

Islamic Banking: Selection Criteria and Implications

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Abstract-Generally, this study offers a descriptive discussion of the acceptance of Islamic Banking but a special focus is on the factors that determine acceptance of Islamic Banking. This considers a sample of 450 respondents from Klang Valley using a non-probability sampling. This study widely uses nominal and ordinal measurement scales and thus, a non-parametric approach is adopted for statistical testing. The results indicate that cost-benefits, service delivery, convenience, friends/relatives' influence do have significant relationships with the acceptance of Islamic Banking.

Keywords-Islamic banking, selection criteria, Islamic principles

I. INTRODUCTION

The establishment of Islamic banking in Malaysia was influenced by both external and internal factors. The external factor could be referred to the establishment of Islamic banks in the Middle East and Islamic Development

Banking. Internal factors include the establishment of the Pilgrims Fund Board in 1963 and the supports from parties such as Bumiputera Economic Congress and National Steering Committee to established Islamic Bank in Malaysia (Islamic World, 2008). The application of Islamic law in banking received tremendous boost with the passing of the Islamic Banking Act 1983. Today, there are seventeen Islamic banking institutions in Malaysia, of which six are wholly foreign-owned and two International Islamic bank which are the Bank Syariah Muamalat Indonesia, Unicorn International Islamic Bank Malaysia Berhad (Bank Negara Malaysia, 2008). Now, there are more than 100 Islamic financial products and services offered by the banks using various Islamic concepts. The main products and services are divided in 5 categories that comprise of deposit, investment, financing, trade finance and card services. The list of Islamic Banks is given in Table 1

Table 1: List of Islamic Banks in Malaysia

No	Name	Ownership
1	Affin Islamic Bank Berhad	Local
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Foreigner
3	Alliance Islamic Bank Berhad	Local
4	AmIslamic Bank Berhad	Local
5	Asian Finance Bank Berhad	Foreigner
6	Bank Islam Malaysia Berhad	Local
7	Bank Muamalat Malaysia Berhad	Local
8	CIMB Islamic Bank Berhad	Local
9	EONCAP Islamic Bank Berhad	Local
10	Hong Leong Islamic Bank Berhad	Local
11	HSBC Amanah Malaysia Berhad	Foreigner
12	Kuwait Finance House (Malaysia) Berhad	Foreigner
13	Maybank Islamic Berhad	Local
14	OCBC Al-Amin Bank Berhad	Foreigner
15	Public Islamic Bank Berhad	Local
16	RHB Islamic Bank Berhad	Local
17	Standard Chartered Saadiq Berhad	Foreigner

Source: Bank Negara Malaysia, 2008

II. DEVELOPMENT OF ISLAMIC BANKING

The first experiment in Islamic banking was set up undercover in Mit Ghamr, Egypt in 1963 by Ahmad El Najjar where the German Savings bank was modified to comply with Islamic principles. Later in 1974, the Islamic Development Bank (IDB) was established as a result of the second Islamic Conference of Foreign Ministers where they adopted a document on "Institution of an Islamic Bank, Economics and Islamic Doctrines". Then followed by the establishment of the first Islamic commercial bank in 1975, which is Islamic Bank of Dubai. Beginning in 1974, several Islamic banks have been established. Today, there are more than a hundred financial institutions that claim to be operating partially or fully on an interest-free basis in 34 countries (Islamic World, 2008).

III. DEFINITION AND PRINCIPLES

Islamic banking is the conduct of banking based on Syariah principles. Islamic bank is prohibited from taking and offering interest (riba). Islamic bank promote profit sharing. Profit sharing is two or more parties pool their sources for investment and share the investment profit and loss (Chong and Liu, 2005). In addition, Islamic law also prohibits gharar, which can be interpreted to mean "contractual uncertainty and/or ambiguity," and maisir, which is gambling. In Islam, money is a medium of exchange. It has no value in itself and should not be allowed to give rise to more money via interest payment. Islam upholds contractual obligations and the disclosure of information as a sacred duty (Kamal, Gupta, and Shanmugam, 2008).

IV. SIGNIFICANCE OF THE STUDY

Islamic Banking is growing rapidly over the past three decades. With Muslim population of the world today is estimated at about 1.5 billion, representing a sizeable 24 percent of the world population of 6.3 billion (Bursa Malaysia, 2005). This fact indeed triggers the interest of the researchers to understand better about the acceptance of Islamic banking. Hence, it is essentially important to recognize the factors that influence the acceptance of Islamic banking. The literature does recognize a number of factors, i. e. religion, cost-benefits, service delivery, size and reputation, staff factors, convenience, friend/relative's influence and mass media advertising. Malaysian model of Islamic banking today is one of the most advanced Islamic banking systems in the world. It is evident that the latest figures of market shares of Islamic deposits and financing stand at 15.6 percent and 11.6 percent of the industry's total respectively. The Islamic banking total assets were 6.9 percent in 2000, whilst Islamic banking deposits and financing constituted 7.4 percent and 5.3 percent respectively. However, total funds deposited in the Islamic system remain insignificant compared to the total deposits in the commercial banks. This could be an indicator of public unwillingness to use the system. Hence, it is worth to study on the level of acceptance of Islamic Banking since its establishment about 25 years, though there have been

studies conducted in the related area. Hence, more empirical work is needed to add more value to the literature of Islamic banking operations. Admittedly, this paper offers more insights by incorporating Malaysians' perception towards Islamic banking in general, the factors that motivate Malaysians to deal with Islamic banking in particular.

V. RESEARCH OBJECTIVES

As to continue the efforts of other researchers, the objectives of this study are, first to offer a descriptive discussion of the acceptance of Islamic banking. The second objective is to evaluate the factors that determine the acceptance of Islamic banking.

VI. LITERATURE REVIEW

1) Principles of Islamic Banking

Islamic banking is a form of modern banking based on Islamic legal concepts developed in the first centuries of Islam, using risk-sharing as its main method, and excluding financing based on a fixed, pre-determined return (Schaik, 2001). It aims to make an actual moral and equitable distribution in resources and social fairness in all Muslim societies as compare to the Western financial system that is based on the capitalistic features of economic and financial processes (Iqbal, 1997). The Islamic principles which govern the operations of Islamic banks are also known as Shariah principles. These principles come from the sources of the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad (Gait & Worthington, 2007). One of the principles that must be adhered by Islamic banking is the prohibition of Riba. Riba is an Arabic word which stands for excess, increase, addition, expansion or growth. Any interest or predetermined payment over and above the actual amount of principle which is Riba is strongly prohibited by the Quran and the Sunnah. Karsten (1982) explains that Riba is prohibited because it reinforces the tendency for wealth to accumulate in the hands of a few, and thereby diminishes human beings to concern their fellow men. Furthermore, Islam does not allow gain from financial activity unless the beneficiary is also subject to the risk of potential loss. Lastly, Islam regards the accumulation of wealth through interest or usury as selfish compared with accumulation through hard work and physical activities. The second principle that must be adhered by Islamic banking is the prohibition of Gharar. Gharar is generally translated as risk, hazard or uncertainty. It implied Gharar as deception based on the absence of knowledge or the unlikelihood of delivery with the prospect of causing harm. Metwally (2006) also argues that Gharar are speculative transactions which are harmful to society. In Islamic banking, contracting parties should have perfect knowledge of the values intended to be exchange in the transaction and the terms of the contract should be well defined and without ambiguity. The prohibition of Gharar is designed to prevent the weak from being exploited. Gambling and derivatives such as futures and options is believed to be violating the Gharar principle. The third principle is prohibition of Maysir. According to Ebrahim & Tan (2001), Maysir entails

speculative elements in a contract where expected gains are not clearly defined at the initiation of the contract. Iqbal and Molyneux (2005) state the reason behind prohibition of Masyir is that gambling and game of chance can lead to greater financial and societal problem. In addition, these are unnecessary for the society because they do not provide any surplus to the societal wealth. The next principle is profit and loss sharing (PLS) principle. PLS is a contractual arrangement between two or more transacting parties, which allows them to pool their resources to invest in a project (Schaik, 2001). The parties then share profits and losses on the basis of their capital share and effort and there is no guaranteed rate of return. Using this paradigm, it is able to simultaneously satisfy financial needs and respects Islamic mandates. According to Khan (1986) the primary advance of PLS is that it leads to a more efficient allocation of capital because the return on capital and its allocation depend on the productivity and viability of the project and therefore promote greater market discipline in Islamic banks. Besides that, the business and investment undertaken by Islamic banks must be on the basis of Halal (legal, permitted) activities. All activities should be in line with Islamic principles, with a special Shariah board to supervise and advise the bank on the propriety of transactions. Zakat is to be paid by the bank to benefit society (Lewis and Algaoud, 2001; Gait & Worthington, 2007).

2) *Difference between Islamic and Conventional Banking*

The key difference is that Islamic banking is based on Shariah foundation while the conventional banking does not. (Ust Hj Zaharuddin, 2007). Islamic bank's functions and operating modes are based on the Shariah rules. All business activities of Islamic bank must be in compliance with Shariah requirements. Any transactions which violated the principle of Shariah will be null and void. The second characteristic that distinct Islamic banking from conventional banking is the nature of relationship between customer and the bank. In the case of Islamic banking, the relationship between Islamic bank and customers is investor and entrepreneur relationship. Islamic bank recognized customers as a partner rather than a borrower or debtor as practiced in conventional banking (Khir, Gupta, & Shanmugam, 2008). The next difference is the prohibition of Riba. The act of a bank to obtain any benefits without bearing the liability of a transaction will be considered as 'Haram' or prohibited in Islam (Haron & Ahmad, 2000). Islamic bank believes that the income the bank earns must be justified by the risk it shares with the customer in any transactions. On the other hand, conventional bank is interest base oriented. Conventional bank charges and receives fixed or floating interest rate for the financing and deposits. (Khir, Gupta, & Shanmugam, 2008). The fourth difference is that Islamic bank usually provides financing thru equity participation. In this mode of financing, the bank and entrepreneur will provide capital jointly to carry out the business project. Profit and loss generated from the investment will be shared based on the pre-agreed ratio

between bank and the entrepreneur. In the case of conventional bank, this type of practice is generally not available. The bank will only provide financing to borrower on an interest basis (Khir, Gupta, & Shanmugam, 2008). Every Islamic bank is required to have a Syariah Supervisory Board to ensure that all business activities are in line with Shariah requirements. The board will decide what and which activities Islamic bank can involve. On the other hand, conventional banking has no such requirement. It can conduct its business operation at its own discretion as long as the bank do not violated the law the guideline issued by the Bank Negara Malaysia (Khir, Gupta, & Shanmugam, 2008).

3) *Selection Criteria Of Islamic Banking*

The first selection criterion is convenience. Convenience include factors such as convenient working hours of ATMs, convenient branch locations and wide branch network convenience, location being near home or work (Haron et al., 1994). Kaynak and Whiteley (1999) observed that the convenience of a bank was a primary motivation for customers in selecting a specific institution. Riggall (1980) in his survey on 250 newcomers to a community in the United States of America also found that convenience of location to both home and work appeared to be the most influential factor for bank selection by newcomers. It was also found that pricing and convenience were the main reasons for selecting a new bank or switching banks (Mokhlis., Hazimah., & Salleh, 2008). The second selection criterion is cost and benefit. Khazeh and Decker (1992) identified interest rates as one of the top five determinants factors that influenced the banking decision among 1198 of business school alumni of Salisbury state university in Maryland. Gerrad and Cunningham (1997) also found that profit or interest rate served as a reason for people maintaining their relationship with Islamic banks. Similarly, Islamic banks in Sudan never reward their current account holders, but a bulk of their funds is supplied through these facilities in light of the Islamic principles (Haron and Noraffifah, 2000). The third selection criterion is the influence by friends and relatives. The importance of recommendations or word-of-mouth in the formation of attitudes in a service purchase decision making context has been discussed in many studies (Wangenheim and Bayon, 2004; Grace and O'Cass, 2003), especially in professional services (Razzouk et al., 2004; Ettenson and Turner, 1997). A study reported in unpublished dissertation of Gray (1977) described an investigation of student attitudes towards banking in the U.K. He reported convenience and parental influence were the most important factors influencing British students' bank selection. Zainuddin et al. (2004) in his study of Malaysian bank customers (to illustrate the different perceptions of users and non-users of Islamic banking services) found out that that the decision-making processes of Islamic bank's users were affected by spouses, friends and relatives as well as their innate religious motivation. The fourth selection criterion is mass media advertising. Edwards (1973) and Kohers and Simpson

(1981) found that a negative but insignificant association between profitability and advertising intensity. Ors (2003) on the role of advertising in commercial banking, found that advertising played a significant role in banking and positively affected the profitability. It was evident that there were size advantages for advertising in banking. Sudin et al. (1994) found that apart from other factors, mass media advertising was considered as an unimportant factor in the bank selection factor, moreover, although mass media advertising was less important for a customer as the bank selection factor, commercial banks were still willing to invest a large amount of money for advertising for greater competitiveness despite the uncertainties of its return. The next selection criterion is religion. Kirkpatrick (2005) defines religion as psychological attachment, a powerful emotional relationship to things. Omer (1992) indicates that religious reason is the primary variable that influences the volume of deposits of Muslims in UK in Islamic financial institution. He also reports that the higher the religious commitment and the lower the level of general education, the stronger the preference for Islamic over conventional finance. Haron et al. (1994) argued that only 38.7 percent of the respondent indicated that religion was a prime reason for using Islamic banking services. Gerrard and Cunningham (1997) found no difference between Muslims and non-Muslims on bank selection criteria. However, Othman and Owen (2001) concluded that cultural and religious factors were identified as the most influential factors that affect Islamic banking adoption in Kuwait. Wakhid and Efrita (2007) stated that religious factor as the key factor that would influence Islamic banking adoption. The sixth selection criterion is size and reputation. Turnbull (1983) found that size of the bank was a significant factor in the choosing a conventional bank because of the need of increasing amount of credit. Tyler and Stanley (1999) found that bank size, reputation and reliability were the crucial factors to gain customers' confidence. Javalgi et al. (1989) argued that reputation could be one of the main criteria. The result was supported by Kennington et al. (1996) who also concluded that the bank's reputation was the most significant factor. Erol and El-Bdour (1989) revealed that customer perceived bank's reputation as one of the most important factors on the selection of the bank whether Islamic or conventional. Sudin et al. (1994) argued that the reputation and image of the bank was ranked the third among non-Muslims respondents. The next selection criterion is service delivery. Lamsali et al. (2005) reveal that it is essentially important to understand the importance of

the service quality elements and that understanding on which dimensions of service quality that significantly influence customer satisfaction. However, Choi and Valikangas (2001) argue that customer service quality is an important tool, but it cannot create sustainable value unless incorporated with more innovative and forward-looking strategies. Choi and Valikangas (2001) also argue that the quality is no longer a competitive differentiator. The last selection criterion is staff factor. Anderson and Cox (1976) found that one of the five most important bank selection criteria was friendliness of staff. Conversely, many customers are neither able to understand nor confident in using self-service machines (Chaoprasert and Elsey, 2004). Sudin et al. (1994) also sought to establish the relative importance of certain bank selection criteria using the Malaysian context. Friendliness of bank personnel is ranked third most important criteria in the bank selection process for Muslims. Staff friendliness was ranked number six for Muslim while it was ranked number eight for non-Muslims (Gerrard and Cunningham, 1997).

VII. METHODS, MEASURES AND PROCEDURES

Specifically, this research looks for some empirical evidence that could be used for explaining the relationship between the factors/selection criteria and acceptance towards the Islamic banking. Data were gathered through questionnaires. Pilot test was conducted to ensure consistency and validity of the measures. A sample size of 450 respondents from Klang Valley was considered for the study and it was a non-probability purposive sampling to suit our requirements. A descriptive analysis via cross-tabulations was first performed then followed by rank test using the means cores. A non-parametric approach was adopted for testing the hypotheses. The dependent variable referred to the acceptance towards Islamic Banking which was actually a dichotomous variable (yes or no). The independent variables were rated by the respondents using a five-point likert scaling. As result, this paper used a non-parametric test, i.e., chi-square test. This non-parametric test could still meet our expectation especially for an exploratory work. A descriptive presentation and the use of non-parametric testing were intended to offer more insightful information in relation to Islamic banking operations.

VIII. FINDINGS AND DISCUSSIONS

a) *below presents respondents' profile.*

Table 3: Respondents' Profile

Demographic factors	Details	Percentage
Religion Status	Muslim	55
	Non-Muslim	45
	Total	100
Race	Malay	50
	Chinese	30
	Indian	18
	Others	2
	Total	100
Gender	Male	46.4
	Female	53.6
	Total	100
Age	Less than 24	25.8
	24-39	31.6
	40-55	28.9
	more than 55	13.8
	Total	100
Education level	Primary/ Secondary school	33.6
	College diploma/ Matriculation/ A-Level	30.7
	Bachelor	24.2
	Professional Qualification	8.0
	Postgraduate (Master or PhD)	3.6
	Total	100
Type of Occupation	Student	14.7
	Non-executive	34.2
	Executive	24.2
	Professional	7.3
	Self-employed	7.8
	Unemployed/ Retired	11.8
	Total	100
Current Income	Less than RM 1000	30
	RM 1000 - RM 3000	35.8
	RM 3001 - RM 5000	19.2
	RM 5001 - RM 10000	8.9
	RM 100001 - RM 20000	5.1
	More than RM 20000	1.1
	Total	100

Based on Table 3, 38.7 percent of the respondents were Muslims and 61.3 percent were non-Muslims. Malay, Chinese and Indians accounted for 50, 30 and 18 per cent respectively. 53.6 percent were female and 46.4 percent were male respondents. The largest age group of respondent was from the age group of 24 to 39 years old which accounted for 31.6 percent. Respondents between 40 to 55 years old carried second a larger percentage (28.9 percent). Besides that, it seemed that most of the respondents were from primary or secondary level which consist of 33.6 percent and followed by respondents with College diploma/

Matriculation/ A- Level, which comprised of 30.7 percent. Percentage od respondents who held a Bachelor Degree was 24.2, while those with professional qualification registered about 8 percent. Master or PhD accounted for only 3.6 percent. There were 34.2 percent of who were in the non-executive category. 24.2 percent were under executive while 14.7 percent were students. 11.8 percent of the respondents were unemployed or retired. Respondents who were self-employed comprised of 7.8 percent. The majority of the respondents (35.8 percent) earned between RM 1000 to RM 3000 monthly. Respondents were mainly under executive or non-executive. 30 percent of the respondents earned less

than RM 1000, this consist of respondent who were under the category of student and unemployed or retired. There were 19.1 percent of the respondents received salary between RM 3001 to RM 5000 and 8.9 percent of the respondent received salary between RM 5001 to RM 10000. 5.1 percent of the respondents earned monthly income

between RM 10001 to RM 20000. Only a very small proportion of respondents, which were 1.1 percent, earned more than RM 20000. Respondents who earned more than RM 3000 normally worked as professional, executive or self-employed.

b) Knowledge on Islamic Banking

Table 4: Knowledge on Islamic Banking

	Do not know	Know a little	Have knowledge	Total
Overall Knowledge	29.1	57.6	13.3	100
Islamic Banking Concepts	57.6	38.2	4.2	100
Products and Facilities	40.4	53.3	6.2	100
Differences of Islamic Products	40.2	52.2	7.6	100

Based on Table 4, it seemed that majority of the respondents knew only a little knowledge on Islamic banking (57.6 percent). However, 57.6 percent of respondents did not know at all about the basic Islamic banking concepts. Only 6.2 percent of the respondents possessed knowledge on the

products and facilities offered by Islamic banks. In addition, 7.6 percent of the respondents were seemed to have some knowledge about the differences of the Islamic banking products.

c) Personal Opinion

Table 5: Personal Opinion

Personal Opinion		Percentage
Reason for selecting Islamic Banking :	Strictly religion	20.40
	Economics	25.30
	Both religion and economics	38.90
	No opinion	15.30
	Total	100
Potential of Islamic Banking	Very good potential	10.20
	Good potential	36.00
	Some potential	32.90
	No potential	4.90
	No potential at all	0.90
Total	100	
Different Name in Highlighting the Product	Absolutely true	2.20
	True	19.30
	Partly true	48.40
	Untrue	22.90
	Absolutely untrue	7.10
Total	100	
Product Marketing	More than enough	1.10
	Enough	10.70
	Just enough	19.60
	Not enough	49.60
	Not enough at all	19.10
Total	100	

Reasons not accepting Islamic Banking	Perception that Islamic Banking is for Muslim	39.30
	Lack of understanding and information	47.30
	Lack of product varieties	10.00
	Lack of available credit with favorable term	6.66
	Lack of Investment opportunity	11.35
	Higher commission and fee	0.66
	Insufficient branch network	18.00
	Lack of financial counseling	15.33
	Others	0.66

From the result above, it was noted that both religion and economics factors affected most of the respondent in choosing Islamic banking by 38.9 percent 36 percent of the respondents felt that Islamic banking would have potentials to grow. On the contrary, there about 1 percent of the respondents felt that Islamic banking did not have any potential to grow. A very high proportion of respondents (48.4 percent) agreed to the fact that it was partly true that product available in Islamic bank and conventional bank were similar but the difference was actually on the terminologies used. Meanwhile, 49.6 percent of respondents

agreed that Islamic banks had not done enough in marketing their products. On the reason why people do not accept Islamic Banking, it seemed that 39.3 per cent perceived that Islamic banking was only for Muslims, lack of understanding and information on Islamic banking was also another main reason (47.3 percent). Meanwhile, lack of Islamic product varieties, lack of available credit with favorable term, lack of investment opportunities, insufficient branch network, lack of financial counseling (10.0 per cent, 6.7 per cent, 11.3 per cent and 18.0 per cent respectively).

d) Selection Criteria

Table 6: Rank of Banking Selection Criteria

	N	Mean	Std. Deviation	Importance Rank
Cost/Benefits	450	3.94	.930	1
Convenience	450	3.90	.918	2
Service Delivery	450	3.83	.965	3
Friend's and Relative's Influence	450	3.31	1.103	4
Religious Factor	450	3.25	1.286	5
Size and Reputation	450	3.19	.831	6
Staff Factors	450	3.15	1.028	7
Mass Media Advertising	450	2.34	1.013	8

Based on the results in Table 6, it was noted that cost-benefit was the most important criterion for the acceptance of Islamic banking. It registered the highest mean scores (3.94). This was followed by convenience and service

delivery (3.90 and 3.83 respectively). Friends' and relatives' influences and religious factor were said to be the fourth and fifth important factors with the mean scores of 3.31 and 3.25. Mass media advertising registered the lowest score among the eight criteria.

Table 7: Chi Square Results between the selection criteria and acceptance of Islamic banking

Hypothesis	Bank Selection Criteria	Chi-Square	p-value*	Results
1	Religion status	10.611	0.031	Sig
2	Cost/Benefits	16.685	0.002	Sig
3	Service Delivery	12.439	0.014	Sig
4	Size and Reputation	9.089	0.059	Not Sig
5	Staff Factor	8.786	0.067	Not Sig
6	Convenience	11.980	0.018	Sig
7	Friends/Relatives' Influence	9.682	0.046	Sig
8	Mass Media Advertising	8.616	0.071	Not Sig

Based on the results presented in Table 7, religion, cost/benefits, services, convenience and influence of friends/relatives registered a significant relationship (at 0.05) with the acceptance of Islamic banking. Whereas, size/reputation, staff factor and advertising were said to be less significant (at 0.10). However, it should noted that the most important (significant) factor was cost/benefits (0.002), followed by service delivery (0.014) and convenience (0.018) and not the religion status of individuals.

IX. CONCLUSIONS AND IMPLICATIONS

This paper provides some important information on the development of Islamic banking. The findings indeed help the relevant parties to further enhance the development of Islamic banking in Malaysia especially on selection criteria preferred by the people. It can be concluded that be it Muslims or non-Muslims, factors such as cost-benefit, service delivery, convenience and influence by friends are the main determinants of accepting Islamic banking. Thus, ethnic background and religion do not really have a significant impact on the selection of Islamic banking. This could be a valuable input for local banks to spread their wings in getting wider markets for their Islamic financial products. However, banks should take note of people's insufficient knowledge in Islamic banking system into consideration especially when promoting Islamic financial services. Hence, banks should revamp their marketing activities accordingly. Therefore, there should be more qualified experts or knowledge-based workforce absorbed into this industry to promote greater innovativeness especially in dealing with Islamic financial products. In light of this, participation of the both public and private universities in the banking sector could offer more input (e.g. designing Islamic financial instruments) for the growth of the Islamic banking.

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