circumstances in which the enterprise is operated by generating opportunities and threats. Satisfying the requirements of primary stakeholders permits superior sustainability of corporate activities, higher competitiveness and enhancement in employees and consumers trust (Pirsch et al, 2007). In addition, it is also important to underscore the specific features of all stakeholders and thus adopt a proper tool to portray the communication between them. Therefore, CSR strategy should be modified to satisfy the needs of number of stakeholders, and build a strong bond with them.

From the above discussion, it is hypothesized that:

H1a: All stakeholder groups are equally important for FP.

H1b: Internal stakeholders are more important than external stakeholders for FP.

This study has taken the following stakeholders for further investigations.

**Investors:** Investors and shareholders are the most important internal stakeholder of the organization and have been prioritized by stakeholder theory and the Carroll's CSR pyramid. Corporations involved in CSR activities are actually indicating to the shareholders that they are sensitive about the shareholders' interests. Any business with the qualities of market leaders and innovators can be in a strong position to attract financiers while setup new corporate activities and penetrates in new market. The more ethical corporations are the latent financiers and investors, exposed to lower risk and thus maximizing the income by minimizing the cost of lending. In

addition, the trend is increasing for the investors to put their money in a business which is ethically and morally strong. As a result, the corporation can attract more investors to underwrite the organizational goals and thus the corporate FP. Another reason is that the more socially responsible companies are exposed to fewer investors criticism and thus lowering the stock price. McGuire et al, (1988) stated that the apparent drop in CSR can lead investors to raise obvious return, while an increase in apparent CSR can develop a corporate reputation, and thus permit it to swap costly explicit claims for less costly implicit charges.

From the above discussion, it is assumed:

H2a: CSRD (Investors-related) has a positive relationship with FP.

**Employees:** Human resource is also the internal stakeholder of the firm and plays a vital role in the corporate operation and FP. While hiring the workforce from the talent pool, the trustworthiness and credibility are very important for many applicants and potential workforce. CSR reporting is one of the best tools to portray the corporate image to the potential and existing workforce. L. Saari and T. Judge (2004) claimed that such type of disclosure of information is very useful to minimize the employee turnover, absenteeism and boost the motivation. CSR disclosure has much influence on the satisfaction, enthusiasm and trust of employees, allows the corporate manager to abstract the potential talents among workforce, which ultimately underwrites the corporate objectives (Torugsa et al, 2012). Stuebs and Sun (2010), confirmed that CSR activities are improving the corporate reputation, which leads to maximum productivity by hunting and retaining the most talented workforce in the human resource market. Due to favorable working condition and a healthy environment, the number of sick days' decreases, and the ratio of faulty work minimize because of proper training and capacity building. Similarly, the efficient workforce can finish their work without spending extra time (overtime) and affecting the productivity.

From the above discussion, it is assumed:

H2b: CSRD (Employees-related) has positive relationship with FP.

**Customers:** Customers are the external but primary stakeholders, and the backbone of any enterprise to sustain its corporate activities to achieve present and future organizational goals. Customer related CSR dimension assures the customers that business is placing their expectation on priority. Satisfied customer will make more transactions with the corporation and convince other potential customers by words of mouth. Customer satisfaction is a collective and universal assessment of the corporate practices, an important monitoring tool of corporate efficiency, one of the very necessary objectives of a corporation, and is an essential dimension of the business strategy (Fornell et al, 2006). Limited or complete devotion to the corporate values, and a high level of trust positively influence the customer's will to be charged with premier price, which in return generate higher financial output, and thus enhance firm performance (Pirsch et al, 2007). According to Carroll (1979), producing the quality goods and services to satisfy the expectation of the consumers is one of the postulates of the CSR concept to fulfil the economic dimension for the corporation, legal and ethical dimensions for the consumers. Mullerat (2010) stated that corporation which is incorporating CSR into their business activities is adopting numerous improvements and innovations in producing the quality goods and services for the customers. The reason is that such type of corporations is very conscious to abolish every type of faults in overall

supply chain ranging from buying raw materials, manufacturing, carriage and marketing of a product to the end users.

From the above discussion, it is assumed:

H2c: CSRD (Customer-related) has positive relationship with FP.

**Community:** Community is the external stakeholder and consists of a large number of members that can influence the corporate behavior up to much extent. CSR is a process of mutual benefits and coordination which enables the corporation to think beyond merely generating profit, providing the goods and services and creating job opportunities for the member of the society. The regular external pressure is forcing the enterprises to assign maximum resources for the development of the society and the general public. These CSR activities are included but not limited to donations, providing health assistance, promoting education and participating or sponsoring sports events. If the corporation is not willing to contribute towards the welfare of the community, then this group with the help of other groups, especially the media, is exerting pressure on the corporation. Wood and Jones (1995) found a direct association between community investments and corporate FP. Patten (2008) examined that the market response after contributing to the community at the time of natural disaster (Tsunami 2004) has positively increased the firm value. Social investments are usually more beneficial with the logic that it will increase the corporate competition and firm reputation (Porter and Kramer, 2006).

From the above discussion, it is assumed:

H2d: CSRD (Community-related) has positive relationship with FP.

**Environment:** The environment is the external and silent stakeholder of the enterprise, which is present globally without the physical boundaries. Implementing environmental standards such as minimizing trash and adopting waste management strategy are beneficial for corporate economic output. The corporate operation is influencing the surroundings in various ways, for example avoiding the use of renewable resources, environmentally hazardous, the humiliation of biodiversity, deforestation and climate change etc. Almost every enterprise is taking initiatives to safeguard the planet for the next generation. In this way, the business community is more concerned to protect the environment due to high pressure from international organizations and consumers. Similarly, enterprises are also incorporating the corporate activities to be environmentally friendly and sustainable. Although, the literature regarding environmental proactivity is not definite (Christman, 2000), however, most of the scholars have associated the corporate environmental assurance with corporate FP (Russo and Fouts, 1997; Klassen and McLaughlin, 1996; Schmidheiny, 1992).

From the above discussion, it is assumed:

H2e: CSRD (Environment-related) has positive relationship with FP.

### 3. Methodology:

Population sample of top 25-companies were taken for 5 years (2011-2015). To investigate the hypotheses and research questions for this study, annual reports were downloaded from the corporate websites to measure different financial and non-financial variables. The data were collected and codified to find out the relationship between the dependent and independent

variables of the hypotheses. Almost every element and dimension of CSR related activities are included as suggested in the earlier studies of prominent researchers to calculate the level of CSR. Content analysis (CA hereafter) was used to calculate the level of CSR by highlighting the dimensions related to financial, charity, donations, legal, ethics, shareholder, human resources, consumers, society, health, literacy, physical activities, environment and government. As per previous studies related to the field of CSR, CA is one of the popular and precise technique to collect, scrutinize, investigate and evaluate various dimensions from the information provided by the firm (Neuman, 2003). Number of researchers (e.g. Adams and Harte, 1999; Gray et al, 1995; Milne and Adler, 1999; Beck et al, 2010) has used CA in their concern studies related to societal and ecological reporting. According to Gray et al (1995), CA is a method or technique employed to measure objectively, systematically and quantitatively the content of the communication. All of the variables were confirmed and tally with the available data line by line to validate the accuracy and excellence of the given data. The given reports were scanned and quantify for the predefined CSR dimensions. Sentence was chosen as a unit to quantify the data. Each sentence got numeric value of '1' if the whole sentence was related to that specific CSR dimension. According to Milne and Adler (1999), taking sentence as a unit for measurement is much accurate as compare to other unit. They further assert that "Most of the social and environmental content analyses, in fact, use sentences as the basis for coding decisions". In this study, in case a sentence has mentioned more than one CSR elements, then the numeric value for single sentence (i.e.1) was divided by the total numbers of CSR elements expressed in that particular sentence. For instance, any CSR element will score "1" in case the concern dimension is disclosed in the given data (reports), otherwise "0". Other researchers (e.g., Eng and Mak, 2003; Haniffa and Cooke, 2002) have also applied similar techniques in their studies.

Through regression analysis, the influence and importance of the independent variables are identified in a relationship with the dependent variable. As per regression model, the following equation denotes the impression of the level of CSR related to various stakeholders and firm performance in term of EPS.

$$EPS_{i,t} = \beta_0 + \beta_1 Inv_{i,t} + \beta_2 Emp_{i,t} + \beta_3 Cust_{i,t} + \beta_4 Comm_{i,t} + \beta_5 Env_{i,t} + \mu$$

Proposed diagnostic tests were carried out for the regression analysis to investigate the relationship between the variables in the dataset and obtain more authentic and assertive results. As suggested by Gujarati (2012), four fundamental assumptions are satisfied before applying regression model. These assumptions are collinearity, heteroscedasticity, normality and linearity tests. In addition, The Hausman test was conducted to set apart the divergence in the given data to identify the tendency of the fixed effects and random effects models.

#### 4. Analysis and discussion:

Different diagnostic tests were conducted to fulfill the assumptions made for regression analysis. Correlation matrix and vector inflation factors were conducted and the issue of multicollinearity was not found among the variables. The tendency in pooled OLS model through of Hausman test was inclined towards fixed effects model.

**Table 1: Diagnostic tests**

<b>Correlation Matrix</b>						
	EPS	Investor	Employee	Customer	Community	Environment
EPS	1					
Investor	-0.04	1				
Employee	0.24***	0.57***	1			
Customer	0.28***	0.25***	0.64***	1		
Community	0.35***	0.14**	0.32***	0.37***	1	
Environment	0.12*	0.37***	0.74***	0.47***	0.54***	1
<b>Vector Inflation Factor (VIF)</b>						
Variables	Investor	Employee	Customer	Community	Environment	
VIF Values	1.538	4.191	1.916	1.545	2.968	
<b>Hausman test</b>						
F (1, 233)	30.8691	A low p-value counts against the null hypothesis that the pooled				
P-value	0.0000	OLS model is adequate, in favors of the fixed effects alternative.				

The product of the regression analysis is shown in table 2. It is easy to observe the coefficient values of all independent variables and t-ratios figured out by the robust standard errors to heteroscedasticity. The employees and community-related CSRD are the significant features that affect positively the FP in term of EPS. This positive relationship is portraying the importance of internal workforce and external community of an enterprise. The relationship among the investors and environment related CSRD were found significant but negative with the EPS. This association affirms that the level of CSRD regarding investor and environment are inversely affecting the financial performance (EPS). The customer is the only insignificant dimension that has a positive relationship with the financial performance (EPS).

**Table 2: Classification of stakeholders relevant to firm performance**

Variables	Pooled OLS			Fixed-effects			
	Coefficient	t-ratio	P-Value	Coefficient	t-ratio	P-value	
Const	16.085	1.731	*	18.91	6.13	***	
Investor	-0.796	-4.034	***	-0.92	-8.59	***	
Employee	0.977	7.232	***	0.91	6.83	***	
Customer	0.039	0.203		0.19	0.9		
Community	0.696	8.74	***	0.58	14.27	***	
Environment	-0.658	-5.064	***	-0.66	-4.19	***	
R-squared	0.263	Adj R-squared	0.247	R-squared	0.349	Adj R-squared	0.332
F (5, 234)	16.698	P-value(F)	0.000	F (6, 233)	20.836	P-value(F)	0.000

Various theories are debating differently for providing the opinion to prioritize the importance of different stakeholder groups. Nevertheless, legitimacy theory and stakeholder theory seem to be more suitable to interpret the positions of these stakeholders. Vishwanathan et al (2012) examined that CSR can only bring corporate advantage when these activities enhance corporate image, designate critical stakeholders, divert corporate risk, and initiate innovation. Accordingly, enterprises not only regularly reconcile their relationship with stakeholders, but they have eagerly released concern information regarding CSR to stakeholders, depends on the extent to which a corporation is facing social and environmental problems (Prado-Lorenzo and García-Sánchez, 2010). Investors, employees, customers, environment, and community are the variables under the investigation of the current study. The division of these various types of stakeholders is not an easy task. The reason is that each stakeholder might belong to more than one group at the same time. For instance, an employee who is working within the corporation might be a consumer and perhaps belongs to the community, and be affected by the natural environment too. Jones (1995) stated that enterprise should contribute more for social development, which is beneficial for a wide range of stakeholders (such as employees, consumers, suppliers, the community, environment, and the government) and corporation.

Investors have the power to exert pressure on the management to formulate or implement a corporate strategy to resolve various corporate issues, including CSR. Therefore, there are chances that the management of the firm is reluctant to disclose the corporate intentions to the investors if they are only concentrating on the negative side. The relationship between the CSR relevant to shareholders and corporate benefits has explored in many research studies. However, shareholders are more interested in the relationship between the CSR investments and FP (Chen et al, 2013). According to the findings of this study, the negative relationship in the context of Pakistan is due to the weak legal system, and the lack of interest of the investors, where the basic needs are hardly meet like other developing countries. Mehar (2005) found that the Pakistani investors are mainly inclined towards the financial gain. It was also found in the context of Pakistan that the individual shareholders are mainly prioritizing the dividend and earning on their investments (Ehsan et al, 2013).

Providing favorable working conditions and taking good care of the workforce leads to a high level of workforce satisfaction, which consequently increases the firm productivity (Aguilera et al, 2007), and attracts the potential workforce to be a part of the perceived organization (Barber, 1998; Breugh, 1992). Contrary, the enterprise involved in irresponsible corporate activities are abolishing the corporate reputations and legitimacy, thus cope with the worst situation while hiring the best talent and retain the current workforce, which ultimately affects the FP (deMaCarty, 2009). According to the human capital theory when an expert employee leaves the workforce, it will give rise to knowledge deficiency within the given setup of the organization. Therefore, the organization with high turnover will face more operational cost, and spend a huge amount of the budget on training and capacity building on the newly hired employees. In this regard, CSR also enhances FP by increasing worker motivation (Stodder, 1998), and encouraging employees attitude (Brammer et al, 2007). The importance and prioritization of CSR regarding workforce are also found in the research studies of other scholars in the context of other emerging/developing countries, for example, Momin & Parker (2013) in Bangladesh, Gao et al (2005) in Hong Kong, Ratanajongkol et al (2006) in Thailand, and Haniffa & Cooke (2005) in Malaysia.

One of the important and most visible contributions of the corporation regarding CSR is the spending on the community-related CSR activities; for instance, job creation, health, education, culture, and infrastructure. Donation and charity are considered to be the most popular form of community sponsorship in developing countries. Vlachos et al (2009) investigated that the involvement in CSR activities related to society and community enhance firm reputation and credibility, which ultimately increase the FP. The reason is that involvement in community-related activities is not only beneficial for the specific people of the society but also noticed by other groups of stakeholders. Wood and Jones (1995) examined that there is a direct link between community investments and financial profitability. Similarly, Waddock and Graves (1997) recommend that strong relationship with the community are beneficial for corporate goals, for example, competitive advantage through taxation, relaxation in regulatory burden, and upgrading the quality and productivity of the workforce. Inoue and Lee (2011) observed the relationship between different CSR dimensions, and found that only community-related CSR activities have a significant and positive relationship with the FP.

In the current era, the concept of climate change got much attention from stakeholder groups all over the world. As a result, enterprises are putting more efforts and utilizing more energy to educate their employees, and sensitize the buyers regarding environmental protection, and waste reduction and recycling. These types of CSR activities are not only important for natural environment but also for the corporate performance in term of reduction in operational cost, and maximize the utilization of corporate resources. Most of the enterprises are involved in the production of reasonable, environmentally friendly products, decentralizing corporate operations, and disclose it to stakeholder to behave like a good citizen (Kotler, 2011). There is a strong association between the environment related CSR activities and the FP. It cuts the budget utilized in the legal process and paying the penalties while a violation of the environmental law. Al-Tuwaijri et al (2004) observed that environmental performance is substantially associated with the corporate FP. The inverse relationship between the environment dimensions and firm performance in the context of Pakistan can be explained well by the legitimacy theory. Usually, the people in developing countries are not much concerned about the natural environment, as their priorities are more concerned about the fulfilment of other basic necessities for living. In addition, they don't have available information regarding the corporate negativity and natural hazards due to corporate activities. Other reason might be that the corporations hesitate to provoke the silent behavior (environmental protection) in the mind of stakeholders of the under-developed and developing countries. In other words, the corporations are reluctant to disclose the information, where they fear that it may activate the passive forces against them (O'Dwyer, 2002). Achim & Borlea (2014) conducted a study in Romania, and found negative relationship between the environmental related CSR dimension and firm performance. Teng et al (2014), observed a U-shaped relationship between the firm performing the CSR dimension relevant to environment and FP within the context of Taiwan. Other reasons can be understood by considering the institutional theory. The institutions and legislation in developing countries are not that much effective to pressurize the enterprises to be involved in an activity which is not considered as core business activities. If we see this issue with the eye of the Triple Bottom Line (TBL), then it is very easy to understand that the environmental line of Elkington (1997) is violated by the top-25 companies in the context of Pakistan.

## **5. Conclusion:**

Usually, it is claimed that the CSR activities are conducted due to the willingness and contributions of the business communities. However, there are also external forces, which are constantly exerting pressures on the enterprises to behave ethically, and be conscious of the stakes of other beneficiaries affected by the business operation. In Pakistan, the scope of CSR is limited to charity and revolves around the philanthropic activities. This might be due to the reason that humanitarian activities in term of philanthropy are one of the pillars of Islamic teaching. In this way, corporations working within Pakistan are using such type of CSR activities for corporate image, promotion and public bonds. In addition, Pakistan is a developing country, where the government lacks resources to provide these basic human rights. Therefore, such types of responsibilities are executed by the business communities. Social activities, like charity, environmental sensitivity, literacy, health assistance, arranging and sponsoring the sports activities, poverty alleviation, and overall communal welfare projects are considered to be the part of philanthropic activities. Employees and community-related CSR are the only stakeholders that have a positive and statistically significant effect with the EPS. On the contrary, investors and environment-related CSR were found to be statistically significant but negatively associated with the FP in term of EPS. In modern days of globalization, the concept of CSR is not restricted only to the corporate social cause but also considered as an integral part of the corporate strategies and operational procedures. The corporate decision makers should classify different stakeholders according to their importance, and align the corporate activities to satisfy their demands. Further, the CSR dimensions should be prioritized according to local needs and urgency for maximum corporate output. Enterprises should be confident to participate in various CSR activities and contribute handsome amount of corporate budget for the wellbeing of overall stakeholders. The reason, such spending can generate directly or indirectly corporate revenue in return.

Despite the significant contributions, there might be the constraint of generalizability of the results, as the data was collected from the “Top 25 companies of the year” listed in Pakistan stock exchange. Although, much care was taken to codify the data, especially in CA, however, there are chances of minor clerical mistakes due to human error. The future research studies should put more efforts to investigate the CSR activities of the domestic firms by comparing with the international firm, listed in Pakistan. Similarly, the impact of the CSR on non-financial corporate benefits is also a grey area for further exploration in the subject field. Particular to Pakistan, more research is needed to be done by comparing the individual and overall dimensions of the CSR activities of the non-listed firm in pre and post-2013 era to examine the understanding level of these companies about “CSR guidelines 2013” its importance.

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