

# Chapter 8

## Organisational Narcissism: A Case of Failed Corporate Governance?

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### Introduction

A developing body of literature has begun to explore the presence of narcissism in organisations and in organisational leaders (Chatterjee and Hambrick 2007; Downs 1997; Duchon and Drake 2008; Roberts 2001). Recent corporate scandals in New Zealand, evidenced by the collapse of a large number of unlisted finance companies, involved senior executives and directors promoting their organisations to investors while potentially defrauding them, and then practising denial when the company's serious financial problems became known.

We contend that some of the behaviour exhibited by these organisations' management-control nexus (i.e. the board of directors (BOD), the chief executive officer (CEO) and the senior management) could be characterised as narcissistic, and contributed to the creation of narcissistic organisations where unethical behaviour was considered normal. Confronted with the challenge of improving ethical standards in general and avoiding narcissistic behaviour in particular, reformers could respond in one of two ways: to place more emphasis on character, or to change the rules of the institutions in which the individuals operate (Bragues 2008). We argue here that the narcissistic tendencies found in some organisational cultures are largely determined at the level of the corporate governance of the organisation. The BOD is ultimately responsible for the moral or immoral identity of the organisation. However, instead of advocating for rule reform, we contend that the problem lies with the *character* of the directors and the manner in which they exercise their judgement in the selection of the CEO and incoming directors.

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## The Vice of Narcissism

In ancient mythology, Narcissus, a particularly handsome young man, rejected the advances of Echo, a river nymph. A heartbroken Echo prayed to Nemesis, the goddess of divine retribution against the proud, who caused Narcissus to fall in love with his reflection in a pool one day without grasping that the face gazing back at him was his own. Eventually, after pining for some time, Narcissus recognised the image in the water and, realising his inability to act upon this love, he wasted away to death at the edge of the pool (alternative versions of this tale have him reaching out to kiss his reflection and drowning or committing suicide by sword). According to the tale, his soul was sent to Hades, where he continues to gaze at his reflection in the river Styx, while the Narcissus flower grew where he died, forever reaching towards the water.

The modern psychoanalytic genesis of the term narcissism is Sigmund Freud's (1914) work 'On Narcissism: An Introduction'. In this, Freud defined narcissism as 'a state of being the centre of a loving world in which the individual could act spontaneously and purely out of desire' (Brown 1997, 644). Freud believed that as infants we experienced this state and as adults we project the possibility of returning to such a state by means of our *ego-ideal*, that is, 'our model of the person we must become in order for the world to love us as it did when we were young' (Brown 1997, 644). Unfortunately, no individual can ever attain this ego-ideal. The resulting futile awareness of this search, and our need to protect our sense of self, causes us to adopt certain ego-defence mechanisms. Central to this understanding of narcissism is the need for individuals to maintain a positive sense of self and the engagement of ego-defensive actions to preserve self-esteem.

In modern parlance, yet still rooted in this ancient myth, narcissism 'generally connotes a person who possesses an extreme love of the self, a grandiose sense of self-importance, and a powerful sense of entitlement' (Duchon and Drake 2008, 303). While useful, this definition needs further unpacking. Brown (1997), while noting the divergent conceptions of narcissism, summarised much of the extant literature into six broad behavioural/psychological predispositions. *Denial*, the first of these, has the narcissistic individual 'disclaiming awareness, knowledge, or responsibility for faults that might otherwise attach to them' (p. 646). *Rationalisation* is the narcissist's attempt at justifying unacceptable behaviours or attitudes and presenting them in a socially acceptable form. *Self-aggrandisement* refers to the tendency to overestimate one's abilities or achievements. The narcissistic personality, imbued with these beliefs, is often accompanied by 'extreme self-absorption, a tendency toward exhibitionism, claims to uniqueness, and a sense of invulnerability' (p. 646). In addition to these traits, and to further self-enhancement, the narcissist also distorts reality through selective perception. The fourth disposition, *attributional ego-tism*, is the tendency to explain events in a self-serving manner and to attribute positive outcomes to causes internal to the self and negative outcomes to external factors. The psychoanalytic literature generally accepts that narcissists use self-serving attributions to preserve and/or enhance self-esteem. A narcissist, bolstered by the above traits, also has a strong *sense of entitlement*. This, in turn, is associated with 'a strong belief in his/her right to exploit others and an inability to empathize

with the feelings of others' (p. 647). Unfortunately, for him or her, this lack of feelings towards others matches an insatiable need for their approval and admiration. Thus, the narcissist finds themselves in the not so enviable position of 'holding in contempt and perhaps feeling threatened by the very individuals upon whom he or she is dependent for positive regard and affirmation' (p. 647). Finally, narcissism is also associated with high levels of *anxiety*. Research demonstrates that narcissists suffer from feelings of dejection, worthlessness, hypochondria, despair, emptiness, fragility and hypersensitivity. While anxiety itself is not an ego-defence, it is what the above ego-defence mechanisms seek to ameliorate.<sup>1</sup>

According to Brown (1997), while these traits define narcissism in broad terms, narcissism also occurs on a continuum from 'normal' or 'healthy' at one end to 'pathological' at the other. It is important to recognise that narcissism per se is a normal phenomenon and a 'universal and healthy attribute of personality' (Cooper 1986, 115) which represents a 'healthy concern with the self and with self-esteem regulation' (Frosh 1991, 75). However, when taken to the extreme, narcissism can constitute a disorder that inhibits an individual's capacity to function normally or to form meaningful relationships.

## Virtue Ethics and Corporate Governance

Our discussion of virtue theory is based on the writings of Aristotle (and Alasdair MacIntyre to a lesser degree). Our focus is on the creation of a narcissistic organisational identity, stemming from the personalities of senior figures. Sison (2008) has developed a corporate governance model based on virtue theory, arguing that good governance requires governors of good character. His system is important in focusing on Aristotle's understanding of governance as '*praxis*' or action, as opposed to '*poiesis*' or production. An 'action' is good if it leads the actor to grow in virtue, while 'production' is simply good if it is efficient.

Before explaining further the implications this model has for narcissistic organisations, some important Aristotelian concepts need further explanation. Firstly, Aristotle provided an account of what it meant to have a successful life and a successful society (Flynn 2008). For Aristotle, a successful or happy life or '*eudaimonia*', is something everyone wants (Blackburn and McGhee 2007). By *eudaimonia*, Aristotle meant a life in which our human capabilities are put to their best use (Flynn 2008). This is a life lived *kat' areten*, that is, a life lived in accordance with virtue. Aristotle arrived at his notion of virtue in the following way: when we say something performs

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<sup>1</sup> The American Psychiatric Association (APA) also lists narcissism among its personality disorders. The APA's *Diagnostic & Statistical Manual IV* (DSM-IV) characterises a narcissistic individual as demonstrating several self-centred attitudes and behaviours including exaggerating achievements, demanding praise and admiration, a preoccupation with fantasies involving unlimited success, power, love and beauty, a feeling of superiority over others and of being more deserving based on that superiority, and being arrogant, haughty, patronising or contemptuous.

well we mean it is fulfilling its purpose and the act or performance is 'good'; if the purpose of the human being consists in the exercise of our cognitive capacities then virtue is nothing more than reason excellently used (Bragues 2006).

Neo-Aristotelians have unpacked these concepts further. Human nature contains a set of natural principles of practical reason, and when a person uses their practical reason (i.e. turns their mind to action), they open themselves to understand that in general good should be done and evil avoided, and that virtue is good (Rhonheimer 2008). In other words, human nature itself provides ethical goals (Annas 1993). This is the basis for Aristotle's conclusion that a virtuous life is indeed a good life.

One's character is a result of one's virtues. The virtues of character (moral virtues) such as courage and self-control arise through habit. They are dispositions engendered through practice but the practice of acquiring virtue always involves a rational choice. Flynn (2008) asserted that practical wisdom (prudence) is the virtue that guides reason in this choice and it grows as one develops in virtue.

Practical wisdom (prudence) ... is a bridge between the intellectual and moral virtues. It entails an appreciation of the difference between what is good and bad in order to live a worthwhile life, and necessitates virtue of character in the sense that it cannot function properly without correct habits. (2008, 364)

Many other approaches to corporate governance consider governance to be an activity belonging to the category of '*poiesis*' or production (Sison 2008). This possibly explains the emphasis placed on rules in many corporate governance regimes. It seems that globally the ideal goal of governance theory, is to create a foolproof instruction manual on the task of good governance (Sison 2008). However, according to virtue theory, the ideal governor would be a prudent one, exercising judgement rather than following rules. The excellence of '*praxis*' is prudence, which develops through the acquisition of all the virtues. Based on this model, the development of a moral organisational identity, as opposed to a narcissistic one, is more likely.

Virtue theory also holds that a person's character not only influences their actions but also their perception. The virtue of prudence or practical wisdom is the ability to know specifically what is good to do here and now and we develop prudence by acquiring virtue.

As Aristotle wrote:

The wise do not see things in the same way as those who look for personal advantage. The practically wise are those who understand what is truly worthwhile, truly important, and thereby truly advantageous in life: who know in short, that it is worthwhile to be virtuous. (Aristotle 1941, book 6, ch 13, 1144b31)

## Virtue and Organisational Identity

Organisations, like individuals, have identities. These identities can be moral or immoral just like those of individuals, can. We argue that an organisation has a *moral* identity when it is centrally oriented towards a collection of virtues that both define what one is and what one tends to do. Morality is a function of an entity's character

and ‘unless virtue is a central part of the organisation’s self-concept, ethical behaviour will never be considered an appropriate metric or standard to judge the outcome of decisions’ (MacIntyre 2007, 303).

In order to assess the development of the narcissistic organisation, let us consider how organisational identities form and the function they have. Whetten defined organisational identity as ‘the central and enduring attributes of an organization that distinguish it from other organizations’ (2006, 220). He referred to these as *organisational identity claims*. These legitimise an organisation’s uniqueness and its capacity to determine a competitive domain and function ideally within that domain. These claims take two forms. Functionally, they consist of organisational attributes that determine similarity and difference from all others (i.e. this is who we are). Invoked consistently in organisational discourse, these attributes refer to specific social categories (e.g. we are a university not a technical institution). This, in turn, signifies the boundaries of appropriate behaviour for a particular organisation. Structurally, organisational identity consists of attributes that configure activity in the organisation as shown in its programs, policies and procedures, and that reflect its most important values. These attributes, invoked in organisational discourse as decision guides and points of communication, provide a foundation for the organisation in all of its dealings (i.e. this is what we do; this is how we do it). When functional and structural attributes operate as irreversible commitments on some basis (i.e. they have passed the test of time; they have gained critical mass) they can ‘partially or completely eclipse the reference point that prevails more broadly external to the organization’ (Duchon and Drake 2008, 301). In other words, the identity of the organisation takes preference over reference points in other social groupings (e.g. family and society).

Organisations develop cultures that reinforce identity. A culture is ‘a set of important understandings that members of a community share in common’ (Sathe 1985, 6). These understandings are ‘largely tacit among members, are clearly relevant to particular groups, and are distinctive to the group’ (Louis 1985, 74). An organisation’s culture displays central and enduring elements that make up its identity. These include such things as ‘customs and traditions, historical accounts be they mythical or accurate, tacit understandings, habits, norms and expectations, common meanings associated with fixed objects and established rites, shared assumptions, and intersubjective meanings’ (Sergiovanni and Corbally 1984, viii). A culture embodies these elements and acts as a transferring mechanism of the organisation’s identity to new members as the correct way to perceive, think and feel (Schein 1992).

Individuals in organisations share a common social identification and organisational self-esteem is the collective self-esteem of the individuals acting as the organisation. Duchon and Drake (2008) contend that organisations, as social entities, ‘exist in their members’ common awareness of their membership, and so come to take on identities that are parts of their members’ identities, needs, and behaviours’ (302). Consequently, when individuals strive to protect or enhance a self-concept derived from a particular social entity, they collectively modify the self-esteem of that entity. Hence, the organisation can regulate self-esteem with ego-defensive behaviours. These, in turn, protect identity and enhance the legitimacy of the organisation. Unfortunately, if

organisations are motivated, like people, to ‘protect their collective identity and legitimacy, then like people, they too can sometimes engage in extreme narcissistic behaviour’ (303).

## Organisational Narcissism

As discussed earlier, the psychoanalytic literature generally views narcissistic behaviours as ego-defence mechanisms used to bolster an individual’s self-concept and protect their identity. Organisations, as collective entities of individuals, are similar. They also have needs for self-esteem that are regulated narcissistically (Brown 1997). This response is a coping mechanism intended to protect and preserve the organisation’s identity. Unfortunately, like individuals, organisational ego-defence mechanisms taken to the extreme can lead to dysfunction and/or ruin. Furthermore, in the effort to protect itself, an organisation may create structures that reinforce and extend an extreme narcissistic identity. The extreme narcissistic organisation ‘loses sight of the “reality” of its position in the marketplace and employs denial, self-aggrandisement, and a sense of entitlement to prop up its damaged sense of identity’ (Duchon and Burns 2008, 355). Such an entity seeks legitimacy at the expense of accountability. They pay scant attention to market responsibility, civic duty or ethical concerns (Ganesh 2003). Consequently, the extreme narcissistic organisation is recognisable by observable attributes and behaviours.

According to Brown (1997), such organisations deny facts about themselves using spokespeople, propaganda campaigns, annual reports and myths. They develop justifications for their actions through rationalisation. They self-aggrandise by making claims to their uniqueness, commissioning corporate histories and deploying their office layouts and architecture as signs of status, prestige and vanity. Narcissistic organisations, stated Brown, attribute failure of their decisions to external factors, while at the same time attributing positive results to the organisation itself. Annual reports, publicity campaigns and the manipulation of the media are among the variety of means utilised to achieve this purpose. Such organisations also assume an entitlement to continued successful existence and a consequent entitlement to exploit resources, people and other organisations to achieve this continued success. Finally, the narcissistic organisation suffers from social instability and alienation.

There are several real-life examples in the research literature that correspond with Brown’s (1997) criteria. Stein (2003), in his investigation of the near collapse of the highly prestigious hedge fund Long Term Capital Management (LTCM) in 1998, found that acute narcissism in this organisation mirrored Brown’s (1997) description. Stein contended that an exaggerated sense of pride and conception of power and knowledge led the directors of LTCM to take unnecessary and extreme risks in the financial markets. Secondly, the feelings of contempt that LTCM’s directors had for others in the market – and a desire to demonstrate their superiority by triumphing over them – led the directors to increase their risk substantially. Ketola (2006), analysing the psychological defences of a company dealing with an oil spill,

identified the ego-defence mechanisms used to protect organisational identity, even at the expense of its morality. When faced with accusations of misconduct, the organisation practised denial, repression, omnipotence and attributional sublimation to avoid having to deal with the facts of their own actions. When confronted with the reality of the spill, they used rationalisation to accept responsibility but devalued the harmful impact of the spill on others and the environment.

Acute narcissistic organisations' identity and culture are excessively self-centred and exploitative. Duchon and Drake contended that:

Their membership will obsessively employ a sense of entitlement, self-aggrandizement, denial and rationalizations to justify their behaviour and so protect the collective identity. Such organizations are not intentionally unethical – they are likely to have formal ethics programmes – but concerns about ethical, or even legal behavior will receive little more than lip service. (2008, 305)

Ethics programs in narcissistic organisations are a form of self-preservation: they are a way of telling the world 'everything is good here'. Furthermore, Roberts (2001) contended, such programs are window dressing; what is relevant is not whether the ethics program is in use but only that a narcissistic organisation appears to be implementing it. This leaves the operational interior free to carry out its usual practices.

The management–control nexus is often a source and perpetuator of organisational narcissism. Research has highlighted the strong relationship between leadership and an organisation's identity (Curry 2002; Voss et al. 2006; Walsh and Glynn 2008) and culture (Schein 1992; Taormina 2008; Toor and Ofori 2009). Leaders embody and enact identity through discourse and policy/procedure setting. Consequently, they become the focal point of decision making in the organisation. At the same time, their behaviours encourage the development of norms that encourage employees throughout the organisation to follow a particular set of actions.

If the organisational leadership is extremely narcissistic, then it is probable that identity and culture will mirror leadership, and individuals within the organisation will reflect narcissistic tendencies. Once these practices become institutionalised, it is probable that individuals will think of their organisation, and themselves, as moral and continue their narcissistic (and likely unethical) behaviour without guilt (Anand et al. 2005). To those on the outside, this seems perverse, but those who have internalised the organisation's culture see nothing wrong in what they are doing. To question what the organisation is doing is to threaten collective, and ultimately individual identities that operate within it. As Duchon and Drake (2008, 306) noted, 'extreme narcissistic organizations cannot behave properly because they do not have a moral identity'.

Duchon and Burns (2008) categorised Enron as having an extreme narcissistic identity. They quoted Kurt Eichenwald's book *Conspiracy of Fools*:

Crime was just one ingredient in a toxic stew of shocking incompetence, unjustified arrogance, compromised ethics, and an utter contempt for the market's judgement. Ultimately, it was Enron's tragedy to be filled with people smart enough to know how to manoeuvre around the rules, but not wise enough to understand why the rules had been written in the first place. (2008, 358)

Duchon and Burns contended people in Enron were unwise because they operated in an extremely narcissistic environment characterised by entitlement, self-aggrandisement and denial that anything was out of order. The management–control nexus at Enron believed they were entitled to success. This led them to skirt around the rules applicable to everyone else. For example, they created and used their own projections for income as opposed to market trading prices. They avoided conventional accounting practices whenever they wanted to. The leadership believed they were entitled to a healthy-looking balance sheet. Enron viewed itself as omnipotent, changing the world for the better in a godlike manner. The executives often spoke in messianic tones and viewed themselves as the best of the best, which in turn resulted in excessive exhibitionism throughout the company. Finally, when everything came to its inevitable conclusion in 2002, Enron and its executives went into denial mode. While this was morally questionable, what was worse was that Enron had been ignoring evidence of fraud and insider trading for years. Indeed, this had become standard practice in a company desperate to protect its identity.

The authors suggest that something comparable may have happened in some of the sixty finance companies which collapsed between the years 2006 and 2008 in New Zealand (albeit on a smaller scale). There appeared to be similar narcissistic defence mechanisms at work in several of these organisations. Many skipped around the rules when it suited because they believed they were entitled to success, a characteristic of narcissistic identity. Several of these companies were classic ‘self-aggrandisers’, exhibiting the belief that normal market rules simply ‘don’t apply to us’. Neglecting to prepare consolidated accounts, engaging in large numbers of inter-company transactions of an allegedly dubious nature and operating with an extremely high ratio of related party transactions (Cone 2004) were just some of the behaviors that occurred in this period. Several companies allegedly made untrue statements in their registered prospectuses concerning the overall financial position, solvency and liquidity (Marwick 2008). Furthermore, some companies continued to advertise themselves as being financially solid when subsequent collapses showed this clearly was not the case (see e.g. Gibson 2008). When it all started going pear-shaped these organizations shifted the blame to the state of the economy and the market.

## **Moral Organisational Identity and Leadership**

We contend that organisational narcissism, as demonstrated in the examples above, begins and ends with the management–control nexus and in particular the individual directors on the board. This is because leaders shape the moral identity of the organisation. Weaver (2006) included leader behaviour as a key determinant in the development of virtuous and vicious identities in organisations. This happens by members modelling leader behaviour (Bandura 1986; Brown et al. 2005; Weaver et al. 2005) and from the way organisational cultural norms undermining or promoting virtue are internalised (Treviño and Weaver 2003).

The wider leadership literature supports this causal link between leader behaviour and the moral identity of the organisation. Gini (2004) asserted that all leadership is



ideologically driven and it is about passing on values so that the ethics of the leaders determine the ethics of the organisation. Andreoli and Lefkowitz (2009) found that an ethical climate created by moral leadership was one of the most significant antecedents of ethical conduct. Others have emphasised the importance of consistency in communication and behaviour, in other words 'leaders needing to walk the talk', and the resulting benefits in terms of effective role modelling and perceived integrity (Gini 1997; Kouzes and Posner 1993; Oliverio 1989; Simons 1999).

Some authors have argued that leader role modelling is the most critical factor determining ethical culture (Dickson et al. 2001; Morgan 1993; Murphy and Enderle 1995; Nielsen 1989; Schein 1992; Sims and Brinkmann 2002). Jackall (1988) suggested that ethical behaviour in organisations is often reduced to adulating and imitating one's superiors. Lord and Brown (2001) claimed that leaders provide a 'natural source of values' for their employees while Bandura (1977), in discussions of socialisation and social learning theory, suggested that employees imitate the values stemming from their leaders. Hood (2003), who looked specifically at the relationship between the CEO's leadership style, values and the ethical practices of the organisation, found that leadership styles do influence ethical practices in the organisation. Brown et al. (2005) considered managers to be a key source of guidance for ethical behaviour.

Given this strong relationship between leadership and moral identity, we argue that if the management–control nexus exhibits narcissism then it is probable that the individuals and the organisation as a whole will reflect these narcissistic tendencies.

So, what does a narcissistic organisation look like? Duchon and Drake (2008) have argued that an organisation's identity operates as an analogy to an individual's personality and essentially determines its moral behaviour. They even went so far as to claim that an extreme narcissistic organisation cannot behave properly because it does not have a moral identity. This is because the organisation's identity does not contain a predisposition to act virtuously and so it is morally flawed.

Narcissistic organisations use ego-defence mechanisms to protect the integrity of their personality even at the expense of sacrificing the morality of their actions (Ketola 2006). They become self-obsessed and use a sense of entitlement, self-aggrandisement, denial and rationalisations to justify anything they do (Duchon and Drake 2008). In such organisations, individuals and groups may be responsible for making decisions but those decisions will tend to be consistent with the larger system's moral identity (Weaver 2006) and so unethical behaviour can emerge unintentionally. This may explain how in the above-mentioned companies individual decision-makers in senior positions appear not have questioned unethical behaviour.

## **Employing a Virtue Model for Leadership Appointments**

We argue that the BOD ultimately determines the moral identity of the organisation through its choice of the CEO and incoming directors. The BOD selects and appoints the CEO, who in turn selects their management team and together they set the tone of the organisation (Schwartz et al. 2005). While the law in New Zealand does not require a CEO and a management team (Institute of Directors 2008), the reality is

that a BOD simply cannot manage a company requiring day-to-day attention. A CEO and executive team under the direction and supervision of a BOD manage the organisation. Consequently, the CEO is the main portal through which a BOD exercises its direction and supervision; and in the main the CEO shapes and nourishes the organisation's identity. The selection of the CEO is therefore one of the most important decisions a BOD makes (IODNZ 2008).<sup>2</sup>

Section 131 of the *Companies Act* in New Zealand requires directors to act in 'good faith' and in what they believe to be the best interests of the company. While current business culture equates this with short-term monetary gain for a few (Pearlstein 2009), this culture could be changed. The board of any company has the power to minimise the likelihood of organisational narcissism occurring by appointing directors and CEOs of 'good' moral character, who also possess the desired attributes such as business ability and ambition to maximise profits. However, the perception of what makes a 'good' director or CEO is a reflection of the moral character of each director on the Board, and the same can be said of the CEO in their selection of the senior management team. "How do we know how a good CEO behaves"?

We contend that directors of 'good' character (in the virtue theory sense) would have a more holistic understanding of their responsibilities. Such a person will aim to achieve wealth in a virtuous way. They will not permit self-interest to take over: they will strive to be virtuous whether it benefits them or others (Annas 2006). They will work for the long-term survival of the company as a whole in a virtuous manner. They will judge a suitable candidate for director or CEO to be one who is committed to these goals. Furthermore, they will resist pressures to act in their own interests or sit back and let others pursue their self-interest or jeopardise the future of the company by excessive risk taking to bolster short-term results.

## Conclusion

We have argued in this chapter that the moral identity of an organisation is directly linked to the good character of individual directors on the board. Prudent directors will ensure moral governance and the virtuous characters of the leaders of any organisation are the main determinants of the identity of that organisation. The sitting directors have the responsibility of selecting the CEO and nominating suitable candidates for future directorships. Their judgement as to the nature of a good governor is crucial. Only a director of good character would recognise that an ideal CEO or director would be one who has a good character. The presence of such leaders would ensure the establishment and maintenance of a moral organisational identity.

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<sup>2</sup>In New Zealand, the existing directors effectively choose new directors. Shareholders are passive and cede significant authority to existing directors in relation to the selection of new directors. Consequently, the board itself determines the culture of the board.

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