Does corporate social responsibility affect shareholder value? Evidence from the COVID-19 crisis

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Abstract
The COVID-19 outbreak and the subsequent lockdown were an unanticipated shock to the global stock market. Managers also had minimal time to counterbalance its effect through corporate policies. Therefore, this health crisis offers a unique opportunity to examine the effect of corporate social responsibility (CSR) on shareholder value. We observe that firms engaged in more CSR activities outperform other firms. This suggests that CSR plays a positive role in determining shareholder value, particularly for an emerging market where minority shareholder rights are weak. Collaborating with our main finding, we further find that governance metrics play a significant role.

KEYWORDS
COVID-19, CSR activities, India, shareholder value

JEL CLASSIFICATION
D22; G32; G34; M14

1 | INTRODUCTION

Does corporate social responsibility (CSR) affect firm value (shareholder value)? Existing studies provide mixed findings (see Bernanke, Gertler, & Gilchrist, 1999; Friede, Busch, & Bassen, 2015; Lins, Servaes, & Tamayo, 2017; Margolis, Elfenbein, & Walsh, 2007; Margolis & Walsh, 2003; Renneboog, Ter Horst, & Zhang, 2008). On the one hand, researchers argue that high-CSR activities resolve agency conflicts stemming from the conflicts of interest between management and other stakeholders (shareholders and non-investing stakeholders), thereby improving firm performance and value (Cespa & Cestone, 2007; Jensen, 2001; Jo & Harjoto, 2011; Scherer, Palazzo, & Baumann, 2006;
Servaes & Tamayo, 2013; Turban & Greening, 1997). On the other hand, the overinvestment hypothesis posits that managers (insiders) may overinvest in CSR activities to build their reputation for being a socially responsible manager at the expense of shareholders, which in turn reduces firm performance and value (Barnea & Rubin, 2010; Cespa & Cestone, 2007). In the same vein, Manchiraju and Rajgopal (2017) show that mandatory CSR expenditures reduce shareholder value. Notably, Nelling and Webb (2009) advocate that the causal relation between CSR and financial performance is a virtuous circle—that is, CSR activities lead to good performance and whether firms showing superior financial performance devote more resources to CSR activities. Thus, extensive literature focusing on the CSR-firm performance relation explores the correlation between firm performance and CSR activities instead of causation (see Cheng, Hong, & Shue, 2013).

In this study, we explore the role of CSR activities in determining shareholder value during the outbreak of coronavirus (aka COVID-19) that has adversely impacted the world economy and financial markets. We use the COVID-19 pandemic as a natural experiment in which the pandemic acts as an exogenous financial shock that disrupts firms’ financial conditions (value), but the levels of CSR activities remain fixed, at least in the short term. In other words, the COVID-19 crisis is a precipitous and unpredictable event, and thus it is exceptionally challenging for firms to adjust their optimal CSR activities concerning a future financial crisis. In such a case, we can contemplate CSR activities as an exogenous variable that explains shareholder value during a subsequent crisis. As a result, we can mitigate endogeneity issues attributable to the recursive CSR-shareholder value relation. Also, unlike previous financial crises, such as the 2008 global financial crisis that originated from financial imbalances and risks that soared over multiple years, the COVID-19 originated out of public health concerns (a viral pandemic) that severely restricted global economic activity (Bernanke, 2020). Subsequently, the COVID-19 pandemic has brought an unprecedented and unpredictable shock to the global economy (Georgieva, 2020; Shehzad, Xiaoxing, & Kazouz, 2020). Managers may be destitute in countering it strategically, leaving them clueless to manage shareholder value, at least in the short term. We, thus, postulate that the COVID-19 is a much apparent exogenous shock to shareholder value.

We focus on Indian firms instead of multicounty firms for several reasons. First, it is difficult to control all country-specific factors that may influence shareholder value and CSR activities. Second, the severity of the COVID-19 pandemic and its impact on the economy is not uniform, and thus, a single-country analysis provides a homogeneous ground for the empirical study. Finally, as a developing economy, India offers many unique characteristics that may influence the stated relation. In India, weak investors’ protection rights coupled with concentrated ownership provide incentives and capacity to controlling owners to expropriate minority shareholders (Bertrand, Mehta, & Mullainathan, 2002; Chauhan & Kumar, 2018). Therefore, it will be exciting to explore the role of CSR activities, particularly governance metrics, in determining shareholder value when the confidence of investors is low, and a drop in expected returns on investments may result in more expropriation by controlling owners, producing a further decline in shareholder value. In the same vein, Johnson, Boone, Breach, and Friedman (2000) find that during the Asian financial crisis, managers of weak corporate governance firms were involved in more expropriation.

We measure shareholder value by common stock prices’ monthly returns over January 1, 2020, to August 31, 2020, and use the Thomson Reuters Refinitive ESG database (formerly known as ASSET 4) to measure CSR activities, reported on December 2019. Refinitive ESG database evaluates firms’ CSR activities based on three pillars: social, environmental, and corporate governance. Using 155 Indian firms, we observe that firms belonging to the top quintile of CSR scores before entering the COVID-19 outbreak have significantly higher stock returns (0.16% per month) than firms belonging to the bottom quintile of CSR scores. This result suggests that investors should expand their focus beyond financial performance to explore the determinants of shareholder value during distress periods.

We further explore the role of an individual pillar of CSR activities in determining shareholder value. We observe that only the governance pillar is positively and significantly related to stock value. This is consistent with Mitton (2002), who suggests that strong corporate governance reduces the likelihood of expropriation, particularly in the financial crisis period when managers are led to expropriate more as the expected returns on investments plummet dramatically. As a result, investors prefer to assign value premiums to firms that instituted strong governance.
Overall, our paper contributes to the existing literature examining the CSR–shareholder value relation (Buchanan, Cao, & Chen, 2018; Flammer, 2015; Jo & Harjoto, 2011; Margolis & Walsh, 2003; Servaes & Tamayo, 2013). Most of the studies explore the CSR–shareholder value relation in a typical scenario. Therefore, the empirical findings may be vulnerable to endogenous concerns that make it challenging to identify whether CSR affects firm value or vice versa. Our paper is very close to Buchanan et al. (2018) and Lins et al. (2017), who study how CSR affects firm value around the 2008 global financial crisis (2008–2009). We believe that a two-year time period is adequate for firms to adjust their policies. Nevertheless, our study exploits the COVID-19 pandemic as a natural experiment that has mushroomed with alarming speed, bringing economic activities to a near standstill as countries imposed strict lockdown. Thus, we contemplate that COVID-19 is a sharper exogenous shock to shareholder value and allows us to directly examine how investors adjust stock value with different levels of CSR activities.

The remainder of this paper is organized in the following manner. The hypothesis of the study is discussed in Section 2. Sections 3 and 4 report information about the variables and empirical results, respectively. Section 5 presents the conclusions.

2 | HYPOTHESES DEVELOPMENT

We develop two testable hypotheses. Our first hypothesis is based on the overinvestment theory, proposing a negative relation between CSR and shareholder value (Barnea & Rubin, 2010; Cespa & Cestone, 2007; Friedman, 1970). This theory is grounded on agency problems stemming from conflicts of interest between managers and shareholders. It posits that managers (insiders) may spend firms’ resources on CSR activities to increase their reputation and portray themselves as socially responsible managers at the cost of outside shareholders. As a result, such overinvestment can destroy firm value. In the same vein, Barnea and Rubin (2010) show that higher insider holding is negatively related to CSR activities. Krüger (2015), Manchiraju and Rajgopal (2017), and Cheng et al. (2013) also show that CSR activities are detrimental to shareholder value. Ben-Nasr and Ghouma (2018) observe that employee’s welfare positively contributes to stock price crash risk. Based on these opinions, we propose our first hypothesis that predicts a negative relation between CSR and shareholder value during the outbreak of COVID-19.

Our alternative hypothesis is backed by the contract theory of firm survival (Coase, 1991) and the stakeholder theory (Freeman, 1984); both theories predict a positive relation between CSR and shareholder value. The contract theory postulates that the firm is a nexus of contracts between managers and other stakeholders wherein stakeholders are the supplier of resources required to operate the firm in exchange for claims outlined either with explicit contracts (e.g., wage contracts or product warranties) or with implicit contracts (e.g., the promise of job security) (Alchian & Demsetz, 1972; Coase, 1991; Hill & Jones, 1992; Jensen & Meckling, 1976). Unlike explicit contracts, implicit contracts are vague and have limited legal supports. Firms, therefore, can violate implicit contracts without legal recourse from other stakeholders. Nevertheless, firms’ commitment, such as CSR engagements, to endorse implicit contracts can increase the value of implicit contracts, increasing firm value (Cornell & Shapiro, 1987).

The stakeholder theory proposed by Freeman (1984) suggests that firms can use CSR activities to resolve conflicts between managers and other stakeholders (non-investing stakeholders). Jo and Harjoto (2011) show that firms can use CSR activities as a mechanism to improve communication between insiders and outsiders, thereby mitigating conflict of interest between managers and other stakeholders. Consistent with this view, Guenster (2010) and Jiao (2010) document a positive valuation effect around CSR activities. In this study, we postulate that CSR activities should pay off for firms when the trust and cooperation from other stakeholders are more valuable, particularly during an enormously uncertain period such as the COVID-19. Moreover, stakeholders’ trust prevailing in firms with greater CSR activities can help investors pay a valuation premium to these firms when the overall market is facing an unprecedented uncertainty.
Based on the contract theory of firm survival and the stakeholder theory, we postulate that the relation between CSR and equity value will be positive during the outbreak of COVID-19.

3 | DATA AND METHODOLOGY

3.1 | Data

We use two databases to collect our variable information. Data for environmental, social, and governance (ESG) scores are collected from Thomson Reuters’s Refinitive ESG database (formerly ASSET 4). The scores are related to the relative performance of ESG factors within the firm’s industry (for E and S) and country (for G) and range from 0 to 100. Previous studies have used Thomson Reuters’s Refinitive ESG scores to measure firms’ CSR activities (see Dyck, Lins, Roth, & Wagner, 2019; Ferrell, Liang, & Renneboog, 2016). Firm-specific characteristics are acquired from the Prowess Database maintained by the Center for Monitoring Indian Economic (CMIE). We exclude financial firms for our study. Our sample consists of 155 firms with all the requisite information. Firms with missing data are dropped from the analysis. We also winsorize all variables at the 1% level (both top and bottom).

3.2 | Variable definitions

We estimate shareholder value by monthly stock returns. We use both Raw Returns and Excess Returns from January 31, 2020, to August 31, 2020. Excess Returns are estimated over market returns, measured by the COSIP index developed by the CMIE.

Our variable of interest is CSR activities measured by self-reported information on the environmental, social, and corporate governance pillars. To ensure that firm characteristics do not drive our results, we control firm-specific characteristics. We include firm size (natural log of total assets [Firm Size]) and return on assets (ROA) (operating profit divided by total assets) since large and profitable firms are likely to face more pressure to invest in CSR activities (Wu, 2006). We include leverage ratio (total borrowings divided by total assets) and standard deviation of stock returns (standard deviation of monthly stock returns measured over 5 years [Std Returns]) for controlling firm risk.

| TABLE 1 | Summary statistics

|                | Mean   | SD      | Min    | Median  | Max    |
|----------------|--------|---------|--------|---------|--------|
| Raw Return (%) | −0.51  | 3.292   | −8.14  | −0.54   | 7.91   |
| Excess Return (%) | −0.671 | 11.366  | −13.519 | −2.656 | 36.794 |
| CSR            | 51.208 | 16.875  | 9.172  | 52.386  | 91.196 |
| SSR            | 56.349 | 19.232  | 7.022  | 57.492  | 97.391 |
| GSR            | 50.303 | 22.69   | 1.825  | 50.671  | 95.182 |
| ESR            | 41.277 | 23.803  | 0      | 39.441  | 96.215 |
| Size           | 12.406 | 1.552   | 9.565  | 12.087  | 16.18  |
| ROA            | 0.145  | 0.097   | −0.029 | 0.124   | 0.503  |
| Leverage       | 0.107  | 0.138   | 0      | 0.034   | 0.536  |
| PB             | 4.922  | 4.812   | 0.146  | 3.505   | 18.796 |
| Std Returns    | −0.111 | 0.946   | −2.58  | −0.11   | 2.605  |
| Previous Returns (%) | 1.866 | 5.253   | −24.31 | 2       | 14.12  |

Note: This table reports the summary statistics of the variables used in the study.
### TABLE 2  Correlation matrix

| Variables         | CSR   | Raw Returns | Excess Returns | Std Returns | Size  | PB    | Leverage | ROA    | Previous Returns |
|-------------------|-------|-------------|----------------|-------------|-------|-------|----------|--------|------------------|
| CSR               | 1.000 |             |                |             |       |       |          |        |                  |
| Raw Returns       | 0.056*| 1.000       |                |             |       |       |          |        |                  |
| Excess Returns    | 0.046*| 0.390***    | 1.000          |             |       |       |          |        |                  |
| Std Returns       | 0.037 | -0.050*     | 0.125***       | 1.000       |       |       |          |        |                  |
| Size              | 0.386***| 0.069**   | 0.022          | 0.069**     | 1.000 |       |          |        |                  |
| PB                | -0.006| 0.048*      | 0.010          | -0.007      | 0.140***| 1.000 |          |        |                  |
| Leverage          | -0.015| -0.005      | -0.006         | -0.004      | -0.182***| -0.125***| 1.000 |        |                  |
| ROA               | 0.016 | 0.068**     | 0.021          | 0.020       | 0.295***| 0.597***| -0.356***| 1.000 |                  |
| Previous Returns  | 0.113***| 0.040     | 0.042          | 0.370***    | 0.145***| 0.025 | -0.023   | 0.142***| 1.000 |

Note: This table reports the correlation between variables used in the study.
*Significance at 10% level.
**Significance at 5% level.
***Significance at 1% level.
since riskier firms are less likely to invest in CSR activities (Orlitzky & Benjamin, 2001). We include market price of equity to book ratio (PB Ratio) to control for glamour stocks. The prediction power of past returns is controlled by the mean returns of stocks’ monthly returns for 2019 (Previous Returns). All control variables are measured for the period ending December 31, 2019. All variables are winsorized at 1% top and bottom to control for outliers.

3.3 Methodology

We use the following cross-sectional regression to study our proposed relation:

\[
\text{Stock Returns}_{im} = \alpha + \beta_1 \text{CSR}_i + \beta_2 \text{Size}_i + \beta_3 \text{Leverage}_i + \beta_4 \text{ROA}_i + \beta_5 \text{Previous Returns}_i + \beta_6 \text{Std Returns}_i + \beta_7 \text{PB}_i + \epsilon_{im}
\]  

Here, \(i\) and \(m\) represent firm \(i\) and months \(m\), respectively. The dependent variables are monthly stock returns and monthly excess returns. To mitigate the concern that managers may adjust CSR activities to counterbalance the pandemic’s effect, we measure CSR activities for 2019. To control firm-level heterogeneity that causes the difference in stock returns, we include various control variables reported in Section 3.2. We also use month and industry fixed effects to control for month effects and industry effects. We follow the two-digit National Industry Classification (NIC) code to classify the industry. The \(t\)-value of coefficients is estimated based on standard error clustered at the firm level.

### Table 3 The relation between CSR activities and shareholder value

| Variables       | (1) Raw Returns | (2) Excess Returns | (3) Raw Return | (4) Excess Returns | (5) Raw Return | (6) Excess Returns |
|-----------------|-----------------|--------------------|----------------|--------------------|----------------|--------------------|
| Intercept       | −1.252***       | −1.614***          | −2.282***      | −2.644***          | −2.650***      | −3.033***          |
|                 | (−4.763)        | (−6.140)           | (−3.261)       | (−3.778)           | (−3.735)       | (−4.209)           |
| CSR             | 0.00762*        | 0.00762*           | 0.00740**      | 0.00740**          | 0.00692*       | 0.00654*           |
|                 | (1.931)         | (1.931)            | (1.995)        | (1.995)            | (1.773)        | (1.656)            |
| Size            | 0.0336          | 0.0336             | 0.0940*        | 0.0972*            | 0.0940*        | 0.0972*            |
|                 | (0.702)         | (0.702)            | (1.811)        | (1.835)            | (1.811)        | (1.835)            |
| Leverage        | 0.812*          | 0.812*             | 0.311          | 0.328              | 0.311          | 0.328              |
|                 | (1.815)         | (1.815)            | (0.616)        | (0.638)            | (0.616)        | (0.638)            |
| ROA             | 2.279**         | 2.279**            | 2.119**        | 2.192**            | 2.119**        | 2.192**            |
|                 | (2.029)         | (2.029)            | (2.161)        | (2.222)            | (2.161)        | (2.222)            |
| Previous Returns| 0.0281*         | 0.0281*            | 0.0212         | 0.0219             | 0.0212         | 0.0219             |
|                 | (1.859)         | (1.859)            | (1.379)        | (1.413)            | (1.379)        | (1.413)            |
| Std Returns     | −0.0190         | −0.0190            | −0.0110        | −0.0123            | −0.0110        | −0.0123            |
|                 | (−0.227)        | (−0.227)           | (−0.131)       | (−0.145)           | (−0.131)       | (−0.145)           |
| PB              | 0.0161          | 0.0161             | 0.0157         | 0.0156             | 0.0157         | 0.0156             |
|                 | (0.900)         | (0.900)            | (0.872)        | (0.866)            | (0.872)        | (0.866)            |
| Ind fixed effects | No             | No                 | No             | Yes                | Yes            | Yes                |
| Month fixed effects | Yes        | Yes                | Yes            | Yes                | Yes            | Yes                |
| N               | 1,373           | 1,373              | 1,203          | 1,203               | 1,203          | 1,203              |
| R-squared       | 0.433           | 0.958              | 0.446          | 0.958               | 0.456          | 0.959              |

Note: The table presents the relation between CSR and shareholder value. \(T\)-statistics are reported in parentheses.

*Significance at 10% level.
**Significance at 5% level.
***Significance at 1% level.
4 | EMPIRICAL FINDINGS

4.1 | Descriptive statistics

Table 1 presents the summary statistics for the variables used in the study. The mean (standard deviation) of Raw Return and Excess Return is $-0.51 (3.292)$ and $-0.671 (11.366)$, respectively, indicating the severity of the COVID-19 crisis. The average CSR score for the sample firms is 51.20, with a range of 9.172 and 91.196, reflecting our sample firms' variability based on their endeavor toward CSR investments. The mean value of the log of total assets (Firm Size) is 12.40, with a standard deviation of 1.552, indicating our sample's concentration toward large firms.

TABLE 4  The relation between CSR subindexes and shareholder value

| Variables  | (1) Raw Returns | (2) Raw Returns | (3) Raw Returns | (4) Excess Returns | (5) Excess Returns | (6) Excess Returns |
|------------|-----------------|-----------------|-----------------|-------------------|-------------------|-------------------|
| Intercept  | $-3.103^{***}$  | $-2.506^{***}$  | $-2.482^{***}$  | $-3.409^{***}$    | $-2.858^{***}$    | $-2.826^{***}$    |
|            | ($-4.062$)      | ($-3.637$)      | ($-3.631$)      | ($-4.523$)        | ($-4.141$)        | ($-4.132$)        |
| GSR        | 0.00593**       | 0.00583**       |                 |                   |                   |                   |
|            | (2.111)         | (2.140)         |                 |                   |                   |                   |
| SSR        | 0.00400         |                 | 0.00335         |                   |                   |                   |
|            | (1.064)         |                 | (0.905)         |                   |                   |                   |
| ESR        | 0.00288         |                 |                 | 0.00278           |                   |                   |
|            | (0.978)         |                 |                 | (0.938)           |                   |                   |
| Size       | 0.136**         | 0.0935*         | 0.0962*         | 0.130**           | 0.0938*           | 0.0937*           |
|            | (2.481)         | (1.728)         | (1.853)         | (2.399)           | (1.714)           | (1.784)           |
| ROA        | 2.544**         | 2.078**         | 2.102**         | 2.478**           | 2.110**           | 2.110**           |
|            | (2.599)         | (2.113)         | (2.149)         | (2.573)           | (2.168)           | (2.176)           |
| Leverage   | 0.400           | 0.293           | 0.286           | 0.495             | 0.412             | 0.399             |
|            | (0.774)         | (0.580)         | (0.568)         | (0.960)           | (0.803)           | (0.779)           |
| PB         | 0.0119          | 0.0152          | 0.0189          | 0.0116            | 0.0148            | 0.0182            |
|            | (0.680)         | (0.832)         | (1.005)         | (0.670)           | (0.823)           | (0.980)           |
| Std Returns| $-0.00927$      | $-0.0138$       | $-0.0111$       | $-0.0128$         | $-0.0183$         | $-0.0159$         |
|            | ($-0.109$)      | ($-0.165$)      | ($-0.132$)      | ($-0.154$)        | ($-0.219$)        | ($-0.191$)        |
| Previous Returns| 0.0233    | 0.0222          | 0.0217          | 0.0223            | 0.0220            | 0.0214            |
|            | (1.490)         | (1.432)         | (1.396)         | (1.439)           | (1.415)           | (1.375)           |
| Ind fixed effects | Yes        | Yes             | Yes             | Yes               | Yes               | Yes               |
| Month fixed effects | Yes      | Yes             | Yes             | Yes               | Yes               | Yes               |
| N          | 1,203           | 1,203           | 1,203           | 1,203             | 1,203             | 1,203             |
| R-squared  | 0.452           | 0.455           | 0.455           | 0.960             | 0.960             | 0.960             |

Note: This table presents the relation between the environmental pillar score, social pillar score, and governance pillar score and shareholder value. T-statistics are reported in parentheses.

*Significance at 10% level.

**Significance at 5% level.

***Significance at 1% level.
Table 2 reports the Pearson correlation between variables used in the study. The correlation between stock value (measured by Raw Returns and Excess Returns) is positive and statistically significant at the 10% level. We observe the highest correlation between firm size (Size) and CSR score. Overall, the correlation between variables suggests that our empirical results are not vulnerable to multicollinearity concerns.

4.2 The relation between CSR activities and shareholder value

Table 3 reports the results. We find that the coefficient of CSR is positive and statistically significant in all columns, suggesting that firms that invested more in CSR activities, particularly in 2019, have performed better than firms that invested less in CSR activities. Our results are also economically significant. Firms belonging to the top quintile (61.576) of CSR activities before the COVID-19 pandemic earned 2% higher annualized raw returns and 1.9% higher annualized excess return than firms belonging to the bottom quintile (37.46). Note that CSR activities are measured before the dependent variable (stock returns). Therefore, our results are unlikely to be vulnerable to endogeneity caused by the recursive relation. Overall, our paper provides empirical support to the stakeholder theory advocating for “doing well by doing good.”

Turning to the control variables, we find that firms that entered the COVID-19 pandemic in better financial conditions (higher operating performance) have higher stock returns.

4.3 The relation between CSR subindex and shareholder value

The CSR score consists of three scores: the environmental score, the social score, and the firm’s governance score. Thus, it is important to study which CSR activities are more relevant to shareholder value during an exogenous financial shock. For instance, corporate governance may be more critical during a financial shock period (COVID-19) since it judges the risk of extreme adverse events that may lead to a firm’s default (Eccles, Serafeim, & Krzus, 2011). To do so, we present a subindex analysis. We rerun our regression equation, with our independent variable being environmental scores (ESR), social scores (SR), and governance scores (GSR), and report the results in Table 4. The coefficient of all three scores is positive, but the coefficient of governance scores (GSR) is statistically different from zero. This is consistent with Mitton (2002), who shows that investors provide a valuation premium to firms with strong corporate governance during the crisis period, particularly in countries where minority shareholder rights are not protected.

5 CONCLUSION

The COVID-19 outbreak was an extraordinary time for the global stock market. Unlike previous financial crises (such as the global financial crisis of 2008), the COVID-19 crisis originated from the health pandemic. Therefore, it is an exogenous shock to equity value. The collapse of the stock market was vigorous and rapid, and firms would not have sufficient time to adjust their policies, such as CSR activities. We use this episode as an exogenous shock to equity value and study the effect of CSR on stock value during the COVID-19 period. Using Indian data, we observe a positive relation between CSR activities and shareholder value during the COVID-19 crisis period. Consistent with the stakeholder theory, it is evident that firms’ concern for various stakeholders pays off during distress periods. As far as three major components of CSR activities (environmental, social, and governance) are concerned, only the governance score has a notable positive impact on firm performance. The result highlights the relevance of strong corporate governance practices to curb managerial expropriation during a crisis period.
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ENDNOTE

1 See https://www.worldbank.org/en/news/feature/2020/06/08/the-global-economic-outlook-during-the-covid-19-pandemic-a-changed-world.
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