

The Relationship between Strategy Implementation and Performance of Manufacturing Firms in Indonesia: The Role of Formality Structure as a Moderator

¹Mahdani Ibrahim, ²Mohamed Sulaiman, ³Ali Al Kahtani and ⁴Ismael Abu-Jarad

¹Faculty of Economics, Syiah Kuala University, Darussalam, Banda Aceh, Indonesia

²Department of Business Administration, Kulliyyah of Economics and Management Sciences, International Islamic University Malaysia, P.O. Box: 10,50728 Kuala Lumpur, Malaysia

³Department of Human Resource Management, King Abdul Aziz University, Jeddah, Saudi Arabia

⁴School of Business Management, College of Business, Universiti Utara Malaysia (UUM), 06010, Sintok, Kedah Darul Aman, Malaysia

Abstract: This study was conducted to investigate the relationship between strategy implementation and firm performance. It also investigated the moderating role of formality structure on the relationship between strategy implementation and performance of manufacturing firms in Indonesia. The population in this study was the manufacturing firms listed in the Jakarta Stock Exchange (JSE). The Primary data on strategy implementation were obtained through questionnaires to CEOs of manufacturing firms while the secondary data were obtained from the Indonesian Capital Market Directory report. Out of 164 questionnaires that were distributed to the CEOs of manufacturing firms, 127 were returned out of which only 112 were used for further analysis. The results of this research showed that there was a significant relationship between strategy implementation and performance of the manufacturing firms. The results also showed that there was a moderating effect of formalized structure on the relationship between strategy implementation (program of budget and control of resources) and performance of the manufacturing firms measured by Return on Equity (ROE).

Key words: Strategy Implementation • Performance • Formalized Structure • Manufacturing Firms • Indonesia

INTRODUCTION

Many researchers have attempted to determine whether organizations have implemented strategic management well or not [1]. Generally, previous research revealed that organizations that implement their strategies effectively will perform better than organizations that are lacking in implementing strategic management [2, 3]. However, organizations have varying degrees of formalized structure, which can enhance or impede the successful implementation of strategies. Research on the practice of strategy implementation at firms indicated that organizational factors such as formalization, centralization and specialization of organization structure, play a role in enhancing organizational performance [4]. Chandler [5] stated that strategy must be followed by appropriate structure.

As for the performance of manufacturing firms in Indonesia, a report of Indonesian Capital Market Directory showed that manufacturing firms listed in the Jakarta Stock Exchange (JSE) have unsatisfactory performance. For example, in the period 1999-2000, the majority of manufacturing firms have incurred losses. Precisely, 28 firms (16.97%) incurred losses in 1999, 76 firms (46.06%) incurred losses in 2000, while 56 firms (33.94%) incurred losses in 2001. Accordingly, it can be assumed that the implementation of the concept of strategic management at manufacturing firms is still lacking the attention from the firm leaders, especially with regards to organizational factors [6].

The general aims of the study are to investigate the performance of Indonesian manufacturing firms and how they are related to the ways strategies being implemented. This study also aims to examine the degree

of formalization in organizational structure of Indonesian firms and how formalization affects the relationship between strategy implementation and performance of manufacturing firms. More precisely, the objectives of this study are (1) to analyze the practices of strategic management in Indonesian manufacturing firms, (2) to examine the relationship between the strategy implementation and performance of the manufacturing firms and (3) to examine the moderating effect of formality structure on the relationship between strategy implementation and performance of manufacturing firms.

Review of Literature

Organizational Performance: Organizational performance is conceptualized and measured differently by different authors. For example, similar to Daft [7], Richardo [8] defined organizational performance as the ability of the organization to achieve its goals and objectives.

Performance has also been conceptualized using financial and nonfinancial measures from both objective and perceptual sources. Objective measures include secondary sources financial measures such as return on assets, return on investment and profit growth. These measures are nonbiased and are particularly useful for single-industry studies because of the uniformity in measurement across all organizations in the sample [9]. According to Doyle [10], there was no single measure or best measure of organizational performance. Organizations adopt different objectives and measurements for organizational performance. For example, Zou and Stan [10] proposed seven categories of financial, non-financial and composite scales to measure performance based on a review of the empirical literature between 1987 and 1997. The financial measures are sales measures, profit measures and growth measures, whereas the non-financial measures are perceived success, satisfaction and goal achievement. Financial measures are more objective compared to the non-financial ones. The success category comprises measures such as the manager's belief that export contributes to a firm's overall profitability and reputation. Satisfaction refers to the company's export performance while the goal achievement refers to the manager's assessment of performance compared to objectives. Finally, composite scales refer to measures that are based on overall scores of a variety of performance measures.

Richardo [8] emphasized that successful organizations were those with the highest return on equity and those who had established performance management system "aligning" every aspect of the organization from top management to the factory floor.

On the other hand, Nicholas [12] argued that many organizations did not give a balanced picture of organizational performance. There was an over-emphasis on financial criteria, with pre-occupation with past performance.

Previous research had used many variables to measure organizational performance. These variables include profitability, gross profit, return on asset (ROA), return on investment (ROI), return on equity (ROE), return on sale (ROS), revenue growth, market share, stock price, sales growth, export growth, liquidity and operational efficiency [13, 14, 15]. Firms' performance is widely measured through the financial success of the organization. Financial stress for most profit-oriented firms can be assessed both in terms of "top-line" (e.g., sales) as well as "bottom-line" (e.g., profitability) measures [16].

Doyle [10], however, argued that profitability was the most common measurement used for organizational performance in business organizations. Other researchers, such as Galbraith and Schendel [17], supported the use of return on assets (ROA), return on equity (ROE) and profit margin as the most common measures of performance. Return on Assets (ROA) is derived by dividing net income of the fiscal year with total assets. Return on Equity (ROE) means the amount of net income returned as a percentage of shareholders equity. It measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Many researchers have used Return on Equity (ROE) to measure firm performance [18,19,20]. This study uses ROE to measure the performance of manufacturing firms in Indonesia.

According to Wheleen and Hunger [21], firm performance is the final result of a firm operating within the specified period of time. This study measured the performance of the manufacturing firms in Indonesia within a period of five years.

Return on Equity (ROE) is the amount of net income returned as a percentage of shareholders equity. It measures a firm profitability by revealing how much profit that a firm generates with the money shareholders have invested. ROE is expressed as a percentage and calculated as: $\text{Return on Equity} = \text{Net Income} / \text{Shareholder's Equity}$ Net income for the full fiscal year (before dividends paid to common stock holders but after dividends to preferred stock). Shareholder's equity does not include preferred shares. The measurement of the return of equity (ROE) is the total net profit earned in the year divided by total capital; the division is multiplied by the percentage [22].

Strategy Implementation: Strategy implementation is an activity of putting strategies and policies into concrete actions in the short term [2]. This study operationalized strategy implementation by looking into the implementation of organizational programs, program budgets and control of resources. Strategy implementation is to execute decisions that have resulted in the formulation of strategies [2, 4]. This opinion was strengthened by Aladwani [23] who said that the strategy implementation means putting the results of planning into a real activity. This shows that strategy implementation means running the plans that have been formulated.

Li Chen [2] stated that the concept of strategy implementation in strategic management requires an appropriate model with overall steps. The compatibility of such a model facilitates and manages the implementation of the plans. This view is closely related to the implementation of strategic plans into business organizations' practices.

Umble, Haft and Umble [24] argued that implementing a strategy needs to be integrated with the firm's management information system because management needs timely and accurate feedback. The human resources factor plays an important role in strategy implementation because it is people who will deliver. Knowledge and skills lie in people especially those who understand the vision, mission, objectives and strategies that were been formulated. They will facilitate the strategy implementation in a short-term [25]. Therefore, implementing a formulated strategy is a more complex problem than formulating it. Thus, it is important that we study and try to understand the problems related to the implementation process [26].

Bonoma and Crittenden [44] suggest that implementation is comprised of two main variables, structures and managerial skills. Structures provide the framework or configuration in which companies operate effectively.

Strategists tend to use powerful terminology to describe the importance of implementation. For example, Beer and Eisenstat [45] use terminology such as killers, confrontation and engagement. Mankins and Steele [46] refer to conquering the gap between strategy and performance and offer tactical specificity for conquering the formulation-implementation-performance process: keep it simple/make it concrete, debate assumptions/not forecasts, use a rigorous framework/speak a common language, discuss resource deployment early, clearly

identify priorities, continuously monitor performance and reward/develop execution capabilities. It is as though strategy implementation requires strategic warfare. Others, such as Porter and Harper [47] use sports phrases such as blocking and tackling and suggest that managers must hone their implementation skills.

Strategy Implementation and Organizational Performance: Mankins and Steele [46] reported that companies realize only 63% of the financial performance promised by their strategies. In addition, Kaplan and Norton [48] attribute this strategy-to-performance gap, in part, to the fact that 95% of a company's employees are not aware of or do not understand their company's strategy. According to Johnson [49], however, 66% of corporate strategy is never implemented. This suggests that the problem lies somewhere in the middle of this strategy-to-performance gap, with a more likely source of being a gap in the formulation-to-implantation process. If employees lack knowledge about the company's strategy, it is unlikely that proper implementation will occur, which in turn leads to poor financial performance.

Bonoma and Crittenden [44] suggested that this habitual mode of poor strategy execution then shapes the next round of strategy formulation, thus weakening the strategy formulated subsequently. Without a doubt, the overall neglect of strategy implementation leads to poor performance both in the current execution and in future strategy formulation processes. Unless caught in time, the endless formulation-implementation-performance cycle leads to subsequent attempts at implementing a mistaken strategy. When this occurs, it is hard to tell if weak performance is due to good implementation of a bad strategy, or the result of poor implementation of a good strategy.

V.L. Crittenden and W.F. Crittenden [50] stated that it is unfortunate that decades of research, teaching and consulting interactions with companies suggest that strategy implementation has become a catchall of phrases and recommendations, with little clarity as to what compromises this necessary cornerstone of a capable organization.

Organizational Structure: Organizational structure refers to the way jobs are divided, where decisions are made and how work roles are coordinated. The role of organizational structure is to facilitate the performance of firms through the implementation of strategy. David [4] stated that a

good structure is essential for an organization to manage the strategies in practice. Moreover, Wheelen and Hunger [21] also stated that organizational structure plays an important role in increasing the consistency of results of strategy implementation. According to Daft [27], organizational structure is a custom form that consists of workers and jobs. Lewis, Goodman and Fandt [28] consider the structure of the organization as an authority and responsibility for results achievement.

Tata and Prasad [29] also argued that the organizational structure is a system that can affect the smoothness of a function in the strategy implementation. Other opinions also described the organizational structure as a consistent establishment; they see the alignment as something very necessary in management because consistency is one of the factors that can affect the achievement of an objective [30]. Organizational structure can be characterized as formalized, hierarchical, centralized or specialized. Formalization refers to the degree of bureaucracy prevalent in the organization; hierarchy refers to how many levels the organization has from the lowest to the highest level, centralization means the extent to which decisions are made at the center; specialization refers to the extent of specificity jobs are divided. This paper will touch only one dimension of organizational structure, i.e. formalization.

Formality Structure: According to Surjadi [34], organizations have a formal structure. A Formal organization means that such an organization has clear written rules (formalized). The rules of the organization determine how it behaves. It is not only the written rules that determine behavior. It is the organization human resources that play certain roles and responsibilities in a written clear structure. This view was also expressed by Kelli [35] who said that formality of organizational structure is a rational system in which the organization is designed to create clear rules and regulations. In a similar vein, Surjadi [34] said that the perspective of rational system is used to see the organization has a specific purpose that is clearly defined.

From the views above, it can be understood that the formality of the structure can be seen as the extent to which an organization activities are carried out unencumbered by rules, procedures and laws. In addition, Grossi, Royakkers and Dignum [36] argued that the formality of an organization is closely associated with the number of writing documents in the activities of the

organization. These documents include procedures, job description, regulations and policy manuals (policy). In line with what Grossi [36], Tata and Prasad [29] added that a high formality shows a lot of things that run officially and in writing. These things include work procedures, job description, communication and decision of a consultation document.

In fact, formality plays an important role in running an organization because the formality of formal authority structure is related to two things, which are the use of SIA to control the subordinates' behavior and the use of SIA to facilitate in decision-making [37].

Formality Structure as a Moderator: Jonhstone [31] stated that some form of authority within an organizational structure would strengthen the relationship between the practice of strategy and corporate performance.

Previous research on the organizational structure as a moderator on the relationship between strategic implementation and the performance of manufacturing firms is still highly limited. Hashim [32] found that the complexity dimension has a moderating effect on the relationship between trade strategy and firm performance. Furthermore, Ritonga [33] proved that the decentralized organizational structure has a moderating effect on the relationship between up-to-date information with staff achievement.

This study attempts to examine the structure of formality precisely the implementation of the program organization, budget implementation and monitoring the implementation of the source as a moderating variable on the relationship between strategy implementation and firm performance.

Formalization is one of the dimensions of organizational structure that is used in this study. This study aims to examine the moderating effect on the relationship between strategy implementation and the performance of the manufacturing firms in Indonesia. Previous research has not yet shown the extent to which formality of structure in the organization moderates the relationship between strategy implementation and firm performance [33, 38, 39]. Hashim [32] found that there was a moderating effect of formality on the relationship between business strategy and performance. Based on the literature review discussed in this study, we propose the theoretical drawn below.

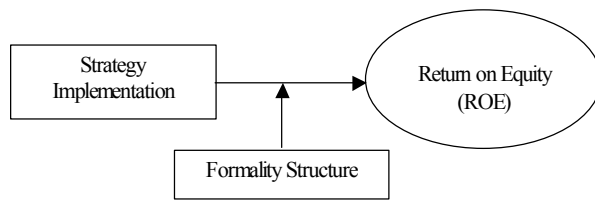


Fig. Theoretical Framework of Research

Based on the theoretical framework of this study, two hypotheses have been formulated. They are as follows:

H₁: There is a significant relationship between strategy implementation and firm performance,

H₂: Formality structure has a moderating effect on the relationship between strategy implementation and firm performance.

MATERIALS AND METHODS

Population, Sample and Respondents: The population in this study was all manufacturing firms listed on the JSE in 1999 - 2001. The population elements are 164 manufacturing firms listed on the JSE. The CEOs of these firms were identified as the respondents in this study.

Measurement of Major Variables

Formality Structure: The measurement of formalization of structure as the moderating variable in this study was adopted from Hashim (2000). Formalization is conceptualized as the level of formality prevailing in an organization. It refers to how much written documents are used by organization managers in their activities. This study looked into five dimensions that measure the formality of structure. These five dimensions are (1) the results of the meeting, (2) the regulatory organization, (3) details of the task (4) changes in the structure and (5) changes in staff duties. Formality of structure is measured by looking at how often the activities of the five dimensions are written down. A 5-Likert scale ranging from 1=not very often to 5= very often was used. The size was determined by Likert scale scoring in five levels, that is, from "not very often" (one) to "very often" (five). The respondents were directed to select the actual score that represent their practice.

Strategy Implementation: The measurement of strategy implementation was adopted by Li Chen [2]. According to Chen [2] the implementation of the strategy is to change a design into a realistic action. This view is in line with the

opinion of Dyson [40] and Wheelen and Hunger [21], which emphasizes the implementation of the strategy to create an action of budgetary and procedure programs. The implementation of strategy also means putting the strategy and policy into concrete actions.

Firm Performance: This study measured firm performance using Return on Equity (ROE). According to Wheleen and Hunger [21], firm performance is the final result of a firm operating within the specified period. Hence, this study measured the performance of the manufacturing firms within a period of five years. The measurement of return on equity (ROE) is the total net profit earned in the year divided by total capital, the division is multiplied by the percentage. Agustina [41] said that one of the factors that determine the development of the firm depends on good financial management system, for returns that are received by the firm or shareholders is a maximum rate of return.

RESULTS AND DISCUSSION

Data Collection and Respondents Profile: The primary data collected in this study was obtained via 164 distributed questionnaires out of which 127 questionnaires (77.43%) were returned. Out of 127 returned, only 112 were used in further analysis. As shown in Table 1 below, the response rate of this study was 77%.

The respondents of this study comprised 11 Managing Directors, 37 directors, 12 deputy directors and 52 heads of divisions/departments. A majority of the respondents (84%) were males. As for education, the majority of the respondents hold bachelor degree (57.10%) and master degree holders (35.70%). With regards to age, 86% of the respondents were between 36-45 years old. In terms of tenure, the majority of them (70.5%) had between 1-5 years of experience.

As for the profile of the manufacturing firms of this study, the firms were from different industries including food and beverage, automotive, clothing, plastic, pharmacy, textiles, chemicals and others.

Factor Analysis and Reliability: The first step in data analysis is to determine the dimensionality of the variables in the proposed model or the relationship in empirical research [42]. Factor analysis is an interdependence technique, whose primary purpose is to define the underlying structure among the variables in the analysis [43]. The principal components factor analysis

Table 1: Factor Analysis -Strategy Implementation

Dimension of Strategy Implementation	Factor		
	1	2	3
Organization Program Implementation			
a. Climate and culture appropriate for a strategy	.86	-	-
b. Changes in leadership style according to the strategy	.83	-	-
Budget Program Implementation			
a. The use of assets for inventory purposes	-	.77	-
b. The use of long and short-term capital	-	.76	-
c. Budget implementation	-	.70	-
d. The cost of production, manufacturing, capital and investment	-	.67	-
e. The budget for staffs	-	.64	-
Source Control Implementation			
a. Control of input, process and output	-	-	.83
b. The cost of output, capital and investment	-	-	.81
c. Allocating resources	-	-	.80
Cronbach alpha	.83	.82	.83
Total variance explained	7.27	6.08	5.58
Eigenvalue	2.25	1.89	1.81
MSA		.69	
Bartlett's test of sphericity	1305.5		
Significance		.00	

with varimax rotation was employed to understand the underlying structure in the data matrix, to identify the most parsimonious set of variables [43] and to establish the goodness of measure for the scales to be used in the testing of the hypotheses.

Table 1 below shows the results of factor analysis of the dimensions examined in the study. In the dimensions of strategy implementation, there are three factors that are worth to be analyzed: organization program implementation, budget program implementation and resource control implementation. The variables are treated to factor analysis and the results are as shown in Table 1. As expected, three components/factors appeared and are named accordingly i.e. implementation of organizational program, budgetary implementation and control of resource inputs. The total variance explained is only 18.9% which is rather low and the MSA (sample adequacy) is only .69 or 69%. However, the Eigenvalues of the three factors are above 1.0 and are significant. The factors are analyzed using the reliability test, which results in credible Cronbach alphas ranging from .81 to .83.

Next, the organization variables were treated to the factor analysis. The results are shown in Table 2. In the dimensions of the organization structure, two factors appeared. These two dimensions were formalization structure and specialization structure, but for the purpose of this paper only formalization structure is used.

Table 2: Factor and Reliability of Organizational Structure

Organizational Structure Dimension	Factor	
	1	2
Formality Structure		
a. Task completion	.85	.31
b. Structure completion	.85	.01
c. Making job descriptions	.73	.03
Specialty Structure		
a. Product distribution	.02	.88
b. Transportation	.18	.86

Reliability: Cronbach Alpha of the major variables of this study ranged between .75 to .83. MSA for strategy implementation was .69 while it was .64 for formality structure. As for the Barlett Test of Sphericity, it was 1305.543 for strategy implementation and 1305.54 for structure formality. After factor analysis and reliability analysis were conducted, correlation and regression analyses were run to achieve the objectives of the study. Table 3 below shows the results of the correlation analysis.

Based on the results of Pearson correlation analysis, it was clearly shown that there was a correlation between the different dimension of the independent variables and the dependent variable. Among these variables are organizational program and budget program implementation. It is the employees who implement any program in the company. In implementation process,

Table 3: Correlation Analysis - Major Variables

Variable	1	2	3	4
1. Organizational prog. implementation				
2. Budget prog. implementation	.196(*)			
3. Source control implementation	.081	.236(*)		
4. Structure of formality	.099	.206(*)	.037	
5. ROE	.446(**)	.407(**)	.264(**)	.330(**)

*Correlation is significant at the 0.05 level (2-tailed).

**Correlation is significant at the 0.01 level (2-tailed).

Table 4: The Results of Hierarchical Regression of Strategy Implementation of Performance with Formalization of Structure as a Moderator

Independent Variables	Regression Coefficient (β)			
	Steps	1	2	3
Organizational Program Implementation		-.01	.02	-.04
Budget Program Implementation		.37***	.32***	-.13
Source Control Implementation		.33***	.29***	-.34
Formality of Structure		-	.30***	-.57
Organizational Program Implementation with x Formality			.03	
Budget Program Implementation with x Formality			.73***	
Source Control Implementation with x Formality				.57***
R		.54	.61	.66
R sq		.29	.37	.43
Adj. R sq		.27	.35	.39
R sq Changes		.29	.06	.06
F		11.30***		
F Sig.		.00		

*p<.10 **p<.05 ***p<.01

such employees are creative thinkers, as Florida and Goodnight [51] refer to them. Florida and Goodnight [51] suggest that a company's most important asset is not its raw materials, transportation systems, or political influence. Rather, these authors claim that a company's most important asset is its creative capital- that is, the creative thinkers in the firm. From an implementation perspective, creative capital must be planned for in the firm and will determine the strategies that are ultimately formulated and implemented.

The Moderating Effect of Formality: To test hypothesis 2 in page 5, a double regression modernization test was conducted on formality structure to test its moderating effect on the relationship between strategic implementation (organizational program implementation, budget program implementation and source control implementation) and the performance of manufacturing firms measured by ROE. Table 4 below shows the results of the double regression modernization test.

The analysis results above show that the correlation coefficient (R) is .54, .61 and .66 which show that strategic implementation (organizational program, budget program and source control) has a strong relation with the firm performance (ROE).

Furthermore, decision analysis showed that the increase of coefficient (R²) of regression step 1 (without variable modernization) of regression step 2 (with variable modernization) and of regression step 3 (with interactive variables modernization) is significant at the level of (p <.01) for the performance of a firm (ROE).

In addition, ANOVA test results showed that F value is 11.30 with significance level of (p<.01). It shows that that the significance is far below .05, which means that strategic implementation variable and modernization of variables influence the performance of a firm (ROE).

Besides, individual parameter significant test (with statistic test) shows that formality structure is significant as moderating variable, which is at the level of (p<.05) for performance measure (ROE).

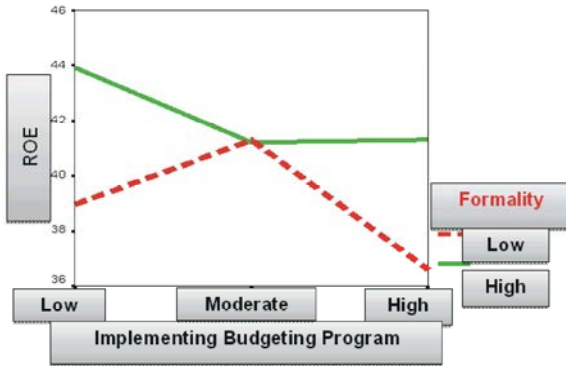


Fig. 1: Moderating Role of Structure formality on the relationship between budget program implementation and performance (ROE)

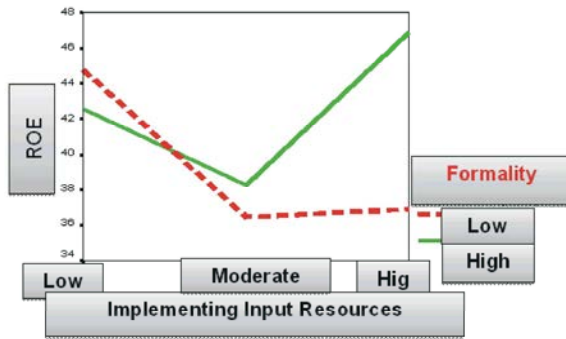


Fig. 2: Moderating role of formalization structure on the relationship between resource control and ROE

Hence, the structure of formality has a moderating effect on the relationship between strategic implementation (organizational program implementation, budget program implementation and resource control implementation) and performance (ROE). This means that the increase of formality structure tightens the correlation of strategic implementation on performance and in the end increases the performance of a firm (ROE). The performance of manufacturing firms is better when strategic implementation is implemented with the formality of structure.

Figure 1 below shows the role of structure formality as a moderating variable on the relationship between strategic implementation (budget program implementation) and the performance of manufacturing firms (ROE).

Figure 2 below; however, shows moderating role of structure formality as on the relationship between strategic implementation (resource control) and the performance of manufacturing firm. The figure explained that performance of the firms is at the high level when resource control implementation was run with formally structured.

CONCLUSION

The results of this study have shown that there is a significant relationship between strategy implementation and the performance of the manufacturing firms in Indonesia. The results have also shown that the structure of formality has a moderating effect on the relationship between strategic implementation and the performance of manufacturing firms. Precisely, formality structure has a moderating effect on the relationship between budget program implementation and resource control implementation on the one hand and performance (ROE) on the other hand. This study has shown that the formality of structure of an organization can strengthen the relationship between strategy implementation and performances of a firm.

This paper has shown that strategy implementation has a positive relationship with performance, that is to say, the more effectively a strategy is implemented, the better the firm perform. The results of this paper assure that much attention has to be paid to the implementation process of the strategy. Generally, the results of this study emphasize that CEOs of the manufacturing firms in Indonesia should take strategy implementation seriously. In this regard, it is worth mentioning the advice given by Beer and Eisenstat [45] with regards to strategy implementation. They described six silent killers of strategy implementation, with the idea being that managers who confront these killers, rather than using avoidance or managerial replacement techniques, could overcome them and therefore become a capable organization. The six silent killers were identified as (1) Top-down or laissez-fair senior management style, (2) Unclear strategy and conflicting priorities, (3) An ineffective senior management team, (4) Poor vertical communication, (5) Poor coordination across functions, businesses, or borders and (6) Inadequate down-the-line leadership skills and development.

Hence, strategy implementation is not an opponent that needs to be conquered or tackled. Rather, it is a critical cornerstone and ally in the building of a capable organization and then use of the appropriate levers of implementation will be the pivotal hinge in the development of that organization [45]. Strategy implementation helps create the future. As an ally and not an opponent, the implementation process works side-by-side with the formulation process and such collaboration leads to plans that are financially, socially and ethically responsible strategies for a company. Successful implementation of a well-formulated and

appropriate strategy will enable a company to become better and better over time, therefore achieving its longer-term vision of a good mission, good planning and overall corporate success [45].

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