

Driving Forces of internationalization – differences between sectors

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Abstract

Globalization and the progress in information and communication technologies, as well as international services trade agreements, have improved the position of service industries in the world economy. Therefore, an increasing number of service firms are engaging in foreign markets. The literature on internationalization, however, does not pay much attention to this sector, tending to focus more on the manufacturing sector and multinational enterprises (MNEs).

Regarding this subject, scholars highlight four features that distinguish services from manufactured goods: intangibility, inseparability, perishability and heterogeneity. Researchers argue that these characteristics influences the motivations of particular service industries to engage in foreign market operations and this also inevitably makes their internationalization motivations and determinants different from that of the manufacturing sector. Bearing in mind this gap in the literature, the main objective of this study is to empirically investigate the driving forces behind internationalization of Portuguese firms, focusing on differences between sectors. Specifically, to examine the factors that determine firm internationalization strategy and the differences between service and manufacturing firms.

To achieve this goal, we used Quantitative Analysis Methodologies. Data collected from 199 valid responses were treated using IBM SPSS Statistics 26.0 software. Given the nature of the data (categorical variables measured on an ordinal scale), the statistical methods used for the data analysis were Descriptive Analysis (frequency analysis and graphical representations) and Inferential Analysis (Kruskall-Wallis nonparametric test with multiple comparisons).

Keywords: internationalization, internationalization determinants, services, manufacturing sector.

Introduction

Business internationalization in macroeconomic terms is related to the flows of exchanges of raw materials, finished and semi-finished products, services, money, ideas and people between two states or nations. Seeking to enter the global market has become imperative, not only in terms of survival but also as one of several growth strategies. In the face of economic globalization, internationalization has become a crucial strategy for companies that want to empower their growth (Luo et al., 2005; Sapienza et al., 2006). Barber and Darder (2004) portray internationalization as a process of strategic management whereby firms assess the changing conditions of the international environment and, based on their resources, develop a suitable organizational response that involves crossing international borders. Fernández and Nieto (2005) argue that internationalization is the most complex strategy a company can undertake, given its uncertainty, its risk and the need for teams with cross-cultural competencies and cultural intelligence.

Internationalization is still seen by many companies as a way of reducing risk across the numerous countries where they operate. Given the role of economic cycles, internationalization is used to offset the performance of some countries with that of others, thereby turning disadvantages into advantages. The prospect of accessing more affordable factors of production in other countries means that companies view internationalization as a means of achieving cost reductions and economies of scale (Fernández and Nieto, 2005; Lockyer, 2013; Hennebel et al., 2017).

Literature Review

Internationalization strategies

Guillén and García-Canal (2009) and Rui and Yip (2008) focus on growth strategies in relation to companies' approaches to foreign market entry to grow beyond the confines of the national market. This decision might be a response to fierce competition, restrictive business expansion public policies, a lack of consumer sophistication or a host of other factors that lead companies to internationalize and exploit opportunities in new markets. Usually, these opportunities are detected by the company's business partners in a given market, or they result from poor partner performance, which leads companies to rethink their strategies (Lambe et al., 2002).

Douglas and Craig (1995) and Magnani et al. (2018) argue that certain internal company factors determine the choice of internationalization strategy. They highlight the international vision and mentality of managers, organizational dynamics and the management of organizational change. Organizational dynamics include core competencies, market access (customer proximity), company integrity (ability to be faster, more flexible or more reliable), product functionality, the ability to adapt to new processes (learning), and organizational inheritance or crisis (Pellegrino and McNaughton, 2015). According to Katsikeas and Pierce (1993), the internal agents are the managers, and the managers of the company are the main

decision-makers for matters regarding internationalization and the identification of competitive advantages, which may include installed capacity, accumulated stock volume and new orders. (Lobo et. al., 2019).

Knowing the local competition is essential to be able to act locally (Peng, 2009). Logistical issues are an important factor in internationalization. The organisation of communication and information networks in a given market must also be considered when choosing the best internationalization strategy (Baum et al., 2000). At the start of the internationalization process, firms tend to incur higher costs than competitors in the external market. These higher costs derive from transaction costs and coordination costs. These costs relate to doing business outside the domestic market (Johanson and Vahlne, 1977), which is known as the liability of foreignness. However, as the advantages of ownership are exploited and the role of the company's strategic objectives is taken into account, the company's performance in international markets will tend to evolve without necessarily following the process of gradual internationalization (Johanson and Vahlne, 2009; Autio, 2017).

Most internationalized SMEs face limitations in terms of resources, skills, information, financial capital, managers' experience and constraints inherent in the vulnerability of the external environment. Alliances are therefore a widely used way for SMEs to internationalize. In addition to minimising costs, sharing risks and enabling access to key resources, alliances also have major advantages in terms of networks, resources and knowledge of partners (Gulati, 1998; Pellegrino and McNaughton, 2015).

According to Peng (2009), the strategic tripod may be the best way to approach the external market. Three fundamental perspectives are considered: the industry, the company's resources and competencies, and the country's institutional environment.

Firm size is also a factor in the internationalization process (Dess et al., 2008). In most cases, resource restrictions condition the choice of market where a company intends to expand, thereby limiting business to frontier countries. Combining the scarcity of resources with the cultural proximity that often exists between frontier countries, means that companies view these as complementary and favourable factors for internationalization in these territories (Yamin and Sinkovics, 2006; Raposo et al., 2014).

Another strategy for the internationalization of companies was proposed by Malhotra et al. (2009), who considered only two perspectives: the environment, or the country's surroundings, and the company's intrinsic variables. The first perspective concerns the characteristics of the market under analysis. Relevant characteristics include human capital, technology and natural resources, as well as political, cultural and government issues, although the company has no scope to influence the management of government.

The second perspective concerns specific company factors such as R&D capacity, knowhow, financial capital, technological means and managers' marketing and distribution skills. In addition to the main trends in new forms of competition and organisation, the prevailing opinion is that there is no place for companies that decide to compete in isolation. If this opinion is true for large firms, it is even more so for small firms (Blomstermo et al., 2004). For Korsakienė and Tvaronavičienė (2012), SMEs are characterised by their flexibility, adaptability

and innovation, but establishing relationships in international markets requires greater skills, management, knowledge and long-term availability, as well as human resources to develop an effective and consistent internationalization strategy.

Many companies lack high-value information. The smallest companies and those taking their first steps towards internationalization need the resources and expertise to identify business opportunities abroad, potential partners, foreign trade practices, export procedures, import regulations, standards and specifications of products, and so on. Korsakienė and Tvaronavičienė (2012) also point out that by their very nature, networks facilitate this interaction between different companies and organisations that share common objectives and interests and represent a source of cost-effective synergies. Being small and acting like a big firm represents a major evolution in strategic terms. One question here is whether it is better for a particular company to take full control of the value chain (integration) or focus on only a part of this chain and to seek agreements with other upstream and/or downstream firms by forming alliances, integrating networks or developing other forms of cooperation (Tang, 2011; Torkkeli et al., 2012; Freeman et al., 2012). Johanson and Vahlne (1977) defined psychic distance as the factors that disrupt the flow of information between the company and the market, including factors such as differences in language, culture, political systems, level of education or level of industrial development. According to the aforementioned authors, this is an important concept because internationalization is based on learning by developing knowledge from experience in foreign markets. To explain internationalization, it was hypothesised that companies successively enter markets with greater psychological distance. However, research (e.g. Magnani et al., 2018) has shown that the different stages of commitment to foreign markets do not follow a linear path. Internationalization does not necessarily start in geographically closer countries. On the contrary, distance in its multiple dimensions may actually be attractive if, for example, these dimensions are consistent with the company's strategic objectives.

For companies such as born globals, geographical location and psychic distance are not relevant factors. Furthermore, because many markets are entered simultaneously, these companies can reduce fixed costs, especially when linked to high technology industries and R&D activities (Gibb and Szałucka, 2012). Founders of born globals are usually characterised by a high degree of entrepreneurial orientation, pro-activity and international experience. Internationalization is mainly based on export activities, through cooperation with local companies and a strong use of personal contacts and business networks.

From another perspective on the influence of age, experience and company size on internationalization strategies, McDougall et al.'s (1994) research on international new ventures challenged the idea that new or small firms could not internationalize (McDougall and Oviatt, 2000; McDougall et al., 1994). They empirically observed that many companies internationalized early, often successfully (McDougall and Oviatt, 1996). There is also empirical evidence that firm size affects internationalization decisions, namely in terms of entry mode. Smaller firms that lack the resources and experience to venture into foreign markets prefer entry modes with shared solutions (Fletcher and Harris, 2012).

Driving forces of internationalization

The determining factors in the internationalization process have been addressed by several traditional theories. Czinkota et al. (1999) enumerate a set of key factors that influence the strategic approach to business internationalization. They group these factors into proactive factors (potential advantages in terms of profits, technology, unique products, information management, tax benefits and economies of scale) and reactive factors (competitive pressure, excess capacity, saturation of the domestic market and proximity to customers). According to Mathews (2006) companies might internationalize for relational motives (by responding to competitors, following up on customers' internationalization processes or acting upon approaches of foreign companies), access to foreign resources (finding lower production costs abroad or accessing technological knowledge through branches) or government incentives (through the support of the home or host government). Additionally, Dunning and Lundan (2008) point out four motivations for firms' internationalization, where Resource-seeking and Strategic asset-seeking are included. Resource-seeking is defined as a search for resources, such as raw material, labour and obtaining technological, management or marketing know-how, which given the scarcity or non-existence in the country of origin, lead to a need for investment in foreign countries. Strategic asset-seeking is mentioned by the authors given that multinational firms (MNEs) constantly seek to exploit gains from market imperfections, or originate them for their own benefit. To do so, acquiring physical goods, specialized labour, know-how in R&D, through mergers or joint ventures, in order to achieve long-term goals.

As we have seen, Czinkota et al. (1999) provide a list of key factors that influence the strategic approach to business internationalization. Pedersen et al. (2002), Puck et al. (2009) and Benito et al. (2009) offer a proposal that resembles Czinkota et al.'s (1999) but is more comprehensive and complementary. They propose two types of factors (reactive and mixed) that influence strategic management of internationalization. Reactive motivations include internationalization by entrainment and the imperatives of the business itself. Mixed motivations include, for example, geographic proximity and cultural and linguistic affinities, the use of economies of scale to take advantage of the country's image, and support from the home or host government. For Nigh (1985) and Sethi et al. (2003) the most important motivations for internationalization are market characteristics in terms of either the limitations of the domestic market or the perceived dynamism of external markets. The broader economic environment, the market conditions, the size of the internal market and the firm's proximity to external markets can also be considered external motivations for internationalization (Dess et al., 2008).

As we have seen, and according to Moghaddam et al. (2014), Dunning's (1992) model is based on four motivational factors: resource seeking, market seeking, efficiency seeking and strategic-asset seeking. Although this typology provides an important reference to explain the motivations for the international expansion of multinationals from developed countries,

empirical research has verified that the motivations of smaller companies may actually be quite different.

In terms of strategic objectives, Van Tulder (2015) identified three groups of motivations for internationalization: intrinsic, extrinsic and mixed. Intrinsic motivations include the aforementioned model designed by Dunning (1992). Extrinsic motivations refer to the motivations to exit the internal market. Mixed motivations relate to the specific dynamics in each sector. Lobo et al. (2019) stress that lack of human, financial, technological and information resources are some of the specific challenges faced by SMEs.

Driving forces of internationalization – differences between manufacturing and services sectors

Globalization and rapid progress in information and communication technologies, as well as international services trade agreements, have improved the position of service industries in the world economy. Consequently, an ever-increasing number of service firms are engaging in foreign markets (Daniels 1993; OECD 2008; Roberts 1999). The literature on internationalization, however, does not pay much attention to this sector, tending to focus more on the manufacturing sector and MNEs. Moreover, the scarce literature that does exist on the topic concentrates on particular branches of the service industry, without much generalization of concepts or findings (Bryson 2001; Contractor, Kundu and Hsu 2003).

Researchers highlight four features that distinguish services from manufactured goods: (1) intangibility (services are not transportable or storable), (2) inseparability (production and consumption occur simultaneously), (3) perishability (services cannot be saved but must be consumed as they are produced), and (4) heterogeneity (services are unique and difficult to standardize) (Zeithaml, Parasuraman and Berry 1985). Of course, different services are characterized by varying degrees of these attributes. Researchers argue that it is the intensity of the respective characteristics that influences tradability and performance of particular service industries in foreign market operations and this also inevitably makes their internationalization pattern different from that of the manufacturing sector (Clark and Rajaratnam 1999; Clark, Rajaratnam and Smith 1996; Ekeledo and Sivakumar 1998; Erramilli 1990; Knight 1999).

Internationalization Theories and Diversity of Service and Manufacturing Firms

The research discussed above deals with various strands of the complex phenomenon of firm internationalization and they complement each other more than they compete (Coviello and McAuley 1999; Daniels 1991). However, each has its own specifics and/or drawbacks that disqualify it from being completely appropriate for this study (O'Farrell et al. 1998).

The main criticism of the Foreign Direct Investment (FDI) theory is that it attempts to explain the extent, form, and location of foreign investment of MNEs by focusing primarily on transaction-cost advantages (TCA), rather than on the pattern of firm internationalization (Johansson and Mattsson 1988).

In fact, many service companies have lower capital needs than manufacturing firms and thus benefit from lower entry barriers into foreign markets in terms of financial constraints—establishing an office, for example, is much cheaper than setting up a manufacturing plant. Indeed, the internalization approach neglects a variety of non-TCA stimuli (e.g., following client's foreign market entry, securing product quality, enhancing firm prestige) that are important determinants of firm internationalization (Bell 1995; Erramilli and Rao 1993; Roberts 1999). Furthermore, and according to Coviello and McAuley (1999), though Dunning claims that firm internationalization should be investigated in a wider strategic context, he does not consider it a managerial decision-making process.

Reid (1983) argues that the stage model approach (Uppsala Theory) is too deterministic and that the internationalization process of individual firms is highly situational. Firms, regardless of industry sector, do not necessarily implement consistent and incremental steps toward internationalization (Bell 1995; Clark and Mallory 1997; Crick, Chaudhry and Batstone 2001; Lautanen 2000). Moreover, stage models appear to be too inflexible to account for firm strategic (re-) orientation (such as combining various modes of foreign market servicing in one country or withdrawing from a foreign market altogether) or foreign market specifics and requirements with respect to entry modes (McKiernan 1992; Turnbull and Valla 1986; Young, Hammill, Wheeler and Davies 1986).

As to the network perspective, researchers emphasize the collaborative nature of the internationalization of knowledge-based services (Bell 1995; Knight 1999; O'Farrell et al. 1998; O'Farrell and Wood 1999). And, indeed, due to their very nature, services generally do require a more intense client-producer interaction than does manufacturing, where standardization of the product across countries is easier to achieve. On the other hand, by focusing only on the interdependencies between actors, the network approach does not provide any explanation for certain foreign market development that is only partially the result of collaboration and even less for that which occurs without any cooperation. Thus, the network perspective provides only a partial explanation for internationalization and needs to be complemented by broader aspects of firm strategy.

Compared to the structures discussed above, the business strategy approach is, on one hand, more multilateral and appears to be flexible enough to deal with the development, characteristics and objectives of individual companies, and on the other hand, to capture the influence of the company's environment (Clark and Mallory 1997; Kim and Hwan 1992; O'Farrell et al. 1998).

Due to the great diversity between the manufacturing and service sectors (discussed above), as well as large differences between specific industries, we will carry out our study focusing on these differences.

Methodology

The data used in this research was gathered through an online questionnaire survey. The questionnaire was built taking into account the literature review and included several variables related to the firm's internationalization. It was sent to all firms registered in the AICEP database of Portuguese internationalized firms, by sending a link via e-mail and using the Google Forms tool. Answers were collected between May 2019 and January 2020. From the data collected, 238 valid responses (Portuguese internationalized firms) were obtained, which were then processed by IBM SPSS Statistics 26.0 software through a quantitative approach based on descriptive and inferential analysis. This study only considered 199 firms (of the 238) corresponding to the three main sectors of activity in the sample: (A) Manufacturing industries (124 firms), (B) Wholesale and retail trade, car and motorcycle repair (51 firms) and (C) Consulting, scientific, technical and similar activities (24 firms). Within the 199 firms, these in terms of size are: 34.2% micro firms (< 10 persons), 42.2% small (10-50 persons), 19.1% medium (50-250 persons) and the remaining are large firms (>250 persons). In this paper the main objective of the study is to empirically investigate the driving forces behind internationalization of Portuguese firms, focusing on the differences between sectors. Specifically, entrepreneurs were challenged to register "how much importance they attach to each of the factors, as a determinant for the decision to internationalize their firm", related to internal and external markets.

The factors related to Internal Market include the following categories: Need to win new markets / customers, Need to exploit own resources, Need to reduce / diversify risks, Need to take advantage of economies of scale and Others. The factors related to External Market include the categories: Weak competition in the market, Favorable growth prospects in a new market, Allow access to new technologies or resources, Track customers, Follow partners, Follow competitors and Others.

The various determining factors have been classified on a 5-point Likert scale: "1-not important", "2-not very important", "3-important", "4-very important" and "5-extremely important".

Results

Regarding the factors related to the Internal Market, we conclude that the most important factor is "Need to conquer new markets / customers" with an average of 4.31 (median 4), followed by "Need to reduce / diversify risks" with an average of 3.58 (median 4), in third place the factor "Need to take advantage of economies of scale" (average 3.44, median 4) and finally the factor "Need to exploit own resources" (average 3.05, median 3).

Figure 1 presents the results for median values of Internal Market factors by sector.

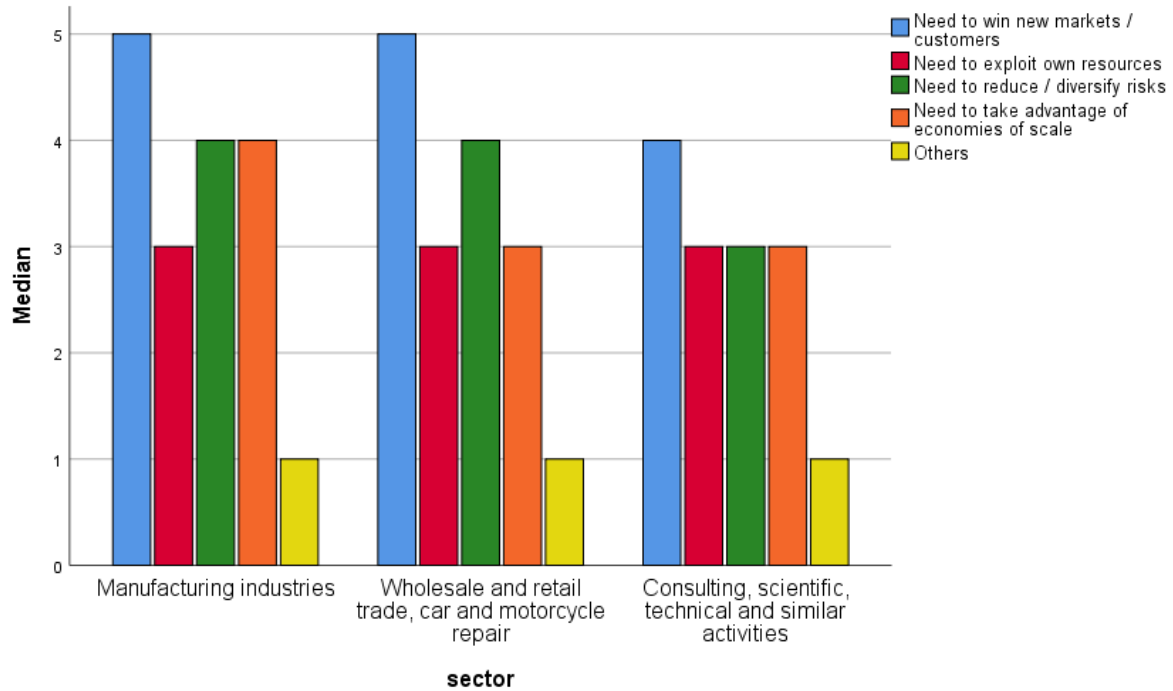


Figure 1- Median values of Internal Market factors, by sector

Also important to note that 87.4% of respondents to the questionnaire considered very important or extremely important “Need to win new markets/customers” and only 54.3%/51.3%, “Need to reduce / diversify risks” and “Need to take advantage of economies of scale”, respectively. Relatively to “Need to exploit own resources”, 61.3% considered important or very important and 8.5 % extremely important. Lastly, 69% consider not important other internal factors than those indicated.

It should be noted that the most important factor in terms of External Market is "Favorable perspectives of growth in a new market" with mean of 3.84 (median 4), followed by the factor "Follow up customers" with mean of 3.61 (median 4), which is why they are considered to be very important factors. Considered as important factors are "Follow partners" (mean 3.07, median 3), "Allow access to new technologies or resources" (mean 2.69, median 3) and "Weak competition in the market " (mean 2.67, median 3). It should also be noted that the "Follow competitors" is the factor with little degree of importance (mean 2.56, median 2). Figure 2 presents the results for median values of External Market factors by sector.

Moreover, 45.2% of respondents considered "Weak competition in the market" as a non-important/not very important factor and 52.8% of respondents attributed the same rating to the "Follow competitors" factor.

On the other hand, respondents rated the following external factors as at least important: “Favorable growth prospects in a new market” (94.5%), “Allow access to new technologies or resources” (57.8%), “Track customers” (84.4%) and “Follow partners” (69.9%). 75.6% considered not important other external factors than those indicated.

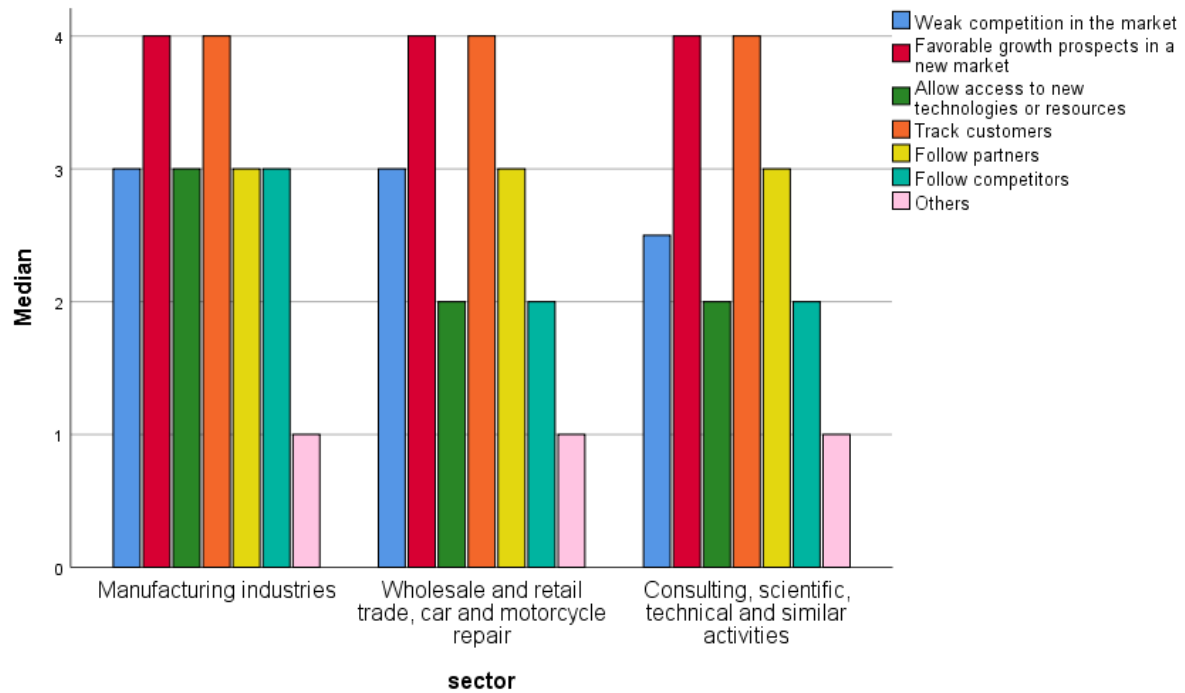


Figure 2- Median values of External Market factors, by sector

To assess the possible existence of significant differences between the 3 main sectors of activity regarding the characteristics of the internal/external market, we used Kruskal Wallis non-parametric test (indicated for variables measured in a Likert scale). Table 1 presents the results for Internal and External Market factors.

	Test Statistics ^{a,b}		
	Chi-Square	df	Asymp. Sig.
Need to win new markets / customers	8,923	2	,012
Need to exploit own resources	4,520	2	,104
Need to reduce / diversify risks	6,999	2	,030
Need to take advantage of economies of scale	1,081	2	,583
Others	,708	2	,702
Weak competition in the market	,245	2	,885
Favorable growth prospects in a new market	1,149	2	,563

Allow access to new technologies or resources	4,955	2	,084
Track customers	3,066	2	,216
Follow partners	1,873	2	,392
Follow competitors	2,284	2	,319
Others	2,150	2	,341

a. Kruskal Wallis Test

b. Grouping Variable: sector

Table 1- Results of Kruskal-Wallis test for Internal and External Market factors, by sector

Significant differences at 5% were found in the factors (characteristics of the domestic market) "Need to win new markets/customers" and "Need to reduce/diversify risks"(p-value=0.012 and p-value=0.030, respectively). For a significance level of 10%, we can also conclude that there are statistically significant differences for the factor (external market characteristic) "Allow access to new technologies or resources" (p-value=0.084<0.1). However, the Kruskal-Wallis test does not allow us to conclude in which sectors are there differences in comparison with the others. Therefore, for this identification, we proceeded to the multiple comparisons test. Table 2 refers only to the first factor identified above.

Multiple Comparisons

Dependent Variable: Rank of Fatores_internal_1

LSD

sector		Mean Difference	Std. Error	Sig.	95% Confidence Interval	
					Lower Bound	Upper Bound
Manufacturing industries	Wholesale and retail trade, car and motorcycle repair	,078669	10,1153	,994	-19,870	20,028
	Consulting, scientific, technical and similar activities	40,2735*	13,5604	,003	13,5306	67,0164
Wholesale and retail trade, car and motorcycle repair	Manufacturing industries	-,078669	10,1153	,994	-20,028	19,8702

	Consulting, scientific, technical and similar activities		40,1948*	15,0521	,008	10,5104	69,8797
Consulting, technical activities	scientific, and similar	Manufacturing industries	-40,2735*	13,5604	,003	-67,016	-13,531
		Wholesale and retail trade, car and motorcycle repair	-40,1949*	15,0521	,008	-69,879	-10,510
*. The mean difference is significant at the 0.05 level.							

Table 2- Multiple comparasions for Internal Market factor "Need to win new markets / customers"

Analysing the output of the multiple comparisons it is possible to conclude that for a significance level of 1%, the statistically significant differences in the degrees of importance assigned to the factor "Need to win new markets / customers" occur between the sectors "Consulting, scientific, technical and similar activities" and "Manufacturing industries" (p-value=0.003<0.01) and between the sectors "Consulting, scientific, technical and similar activities" and "Wholesale and retail trade, car and motorcycle repair" (p-value=0.008<0.01). A more detailed analysis also allows us to conclude that the "Wholesale and retail trade, car and motorcycle repair" sector attaches a higher degree of importance than the "Consulting, scientific, technical and similar activities" sector to the factor "Need to win new markets / customers". The same applies to the "Manufacturing industries" sector in relation to the "Consulting, scientific, technical and similar activities" sector.

Proceeding the same way for the factor (inside the characteristics of the internal market) "Need to reduce / diversify risks", through multiple comparisons method, it was observed the existence of significant differences, at a significance level of 5%, between the "Consulting, scientific, technical and similar activities" sector and "Manufacturing industries" sector (p-value=0.016<0.05). The "Manufacturing industries" sector attributes a higher degree of importance to this factor than the "Consulting, scientific, technical and similar activities" sector. While 58.9% of the companies in the Manufacturing sector consider this factor very or extremely important (and 90.4% at least important), with regard to "Consulting, scientific, technical and similar activities" sector, only 37.5% consider it very or extremely important and 25% of companies in this sector consider the factor to be unimportant or not very important. As mentioned above, for a significance level of 10% we can also conclude that there are statistically significant differences for the factor (external market characteristic) "Allow access

to new technologies or resources" (p-value=0.084<0.1). Again the multiple comparisons allow us to conclude that this difference arises between "Manufacturing industries" and "Wholesale and retail trade, car and motorcycle repair" (p-value=0.038). The degree of importance attributed is higher in the Manufacturing industries than in the "Wholesale and retail trade, car and motorbike repair" sector.

Conclusions and future work

The most important factors related to the 'internal market' are "Need to win new markets/customers", followed by "Need to reduce / diversify risks" and "Need to take advantage of economies of scale". The most important factors concerning the 'external market' are "Favorable perspectives of growth in a new market and "Follow up customers". All these factors are considered as very important to the entrepreneurs, concerning their motivations towards internationalization. Regarding the differences between sectors, the most relevant driving forces that distinguishes Manufacturing industries from the Services sector (where we can include 'Wholesale and retail trade, car and motorcycle repair' and 'Consulting, scientific, technical and similar activities'), in particular those related to consulting and scientific activities, are the need to reduce or diversify risks and also the need to access new technologies or resources. In the services sectors motivations, it stands out, mainly, the need to win new costumers.

Taking these results into consideration, we can state that the industrial sector still lacks innovative resources and technologies, as well as ways to manage the risk of national and international markets, while for the services sector the main concern is to broaden the target market.

Concerning future work we intend to assess the impact of the COVID-19 pandemic on these driving forces of internationalization. We think that above all the biggest impact will be on the importance that risk diversification will have for all sectors, since the post-covid reaction will be different in all countries, as well as the recovery of demand.

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