Related Party Transactions and Performance of Banks in Ghana

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Abstract: This study examines the impact of related party transactions on performance of banks in Ghana. Specifically, the study examines the effect of total related party transactions on firm performance as measured by Return on Assets (ROA). The study uses a sample of banking institutions listed on Ghana Stock Exchange (GSE) over the period 2013 and 2017. Out of the 9 listed banks, 7, representing 77.78% were used for this study and data was gathered from their annual reports. The data pulled out was processed and analysed by carrying out Fixed Effects regression based on the outcome of Hausman test using Statistical software package, STATA version 15. The study revealed that related party transactions has a significantly negative effect on firms’ performance. The research hypothesis is duly accepted and the study therefore provides evidence that the amount of related party transactions that a firm engages in can negatively affect its profitability. It is therefore prudent for practitioners to be careful of the kind of and the extent of related party transactions that they engage in. Regulators must also streamline dealings in relation to related party transactions and ensure that firms are closely monitored to reduce or guide related party transactions.

Board size, leverage and firm size were also employed as control variables in this study and it was revealed that board size is positively related to performance but has no influence on the performance of firms. However, firm’s leverage, measured by total debt over total assets has a negative and statistically significant effect on performance. Leverage negatively affects firm performance possibly due to high interest rates common in developing economies such as Ghana.

Lastly, the size of the banks measured by the natural log of total assets is negative and statistically related to ROA. The findings of this study supports the school of thought that, the larger the firm, the more the inefficiencies leading to diseconomies of scale. Listed banks in Ghana may not be taking advantage of their size to be more efficient and profitable and they have to look into their operational and related efficiency matters to become more profitable.

Keywords: Related Party Transaction, Performance, Return on Assets, Banks, Ghana

INTRODUCTION

Banks play a very significant role in the economic development of economies across the globe and they are highly monitored and regulated for a number of reasons including the level of fraud, collapse and instability that the sector has witnessed in almost all economies both developed and developing countries over decades. The corporate scandals, in recent past decades have raised much concern among regulators, investors, academicians and other stakeholders about corporate governance across the global market. One issue that has not been left out of everyday discussion is related party transactions and the magnitude of it.

Globally, RPTs have been subjected to a number of regulation in that, it is regarded as two-sided sword that plays dual roles on a firms’ operations. It can be for both value-generation and value-destruction purposes. Available literature has documented mixed results on the effects of RPTs on firms’ operations in particular and the quality of its reported earnings in general. A number of studies have revealed the positive aspects of RPTs within the value generation process of a firm (Jian and Wong, 2010; Loon and Ramos, 2009). Reduced transaction cost, speedy decision-making, efficient resource generation and allocation through internal market within the group, and sustenance of important but less profitable business units are some of the benefits associated with RPTs (Loon and Ramos, 2009). While it is argued that RP transactions are normal business activities that fulfill corporate economic needs, other studies suggest that many RP transactions appear to be used opportunistically to transfer assets or liabilities between related parties.

Moreover, the issue of firm performance is of much interest to all stakeholders especially shareholders who coincidentally, sometimes associated with related party transactions. The performance of companies in every economy is ideal for sustainable economic growth. The reason is that, profitable firms create value, jobs, generate revenue for government through corporate tax among others. Therefore, anything such as related party transactions that may seem to work against firm’s performance is worth to look at.

In the case of Ghana, the recent re-capitalisation and cleansing of the banking sector by the Bank of Ghana and subsequent collapse of some key commercial banks brought into light the extent of related party transactions and raised the question of whether the performance of banks is in any way influenced by related party transactions. Despite this, little or no research work on this issue has been done in Ghana. Previous studies have been biased towards Europe, America, Asia etc. as against Africa in general and Ghana in particular.

This therefore highlights a major gap in the literature considering the differences that exist in culture, efficiency of legal system and economy between developed and developing countries such as Ghana. Secondly, there is
conflicting results from the outcome of previous empirical studies as to the effect of related party transaction on firm performance. This study therefore examines whether there is a relationship between related party transactions and performance of banks in Ghana. Specifically, the study examines the effect of total related party transactions on firm performance as measured by Return on Assets (ROA).

LITERATURE REVIEW

This section of the study reviews literature that are closely related to the topic understudy. Theoretical and empirical reviews on performance of banks and related party transaction and hypothesis development are captured in this section.

Bank Performance (Profitability):
Generally, a number of financial ratios are used to assess the performance of financial intermediaries. In measuring performance, many researchers have argued for the return on assets (ROA) while others go for return on equity (ROE). According to Hassan & Bashir (2003), ROA shows the profit earned per dollar of assets and most importantly, it reflects the management's ability to utilise a bank's financial and real investment resources to generate profits.

For any bank, ROA depends on the bank's policy decisions as well as on uncontrollable factors relating to the economy and government regulations. Rivard and Thomas (1997) suggest that bank profitability is best measured by ROA in that ROA is not distorted by high equity multipliers and ROA represents a better measure of the ability of a firm to generate returns on its portfolio of assets. However, this approach does not consider the risks related to the referred assets, for instance, the underlying risks of the transactions, and also with the growth of off-balance sheet activities. Thus the riskiness of underlying assets becomes more and more important. Thereby, banks turn to focus on the ROE to measure the net profit to the book equity in order to find out the most profitable business and to do the investment. In this study, return on assets is used to represent firm’s performance.

Related Party Transactions (RPT):
Related party transactions are defined as transactions between a company and its subsidiaries, affiliates, principal owners, officers or their families, directors or their families or entities owned or controlled by its officers or their families (Statement of Financial Accounting Standards No 57, FASB 1982). In other words, RPT is a transaction which takes place between two parties connected through a special relationship before the transaction being occurred. The transaction may take any form of deal- a business, financial contracts, an arrangement, remuneration, etc. Again, RPTs may take place as one-off phenomenon, recurring or a series of transactions. A related party may enter into transactions with the related firm by using different economic terms compared to an independent party. That is, a related party may use related party transactions to transfer resources in or out of the company due to its influence on the company's decisions.

The related-party transactions (RPTs) are one of the manifestations of principal-agency conflict. There are two opposing opinions as to the effect of related party transactions on firm performance, namely, the conflict of interest view and efficient transaction view. That is, RPT could either be detrimental to shareholders or it could be beneficial by representing a strategic economic decision by the company and therefore increases shareholders value (Gordon et al 2004). The former perspective sees RPT as a conflict of interest between the principal and agent as seen in the agency theory leading to exploitation of company’s resources. This is known as tunnelling and it is seen as hazardous to the interest of shareholders. The second view, however, acknowledges it as managers’ genuine attempts and sees these transactions as relevant business dealings fulfilling the economic needs of the company. This is known as ‘propping or efficient transaction hypothesis.

According to Ge et al. (2010), related party transaction can optimize internal resource allocation, improve return on assets and reduce transaction costs for firms. Shan (2009) argued that appropriate related party disclosure aids in protecting minority shareholders’ rights. Buysschaert, (2004) discovered that intergroup equity transactions create value for non-controlling shareholders. RPT provide a platform for transfer of resources between different stakeholders resulting in gains shareholders in some cases (Agnes et al. 2010). There are a number of other previous studies that argue that related party transactions among group members can help reduce transaction costs and enhance the enforcement or property rights and contracts (Fisman & khanna, 1998; Fan & Goyal, 2002) and these support the efficient transaction hypothesis. On the other hand, other researchers like Jian and Wong (2004), posit that profits and cash can be diverted away from firms in a group either directly into controlling shareholders’ pockets or to assist troubled group firm(s) through related party dealings.

Related Party Transactions and Firm Performance:
A number of researchers have observed that when prominent shareholders use related party transactions to siphon off company’s resources, corporate value is negatively impacted (Claessens et al., 2002). Chen et al (2009) also showed that when a listed company is controlled by a related party, the level of RPTs was inversely proportional with operational performance of the company. The results indicated that the RPTs involving sales, guarantees and mortgages, loans, leases etc. have been found to negatively contributing the performance of firms. Chen, Cheng, and Xiao (2010) examined the impact of RPT-based earnings management on the operational performance of listed companies prior to stock market listing with operational performance after listing and found that RPT did affect the performance.

According to Saha (2006), most studies on Indian data showed that the extent of RPTs with group companies was negatively associated with the performance, but for stand-alone companies it showed positive association. However, in the same market, others had a contrary view and they reported no clear association between RPTs or tunnelling to firm’s value (Cheung, Rau, and Stouraitis, 2006). Cynthia, and Sidharta (2014) conducted a study based on listed companies of the Indonesian Stock exchange, and they concluded that the size of the related party transactions had positive impact on the firm.
Again, Kohlbeck & Mayhew (2010) found that firms that have related party transactions have significantly lower valuation and subsequent returns are marginally lower than firms with no such transactions. Khanna & Yafeh (2000) revealed that firms under one group can manipulate profits by adjusting either the price or volume of intra-group trade. Others also suggest that controlling shareholders can take advantage of these related party transactions for opportunistic purpose supporting the conflict of interest view.

Bona-Sánchez et al. (2017) examined the companies of Spain, and their study revealed that all dimensions of related party transactions such as financial operating and investment negatively affect firms’ value because of the presence of impounding effect of related party transactions. Rafizadeh (2016) revealed a significant relationship exist between RPT and firm’s performance. According to Munir, Sosheen and Gell (2010), RPT has negative correlation with performance while Pozzoli & Venuti (2014) posit that RPT and performance are not correlated and there is no evidence of cause-effect relation.

Per the exiting literature, there seems to be a difficulty to determine if related party transactions are beneficial or detrimental to the performance of a company. Some studies even find no evidence of positive or negative effects resulting from RPTs. Therefore, there is still a lack of consensus among researchers about the empirical relationship between RPTs and firm performance. This provides a good ground for this study to further examine the issue, in the context of Ghana and particularly in the banking sector. This study based on the reviewed literature investigates whether there is an association between related party transactions (RPTs) and firm performance of banks and the hypothesis of the study is as follows:

**H₁: Related party transaction (RTP) has significant relationship with Performance of banks.**

**METHODOLOGY**

**Population and Sample Selection**

This study uses the banking institutions listed on the Ghana Stock Exchange (GSE) covering the period 2013 and 2017. That is, all listed banking firms in Ghana formed part of the population of this study. However, the researchers considered readily available and up-to-date information and purposively selected the sampled banks and hence two banks were dropped because of insufficient data points over the five-year period. In effect, out of a total of 9 listed banks, 7 representing 77.78% were used for this study. The bank-level data were extracted from the year-end annual report of the banks.

**Research Model:**

An empirical regression model was employed to investigate the impact of RPTs on firm performance which is in line with earlier researchers such as Chen et al. (2009). However, RPTs is represented by the total amount of related party transactions in this study. The other bank-specific variables used as controls include corporate governance; board size, leverage and size of the banks. The panel regression model is presented in equation 1 below:

\[
ROA_{it} = \alpha_i + \beta_1 RPT_{it} + \beta_2 BOS_{it} + \beta_3 LEV_{it} + \beta_4 SIZE_{it} + \epsilon_{it}
\]

Where, \(i\) and \(t\) represent bank and year, respectively, ROA is return on assets, RPT is related party transactions, BOS represents board size, LEV is leverage and SIZE represents the size of the firm.

**Variable Description:**

Firm performance is considered as the dependent variable. The Return on Assets (ROA) has been taken as a proxy for measuring the firm performance. ROA is measured as the Net Profit income divided by Total Assets (Pozzoli and Venuti, 2014). Researchers have used different types of RPTs as independent variables in their studies (Friedman et al., 2003; Berkman et al., 2009). In this study, total amount in related party transactions is used as independent variable. Also, certain control variables which are considered in earlier studies (Navissi and Naiker, 2006; Villalonga and Amit, 2006) were used. Firm’s size, leverage and corporate governance; size of board of directors were used as the control variables in our study. All variables used in the study and their operational definitions, are outlined in Table 1 below:

| Variable | Proxy | Measurement |
|----------|-------|-------------|
| ROA      | Return on Assets | Net income divided by Total Assets |
| RPT      | Related Part Transactions | Natural log of total amount in related party transactions |
| BOS      | Board Size | Number of members in the board of directors |
| LEV      | Leverage | Total Debt divided by Total Assets |
| Size     | Size of a bank | The natural log of total assets |

**DATA ANALYSIS AND EMPIRICAL RESULTS**

Tests for multi-collinearity, data normality, heteroscedasticity, autocorrelation, and model specification were carried out by the researchers and the results have been presented in this section. Also, the descriptive analysis as well as the regression results are presented in this section.

**Test for Multi-Collinearity:**

A test for multi-collinearity was performed using the Variance Inflation Factor (VIF) or the degree of Tolerance (1/VIF). The decision rule was that, a variable with a VIF greater than 10(VIF > 10) or a degree of tolerance less than 0.1 (1/VIF < 0.1) was considered to be highly collinear with other explanatory variables. As seen in Table 2 below, the VIFs and their corresponding degree of tolerance (1/VIF) for RPT, BOS, LEV and SIZE show that they are not highly
correlated with each other since none of them has a VIF up to 10 or less than a degree of tolerance of 0.1.

Table 2: VIF and Tolerance Test

| Variable | VIF | 1/VIF |
|----------|-----|-------|
| RPT      | 1.24| 0.803854 |
| BOS      | 1.18| 0.849517 |
| LEV      | 1.10| 0.908166 |
| SIZE     | 1.06| 0.939615 |
| Mean VIF | 1.15|       |

(Source: STATA Output, 2019)

**Test for Data Normality:**

The Shapiro and Wilk (1965) test was used to test for normality and the result is presented in Table 3. As displayed in Table 3, the z-values for BOS, and SIZE are all insignificant at α=5% (p=0.00000) and the study therefore accepted the null hypothesis that, the data values of BOS, and SIZE came from a normally distributed population and concluded that, the data values of the mentioned variables were normally distributed. However, the z-values of ROA, RPT and LEV were statistically significant at α=5%. Hence, the study failed to accept the null hypothesis that, the data values of ROA, RPT and LEV came from a normally distributed population and concluded that, the data values were not normally distributed. Therefore, a more robust regression estimator was considered as ideal for the data values of the study as such estimators correct the issue of data abnormality in the classical regression analysis.

Table 3: Shapiro-Wilk test for Data Normality

| Variable | Obs. | W   | V   | z    | Prob>Z   |
|----------|------|-----|-----|------|----------|
| ROA      | 35   | 0.91320 | 3.098 | 2.360 | 0.00913  |
| RPT      | 35   | 0.92937 | 2.521 | 1.930 | 0.02680  |
| BOS      | 35   | 0.98643 | 0.484 | -1.513 | 0.93489  |
| LEV      | 35   | 0.79860 | 7.188 | 4.117 | 0.00002  |
| SIZE     | 35   | 0.97064 | 1.048 | 0.998 | 0.46098  |

(Source: STATA Output, 2019)

**Test for Heteroscedasticity:**

For the purposes of this study, Breusch and Pagan (1979) and Cook and Weisberg (1983) test for heteroscedasticity, which tests the null hypothesis of homoscedasticity or the lack of heteroscedasticity in linear regression models, was used. The result in table 4 below shows that the chi2 value of 0.05 for the ROA working model turned out to be statistically insignificant at α=5% (p=0.8181)>0.05 the 5% significance level [(p=0.0000). Therefore, the study failed to reject the null hypothesis of the absence of heteroscedasticity among the fitted values of the ROA working models, and it concluded that there was no heteroscedasticity among the fitted values of the RAO working model.

Table 4: Heteroscedasticity

| Model | Chi2 (4) | Prob > Chi2 |
|-------|---------|------------|
| ROA   | 0.05    | 0.8181     |

(Source: STATA Output, 2019)

**Test for Serial Correlation:**

The Durbin-Watson test for serial or autocorrelation was used in this study to test the null hypothesis that which states that the errors are serially uncorrelated as against the alternative hypothesis that, the errors are serially correlated (Durbin & Watson, 1950; Durbin & Watson, 1951). The test produces a d-statistic with a value from 0 to 4 where; if the value is 2, it means no autocorrelation, to <2 means positive autocorrelation, and >2 to 4 indicates a negative autocorrelation detected in the sample.

As shown in Table 5 below, the Durbin-Watson d-statistic value for ROA and ROE were 0.9601903 and 1.206673 respectively and therefore, the study failed to accept the null hypothesis that, the errors were serially uncorrelated and indicated that there existed first order positive autocorrelation in the sample. Ideally, a more robust regression estimator was viewed as appropriate for estimating the study’s working models.

Table 5: Serial correlation

| Model     | Durbin-Watson d-statistic |
|-----------|---------------------------|
| ROA       | 0.9601903                 |

(Source: STATA Output, 2019)

**Estimation Approach:**

The time series cross-sectional nature of the dataset makes the use of panel data technique in the estimation of the data necessary. In line with literature, the fixed effects (FE) and random effects (RE) techniques are the most common technique for panel data. Empirically, the Hausman (1978) specification test has been used to test the fitness of the dataset among the two techniques. Per the null hypothesis of RE, the FE become the preferred estimator if the probability of the estimated test statistics is less than 0.05, thereby leading to the rejection of RE.

As seen in Table 6, the Durbin-Wu-Hausman test for the model specification for ROA working model showed a Chi2 of 56.94 which was statistically significant at α=5% [ch2(5) = 56.94, (p=0.0000)<0.05]. Hence, the study rejected the null hypothesis that, the random effects model was preferred against the fixed effects model and concluded that, the Fixed Effects estimator was the best fit for both ROA and ROE working models.

Table 6: Model Specification

| Model     | chi2(4) | Prob>chi2 |
|-----------|---------|-----------|
| ROA       | 56.94   | 0.0000    |

(Source: STATA Output, 2019)

**Descriptive Statistics on Study Variables:**

Statistical software package, STATA version 15 was employed for all the data analysis at an alpha level of 5% (p≤0.05). The basic descriptive statistics of the variables are presented in Table7. For each variable, the table shows mean, standard deviation, minimum and maximum. ROA had a mean value of 0.0483381 with a standard deviation of 0.0331556. The result also indicates that the sampled banks hadROA of -0.04695 minimum and a maximum of 0.091776. RTP had a mean value of 12.49326 with a standard deviation of 1.243434. The result also indicates
that the sampled banks had RTP of 9.777811 minimum and a maximum of 14.18688. The mean of BOS is 9.5 while the number of board of directors ranges between 8 and 12 minimum and maximum with a standard deviation of 1.40048. The sampled banks had leverage with a mean of 0.8527169 and a standard deviation of 0.0359387. The minimum and maximum values for leverage were 0.782478 and 1.010586 respectively. The mean of the natural log of total assets measuring bank’s size amounts to 14.99966 while it varies between 13.80681 and 16.0729 with a standard deviation of 0.5217406.

### Table 7 Descriptive Statistics

| Variables | ROA | RTP | BOS | LEV | SIZE |
|-----------|-----|-----|-----|-----|------|
| Mean      | 0.0483381 | 12.49326 | 9.542857 | 0.8527169 | 14.99966 |
| Std. Dev  | 0.0331556 | 1.243434 | 1.40048 | 0.0359387 | 0.5217406 |
| Minimum   | -0.04695 | 9.777811 | 8 | 0.782478 | 13.80681 |
| Maximum   | 0.091776 | 14.18688 | 12 | 1.010586 | 16.0729 |
| Observation | 35 | 35 | 35 | 35 | 35 |

(Source: STATA Output, 2019)

**Regression Results:**

To assess the effect of related party transaction on performance of the sampled firms, the ROA was regressed on RTP, BOS, LEV and SIZE and the results are shown in Table 8 as below:

### Table 8: Robust Fixed Effects of RTP on ROA

| Variable | Coef.(β) | Robust Std. Err | t     | Prob(t) |
|----------|----------|-----------------|-------|---------|
| RTP      | -0.0063865 | 0.0026854 | -2.38 | 0.055*  |
| BOS      | 0.0009525  | 0.0031963  | 0.30  | 0.776   |
| LEV      | -0.356034 | 0.0435324 | -8.18 | 0.000***|
| SIZE     | -0.0264452 | 0.0079465 | -3.33 | 0.016** |
| CONS     | 0.8193025 | 0.1440718 | 5.69  | 0.001   |
| R-squared: |         |                |       |         |
| Within   | 0.3250    | F(4,6) | 44.31 |         |
| Between  | 0.0047    | Number of obs | 35   |         |
| Overall  | 0.0897    | Number of groups | 7 |         |

(Source: STATA Output, 2019)***, ** and * denotes significance at 1%, 5% and 10%, respectively.

As shown in Table 8, the coefficient of RTP which represents the total amount in related party transactions has negative relationship with ROA which measures firm’s performance and it is statistically significant in influencing the performance of banking firms. However, the level of influence is not so strong since it is at 10% significance level compared to 5% or 1%. The negative and statistically significant relationship as revealed in this study is in agreement with previous research findings (Claessens et al., 2002; Chen et al., 2009; Kohlbeck & Mayhew, 2010; Bona-Sánchez et al., 2017; Munir et al., 2010), but contrary to Cynthia, and Sidharta (2014) who concluded that the size of the related party transactions had positive impact on the firm. Also, the statistically significant relationship between RTP and firm performance is contrary to (Pozzoli & Venuti, 2014; Cheung, et al, 2006) who revealed no significant relationship between RTP and ROA.

The coefficient of BOS measured by the number of members in the board of directors, being used to represent corporate governance is positive but statistically insignificant in determining firm’s performance and this supports Aggarwal et al. (2007), who found no relationship between board size and the performance of firms. The positive and insignificant relationship is contrary to the findings of (Eisenberg, et al, 1998; Mak and Kusnadi, 2005) who found negative correlation between board size and profitability.

The size of the banks measured by the natural log of total assets has a negative coefficient with ROA and it is statistically significant in determining firm performance and this in agreement with Hassam and Bashir (2003) who found that banks total assets have negative and significant relationship with profitability (ROA). However, Ali, Akhtar and Ahmed (2011), found a positive but insignificant relationship between total assets and firm performance of banks in Pakistan. Other studies also found positive and statistically significant relationship between these two variables (Molyneux and Seth, 1998; Goddard et al. 2004; Alper and Anbar, 2011).

Firm’s leverage, measured by total debt over total assets has a coefficient that is negative and statistically significant. This is in strong agreement with Goddard et al (2005), Asimakopoulos et al (2009), Macas Nunes et al (2009) who found a negative effect of leverage on firm profitability.

The overall R-squared (R2) value of 0.0897 depicts that, the explanatory variable accounted for 9% of the variations in ROA, whilst the unexplained variations [91% (100-9)] were accounted for by other inherent variabilities. The overall R2...
value was statistically significant at $\alpha=1\%$. Fitting the coefficients into the ROA working model, the final model became;

$$ROA_{i,t} = 0.8193025 - 0.0063865RPI_{i,t} + 0.0009525BOS_{i,t} - 0.356034LEV_{i,t} - 0.0264452SIZE_{i,t} + \epsilon_{i,t} \quad (2)$$

**CONCLUSION AND RECOMMENDATIONS**

The paper investigates the relationship between related party transactions and bank performance using the listed banking institutions on the Ghana Stock Exchange over five-year period spanning from 2013 to 2017. The corporate annual financial reports of the banks were utilised as the source of data. The research hypothesis was developed taking into account the existing literature in the subject area and only firm-specific variables were considered. After carrying out diagnostic and specification tests in line with the basic assumptions of the Classical Linear Regression Model (CLRM) and running the regression, using Fixed Effects estimator, the study revealed that related party transactions have a significantly negative effect on the firms' performance. The research hypothesis is duly accepted and the study therefore provides evidence that the amount of related party transactions that a firm engages in can negatively affect profitability levels of such a firm. It is therefore prudent for practitioners to be mindful of the kind of and the magnitude of related party transactions that they engage in. Regulators must also streamline dealings in relation to this act and ensure that firms are closely monitored to reduce or guide related party transactions.

Control variables, namely board size, leverage and firm size were employed in this study and it was revealed that board size has no influence on the performance of firms. However, the positive coefficient of board size (BOS) seem to support the view that, the performance of the firms moves in the same direction as the number of members in the board of directors, hence the higher the number the better. Future studies should test the significance of this relationship again to confirm or reject what has been revealed by the current study.

Firm’s leverage, measured by total debt over total assets has a coefficient that is negative and statistically significant. Leverage negatively affects firm performance possibly due to high interest rates common in developing economies such as Ghana. The managers of the economy therefore have to work hard to bring the interest rate down and keep it as such.

Lastly, the size of the banks measured by the natural log of total assets is negative and statistically related to ROA. The findings of this study supports the school of thought that, the larger the firm, the more the inefficiencies leading to diseconomies of scale. Listed banks in Ghana may not be taking advantage of their size to be more efficient and profitable and they have to look into their operational and related efficiency matters to become more profitable.

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