

## 14. Characteristics of strategic decisions during a period of transition

### Abstract

This paper analyses the strategic decisions of Hungarian firms in the period of the transition to a market economy. Strategic decisions are discussed in the broader context of strategic behavior of enterprises making distinction between the content and the process of strategy formulation. Three categories of firms are investigated: formerly state owned firms, private Hungarian firms, and joint ventures with foreign partners. Strategic decisions show many differences between these categories of firms and that it is only possible to speak about general strategic characteristics at a high level of abstraction.

### Research background

Strategic decisions are crucial elements in organizational adaptation to rapidly changing conditions. Analysing strategic decisions we may rely on different theoretical approaches.

One is the behavioral approach founded by James March, Herbert Simon and others connected to the 'Carnegie School' (March and Simon, 1958; Cyert and March, 1963). Following behavioral scientists we can approach organizational decision-making as starting with the individual as member of an organization.

When discussing strategic decisions of enterprises we have to take into account that individual members of organizations have differing possibilities to influence the strategic direction of the firm they work for. In general members

close to the top of the organization have more possibilities to influence strategic decisions. That is the reason to discuss strategic decision-making as 'top level decisions' (Donaldson and Lorsch, 1983; Hickson et al., 1986). Organizational members, however, may have strong influence over the strategic directions of their firm even when they are not formally at the top of the hierarchy. Therefore, we agree with Child in using the concept of 'dominant coalition' when describing the mechanisms of strategic choice (Child, 1972). The people that have – formal or informal – influence on the content and process of strategic choice are the real decision makers, and they are the members of the dominant coalition within their organization.

Possibilities for lower level members of the organization for participation in strategic decisions are influenced by management style (Likert, 1964), and also by the strategy the company has developed (Burgelman and Syles, 1986). Burgelman distinguishes between induced and autonomous strategic behavior (Burgelman, 1985). The former is connected to the present strategy of a firm, and is initiated by top management, while the latter is much more of a bottom-up type of relying on new initiatives developed at lower levels in the organization. We can conclude that it is important to take the organizational context into account when trying to understand decisions in organizations (Koopman and Pool, 1990).

Strategic decisions are often seen as part of the strategic planning process. When this is the case specific orientations to planning influence the process and the outcome of decisions. Ackoff (1981, pp. 52–76) distinguishes four basic orientations to planning, namely: reactive, inactive, proactive, and interactive. He argues for the interactive concept '... as the design of a desirable future and the invention of ways to bring it about' (Ackoff, 1981, p. 62). Here, we are close to the question whether our existing theories of organization are useful to solve future challenges or whether there is a need for a new organizational paradigm to overcome crucial difficulties companies are faced with. Drucker has a quite decisive viewpoint on it when he argues: 'Whenever a business keeps on going downhill despite massive spending and

heroic efforts by its people, the most likely cause is the obsolescence of its business theory,' (Drucker, 1993). There are other strong voices for the necessity of paradigm shift too (eg.: Perlmutter and Trist, 1986; Davis, 1987; Liu, Denis, Kolodny, and Stymne, 1990; Human Relations, 1990).

Studying organizational changes in Central and Eastern Europe, the problem we are faced with is even more complex as there is no previous example of transition from bureaucratic socialism to market economy. Kornai (1993) uses the label 'transformational recession' when describing the deep recession of post-socialist countries. It is sometimes difficult to understand what is going on in the Central and East European countries even for researchers living and working inside the region (see: Kiezun, 1991; Balaton, 1993/b).

Organizational learning also seems to be relevant in studying the strategic behavior of enterprises in the transition period. Learning from experiences of other companies working under market economy conditions is clearly observed when studying organizational changes in Hungary (Balaton, 1992). But learning may take other forms as well. Organizations faced with new environmental conditions often try new ways of adaptation. Distinguishing between 'exploration' and 'exploitation' (March, 1991) seems fruitful for acquiring more extensive knowledge on organizational transition. 'Exploration includes things captured by term such as search, variation, risk taking, experimentation, play, flexibility, discovery, innovation. Exploitation includes such things as refinement, choice, production, efficiency, selection, implementation, execution' (March, 1991, p. 71).

Strategic decisions can successfully be supported by modern information technologies. Information technology has strategic relevance due to at least two reasons. First, strategic decision-making can successfully be advanced by up-to-date applications of new information technology (see: Simon, 1977; Koopman, 1990; Simon, 1990). Secondly, information technology extends the number of options in developing new strategies and organizational structures (Child and Loveridge, 1990; Balaton,

1990). Information technology has changed the nature and means of competition. Firms have to respond to the new challenges (McFarlan, 1984; Porter and Millar, 1985; Balaton and Loveridge, 1985).

Researchers analysing strategic decisions from a strategic management viewpoint used to distinguish between the content and the process of strategy development (Miller, 1989). That distinction is important to take into consideration. It is also important to study the implementation and performance that accompany specific strategies. The problem with strategic planning is connected to the lack of involvement of managers in strategy formulation. The rather simplified strategic planning approach, often criticized (e.g. Mintzberg, 1994; Leavitt, 1986), is partially due to the lack of understanding the nature of strategic processes.

Besides the kind of rationality in developing new strategies, we have to take into account the influence of existing organizational structures (Peters, 1984), the elements of learning (March, 1991; Burgelman, 1990), the power relations (Pettigrew, 1985; Pfeffer, 1981), the nature of incrementalism (Quinn, 1980), and the selection mechanisms in organizations (Burgelman, 1991).

When analysing national and organizational level transition in Central and Eastern Europe, students often forget that the transformation is not only driven by socio-political and economic factors, but also by technological factors. Strategic response to technological innovations has started, but the gap is still large (Child and Loveridge, 1990; Balaton, 1990; Child and Balaton, 1990). The task to be performed is huge. It is not only a question of technology and organizational design but also of changing the cultural background both at organizational and national level.

### **Empirical research projects**

The paper is based on two streams of research in which the author is involved. First, we should mention the project 'Organizational Change in Eastern Europe' which was started in 1990 together with Professor James G.

March. The aim of this project is to conduct a longitudinal study of organizational changes that go parallel with the ongoing socio-political and economic transformation of Central and Eastern European countries. The actual research work is in progress in Hungary and the Czech Republic.

The second research background is the study of strategic management of Hungarian enterprises which is closely related to developing new teaching materials for the Budapest University of Economic Sciences (involving both theoretical work and case study development).

The afore-mentioned research projects are connected to other similar empirical investigations throughout Europe within the framework 'European Management and Organizations in Transition' (EMOT).

## Research methods

Designing the project 'Organizational change in Eastern Europe' we did not want to rely on 'strong prejudices with respect to methodology, but ...instead to begin with procedures that emphasize the contextual richness of the processes' (Balaton, Dilova, Dobák, and March, 1990). We use qualitative case study analysis, and want to compare individual cases across nations. Qualitative cases are generally favored to quantitative data analysis, because they provide deeper insight into what is happening in organizations (Van Maanen, 1979). As we conduct a longitudinal analysis of organizational changes, the case method is well suited to the research design. In some of the organizations we are analysing there is the possibility of providing feedback for managers our understanding of the situation and discuss it in small groups (Heller, 1969).

As there are large differences between cases with respect to ownership, branch of industry, year of foundation etc., it is our intention to use quantitative comparison of change patterns in the second phase of our empirical research work. Thus, we benefit from both the richness of qualitative case studies and the advantage of being able to cover a larger sample of organizations (Lammers and Hickson, 1979; Jick,

1979). The author believes that the triangulation method (Jick, 1979) is relevant and necessary to study such complex problems as organizational transitions.

Both projects mentioned above are in progress, and the number of cases studied is gradually increasing. Up till now we have four cases within the 'Organizational change in Eastern Europe' project and six others in our teaching related research. Through the EMOT network we obtained three other cases in Hungary. (The present paper is based only on Hungarian experiences.) Altogether the paper relies on 13 cases.

## Empirical findings

In the remaining part of the paper we provide a summary of first empirical findings. First, some general characteristics of strategic behavior are described, followed by a more detailed analysis of the content and process of enterprise level strategies in the transition period.

### *General characteristics of strategic behavior*

In order to provide a proper analysis of strategic behavior it is necessary to distinguish different types of organizations (e.g. on the basis of ownership, profile – manufacturing or service -, size, year of foundation). It is only possible to speak about an emerging general pattern of strategic behavior at a rather abstract level. A characteristic feature is the shortening of strategic horizons compared with the one before the transition. This can be illustrated by one of the companies in the sample. The first strategy of this firm was developed in 1982, and long-term planning ranged until 2000 (18 years). In 1989 the company reformulated its strategy, and the time horizon was again the year 2000 (11 years). In 1992 the top management felt the need to prepare a new strategy due to the accelerated changes in the company environment. The new strategy contained aims and means for the coming 4 to 5 years. This tendency of shortening strategic horizons can also be observed in Western countries – due to

increasing environmental turbulence and uncertainty (Davis, 1987).

Strategic processes show stronger organization-related, specific characteristics than types of strategies. Organizational traditions with strategy creation influence the type of strategic process – e.g. induced or autonomous strategic behavior (Burgelman, 1985) – which is favored by the organization analysed. In case of small sized companies induced strategic behavior was characteristic, while larger firms relied more on lower level initiatives and participation in developing new strategies.

When deciding on the type of strategy they will use, Hungarian organizations rely on existing types of strategies (e.g. diversification, focus cost leadership, see: Porter, 1980). Available types (or types the organization is familiar with) reduce the variety of possible strategies. A strategic process dominated by following others' example results in less innovative, 'follower-type' strategies.

Strategy development in Hungarian enterprises is usually based on Western European or North American methods developed during the 1970's. That is the main reason for the planning approach being characteristic for enterprises in Hungary. The influence of recent developments in strategy research is hardly found in Hungarian firms.

Types of strategies generated by following others' example (institutional process) do not always fit into the existing reality of Hungarian firms. A lack of taking the traditions of organizations, their structural and cultural characteristics into account as one factor influencing successful future strategies can often be observed. Implementation of decentralized, divisional organizational structures is frequently observed in Hungarian firms, but the necessary preconditions are often missing, resulting in disturbances in management. Sometimes there is a clear-cut, purposeful action not to rely on past events, because it was 'under communism'. In our opinion it is partially right. But it is right only to the extent that past routines, structures, and behavioral patterns reflect the so-called normal way of behavior under the previous system. Those who argue strongly to make a clean break with the past often forget that there

are also non system-specific elements in the functioning of organizations that we could rely on when developing new approaches to emerging problems (e.g. many Hungarian state owned firms were innovative during the 80's in using self-managed work co-operatives as a special form of secondary economy.) Anyhow, we have to solve difficulties arising from the fact that traditions and cultures of our organizations established before the transition, are based in the command controlled system. The most effective way of solving this problem is probably not the one which copies generally accepted strategies in market economies around 1980. There are some weak signals showing that both business firms and state-owned organizations dealing with privatization and economic restructuring are becoming aware of this fact, and change their strategy.

Another general characteristic of strategic behavior is that the post-socialist recession (Kornai, 1993) has a strong influence on both the content and the process of strategic decisions. Survival is often the primary strategic purpose of companies and strategic management of changes can in many cases be described as crisis (or turnaround) management. In general, although there are differences between the firms in our sample, short term liquidity, crises management and preservation of individual positions of managers are characteristic for Hungarian firms.

#### *Characteristics of strategy content*

In the following we shall describe the most important features of the content of strategies by grouping the organizations according to ownership. Four categories of organizations are distinguished:

- Formerly state owned firms in the period of transition;
- Privatized firms owned by Hungarians; subcategories applied within it:
  - companies founded before the socio-political transition,
  - companies founded in the period of or

after the socio-political changes (in 1990 or later);

- Joint ventures with foreign partners located in Hungary.

#### STRATEGY CONTENT IN FORMERLY STATE-OWNED FIRMS

It has already been mentioned that the *time horizon* of firms *tends to decrease*. This is especially characteristic of formerly state owned firms. We should mention that it was not a general practice in the Hungarian firms in the previous socio-economic system to have corporate level strategies. In many cases it was simply neither possible nor necessary to rely on strategies for being successful (Balaton and Mohai, 1988).

*The most important characteristic of the strategies of formerly state owned firms is privatization.* Until 1993 each firm had to be transformed from the previous position of being under direct state supervision into a company based on the 1988 Act. The State Property Agency (founded in 1990) is responsible for privatizing the companies. Firms regarded as strategically crucial will remain in at least partial state ownership and belong to the Assets Holding Company or to Ministries. Formerly state owned firms are now in different phases of the privatization process. Some have already been privatized, others have not yet started this process, and a third group is now being privatized.

Before privatization the major characteristic of strategic decisions is *acquiring an advantageous position* for the coming stage. No important strategic decisions were made in this period because of the high level of organizational and personal uncertainty. We have some examples when strategic decisions due to be made according to previous schedules were postponed because top managers were afraid of possible disadvantageous evaluations of future owners. This period can be described as strategic stagnation, sometimes resulting in devaluation of company properties.

Companies dealing with formulation of new strategies in the transition period frequently

develop only *strategic guidelines instead of formerly used detailed strategic plans*. The conditions do not allow for preparing voluminous documents. This is similar to companies in market economies in the same period of time (Eisenhardt, 1990).

As a consequence of rather insecure environments and future prospects *alternative strategic decisions* are frequently favored. Formerly, development and careful analyses of two or more options was hardly observed.

*Marketing orientation* and aspirations to meet customer expectations seem to increase in importance for decisions makers. This reflects an important first step in shifting the orientation from hierarchy towards market.

#### STRATEGY CONTENT IN PRIVATE HUNGARIAN FIRMS

Analysis of our empirical data shows different patterns of strategies in firms that were founded before the political and economic changes in 1990, compared to those founded later. Newly established private firms often follow the example of their predecessors, sometimes even the unsuccessful or dangerous strategic pathways.

One of the most important features of strategy content in the category of *private firms founded before 1990* is intended *growth*. Profit ratios are often subordinated to possibilities for growth. All types of growth strategies (Ansoff, 1988) are found in our samples, namely: increase in market share, market development (invading new markets), product development, and diversification (both market and product development).

In some firms emphasis on growth resulted in a level of *accelerated growth which exceeded the resource and managerial capabilities of firms*. Here we are faced with the typical problems of young firms being too successful in meeting growth targets. In Hungary a specific condition which contributed to failures of fast growing private firms, was the high interest on loans. Growing firms were generally in shortage of funds, so acquiring loans became a consequence of their strategies. When the annual rate of interest is about 40%, it is rather difficult to



be successful in manufacturing industry or even in the trading sector. Increasing debt and insolvency were characteristic for some of the studied enterprises.

Another reason for failures in case of fast growing firms is that attention is centred around increasing turnover and *organization structures are not always redesigned* as a consequence of increasing size. The informal way of doing business contributing to success in earlier stages does not apply to larger sizes and diversified activities. Time and attention for organizational design issues is frequently lacking.

*Strategies of privat firms are rather entrepreneurial* in nature. High risk taking is generally regarded as a precondition for success.

Several of the firms belonging to the category of *private firms established in 1990 or later* follow strategies similar to those described above.

Some other firms developed strategies for *short term profit making*. Sometimes longer term survival is not regarded as an important strategic issue. Means for meeting profit targets may induce legal, partially legal or totally illegal ways of doing business. Sometimes information on these activities is obtained from criminal news.

#### STRATEGIES OF JOINT VENTURES WITH FOREIGN PARTNERS

Increasing numbers of multinational firms regard the newly opening Central and Eastern European countries as a new and challenging region for market diversification (Humes, 1993). *Entering the market and benefiting from possible advantages of first movers* is a major characteristic of international joint ventures established in Hungary. The Hungarian Government offered favorable conditions such as tax holiday, duty-free zone for the first multinationals investing in the country.

Another important strategic consideration is *using relatively cheap but skilled labor* available in the country. In the motor industry the average Hungarian wage level of GM Hungary is six times lower than in Austria and eight times lower than in Germany (Balaton, 1993/a). Strategies based on cheap labor can success-

fully be used until the Hungarian wage level approaches the Western European standards.

Joint ventures in the manufacturing industry usually *focus on production*. Research and development is only found in exceptional cases such as General Electric Tungsram or Chinoin-Sanofi (Tari, 1993). It is important to note that both examples above are connected with long traditions of innovative company activities.

Tungsram was world leader in the early decades of this century. On the other hand, there was no car production in Hungary in modern times (Balaton, 1993/a).

Strategic alliances with Hungarian partners are often based on *existing distribution networks and personal relations* which are rather important in Central and Eastern European countries. Long traditions of doing business with countries of the former Soviet Union is a major, strategically important asset for many multinationals.

*Multinational firms are rather cautious* in making major investments in Hungary and neighboring countries. Violence and ethnic conflicts in the region reduce the attractiveness of the transforming economies. Hungary is often regarded as a 'bridge-head' for possible further expansion, due to its political stability and the relatively well developed legal and banking infrastructure.

Up till now international joint ventures have resulted in only *low levels of integration of the Hungarian economy into the world business*. There are many further possibilities to increase this integration.

Hungarian suppliers have only a limited role in the production processes of joint ventures. There are positive signs showing the possible *emergence of background industries* which is one option for the Hungarian industrial restructuring.

#### *Characteristics of strategy processes*

#### STRATEGIC PROCESSES OF STATE OWNED FIRMS DURING TRANSFORMATION

It has already been mentioned that companies in this category have limited experience with strategic management. *Approaches favored* and disseminated by Government level organiza-

tions were connected to strategic planning. Since 1977 methodological guidelines were provided for state owned firms, and the attention of top management of firms was often drawn to the topic of starting strategy development (Csath, 1990).

The approach to strategy creation was the planning approach, rooted in rational decision-making. Other characteristics of strategic processes, such as the influence of the existing organization, power relations, and the role of culture (Schwenk, 1988) were not emphasized.

Hungarian companies were rather receptive to the planning approach, which is clearly comprehensible. They had ample experience with annual and five year planning. Enterprise level five year planning had been compulsory in Hungary since 1971. In practice, this planning was a standardized process with detailed tables to be filled out. Enterprises did not analyse environmental trends or their own strategic capabilities, but rather extrapolated from former trends of development. Sometimes the difference between the traditional five year planning and strategic planning was not clear for managers.

Processes of strategy implementation are less emphasized than strategic planning. In one company in our sample the term strategic planning has been widely accepted now. Its proponents do not dare to change to strategic management because they are afraid of confusion among organizational members possibly resulting from changing a term that has just been accepted.

Uncertainty in the strategy creation processes is high, and the decisions of state administration often increase it. Top managers sometimes feel uncertain about their future position.

Strategy creation was strongly centralized in state owned companies before privatization. Uncertainties and severe financial conditions resulting in crisis situations did not provide a favorable background for developing autonomous strategic behavior.

The institutional processes are also present in strategic decision-making. Part of our firms copy strategic processes of Western firms. Similarity is often seen as precondition of acceptability. The socio-political environment

emphasizes being similar to Western partners, as a means for enhancing the communication and cooperation, crucial for inviting foreign investors in the privatization process.

Some elements of *learning by exploitation* (March, 1991) can be observed as well. A further analysis of the change processes reveals different approaches when the early period of transition (1990 and 1991) and the present situation are compared. In our sample we have that experience with attitudes toward profit centres as forms of decentralized structures. In one of the companies profit centres were forced by higher level decision-making bodies. Nowadays it is clear to professionals that the necessary preconditions for using profit centres effectively are missing, and it would be advisable to change the organizational structure. Interesting examples are found using the *scenario technique* in strategic planning. Although most of the companies we studied are not familiar with the exact characteristics of the portfolio approach, an unconscious and simplified use of this approach can frequently be observed. We had similar experiences with *logical incrementalism*. One of the managers interviewed by the author described the process of their strategic planning as incremental without having heard about the concept described first by Quinn (1980).

#### STRATEGIC PROCESSES OF PRIVATE HUNGARIAN FIRMS

Here a distinction will be made between companies founded before the transition of 1990 and those set up during or after 1990.

One of the distinguishing features of strategic processes in firms established before 1990 is that the *formulation of strategic decisions is rather informal*. These firms started as small companies in which the owner/founder had a decisive role in both strategic and operational decisions. While growing, many characteristics of informality were preserved. In fast growing companies managers other than the owner also became involved in strategic decisions. The dominant coalition (Child, 1972) could in many cases easily be identified, as the (relatively small) group of people (managers and some-

times leading experts) who had a decisive role in strategic decision-making.

Strategy formulation processes reflected a *high level of adaptivity*. It was especially characteristic for the 1970's and the 1980's that these firms, although they were allowed to exist, were faced with unfriendly, hostile political and social environments imposing more and more restricting regulations. One of the managers remembers these years as follows:

'We were constantly subject to tax authority investigations and vigorous political attacks. My activity was considered dangerous for the establishment and for some people, because in their eyes it was very unusual. All in all, the climate in those times was everything but supportive' (Vecsenyi and Szántó, 1991). Legal forms of the private firms changed frequently, reflecting adaptive behavior of firms to the altering taxation or other regulations.

*Learning* can be seen as a *crucial element* of organizational change. We identified both learning by experimentation and learning by exploitation (March, 1991). The highly entrepreneurial strategies made experimentation crucial in enlarging organizational knowledge.

In later stages of development (second half of the 80's or later) there are *some signs of emerging autonomous strategic behavior*, especially in these where relatively individual business units were created as an organizational response to growth (see the example of Graphisoft, the successful architectural software developing firm, Hisrich and Vecsenyi, 1990; Dyran, 1991).

From the point of view of strategy creation, firms established in 1990 or later can be characterized as having *no formal strategic decision-making processes*. Informality and the decisive role, of the owner/manager are characteristic. In many cases there were no dominant coalitions except the number one manager/owner. Spontaneity and intuition played an important role, leading to both success and failure.

These late coming private firms *often follow the example of their successful predecessors* founded before 1990. Following examples can be regarded as rational action from two points of view:

1. it helps when availability of knowledge is

limited (as institutional mechanism contributing to enlarging organizational knowledge);

2. it helps in gaining acceptance of others. Newly established private firms are less protected from natural selection mechanisms when trying to be similar to others (see: Torres, 1988).

The *strategic decision-making processes* are *rather incremental* in their nature. Usually there are no formal procedures for both strategic and operational decisions.

*New information technologies*, which are more easily available as a consequence of being freed from COCOM restrictions, are used as an unavoidable means of business activity. These have strategic importance in the birth of new ventures. In that respect there is a clear cultural difference between these private firms and formerly state owned larger companies. As a consequence, these newly established private firms were not faced with the problems of organizational conservatism in relation to new technologies (Child, Ganter and Kieser, 1987).

#### STRATEGIC PROCESSES OF JOINT VENTURES WITH FOREIGN PARTNERS

Strategic decision-making in international joint ventures located in Hungary reflect *power inequalities between the host country and the foreign partners* (Child and Markóczy, 1993). The typical situation entails that the foreign partner dominates the decision processes. This is partially explained by foreigners in that they regard it as their role to transfer managerial and organizational knowledge to Hungary (Balaton, 1993/a). Similar patterns of behavior can be observed in other parts of the world as well (see Bonazzy and Botti, 1993; Rolfsen, 1993; Nishida, 1993). Our Hungarian examples do not support the statement that intercultural learning is important from a long term success point of view (Duenas, 1993).

*Decision-making often involves conflicts* among the partners in alliances due to cultural differences, alterations of interests and power struggles. The foreign partners have in many cases tried to acquire a dominant role through ratio of ownership, inside contracts, and man-



agerial dominance. Power struggle is especially characteristic before dominant positions are acquired.

*Strategic decisions frequently follow the patterns of decisions of the foreign partners* in their mother company. Sometimes this is labeled as 'it is our way of doing business'.

*Organizational learning* is present and often takes the form of 'imposed learning' prescribed by the foreign partners. There are some indications that learning is present on the side of the foreign partners as well. But this is generally only true in case of failures or serious difficulties and conflicts in the joint ventures (Makó and Novoszáth, 1993).

## Discussion

Space does not allow here to go into detailed discussion of empirical findings. We shall restrict the discussion to some general patterns of organizational changes.

One lesson we can learn is that the organizational transformation in the period of sociopolitical transition in Hungary shows much dynamism. Change processes are not linear, the recent phase (between 1992 and May 1994) has somewhat different characteristics than the earlier stage (between 1990 and 1992).

The period just before privatization is not favorable from the point of view of strategy development. Everybody is interested in ownership changes and possible consequences for organizational structure and employment.

The differences in strategic behaviors are partially due to personal characteristics of members in the dominant coalition. Those eager to get into power positions follow strategies not always best for the whole organization or for the owner.

Consultancy firms have strong influence on strategic behavior of enterprises. Therefore, their responsibility is large in suggesting directions leading to success of their clients.

The first years of post-socialist recession are not favorable for creating innovative and entrepreneurial strategies.

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