

## ENTREPRENEURSHIP FINANCING: A SHIFT TO CROWDFUNDING AS ENABLER OF STARTUP AND BUSINESS SUSTAINABILITY

By

ADESANYA, A. O AND IFERE, S. E

University of Lagos Business School (ULBS), University of Lagos,  
Lagos, Nigeria  
[opeadesanya007@gmail.com](mailto:opeadesanya007@gmail.com)

### **Abstract**

*Entrepreneurship remains one of the most studied topics in the literature because of its assumed impact on generating employment, poverty alleviation and contribution to economic growth worldwide. Despite the assumed benefits, access to financial resources continues to be a major factor hampering startups, connectivity of entrepreneurial firms to global networks and competitiveness. The objective of this paper is to explore the role of the crowdfunding financing model, generally viewed as a modern financing option, in startups and venture sustainability. It critically examines whether crowdfunding is a viable alternative to the traditional methods of financing entrepreneurial businesses and its effect on business sustainability. A literature review approach was adopted to identify the effect of two crowdfunding options, crowd-equity and peer-to-peer, on startups and entrepreneurial firms' sustainability. Findings reveal a positive influence of crowdfunding on financing startups, and on entrepreneurial sustainability as it covers the financing gap of traditional sources such as bank loans, business angels and venture capitalists. The study suggests that there is a need for more emphasis on crowdfunding as a strategic option for promoting and sustaining entrepreneurship. The introduction of regulatory framework aimed at protecting crowd-funders from losing their investments will enhance crowdfunding outcome.*

**Keywords:** Crowdfunding, crowd-equity, peer-to-peer equity, entrepreneurial business sustainability

### **1.0 Introduction**

Entrepreneurship retains the position of a powerhouse for the growth and development of an economy globally. As indicated by Marcotte (2012) and Harash (2014), entrepreneurship has become increasingly recognized as a pivotal factor in economic development and accepted globally as the engine of economic growth, including employment generation. For these reasons, economies globally are now deliberate about policies aimed at encouraging the development of entrepreneurship premised on its far-reaching benefits to the economy. Furthermore, Schumpeter (1934), in the Theory of Economic Development, highlighted the role of the entrepreneur as the significant cause of economic development. From a global perspective, entrepreneurial ventures have become an increasingly pivotal element in driving economic development and growth. Entrepreneurship offers an array of advantages, such as fostering employment creation, fueling innovation, boosting productivity, and intensifying competition.

Finance is crucial to the success of any business. Accessing financial resources remains a significant hurdle for entrepreneurs in Nigeria just like many other countries, hence the importance attached to the studies on the subject. Typically, entrepreneurs initially rely on personal savings, and financial support from family and friends before turning to formal avenues such as banks, business angels (BAs), venture capitalists(VCs), and other similar options. As the challenges of sourcing for finance persist, it becomes necessary to seek

innovative solutions, particularly through entrepreneurial initiatives that will improve access to financing for startup and growth ventures.

There are several internal and external reasons why finance remains a major challenge to entrepreneurs. The internal challenges affecting access to finance include the level of savings and investment, level of income generated out of previous economic activities of the entrepreneurs, level of income and liquidity of family and friends, and the size of capital required amongst other reasons. Challenges with external sources (for example, bank loans, venture capitalists, business angels, and venture capitalists) includes the inability to satisfy the requirement for collateral, bank financing policies of sector specificity, historical performance of the business, promoters pedigree, and inadequate government policies to ease access to funding opportunities. Facing the challenges of finance, it becomes critical for entrepreneurs to seek innovative solutions that would enhance access to financing for startups and the growth of their ventures. Hence, modern solutions like bootstrapping, invoice and supply chain financing, and crowdfunding (crowdequity and peer-to-peer (P2P), also referred to as marketplace lending) become an important consideration for entrepreneurs to support kick starting their ventures and the sustainability of the business.

As stated in a World Economic Forum (2015) report, the traditional business financing models are beginning to be challenged by the modern approaches listed above, which create efficiencies, and risk reduction and make businesses more profitable.

Entrepreneurship traditional financing model in the context of this paper implies pre-crowdfunding options including the indigenous (Yoruba and Igbo regions in Nigeria) models, and other options identified in line with the Pecking order theory of Myers 1984 which are own equity, finance from family and friends, bank loans, business angels, venture capital and the capital market. The modern financing model is focused on crowdfunding (equity crowdfunding and peer-to-peer). Hence, the use of crowdfunding in this study refers to both equity crowdfunding and peer-to-peer (also referred to as marketplace lending).

Crowdfunding can be described as a transformation in the financial market caused by the advent of technology due to the challenges in accessing external financing by entrepreneurs. The term “crowdfunding” is coined from a process of raising funds from a number of interested individuals “crowd” through an online platform for a specific project. The crowd members individually pledge small amounts to a pool of funds as investments on the project through an online platform. Agrawal et al. (2011) and Khavul (2010) asserted that the idea of sourcing funding from an anonymous group of people is rooted in small loans in developing countries. Crowdequity is often referred to as equity crowdfunding is a model where entrepreneurs raise funding from a large number of investors using a technology platform whilst offering equity shares as a form of ownership in the business. Similarly, Cumming, Leboeuf and Schwienbacher (2019) posits that the model allows businesses to access finance by selling bits of equities to many investors, enabling the companies to bypass the traditional financing route and, directly appealing to the crowd investors with the intention of profit sharing.

Beyond kickstarting, businesses often struggle in terms of long term growth and sustainability which might eventually leads to a collapse of its operations. One of the identified factor that affects business sustainability is the access to finance. Hall, Daneke and Lenox (2010) discusses the critical role of access to finance in supporting the sustainability of businesses and suggested alternative financing models.

Many studies have been conducted on the relationship between crowdfunding and entrepreneurship in developed economies. However, studies on the topic are scarce in the Nigerian context, which provides an opportunity for empirical and insightful contribution on the topic from the country’s perspective. As Meyer (2015) points out, there is a need for more context based studies from the understudied regions of the world.

Studies carried out on the relationship between crowdfunding and entrepreneurship are inadequate and do not address the specific area of this study. For example, study by Oyedokun and Bello (2020) highlights the opportunities and challenges of implementing crowdfunding in the Nigerian context, including regulatory concerns and investor protection however with less on the extent of embracing the option for starting and sustenance of Small and Medium sized Enterprises (SMEs) .

The studies of Cordova, Dolci, and Gianfrate (2015); Olafusi, Ishola, Abimbola, and Idowu (2022); Mollick (2014) and Adjakou (2021) are associated with the features of crowdfunding and impact of proper regulatory framework on protection of investors. Furthermore, Samarah and Alkhatib (2019) and Mollick (2014) studies are on the importance of technology as a means of raising funds through Crowdfunding and the impact of environment on the sustainability of crowdfunding financing option. None of these studies examined specifically the extent to which crowdfunding has led to entrepreneurial startup and sustainability, which is the focus of this study. Mollick (2014) acknowledged the need for research on how crowdfunding enable kickstarting and the sustainability of ventures.

### **Aim and objectives of the study and research questions**

This paper aims to analyse the effect of crowdfunding on entrepreneurial startup and sustainability. The specific objectives are to i) investigate the role of crowdfunding financing model in entrepreneurial startup in Lagos state, ii) Analyse the effect of crowdfunding financing model on sustainability.

The relevant research questions: i) What is the effect or role of crowed funding financing model on entrepreneurial startup? ii) Does crowdfunding financing model affect entrepreneurship sustainability?

## **2.0 Literature review**

### **Theory**

The theories which underpin this study are, the Social Network theory, Social Identity theory and Fundamental theory.

### **Social network theory**

According to Fuhse (2015) Social network theory focuses on individuals, teams and organisations, and the network of interpersonal associations that both constrain and enable human action in these social systems. Borgatti and Halgin (2011) sees a network as a set of nodes or actors that are connected by a set of ties that are specified and linked together. They also observed that the term, social network, has expanded to cover anything from connecton through a website to a private one, which leads to conceptual confusion.

Vismara (2016) extended social network theory to explain the role of entrepreneurs' professional connections in the success of crowdfunding campaigns. He points out that it is difficult for first time entrepreneurs to access funding through investment banks and therefore turn to social networks and explore the crowdfunding network option. Baeck, Collins, and Zhang (2014) argues that in the UK, crowdfunding platform fundraisers see their social networks as the most important avenue for sourcing funds. Leyden et al. (2014) and Vismara (2016) document the significance of social networks in reducing uncertainty and promoting innovation. The social aspect of entrepreneurship increases the probability of entrepreneurial success by increasing the likelihood of raising funds in crowdfunding campaigns (Vismara 2016).

### **Social identity theory**

According to Gerber and Hui (2013), social identity theory proposed that human behaviour is often affected by the selection of identity, which impacts actions and motives. Kraut et al. (2012) stated that individuals with strong identities can influence the directions of other members within their group. A strong sense of affiliation that lies in identity causes people to

move collectively with fellow members of their group (Aaker & Akutsu, 2009). In the crowdfunding context, this identity power can help the fundraising process due to the emergence of a sense of devotion between backers and fundraisers. Therefore, it is important for fundraisers and funders to identify themselves with those with similar identities so that fundraisers can secure support from them (Damayanti & Sulung, 2021). Kromidha and Robson (2016) applying the study on Social identity theory (Tajfel & Turner, 1979) to investigate crowdfunding success confirmed that the greater the number of fundraiser's Facebook friends (translated as the network size) the greater the funders. According to Tajfel and Turner (1979), the social identity theory is where a group of people categorizes themselves as belonging to a group, aligning and acting following the identity of the group.

### **Conceptual review**

#### **Traditional financing – Igbo and Yoruba indigenous apprenticeship systems**

The two common traditional financing options identified in this study are associated with the Igbo and Yoruba apprenticeship systems.

As indicated by Onyima, Nzewi and Chikezie (2013), the Igbo apprenticeship system gained prominence after the Nigerian civil war when many parents who lost their assets during the war resorted to sending their children between the ages of 8-20 years old to learn to trade as a survival option. In the system, the master, popularly called 'Oga' and the apprentice called 'Nwaboyi' are in an agreement where the apprentice serves the master for a period ranging from 4-7 years and learn to be an entrepreneur within the period. The startup financing phase of the process is referred to as settlement which takes place at the maturity of the pre-agreed period at which the apprentice was to serve the master. Okwuowulu (2022) notes that the master settles the apprentice by setting up a business and providing startup capital and gives the required guidance up until a certain level of business maturity.

Olarewaju, Adebisi and George (2018) indicate that under the Yoruba apprenticeship system the craft or discipline to be pursued by an individual is determined by the parent or guardian and an expert in the discipline or craft is identified to take up the training of the individual, followed by a conversation on the expectations in terms of period or years of training. After the apprenticeship period, the apprentice is expected to become a master and start a new business venture. The sources of financing for startup and sustainability are not clearly defined and structured in the Yoruba indigenous model of entrepreneurship.

#### **Traditional financing - Own equity, family, friends, business angels and venture capital**

At the pinnacle of the financing options for entrepreneurs is own equity. This is in line with Colombo and Grilli (2007) supposition that most startups depend on own funds, then family, friends and fools (3 Fs), followed by bank loan to fund their operations, in their study to explore the challenges high-tech startups face in securing external financing, specifically bank loans, which are often essential for their initial growth and innovation efforts. Evans and Jovanovic (1989) in a study on an estimated model of entrepreneurial choice under liquidity constraints developed an economic model to examine how liquidity constraints affect individuals' decisions to pursue entrepreneurship. The authors argue that limited access to capital significantly influences who becomes an entrepreneur, as potential entrepreneurs are often constrained by their personal wealth and external financing availability. From the point of view of Evans and Jovanovic (1989), individuals with greater access to capital are more likely to venture into entrepreneurship emphasizing the ease of risking of own capital against those of other sources.

Harvie and Lee (2005) provides a comprehensive analysis of the role of small and medium-sized enterprises (SMEs) in the economic development of East Asian countries, highlighting their importance in employment, innovation, and economic resilience using case studies. They find that in developing countries, it is a daunting task for SMEs to access bank loans due to the high risk of failures of businesses, lack of collateral required by the banks, and low profitability

of startups, while Fisman and Love (2003) state that SMEs struggle to obtain loans due to underdeveloped financial institutions and this is common in countries with weaknesses in the developments of its financial intermediaries. Carpenter and Petersen (2002) posit that bank loans are not suitable for ventures at their early stages. However, after building up a record of commercial experience such ventures become attractive to external providers of financing like bank loans.

Roberts (2015), views business angels (BAs) in respect of their importance in financing innovative startup and Gregson (2014) points out the consultancy services and easing of the financial constraint role of the BAs. Madill et al (2005) views BAs as being highly regarded for their ability to support business ventures to the stage when they can attract more institutional investors, especially venture capital. Ramadani (2009) state that the term ‘business angels’ came from Broadway at the end of the 19th century when wealthy investors began providing funds to finance the production of new plays and musicals. They were motivated to provide funds to the directors for financial benefits and love for the theatre as well as providing the opportunity for them to meet and socialise with famous producers, writers and actors.

Olarewaju, Adebisi and George (2018), Van Osnabrugge (2000) and Morrisette (2007) describes the activities of venture capital (VC) as a consortium of investors that accumulate funds from various sources with the intention to invest in existing businesses that have the potential to continue being profitable, with an objective to earn returns on investment within a predetermined period, which is usually the shortest possible time. The investment objective of the VC is different from BA in terms of its focus, the concentration of its investment is on already profitable ventures, while that of later includes a start up venture. VCs provide operational assistance, technical support, and managerial participation apart from investing in business ventures.

### **Crowdfunding financing**

Crowdfunding is a method for raising finance in which startups raise capital directly or indirectly to a group of investors through the Internet. It further be described as a transformation in the financial market caused by the advent of technology and as a result of the challenges in accessing external financing by entrepreneurs. The term “crowdfunding” is coined from a process of raising funds from the crowd through an online platform for a project. The individuals in the crowd pledge a small amount to a pool of funds for the project. Agrawal et al. (2011) and Khavul (2010) asserts that the idea of sourcing funding from an anonymous group of people is rooted in the practice of raising small loans in developing countries. According to Cahery, Fenwick, and Vermeulen (2017), crowdfunding has evolved from a way of financing creative projects, such as books, films and games, into a new type of entrepreneurial finance option, which has the potential to dramatically change the venture financing ecosystem. According to Agrawal, Catalini, and Goldfarb (2013), crowdfunding is associated with two companies in the music industry, Sellaband, a music platform based in Amsterdam founded in 2006, and Kickstarter, based in New York and founded in 2009. Mollick (2014) sees crowdfunding as a rapidly growing phenomenon that started its development about a decade ago as an alternative option available to finance ventures through online platforms by pooling funds from a large number of investors.

Murray (2015) identifies four types of crowdfunding, which include, reward, lending, donation and equity. This paper is focused on the crowdequity and peer-to-peer lending because they are forms of venture financing that involves funding businesses or projects with the expectation of financial return, while reward and donation crowdfundings are not considered venture financing in the traditional sense because there is no expectation of financial return. In equity-based crowdfunding, investors receive equity (or royalties) in a company (Beaulieu et al. 2015). Lending-based crowdfunding is used to loan money that is repaid (usually) plus interest. Beaulieu et al. (2015) distinguish between microfinancing and peer-to-peer lending. The latter



focuses on very small loans, which support small projects mostly in underdeveloped countries (Hoegen, Steininger & Veit, 2017).

According to Khavul et al. (2013) and Steinberg (2012), crowdfunding is an increase in competition for the traditional financing models such as BAs, VCs and banks as a source of financing, while Bruton et al. (2015) stated that it provides alternatives for entrepreneurs sourcing for financing. It is the most widely accepted avenue for finance whereby funds are supplied directly to entrepreneurs without the costly interventions of intermediaries. Massolution (2015) gave an insight on the volume of crowdfunding activities, which grew to over \$34 billion in 2015, while scaling over more than 1000% in three years, and projected to surpass the volume of VC financing globally in 2016. Agrawal et al. (2013) indicates that the crowdfunding innovations are anticipated to enhance the efficiency of the financial markets and ease how demand meets the supply of capital.

According to (Rauch, 2001), the dot-com boom was based on heavy reliance on technology and then there was a burst. As the crowdfunding option continues to expand, it is important to be reminded of the dot-com burst catastrophe that affected the U.S. economy in the year 2000. Hirakubo & Friedman (2002), states that 210 dot-com companies failed in 2000 and Callahan & Garrison (2003) observe that a total of 762 dot-coms shut down in the period January 2000 to December 2001 all due to the technology burst.

### **3.0 Methodology**

The extant empirical literature on crowdfunding were reviewed to identify the relationship between financing entrepreneurial startup and sustainability, and the decision to embrace the crowdfunding financial model. The researcher sourced for data from viable sources to determine the size of funding from the accessible crowdfunding platforms as well as the financing sourced from the traditional financing models. For a more diverse view on the subject matter, the researchers adopted the approach of Hoegen, Steininger, and Veit (2017), using keywords and phrases to search on Online Systematic Review (OSR). The keywords and phrases include peer-to-peer, P2P, crowdfunding, marketplace lending, crowdfunding, fintech, crowdequities, and technology enhanced finance, which produced hits of 700 articles of which the duplicates and those irrelevant to the focus of the study were excluded and shortlisted to 50 most relevant articles. Webster and Watson (2002) approach of going backwards to review the citations to the identified articles to determine prior articles, and going forward to identify articles citing the key articles identified previously, was used to determine the articles shortlisted for the literature review.

The researchers extracted information on the types of crowdfunding, level of funding received by entrepreneurs from crowdfunding, successes recorded in using the crowdfunding options and its effect on the sustenance of the entrepreneurial ventures from the shortlisted articles, crowdfunding platforms websites and related sources. With a specific focus on Nigeria, the researchers attempt to respond to the questions on the role of Crowdfunding options in enhancing access to start-up finance and the effect on entrepreneurship sustainability.

## **4.0 Results and Discussions**

### **Results**

Table 1: Summary of findings on role crowdfunding financing model in startups

Entrepreneur's sources of finance 2017 - 2020

S/N	Traditional	Amount (\$)	Crowdfunding	Amount (\$)
1	Microfinance Banks	658 Million	Marketlending (peer-to-peer) and Crowdlending	74.5 Million
2	Private Equity and Venture Capital	640 Million		
3	Commercial Banks	340 Million		
		<sup>1</sup> 1.638 Billion		<sup>2</sup> 74.5 Million

Sources: <sup>1</sup>IFC Nigeria finance market bite November 2022. <sup>2</sup>Statista digital capital raising in Nigeria

Table 2: Summary of findings on effect of crowdfunding financing model on sustainability

S/n	Crowdfunding Platforms	Amount Raised	Role/Purpose/Projects in Nigeria	Base	Status (sustainability check) > 5years	Source
1	Kickstarter	\$7.7 Billion	Financing >130 projects (entrepreneurs) in Nigeria	USA	Active	<a href="https://www.kickstarter.com/discover/advanced?ref=nav_search&amp;result=all&amp;term=nigeria">https://www.kickstarter.com/discover/advanced?ref=nav_search&amp;result=all&amp;term=nigeria</a>
2	Indiegogo	Not specified	Financing unspecified number of projects/entrepreneurs	USA	Active	<a href="https://www.indiegogo.com/about/our-story">https://www.indiegogo.com/about/our-story</a>
3	Patreon	\$3.5 Billion	Financing unspecified number of projects/entrepreneurs	USA	Active	<a href="https://www.patreon.com/about">https://www.patreon.com/about</a>
4	Crowdfunder	\$100 Million	Financing unspecified number of projects/entrepreneurs	USA	Active	<a href="https://www.crowdfunder.co.uk/about-us">https://www.crowdfunder.co.uk/about-us</a>
5	Porkmoney	Not specified	Financed Piggery farming and other unspecified number of projects/entrepreneurs	Nigeria	Shut down	<a href="https://businessday.ng/technology/article/porkmoney-founders-flee-from-interpol-over-multiple-million-dollar-fraud/">https://businessday.ng/technology/article/porkmoney-founders-flee-from-interpol-over-multiple-million-dollar-fraud/</a>
6	Farmcrowdy	\$1 Million	Financing Agricultural sector entrepreneurs (unspecified number)	Nigeria	Restructured - Active	<a href="https://farmcrowdy.com/">https://farmcrowdy.com/</a>
7	ThriveAgric	\$56.4 Million	Financing Agricultural sector entrepreneurs (unspecified number)	Nigeria	Restructured – Active (accessing funding from DFIs and commercial banks)	<a href="https://www.thriveagric.com/our-work/our-technology">https://www.thriveagric.com/our-work/our-technology</a>
8	NaijaFund	Not specified	Financing unspecified number of projects/entrepreneurs	Nigeria	Active	<a href="https://www.naijafund.com/">https://www.naijafund.com/</a>
9	Monieworx	\$217,155 N360 Million	Financing unspecified number of projects/entrepreneurs	Nigeria	Active	<a href="https://monieworx.com/">https://monieworx.com/</a>
10	Lendingclub	Not specified	Financing unspecified number of projects/entrepreneurs	USA	Acquired Radius Bank (now operates as a bank)	<a href="https://funderenterprise.org/">https://funderenterprise.org/</a>

Source: Researchers 2024

## Discussion

Continuous access to financial resources is considered significant for starting and sustainability of business ventures. Given this context by which entrepreneurs access resources, the author sourced secondary data on the traditional financing and crowdfunding options from 2017 – 2020. The first resource examined was the additional contribution of crowdfunding to startup financing.

Table 1 above indicates that a cumulative contribution of \$74.5 Million in additional financing was provided by crowdfunding as an alternative to the traditional option for the use of startup entrepreneurs. This result is in line with the position of Łasak (2022) that crowdfunding creates and enhances new financing options for entrepreneurs in emerging markets. Wieck, Bretshneider, and Leimeister (2013) and Fleming and Sorenson (2016) also point out that crowdfunding provides significant alternative source of finance for startup businesses. However, comparing the contribution of both financing options to startups in terms of significance of the amount, within the observed period, it is difficult to conclude that there is a major shift from traditional to modern financing option for kickstarting a business venture.

Table 2 shows the level of venture supports from crowdfunding financing in Nigeria, with Kickstarter as an example, financing 137 projects as at 03/11/2024. This number translates to an additional financing input into the entrepreneurial ecosystem from a single platform.

According to the International Labor Organization, small- and medium-sized businesses account for the majority of enterprises and employment in Nigeria. However, about 80% of these businesses fail within the first five years. Some of the reasons for the failure of businesses are associated with the source of financing and the challenges faced by the business includes high interest rate, request for collaterals, unfavourable terms and conditions for credit facilities and small size of own-funds. With the indications that the failed businesses were financed with traditional financing approaches including self-finance, bank loans and so on. However, the empirical result of in Table 2 above indicates that the crowdfund financing approach might have a positive implication on sustainability of ventures, since it is devoid of the challenges of the traditional options and with a 70% survival rate of the platform, this indicates a positive trend towards acceptability of crowdfunding as a viable option and arguably, a source of finance for sustainability of ventures. Note that the crowdfunding platforms were selected based on their popularity at the two locations, which are the United States of America, and Nigeria which is the primary focus of this study. As Gerber, Hui and Kuo (2013) observes, crowdfunding provides a viable and potentially better alternative for those who are unable to readily access finance from traditional sources such as banks and venture capitalists.

## **5.0 Conclusion, recommendations, limitations and suggestions for future studies**

### **Conclusion**

Crowdfunding as an alternative to traditional financing options is being embraced by potential and existing entrepreneurs in Nigeria and other developing countries due to ease of access, low cost of fund and the evidence of success it has generated, when compared to some traditional financing models. The size of funds accessed through this financing source is still not significant when compared with the traditional model. This can be explained by the longevity of existence, with the traditional model having longer history than crowdfunding. Scholars are of the opinion that crowdfunding is generating a competition with the traditional models which they suggested could have a positive effect on the access to financing for entrepreneurs. Some of the expected outcome of such competition includes, easing the stringent requirements by both business angels and venture capitalist, and reduction in cost of borrowing from banks, such effect which would make the traditional financing models to remain competitive.

### **Recommendations**

The findings further indicate the importance of crowdfunding as a financial option that enables access to funds for starting and for business sustainability. It is therefore recommended that the government of Nigeria and other developing countries encourage crowdfunding activities to promote entrepreneurship development as well as provide legal framework to regulate its operations in a way that would ease access to finance whilst protecting the crowd investors. It is also necessary for the government to consider the effect of over regulations as this would discourage the class of investors in the modern financing ecosystem.

### **Suggestion for future studies**

This study used selected crowdfunding platforms with interest in projects in Nigeria, based either in the country or USA, future studies could consider the use of a larger numbers of platforms. A comparative study involving a number of developing countries will also enhance an understanding of the contribution of crowdfunding to entrepreneurship startup as well as sustainability.



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