

## EFFECT OF BUSINESS ENVIRONMENT ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMES) IN KATSINA STATE.

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### Abstract

*The study examined the effect of business environment on Small and Medium Enterprises of Katsina State of Nigeria. The population comprised 7,372 registered SMEs operating in Katsina State (Bureau on Public Procurement, 2023). A sample size of 379 was determined using the Taro Yamane formula while the stratified and purposive sampling techniques were used to select the sample representatives. The study adopted a survey design and a set of structured questionnaire was used for data collection which was validated and piloted for reliability. The study's hypotheses were tested using the Partial Least Square Structural Equation Modeling (PLS-SEM). The findings revealed a positive and significant relationship between Government policies, access to finance, human resources and technological innovation and SMEs performance. Although Government Policies positively influence SMEs performance, but their impact is smaller compared to other factors. Based on the findings, the study recommended that Governments should streamline administrative processes and provide more targeted support to SMEs. Policies should focus on easing regulatory burdens, offering incentives for growth and innovation, and improving communication channels to ensure SMEs can take full advantage of available support. Additionally, SMEs should prioritize the development of their workforce by offering training programs as this will help attract and retain skilled employees, which is essential for sustained growth and innovation.*

**Keywords:** Business environment, Government policies, Human resources, SMEs performance, Technological factors

### Introduction

SMEs are acknowledged as the solid backbone of economy growth and development globally and Nigeria inclusive and they serve as more than just a catalyst. Many economies around the world have grown, developed, and become more industrialized as a result of the contributions of Small and Medium Enterprises (SMEs). In Nigeria, small and medium-sized enterprises (SMEs) have not performed up to expectations because of a variety of issues, including the SMEs' own attitudes and

habits, environmental factors, political instability, and frequent policy changes and yanks. However, it has been annoying that some SMEs in Katsina state have underperformed relative to expectations in spite of the incentives, policies, programs, and support meant to revive them (Ambore, Hassan & Gambo, 2023). Many individuals, groups, and businesses have put forth different theories as to why SMEs have been able to fulfill their promises. While a typical operator would always blame his failure on a lack of funding, some others think otherwise claiming that poor infrastructure, poor management abilities, difficulty entering international markets, a lack of entrepreneurial know-how among are mostly to blame. It is infuriating that the subsector in Nigeria has underperformed despite incentives, useful policies, regulations, and preferential support from the government aimed at enhancing SMEs (Onugu, 2019). This becomes even more alarming when one considers that Nigeria is still the largest market on the African continent with plenty of unexploited investment potential (Abiodun, 2018).

The success or failure of a business could greatly depend on the environment in which it operates. Dionco-Adetayo and Adetayo (2018) posit that an unbalanced environment is incompatible with the survival of a robust business. Oluremi and Gbenga (2019) contend that business sends its outputs to the environment after obtaining its inputs, ideas, information, finance, raw materials, and labor from the business environment. According to Tijani (2018), the business environment serves as the basis for expressing the goals, mission statement, policies, strategies, and tactics of the company. According to Ibidunni and Ogundele (2018), the personality of the business environment is stable, dynamic, and unbalanced, which typically helps a business enterprise choose the best strategies. Adeoye (Hakim, 2020) believes that in order for a business to survive in the competitive nature of the business world and the rapidly changing nature of the working environment, it must grow and develop appropriate plans that will enable it to continue operating while also achieving the desired outcome.

The internal and external environmental factors affecting the performance make up its business environment. According to Alkali and Isa (2019) small businesses must support both their internal and external environments in order to accomplish their aims and goals. Open systems theorists were the first to identify an enterprise's external environment when they observed that organizations do not function as autonomous, isolated entities but rather engage in continuous, unavoidable interaction with the larger system within which they operate. Sedyastuti, Rahadi, and Handayani (2021) defended this claim by stating that an organization's business practices are influenced by their external environment and that the nature of the impact is depending on how its influence is managed. Adejumo (2019) asserts that the modern business enterprise manager operates in a challenging environment. The corporate operating environment has undergone rapid and unstable adjustment (Fatai, 2011). In light of this, Bayode and Adebola (2012) proposed that consumers in domestic and global markets have been indicating distinct behaviors. The most notable shift, competitive density, has forced competitors to adopt various tactics in order to cope with the unstable nature of the business environment (Bayode & Adebola, 2012; Ibrahim, Ambore, Hassan & Gambo, 2023).

Even though there are many studies on SMEs in developing countries, there is a lack of study on business performance evaluation, especially in the Northwestern region of Nigeria. However, the extent to which environmental factors affect SMEs' profit, sales, and employment as well as the evaluation of their performance in Katsina state has not been thoroughly explored. Most empirical studies carried out in developing countries, especially in Nigeria, focus primarily on the issues facing SMEs.

In terms of gaps, extant literature by Angbazoo and Iyimoga, (2022) revealed that previous studies on the relationship between the business environment and performance of SMEs such as Muazu et al. (2020), Laouiti et al. (2014), Mappingau and Maupa (2012) had varying findings and conclusions and were conducted on different populations in different geographical locations and at different times, with potentially non-generalizable findings to the modern Nigerian context for SMEs in Nigeria because of the various and distinct business environmental factors that exist in the various areas. Moreover, studies by Abubakar and Junaidu (2019); Adeyori and Agbadudu (2018); Audrey (2016); Chukwuma and Chukwuma (2015); Olawale (2014) focused mainly on the external environmental factors while ignoring internal factors. On the other hand, previous studies conducted by Muazu et al. (2020) concentrated mainly on the internal factors of business environment without incorporating external factors in their studies. This study therefore fills this existing gap by incorporating both internal and external factors of business environment on the performance of SMEs in Katsina State. Moreover, from the empirical studies reviewed in section two, there exists methodological weaknesses as most of the studies used the same statistical tools in their analysis. For example, Muazu et al. (2020) employed correlation and multiple regression analysis. In the same vein, Abubakar and Junaidu (2019); Fasesin, Ajiboye and Aremu (2019) used multiple regression technique and descriptive statistics. Similarly, Adeyori and Agbadudu (2018); Kebede and Simesh (2015); Adeoye and Elegunde (2012) adopted multiple regression analysis. Furthermore, Chukwuma and Chukwuma (2015) used Ordinary Least Square (OLS). While, Idris (2014) employed factor analysis. This study therefore, aims to fill this existing gap by employing a rigorous statistical tool like Partial Least Squares Structural Equation Modeling (PLS-SEM) approach.

In order to actually determine why small and medium enterprises (SMEs) are not playing the vibrant and vital roles in the Nigerian economy like they do in other developing economies that share some similarities with Nigeria in terms of population and other demographic variables, this study aims to critically evaluate the effect of business environment on the performance of SMEs in Katsina State specifically using the four dimensions of business environment such as government policies, technological factors, human resources and access to finance as defined in this study. To achieve this, the following research hypotheses are formulated:

H<sub>01</sub>. Government policies have no significant effect on the performance of small and medium scale enterprise (SMEs) in Katsina State.

H<sub>02</sub>. Human resources have no significant effect on the performance of small and medium scale enterprise (SMEs) in Katsina State.

H<sub>03</sub>. Technological factors have no significant influence on the performance of small and medium scale enterprise (SMEs) in Katsina State.

H<sub>04</sub>. Access to finance no significant effect on the performance of small and medium scale enterprise (SMEs) in Katsina State.

## 2. Literature Review

This section is divided into three main parts that include concept of SMEs performance, concept of business environment, review empirical studies and theoretical framework.

### 2.1 Concept of SMEs Performance

Performance for SMEs is defined as the outcome of efforts made in the form of business enterprise activities, including strategy and operational activities as well as management of all business enterprise segments, including marketing, finance, production, and human resources (Onugu, 2019). It is the amount of effort a company makes to achieve its stated objectives, which could include increasing employment, profitability, sales growth, customer and employee satisfaction, and societal satisfaction. Therefore, the performance of SMEs can be defined as actual output compared to expected output (Oba & Onuoha, 2019). According to Bello (2020), SMEs performance also involves how well the enterprise is managed in terms of the value that customers perceive the organization to be providing, and other stakeholders should be considered when defining performance.

Akinlabi, Asikhia and Muraina, (2021), Tamara and Riste (2015) asserted that SMEs are the primary drivers of economic growth in Nigeria. SMEs are acknowledged as the driving force behind rapid employment, improved living standards, the creation of value-added goods and services, and the primary creator of robust economies (Akinlabi, et al., 2021). Nigeria's economy relies heavily on small and medium enterprises (SMEs), which are its main engine. A few years ago, the number of businesses in the industrial sector was approximately 90% SMEs (Oluwadare & Oni 2016). This SMEs are crucial to the nation's long-term economic growth, and its significance can be appropriately viewed in light of the Nigerian economy's structure, which has produced numerous innovative products and technological advancements (Ibrahim, et al., 2023).

Small and medium enterprises (SMEs) have turned out to be a progressively extra superior component of economic growth (Fitriasari, 2020). Globally, SMEs and the rise of entrepreneurship are recognized as tools for achieving economic development and growth, as well as appealing engagement opportunities (Benjamin and Rebecca, 2019). In support of this, Putra and Santoso (2020) stated that the absence of vibrant small and medium enterprises in every economy renders progress unattainable. Tamara and Riste (2015) assert that one of the primary components of economic growth is the

presence of SMEs. SMEs are acknowledged as the driving force behind high employment rates, engagement levels that raise living standards, the creation of services and products with added value, and they are primarily responsible for the development of robust economies (Naradda, et al. 2021).

## **2.2 Concept of Business Environment**

This section of the study reviews the existing body of knowledge regarding the variables of the study.

### **2.2.1 Government Policies**

Over the years, the Nigerian federal government has worked to support the growth and development of the SMEs sector, primarily in the areas of developing industrial, fiscal, and monetary policies (Hodgson, 2022). Since the 1970s, the Nigerian government has launched a number of development assistance programs to help diversify the nation's economy away from its reliance on the oil sector and to improve the performance of SMEs investors through financing (Abiodun, 2014). In order to accomplish this, the federal government of Nigeria is dedicated to policy interventions aimed at financing SMEs in order to improve the realization of the estimated contribution of SMEs to economic development and growth. Nigeria has launched a number of initiatives aimed at enhancing the performance of SMEs and enable entrepreneurs to turn a profit (Ibrahim, et al, 2023).

### **2.2.2 Human resources**

*Human resources play a key role in developing, reinforcing and changing the culture of an organization (Onugu, 2019). Therefore, effective human resource contributes to the success of small and medium enterprises.* According to Hodgson, (2022), training and development, recruitment and onboarding and reinforcing the values of the business are all essential elements of business culture covered by *human resources*. Businesses that employ qualified manpower are able to compete on a global scale (Adudu, et al., 2021).

### **2.2.3 Technological Factors**

Angbazo and Iyimoga, (2022) emphasized that the firm's ability to acquire, create, and utilize technological knowledge assets is essential to attaining distinct levels of profitability. Similarly, Voola et al. (2012) asserts that a firm's ability to adopt new technology determines its competitive advantage. According to Liman, Burah and Jibir (2021), technological changes have the potential to impact prices, quality, and encourage more creativity, innovation, and competition. Technology has the power to increase productivity, quality, and speed. The rate of technological change and diffusion, new methods of producing goods and services, the use of new machinery and processes, the transfer of

foreign technology, its cost, quality, and value chain are the primary elements of the technological environment (Adudu, Osisanya, & Adebajo, 2021). Businesses that employ outdated technology are unable to compete on a global scale (Adudu, et al., 2021). Therefore, improving technological development is essential to making business firms more competitive. Adoption of new technology by the company determines its competitive advantage (Voola et al. (2012).

#### **2.2.4 Access to Financial**

According to Morgan et al. (2017), financial accessibility enables easy expansion and growth of SMEs leading to better performance. It encourages growth and development of SMEs and thereby enhance business activities and performances. Svatoova (2017) asserts that government established financial institutions mainly to ensure equitable financial accessibilities among SMEs in the country. According to Bender and Ward (2012), effectively generating the funds required by the company and controlling how those funds are used within and outside the company, including the choice to distribute or reinvest any additional returns, are the two components of financial strategy. The essence of financial accessibility is to ensure sustainability of SMEs that create jobs for the youth and (Martina et al., 2015).

#### **2.3 Relationship between Business environment and SME's performance:**

Since the business environment has a positive impact on SMEs performance, practitioners believe that managers of the organizations should conduct a thorough analysis of the business environment prior to initiating or pursuing activities that will lead to the achievement of organizational goals (Oluwadare & Oni, 2016). Furthermore, since components of business environment such as government policies, technological factors, economic factors, human resources and access to finance among others enhance organizational performance, it is recommended that SMEs establish suitable internal management structures, procedures, and policies (Ibrahim, et al, 2023). According to Oluwadare and Oni, (2016), the performance of SMEs was evaluated based on their capacity to create jobs and wealth through the establishment, maintenance, and expansion of businesses.

#### **2.4 Review of Empirical Studies**

This section provides a review of relevant studies on Business Environment and Performance of SMEs, aiming to identify existing findings and research gaps.

Several empirical studies have explored the relationship between External Business Environment and Performance of Small and Medium Scale enterprises. For instance, Adudu, Osisanya, and Adebajo, (2021) investigated the effects of External Business Environment on Performance of Small and Medium Scale enterprises. This aligns with the findings of Liman, Burah and Jabir (2021); Angbazo

and Iyimoga, (2022); Oluwadare, and Oni (2016); Ifedoro, and Kurah, (2020); Adeyoriyu and Agbadudu (2018); Muazu et al. (2020). However, these findings are also consistent with the results of Ibrahim, Ambore, Hassan and Gambo, (2023), who reported a negative and significant relationship between Business Environment and SMEs Performance.

In terms of gaps, previous studies conducted by Ifedoro, & Kurah, (2020); Adeyoriyu and Agbadudu (2018); primarily focused on the external environmental factors while ignoring internal factors. On the other hand, studies by Oluwadare, and Oni (2016); Muazu et al. (2020) concentrated largely on the internal factors of business environment without including external factors in their studies. Therefore, the current study fills this existing gap by incorporating both internal and external factors of business environment on the performance of SMEs in Katsina State.

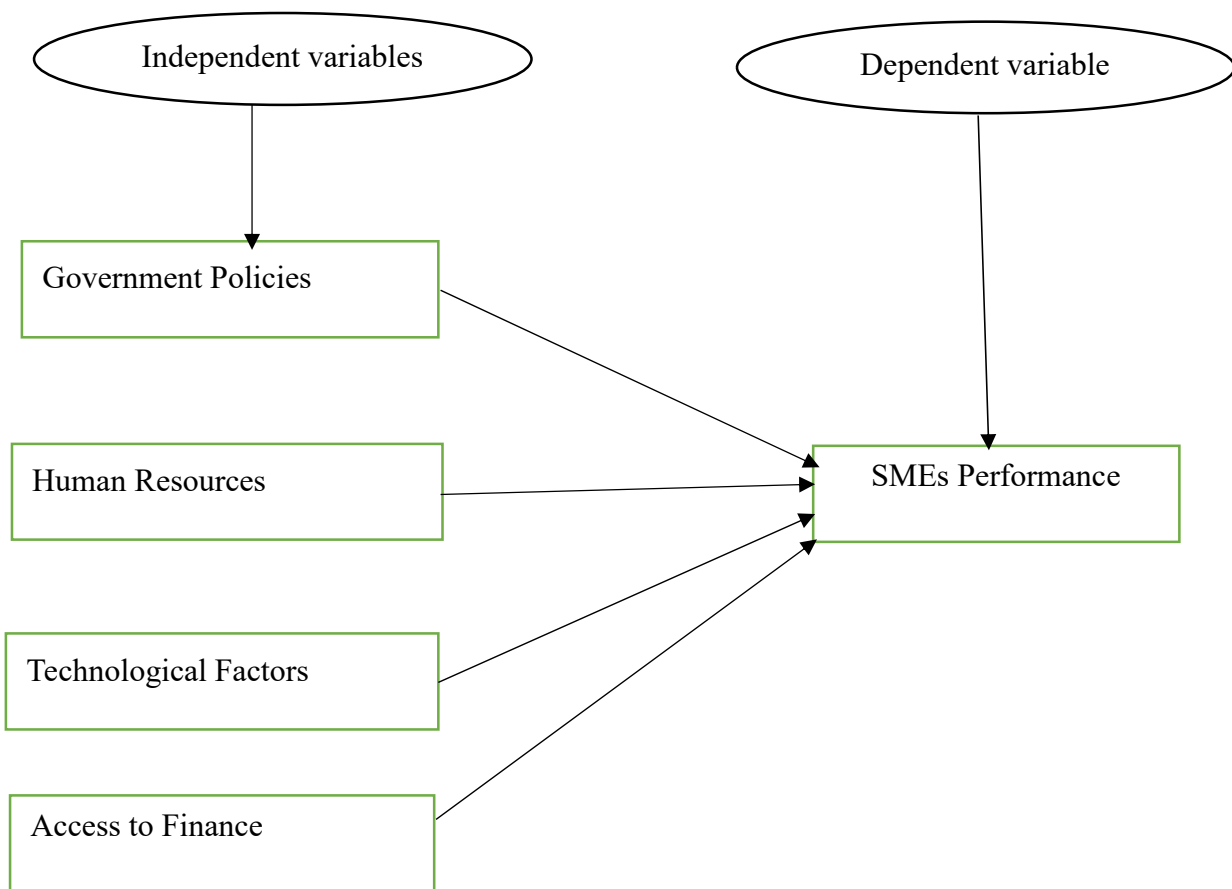
Moreover, the aforementioned studies used different statistical tools for analysing data other than PLS-SEM. This study therefore, aims to fill this existing gap by employing Partial Least Squares Structural Equation Modeling (PLS-SEM) approach.

## **2.5. Theoretical Framework**

The theory underpinning this study is theory of contingency. This theory contingency theory was propounded by Fiedler in 1960s. The theory of contingency asserts that there is no one best way for businesses to operate. Different environmental requirements will be created by situations for business owners and managers. A manager's course of action is contingent upon the external factors influencing the situation (Scott, 1981). According to Fiedler, in order to enhance performance, we need to address situational factors that impact performance in addition to the environment. The ability of the environment to fit the situation or the situation to fit the environment can both enhance performance. For instance, the theory pertains to the independent variables in the logic of the environmental factors related to economics, society, and technology that any SMEs' management can implement for the company, while the dependent variable is performance, which is a function of the business environment adopted (Pennings, 1975).

### **2.5.1 Conceptual Framework**

The conceptual framework of this study has five (5) variables (Government policies, human resources, technological factors, access to finance and SMEs performance). Specifically, Government policies, human resources, technological factors and access to finance are the independent variable, while SMEs performance is the dependent variable. Thus, the conceptual framework of the study is presented below:



A survey research design was employed for the study. The study population comprised 7,372 registered SMEs operating in Katsina State (Bureau on Public Procurement, 2023). A sample size of 379 was determined using the Taro Yamane formula while the stratified and purposive sampling techniques were used to select the sample representatives. Structured questionnaire was used as instrument for data collection which was validated and tested to be highly reliable. Out of 379 copies of questionnaire that were distributed, 347 copies were validly filled and returned by the respondents. The descriptive and inferential statistics were used in the study to analyze the data gathered from respondents. The Partial Least Square structural equation modeling (PLS-SEM) was used to determine the relationship between business environment and SMEs performance. The PLS-SEM was employed in this study due to its sufficient and universal acceptance amongst researchers in

International Standard (IS), behavioural and social science (Blunch, 2008). However, the study also employed descriptive statistics. The tolerable margin of error, or degree of freedom (0.05) Therefore, the expected risk level is 95 percent confidence level, meaning that 95 out of 100 samples have the true population mean value.

#### 4. Results and Discussion

In this section, a PLS-SEM approach was used to test the measurement model, which included analyses of discriminant validity, convergent validity, internal consistent reliability, and indicator reliability. The empirical findings of the hypotheses were also tested using the structural model.

Table 4: Hypotheses test for direct relationship

Relationship	Beta		T Statistics	P
	Values	Standard Deviation		Values
Access to Finance -> SMEs				
Performance	0.32	0.05	5.91	0.00
Government Policies -> SMEs				
Performance	0.16	0.06	2.65	0.01
Human Resources -> SMEs				
Performance	0.24	0.06	4.14	0.00
Technological Factors -> SMEs				
Performance	0.23	0.06	4.21	0.00

Table 4 presents the results of the hypothesis tests for the direct relationships between various business environmental factors—Access to Finance, Government Policies, Human Resources, and Technological Factors—and SMEs Performance. These relationships are evaluated using Beta values, Standard Deviation, T-statistics, and P-values to assess the strength and significance of each factor's influence on SMEs performance.

The first relationship, Access to Finance -> SMEs Performance, has a Beta value of 0.32, indicating a moderately strong positive effect of access to finance on SMEs performance. The T-statistic of 5.91 and a P-value of 0.00 (significant at the 5% level) confirm that this relationship is statistically significant. This suggests that better access to finance has a substantial and significant impact on the performance of SMEs, emphasizing the importance of financial resources for business success.

For Government Policies -> SMEs Performance, the Beta value is 0.16, indicating a weaker but positive influence of government policies on SME performance. The T-statistic is 2.65, and the P-value of 0.01 shows statistical significance at the 5% level. Although the effect is smaller compared to

other factors, the result highlights that supportive government policies can play an important role in improving the performance of SMEs.

The relationship between Human Resources -> SMEs Performance shows a Beta value of 0.24, suggesting that human resources have a moderate positive effect on the performance of SMEs. The T-statistic of 4.14 and the P-value of 0.00 confirm that this relationship is statistically significant. This underscores the importance of having skilled and capable human resources in enhancing the overall performance of SMEs.

Lastly, Technological Factors -> SMEs Performance has a Beta value of 0.23, indicating a moderately strong positive relationship between the adoption of technological factors and SME performance. The T-statistic of 4.21 and a P-value of 0.00 indicate that this effect is statistically significant. This result suggests that the use of technology significantly contributes to improving SME performance, demonstrating the critical role of technological advancements in business success.

In summary, all the hypothesized relationships are statistically significant, with Access to Finance having the strongest effect on SMEs performance, followed by Human Resources, Technological Factors, and Government Policies. These results highlight the importance of financial resources, human capital, and technology in enhancing the performance of SMEs, while government policies, though significant, have a relatively smaller impact.

#### 4.3 The Determination Coefficient ( $R^2$ ), the Effect Size ( $F2$ ) and the Predictive Relevance ( $Q2$ )

The amount of variation explained by exogenous latent variables over endogenous latent variables was calculated using the coefficient of determination or R-square level. According to Chin (2010),  $R^2$  values of 0.67, 0.33, and 0.19, respectively, are considered significant, moderate, and weak. Using a criterion of 0.02, 0.15, or 0.35 to indicate small, medium, or large, the two numbers represent the potential impact or effect of an exogenous variable on an endogenous variable (Cohen, 1988). Nevertheless, cross-validated redundancy criteria, which represent endogenous latent variables, were used in this study to evaluate the predictive correlation ( $Q2$ ) of external latent factors, as indicated in Tables 4, 5, and 6 below.

Table 5. Coefficient of Determination ( $R^2$ )

Constructs	R Square	R Square Adjusted
SMEs Performance	0.634	0.63

Table 5 presents the Coefficient of Determination ( $R^2$ ) for the construct of SMEs Performance. The  $R^2$  value of 0.634 indicates that approximately 63.4% of the variance in SMEs' performance can be explained by the independent variables analyzed in the model, including access to finance, government policies, human resources, and technological factors. This suggests a strong explanatory power, meaning that the model is effective in capturing the key drivers of SMEs' performance.

Table 6. Assessment of Effect size ( $f2$ )

Constructs	SMEs Performance	Effect Size
Access to Finance	0.132	Small
Government Policies	0.028	Small
Human Resources	0.055	Small
Technological Factors	0.061	Small

Table 6 reveals the Assessment of Effect Size ( $f^2$ ) for the different factors influencing SMEs Performance. All constructs that include Access to Finance, Government Policies, Human Resources, and Technological Factors—demonstrate small effect sizes, indicating that while each factor contributes positively to SMEs' performance, their individual impacts are modest when considered independently. Access to Finance has the largest effect size at 0.132, followed by Technological Factors (0.061) and Human Resources (0.055), with Government Policies showing the smallest effect size at 0.028. This suggests that while these factors are important for SMEs success, their effects are stronger when combined with other variables rather than in isolation.

According to Cohen (1988), the benchmark for determining small effect size value is 0.02. However, Chin et al. (2003) emphasize the importance of considering even the smallest effect size of an exogenous variable, as it may still have an impact on the endogenous variables.

Table 7: Predictive relevance on endogenous variables: Q-square

Construct	SSO	SSE	$Q^2 (=1-SSE/SSO)$
SMEs performance	1750	1114.576	0.363

Table 7 represent the blindfolding result of the cross-validated redundancy ( $Q^2$ ) of the endogenous latent variables of this model. As the cross-validated redundancy ( $Q^2$ ) is greater than zero as shown on Figure 4.10, it clearly indicates that there is a path model predictive relevance on firm performance (Chin, 1998; Hair et al., 2014; Hayes, 2009).

#### 4.4 Discussion of Results

This study examines the effect of business environment on the performance Small and Medium Enterprises of Katsina state of Nigeria. The results obtained through Partial Least Square Structural Equation Modelling (PLS-SEM) analysis shed light on the extent to which business environment influence the performance SMEs.

i. The analysis indicating a moderately strong positive effect of access to finance on SMEs performance, with a p-value of 0.00 at a 5% level of significance. Since the calculated p-value (0.00) is less than the 5% level of significance, the study rejects the null hypothesis and accepts the alternative hypothesis. These findings align with the research of Akinlabi, et al., (2021);

Umar, Sam & Anu, (2022)

ii. The analysis also reveals a weaker but positive influence of government policies on SME performance, with a P-value of 0.01 shows statistical significance at the 5% level. Although the effect is smaller compared to other factors, the result highlights that supportive government policies can play an important role in improving the performance of SMEs. These findings support the research of Akinlabi, et al., (2021); Ifedoro, and Kurah, (2020). However, they differ from the findings of Ibrahim, et al, (2023).

iii. In line with the second hypothesis, human resources have a moderate positive effect on the performance of SMEs, with P-value of 0.00 confirm that this relationship is statistically significant. This underscores the importance of having skilled and capable human resources in enhancing the overall performance of SMEs. Therefore, the study rejects H2 and accepts the alternative hypothesis, which suggests that human resources have a moderate positive effect on the performance of SMEs. However, the results align with the study conducted by Oluwadare, and Oni (2016).

iv. The results also discovered a moderate strong positive relationship between the adoption of technological factors and SME performance. The T-statistic of 4.21 and a P-value of 0.00 indicate that this effect is statistically significant. These findings align with the research of Adudu, Osisanya, and Adebajo, (2021); Angbazo and Iyimoga, (2022); Ifedoro, and Kurah, (2020) which indicate a positive significant relationship between technological factors and SME performance. But, inconsistency with the findings of Liman, Burah and Jibir, (2021).

## 5. Conclusion and Recommendations

Based on the findings of the study, it is concluded that all the variables that include Government Policies, human resources, technological factor and access to finance are critical determinant of SMEs' performance. Although Government Policies positively influence SME performance, their impact is smaller compared to other factors.

In light of the conclusion, the following recommendations are made:

Financial institutions and policymakers should develop more inclusive financial systems tailored to SMEs. This includes offering affordable credit options, reducing collateral requirements, and providing financial literacy training to enable SMEs to better manage and access funding. Governments' policies should focus on easing regulatory burdens, offering incentives for growth and innovation, and improving communication channels to ensure SMEs can take full advantage of available support. Moreover, SMEs should prioritize the development of their workforce by offering training programs as this will help attract and retain skilled employees, which is essential for sustained growth and innovation. Moreover, SMEs should prioritize the development of their workforce by offering training programs, competitive benefits, and clear career progression

opportunities as this can help attract and retain skilled employees. Additionally, SMEs need to be supported in adopting new technologies that can improve operational efficiency and market competitiveness.

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