

Determinants of Working Capital Management on Financial Performance of Orchards in Kenya: A Case Study of Mount Elgon Orchards

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Abstract: Business success depends heavily on the ability of financial managers to effectively manage the components of working capital. This study arose from the need to manage working capital of orchards more effectively and efficiently – keeping viability and continuity in view. The purpose of the study was to examine the determinants of working capital management on financial performance of orchards in Kenya: A case study of Mount Elgon Orchards. The study was guided by the following specific objective; to establish the effects of accounts payable management on financial performance of Mount Elgon Orchards, The study's theory applied was Financing Theory, Risk Return trade-off theory and Liquidity Theory. A descriptive survey design was used in this study. The research population included the management, heads of departments, assistant heads of departments and employees of Mount Elgon Orchards working in the Finance Department only. The study employed census sampling technique and the sample size of the study included 22 respondents. The instrument that was used to collect primary data was self-administered structured questionnaires. This study used descriptive and inferential statistics in data analysis. Collected data was analyzed using Statistical Package for Social Sciences (SSPS 21). Analyzed data was presented in form tables, graphs and pie charts. The study concluded that accounts payables management had strong positive effects on financial performance of Mount Elgon Orchards. The firm received credit facilities from their suppliers, cash discounts from suppliers upon payment within a stipulated period of time and payment period allowed by their suppliers was reasonable. However, they were at times charged with an interest and sometimes unable to pay their suppliers. Based on the findings of the study, the researcher recommended the following: firms should reduce the receivables collection period by accelerating debt collections, firms should also try to negotiate good credit terms with their suppliers to cushion against the receivable period granted to trade debtors in order to prevent them from cash inadequacy and its related problems.

Keywords: Working Capital, Accounts Payable Management.

1. INTRODUCTION

Working capital performance provides significant view of the status of a firm's financial position. Availability of a firm's working capital is one of the first items a lender or investor will examine on a balance sheet (Nkwankwo and Osho, 2010). Globally thousands of companies lose over \$2 billion annual because of poor working capital management. The current

financial crisis creates the need for firms to maintain a vigorous cash position. The risk of companies being unable to meet their short and long term financial liabilities increases in times of credit constraints and economic decline. However, firms may still be unable to properly assess their cash needs (Filbeck and Krueger, 2012). Working capital presents a huge opportunity for companies to release cash from their balance sheets and operate more effectively. Well-managed cash normally provides companies with financial growth without the need for any additional funding. Two ways of financing a company are long and short term financing. Long term financing meets a firm's capital expenditure while short term financing meets a firm's specific expenditure like day-to-day expenditures and payment of wages. Working capital management is closely associated with profitability and liquidity of an organization. Proficient working capital management improves the operating performance of a company and enables it to meet its short term liabilities.

Inflation on the other hand affects working capital management and policy. Inflation affects both balance sheet and income statement of all companies. The key principle to be followed during inflationary times is; cash loses value and physical assets gain value over time. Working capital is the difference between current assets and current liabilities. It is a trading capital, not retained in the business in a particular form for longer than a year. The money invested in it changes form and substance during the normal course of business operations.

Working Capital Management (WCM) is a tool used to immunize financial upheavals. When working capital management is properly managed it improves a company's competitive position and profitability (Gill, 2011). Increase in the speed of cash conversion cycle through receivable and payable management improves a firm's profitability and liquidity. In addition, effective inventory management is also key in the management of liquidity and profitability of companies (Gill, Bigger & Mathur, 2010). Today, there is a high rise in capital cost and scarcity of funds. The profitability of a firm highly depends on how working capital is managed. Both excessive and inadequate working capital positions are risky for any firm (Islam and Mili, 2012). Excessive working capital may lead to unproductive use of limited funds. This also means that withholding costs and idle funds earn no profits for the company but lead to reduced profits. Inefficient management of working capital hinders profitability and disrupts normal operations of a firm and this may lead to serious financial crisis and bankruptcy (Mohamad, 2011). On the other hand, proper management of working capital leads to optimal financial returns on the minimum level of capital employed. The flow of funds is very necessary to maintain business. If working capital is weak, the business can hardly survive.

Globally, Karaduman, Aknas, Kaliskan, *et al.* (2011), examine the empirical relationship between efficiency of working capital management and corporate profitability of selected companies in the Istanbul stock exchange for the period of 2005 – 2009. The cash conversion cycle was used as a measure of working capital management efficiency, and return on assets used as a measure of profitability. They found out that reducing cash conversion cycle positively affects return on assets. Padachi (2016) in his study also studies on the trends in working capital management and its impact on firms' performance: analysis of Mauritian small manufacturing firms, to identify the causes for any significant difference between the industries. The study established a strong significant relationship between working capital management and profitability. Lyrondi and Lazardis (2010) investigate the cash conversion cycle and liquidity position of the food industry in Greece as liquidity level indicator of the food industry in Greece. They found significant, positive relationship between cash conversion cycle and payable deferred period. The relationship between liquidity measurement variables and profitable measurement variable was not statistically significant and there was no relationship between cash conversion cycle and leverage ratio. In Africa, Nwakaego and Ikechukwu (2016) examined the effect management of accounts payable on the financial performance of Industrial/Domestic manufacturing companies in Nigeria. At the end of the study, the results showed that accounts receivable had positive and significant effects with the profitability ratio. Both Debt ratio and sales growth rate had negative and non-significant effect on these companies.

In Kenya, Ngugi, Amanja and Maana (2010) confirmed that a well-functioning capital market increase economic efficiency, investment and growth of listed firms. This means that the performance of the listed firms in any economy is vital to the performance of the stock market and of that economy at large. Shareholders, economists and lenders have invested heavily in the listed firms financially and providing a healthy environment for conducting business. Therefore these stakeholders expect such companies to perform to the expected standards. Some companies have been delisted from the NSE due to financial reasons (Chebii, Kipchumba and Wasike, 2011). A study carried out by Makori and Jagongo (2013) on working capital management and firm's profitability on manufacturing companies listed on Nairobi Securities Exchange found that working capital has a significant impact on profitability of the firms and play a key role in the value

creation for shareholders as longer cash conversion cycle has a negative impact on profitability of a manufacturing firm. Muchina and Kiano (2011) and Nyabwanga, Ojera, Lumumba, Odondo and Otieno (2012) found that manufacturing firms in Kenya are facing problems with their collection and payment policies as well as not paying attention to inventory levels. These have affected profitability of the manufacturing firms and in turn have affected the value of companies.

Business success depends heavily on the ability of financial managers to effectively manage the components of working capital (Filbeck and Krueger, 2015). In Kenya, since early 2000, many firms are struggling to thrive and some key players have been forced to move their operations to other countries. Others have shut down their operations as evidenced by recent closure of Pan Paper Mills in Webuye and Cadbury East Africa. All these companies cite high operation costs as the main cause of the precarious financial situation. Companies are closing doors and others are operating at breakeven point (KAM, 2016). If this trend continues unabated, Kenya's hope of rising to a middle level economy as envisioned by vision 2030 is in doubt. Some public and private companies such as Hutchings Biemer, Pan Paper Mills, Nakumatt and Uchumi Supermarkets Ltd as well as banks like Chase bank and Imperial Bank have been put under statutory management in the recent past due to liquidity problems since they were unable to pay their short term financial obligations as and when they fell due.

This study arose from the need to manage working capital more effectively and efficiently – keeping viability and continuity in view. Studies conducted in Kenya to explore the effect of working capital management on financial performance have not addressed working capital management among orchards in Kenya. Kungu (2015), Mwangi (2014), among others studied the effects of working capital management on profitability of firms listed in Nairobi Securities Exchange while Mathuva (2009) considered working capital management in terms of the operating cycle. Muchina and Kiano (2011) as well as Nyabwanga et al., (2012) studied the influence of working capital management on firm's profitability of small and medium enterprises in the country. It is against this background that this study intended to fill this gap by investigating the determinants of working capital management on financial performance of orchards in Kenya: A case study of Mount Elgon Orchards. The study sought to establish the effects of accounts payable management on financial performance of Mount Elgon Orchards.

2. EFFECTS OF ACCOUNTS PAYABLE MANAGEMENT ON FINANCIAL PERFORMANCE

Nwakaego and Ikechukwu (2016) examined the effect management of accounts payable on the financial performance of Industrial/Domestic manufacturing companies in Nigeria. The study used a cross-sectional research design. The data was collected from the Annual Reports of the companies under study. The hypotheses were tested using multiple regression technique. At the end of the study, the results showed that accounts receivable had positive and significant effects with the profitability ratio at 1% levels of significance. This means that unit increase in the variables shall bring about corresponding increase in the profitability ratio of the Building/Chemical and paint companies in Nigeria. Both Debt ratio and sales growth rate had negative and non-significant effect on these companies. Muchina and Kiano (2011) in their study analyzed the influence of working capital management on firms' profitability in Kenya. The study employed a descriptive research design. They used fixed panel data of 232 firms. The result indicated that the average debtor day, stock turnover period and the cash conversion cycle are significantly affecting the profitability of the firms. They found out also that the manufacturing firms are in general facing problems with their collection and payment policies. Moreover, the financial leverage, ratio of current asset to current liability and firm size also have significant effect on the firm profitability. The study also concluded that SMES in Kenya are following conservative working capital management policy and payment policy. They suggested that the effective policies must be formulated for the individual component of working capital and that efficient management and financing of working capital (current assets and current liabilities) can increase the operating profitability of manufacturing firms. For efficient working capital management, specialized persons in the field of finance should be hired by the firms for expert advice on working capital management in the manufacturing sector (Muchina and Kiano, 2011).

Karaduman, Aknas, Kaliskan, *et al.* (2011), examine the empirical relationship between efficiency of working capital management and corporate profitability of selected companies in the Istanbul stock exchange for the period of 2005 – 2009. The study used a survey research design. The panel data methods were employed in order to analyze the mentioned relationship. The cash conversion cycle (CCC) was used as a measure of working capital management efficiency, and return on assets (ROA) used as a measure of profitability. He found out that reducing cash conversion circle (CCC)

positively affects return on assets. Padachi (2016) in his study also studies on the trends in working capital management and its impact on firms' performance: analysis of Mauritian small manufacturing firms, to identify the causes for any significant difference between the industries. The study employed a quantitative research design. The dependent variable return on total assets is used as a measure of profitability and the relation between working capital management and corporate profitability was investigated for a sample of 58 small manufacturing firms, using panel data analysis for the period 1998-2003. The regression result shows that high investment in inventories and renewable is associated with lower profitability. The key variable used in the analysis was inventories days, accounts receivables days, accounts payable days and cash conversion cycle. A strong significant relationship between working capital management and profitability has been found in previous empirical work.

Lyrondi and Lazardis (2010) investigate the cash conversion cycle and liquidity position of the food industry in cycle as liquidity level indicator of the food industry in Greece and tried to determine its relationship with the traditional liquidity measurement and profitability measurement on return on investment, return on equity and net profit margin. The study used a quantitative research design. They found significant, positive relationship between cash conversion cycle and payable deferred period. The relationship between liquidity measurement variables and profitable measurement variable was not statistically significant and there was no relationship between cash conversion cycle and leverage ratio. The relationship of these traditional and modern liquidity measurement techniques are studied by Lyroudi and MC Carty (2013) for small U.S companies for the period 2004 – 2008. The study employed a cross-sectional research design. They found that cash conversion cycle was negatively related with the study revealed difference between current ratio but positively related with quick ratio. In addition, the study revealed difference between the concept of cash conversion cycle in manufacturing retail, wholesale and Service industries. The advantage of using modern liquidity measurement technique is that it will help to evaluate working capital change and it facilitates the monitoring and controlling of its components, receivable inventories and payable. The smaller value of cash conversion cycle shows that, the quicker the firms can recover cash from sales of finished products and the more cash will have hence this will lead to have more liquid assets by firms. If cash conversion is high, it will take longer time recover cash, thus high cash conversion cycle implied an existence of problem in liquidity.

Achode and Rotich (2016) studied the effects of accounts payable on financial performance of public listed manufacturing companies at NSE, Kenya. Descriptive research design was used in the study. Census sampling technique was used and the study used secondary data, which was obtained from the companies' statistics and journals at the Nairobi Securities Exchange. SPSS was used to carry out the descriptive analysis of the variables, requisite analysis and advanced analysis of the data. A multiple regression model was used to test the relationship between the Accounts payable and firm performance. The results from this research suggested that in most of the manufacturing firms listed at the NSE, there was a direct positive relationship between Accounts Payable and the dependent variable, Profitability and Liquidity, supporting the Pecking Order Theory. The study recommends that finance managers and financial officers of companies should establish a long-term relationship with their suppliers in order to access trade credit in a more easy and fast way, as increased use of trade credit enhances performance of companies through increased profitability. The priority of top management of every company should be to manage their trade credits prudently in order to remain profitable and competitive. It is therefore important know how and what working capital structure will influence their performance (Achode and Rotich, 2016).

Munene, (2011), examined The Effect of Lease Financing on The Financial Performance of Companies Listed at the Nairobi Securities Exchange. The study employed a correlational research design and found that lease financing and size of the firm had negative effects on ROA while liquidity and leverage had positive effects on ROA. The study concluded that lease financing did not influence the financial performance of listed firms in Kenya. Leonard, (2014), employed a descriptive research design and found that debt and equity were major determinants of financial performance of firms listed at the NSE and there was evidence of a negative and significant relationship between capital structure and all measures of performance, implying that the more debt the firms used as a source of finance they experienced low performance and firms listed at NSE used more short-term debts than long-term debts. Mbugua, (2010) investigated the application of pecking order concept by NSE companies. The study used a correlational research design and found that NSE gave priority to internal resources for finance as their total assets' profitability, liquidity levels and sales amounts increased and preferred a lower level of external resource use. The study further revealed that those companies with more

internal funds utilized these internal funds to fund their new projects rather than using debt or even equity, while those companies with limited internal funds opted to get debt to fund their projects and if debt was not readily available they opted for equity, thus following the pecking order theory. Pratheepkanth, (2011), study found a weak positive relationship between gross profit and capital structure. The study used a quantitative research design and there was a negative relationship between net profit and capital structure. ROI and ROA also had negative relationship with capital structure at -0.104, -0.196 respectively. Kajirwa, (2015), examination revealed that debt negatively affects firm performance of NSE Commercial Banks, though not statistically significant as measured by ROA. Kajanathan & Nimalthasan (2013) used descriptive research design and indicated that gross profit, net profit, return on equity, return on assets, were not significantly correlated with debt equity ratio and Gross profit margin and Return on equity were significantly correlated with debt assets ratio as the measures of capital structure and capital structure had significant impact on gross profit and return on equity.

Quainoo, (2011) study investigated the impact of loans on SMEs in Ghana. The study used a cross-sectional research design and found that term loans were the most patronized type of bank loans due their repayment structure which were structured in line with the business cash flows; that most SMEs used loans as working capital mainly to source raw materials for production; that bank loans for SMEs were mostly used improve their performance and that there was a major disadvantage of accessing a bank business loan because of the high cost of capital (usually high interest rate) charged mostly on SMEs. Charitou, Elfani, and Lois (2010), performed a study on the effect of working capital management on firm's financial performance. The study employed a descriptive research design and found that the cash conversion cycle and all its major components; namely, 28 days in inventory, days' sales outstanding and accounts payable payment period – were associated with the firm's profitability and that working capital management led to improved profitability. Ikram, Mohamad, Khalid and Zaheer (2011) studied working capital management on profitability in the cement industry. The results of the study were based on only one sub sector within the manufacturing sector. Therefore, the results of this study should be used with caution and should only be generalized to the cement industry and not entire manufacturing sector. Mathuva (2010) concentrated on the firms listed in Nairobi securities exchange. The companies listed in the stock exchanges are large companies. Small companies were excluded from this study. Therefore, the results of study can only be generalized on large and listed companies.

Studies on working capital management use secondary data. Mousavi and Jari (2012), Kaddumi and Ramadan (2012) and Gakure, Chegulet, Onyango, *et al.*, (2012) used record survey sheet to collect the secondary data. However, Nyabwanga *et al.*, (2012) studied the effects of working capital management practices on performance of small enterprises in Kisii South District in Kenya. They used a questionnaire to collect the primary data. Secondary data from financial statements give values at a specific date and therefore require to be supplemented by primary data collected from opinions of finance managers. Muchina and Kiano (2011) studied the influence of working capital management on firm's profitability of small and medium enterprises sector. The study employed qualitative and quantitative research designs. They argued that despite significant role played by SMEs, their financial management environment is not well understood especially in the area of working capital management. However, in their study they attempted to analyze the relationship between working capital management efficiency and profit in SME sector in Kenya. They looked at the whole spectrum of enterprises and did not confine themselves on manufacturing firms. They also used secondary data only. Gill *et al.*, (2010) carried out their research on American manufacturing companies. They argued that the results of their findings could only be generalized to manufacturing firms similar to those that they included in their research. The sample size that they used was also small. They further argued that future research should investigate generalization of the findings beyond the American manufacturing companies.

3. METHOD

A descriptive design was used in this study with a target population which comprised of 3 top management, 7 heads of departments, 7 assistant heads of departments and 5 employees of from the finance department only. A total target population of the organisation included 22 study participants which formed a census. Data collection instrument was questionnaire. Piloting was done to test the validity and reliability of the research instrument. Data was coded, edited, organized to bring a meaning. It was analyzed using inferential statistics. Multiple linear regression analysis model was computed to determine the statistical relationship between the independent variable and the dependent variables. Analyzed data was presented descriptively using tables and pie charts.

4. DISCUSSION

The study sought to establish the effects of accounts payable management on financial performance of Mount Elgon Orchards. The findings are presented in a five point Likerts scale where SA=strongly agree, A=agree, N=neutral, D=disagree, SD=strongly disagree and T=total. From table 4.1 below, the respondents were asked whether their firm received credit facilities from its suppliers. The findings of the study showed that majority of the respondents 30% strongly agreed to the statement, 25% of the agreed, another 25% of them were neutral while 10% of the disagreed and strongly disagreed respectively. This implies that firm received credit facilities from its suppliers.

The respondents were also asked whether their firm was at times charged interest by its suppliers for late payment. Majority of them 50% agreed to the statement, 30% of them disagreed while 30% of them were neutral. None of the respondents strongly agreed and strongly disagreed to the statement. This implies that the firm was at times charged interest by its suppliers for late payment. The study sought to find out whether their Mount Elgon Orchards was at times unable to pay its suppliers on time. Majority of them 75% strongly agreed to the statement while 25% of them agreed to the statement. None of the respondents were neutral, disagreed and strongly disagreed to the statement. This implies that Mount Elgon Orchards was at times unable to pay its suppliers on time.

The study sought to find out whether Mount Elgon Orchards received cash discounts from its suppliers upon payment within a stipulated period of time. The results of the study showed that majority of the respondents 50% strongly agreed to the statement, 25% of them agreed, 15% of them were neutral while 10% of them disagreed. None of the respondents strongly disagreed to the statement. This implies that Mount Elgon Orchards received cash discounts from its suppliers upon payment within a stipulated period of time.

The study also sought to establish whether the payment period allowed by Mount Elgon Orchards suppliers was reasonable. Majority of the respondents 40% were neutral to the statement, 25% of them agreed, 15% of them agreed while 10% of them disagreed and strongly disagreed respectively. This implies that the payment period allowed by Mount Elgon Orchards suppliers was reasonable

Finally, the study sought to establish whether the firm's past debts had ever been waived by its suppliers. Majority of the respondents 60% were neutral to the statement, 25% of them disagreed while 15% of them strongly disagreed. None of the respondents agreed or strongly agreed to the statement. This implies that the firm's past debts had never been waived by its suppliers.

Table 4.1: Accounts Payable Management

Statement		SA	A	N	D	SD	T
Our firm receives credit facilities from its suppliers	F	6	5	5	2	2	20
	%	30	25	25	10	10	100
Our firm is sometimes charged an interest by its suppliers for late payment	F	0	10	6	4	0	20
	%	0	50	30	20	0	100
Our firm is sometimes unable to pay its suppliers on time	F	15	5	0	0	0	20
	%	75	25	0	0	0	100
Our firm receives cash discounts from its suppliers upon payment within a stipulated period of time	F	10	5	3	2	0	20
	%	50	25	15	10	0	100
The payment period allowed by your suppliers to our firm is reasonable	F	5	3	8	2	2	20
	%	25	15	40	10	10	100
Our firm's past debts have ever been waived by its suppliers	F	0	0	3	12	5	20
	%	0	0	15	60	25	100

Correlation Analysis

The study sought to establish the strength of the relationship between independent and dependent variables of the study. Pearson correlation coefficient was computed at 95 percent confidence interval (error margin of 0.05). Table 4.2 illustrates the findings of the study.

Table 4.2: Correlations

		Accounts Payable	Accounts Receivables	Liquidity Management	Financial performance
Accounts Payable	Pearson Correlation	1	.138	.244	.995
	Sig. (2-tailed)		.310	.070	.001
	N	20	20	20	20

Ho₁: Accounts payable management has no significant effect on financial performance of Mount Elgon Orchards

The p-value for accounts payable management was found to be 0.001 which is less than the significant level of 0.05, ($p < 0.05$). Thus, the null hypothesis was rejected while the alternative hypothesis was accepted. The result indicated that Pearson Correlation coefficient (r-value) of 0.995, which represented a strong, positive significant effect between accounts payable management and financial performance at Mount Elgon Orchards.

Regression Analysis

Coefficient of Determination

The coefficient of determination (R squared) shows the proportion of variance in the dependent variable that can be explained by in the independent variables. It is the overall measure of strength of association between independent and dependent variable. In line with this, 0.451 was found to be the coefficient of determination indicating a positive association between independent and dependent variables. R is 0.671 shows a positive correlation between observed and predicted values of dependent variable. Table 4.3 (a) shows the findings of the study.

Table 4.3 (a): Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.671 ^a	.451	.405	3.02892

Analysis of Variance

Table 4.4 (b) below shows the analysis of variance (ANOVA) of the regression model. The p-value was found to be 0.004 which is less than 0.05 at 3 degrees of freedoms. This indicates that, the overall regression model statistically significantly predicts the outcome variable and all the model coefficients are significantly different from 0.

Table 4.4 (b): Anova^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2048.061	3	682.687	31.176	.004 ^b
	Residual	350.373	16	21.898		
	Total	2398.434	19			

Regression Coefficients

The findings of the study were regressed on a linear model to establish the relationship between the dependent and independent variable as shown on table 4.5. Based on the findings of the study, the regression equation model for the study is:

$$\text{Financial Performance} = 12.513 + 0.086 \text{Account payable management}$$

In addition, all the study variables were found to be significant variables since their significant values 0.025, 0.000 and 0.000 respectively were less than the p-value (0.05).

Table 4.5: Coefficients ^a

Model	Unstandardized Coefficients		Standardized Coefficients t	Sig.
	B	Std. Error	Beta	
1 (Constant)	12.513	1.964	11.974	.000
Account payable	.086	.169	.037	.025

5. CONCLUSION AND RECOMMENDATIONS

The study sought to establish the effects of accounts payable management on financial performance of Mount Elgon Orchards. The findings showed that the firm received credit facilities as well as received cash discounts from its suppliers upon payment within a stipulated period of time. The payment period allowed by Mount Elgon Orchards suppliers was reasonable but the firm was at times unable to pay its suppliers on time. However, the firm was at times charged interest by its suppliers for late payment and the firm's past debts had never been waived by its suppliers.

The p-value for accounts payable management practices was found to be 0.001 which is less than the significant level of 0.05, ($p < 0.05$). The result indicated that Pearson Correlation coefficient (r-value) of 0.995, which represented a strong, positive relationship between accounts payable management practices and financial performance. The findings of the study are consistent with the findings of Kalunda et al., (2012) stated that Management of accounts payables is an important aspect of ensuring efficient management of working capital. It is important for a firm to ensure that it has a good working relationship with its suppliers so that there can be a constant supplies of inventories. Firms should avoid delays in paying for their supplies because of the disadvantages attached to such delays that include lost cash discounts and reduced trust by the suppliers.

The study concluded that accounts payables management had strong positive effects on financial performance of Mount Elgon Orchards. The firm received credit facilities from their suppliers, cash discounts from suppliers upon payment within a stipulated period of time and payment period allowed by their suppliers was reasonable. However, they were at times charged with an interest and sometimes unable to pay their suppliers.

Based on the findings of the study, the researcher recommended the following: firms should reduce the receivables collection period by accelerating debt collections. A strong credit policy system will ensure that account receivable period is shorter than account payable period should be enacted.

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