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Does ESG Transparency Improve Financial Performance? Evidence from an Emerging Market

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ABSTRACT

Study's aims: This study aims to examine the effect of Environmental, Social, and Governance (ESG) disclosure on the financial performance of Indonesian non-financial firms. It seeks to analyze whether corporate transparency in ESG reporting enhances profitability and supports sustainable business practices. **Design/Methodology/Approach:** This research employs a quantitative approach using a purposive sampling method. The sample consists of Indonesian Stock Exchange-listed non-financial companies that publish both annual and sustainability reports. Financial performance is measured using Return on Assets (ROA), Return on Equity (ROE), and Return on Invested Capital (ROIC). Statistical analysis is conducted to evaluate the relationship between ESG disclosure and financial performance. **Findings:** The findings indicate that ESG disclosure significantly affects financial performance. ESG disclosure shows a negative association with ROA, suggesting short-term cost pressures. However, ESG disclosure positively and significantly influences ROE and ROIC, indicating enhanced shareholder value and long-term capital efficiency. Firms with higher ESG transparency tend to strengthen stakeholder trust, reduce regulatory risks, and improve corporate reputation. **Theoretical contribution/Originality:** This study contributes to stakeholder theory by demonstrating how ESG transparency serves as a strategic mechanism that influences financial outcomes differently across profitability measures in an emerging market context. **Practitioner/Policy implication:** The results highlight the importance of integrating ESG practices with sound financial strategies and encourage regulators to strengthen ESG disclosure frameworks. **Limitation/Implication:** This study focuses only on Indonesian non-financial firms. Future research should include broader sectors and methodological refinements, including additional robustness tests.

Keywords: ESG Disclosure; Corporate Financial Performance; Corporate Sustainability



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Introduction

Financial performance is the company's primary reference. Financial performance is the main focus used to measure a company, determining whether or not the performance is good by looking at the financial statements presented by the company (Olayinka, 2022). The financial statements are prepared to develop the company's financial statements (Osadchy et al., 2018). By providing accurate and transparent financial reports, companies can build the trust of stakeholders, especially investors, by using benchmarks to determine the company's financial position (Jati & Jannah, 2022).

Stakeholder theory holds that a business's capacity to manage its relationships with all stakeholders and its financial performance define a company's success (Schaltegger et al., 2019). Environmental, Social, and

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Governance ESG disclosure is one of the essential mechanisms in the stakeholder management approach and is also related to prospective financial performance (Wahdan Arum Inawati & Rahmawati, 2023). When businesses invest in policies promoting diversity and equal opportunity, labor productivity, and environmental innovation, higher ESG disclosure levels are typically associated with tremendous financial success for companies (Muhlis & Gultom, 2021). This action is a genuine effort by the company to demonstrate its commitment to upholding prevailing social values and carrying out environmental responsibility optimally (Arisanty et al., 2024).

ESG practices and firm values are interconnected. The focus is on the determinants of corporate performance and ESG practices (Minggu et al., 2023). Investors and stakeholders also consider ESG practices to ensure the company's value increases (Zumente & Bistrova, 2021). Through consistent ESG implementation, companies can achieve long-term sustainable profits. Adequate ESG disclosure is essential in attracting sustainability-oriented investors, building stronger customer relationships, and increasing the company's resilience in various challenges (Wan Mohammad et al., 2023). Previous studies have consistently shown that implementing ESG practices positively correlates with corporate financial performance (Ismail et al., 2022). Businesses that actively engage in ESG practices typically maximize long-term value and cultivate closer relationships with stakeholders. Based on international data (Shaikh, 2021), the findings (De Lucia et al., 2020) indicates that implementing strong ESG principles can positively impact the company's financial performance. According to another study, businesses that invest in environmental innovation, labour productivity, diversity and equal opportunity policies, and other initiatives show a favourable correlation between their ESG practices and financial metrics such as ROA, ROE, and ROIC. Higher ESG disclosure levels are typically associated with more tremendous financial success for companies. However, existing research in Norway indicates a negative impact on financial performance, as measured by ROA. These findings suggest a lack of research on ESG practices in Indonesia and inconsistent measurement of variables. So, this study examines the effect of financial performance on ESG in Indonesia using a more varied methodology.

ESG disclosure has become a prerequisite for modern companies in response to the increasing global sustainability awareness (Singhania & Saini, 2023). Empirical research, such as that conducted by (Almeyda & Darmansya, 2019), consistently shows a positive correlation between the quality of ESG disclosures and firm performance. Thus, comprehensive ESG disclosure is critical to building a solid reputation and attracting sustainability-oriented investors. Research has confirmed that ESG disclosure can increase a company's market value, particularly when it emphasizes social and governance aspects. They also found that companies with good governance can manage risks more effectively, positively impacting profitability. In addition, ESG integrated into business strategy attracts investors who care about sustainability, helps companies build a strong reputation, and reduces reputational and regulatory risks. With this approach, companies demonstrate their commitment to sustainability and better position themselves in an increasingly competitive market.

Although corporate sustainability (ESG) has attracted significant attention, few studies have examined how it directly affects financial performance. Studies that examine the connection between company performance and HRM practices are more likely to be conducted. Duan et al. (2023) investigated how China's corporate value is affected by ESG performance. Their research revealed that the market value of firms with good ESG ratings increases. Furthermore, they discovered that ESG performance contributes to greater investment efficiency, thereby increasing company value. The use of ESG principles is crucial for enhancing corporate value and fiscal outcomes, as this analysis makes clear. It illustrates how strategically applying ESG principles can improve a company's financial performance, particularly over the long term. According to the study, businesses that incorporate social, environmental, and appropriate governance aspects into their business plans are more appealing to investors and less susceptible to risk.

Indonesia still needs to work on ESG disclosure scores. A standardized formula for disclosing ESG practices has led to favourable corporate financial performance (Harymawan et al., 2021). Indonesia has a low level of ESG disclosure compared to ASEAN countries, at 53.6%, indicating that corporate accountability and openness regarding ESG policies still have room for improvement (Ismail et al., 2022). The Indonesia Stock Exchange (IDX) has proactively encouraged listed companies to report on their ESG performance more effectively. These initiatives include providing detailed guidance to help companies understand and implement relevant ESG

reporting standards aligned with international best practices. In addition, the IDX has also introduced various indices specifically designed to help companies adopt sustainability practices, such as the SRI-KEHATI Index, which highlights companies with a solid commitment to environmental, social, and governance sustainability. Through these indices, companies can increase their visibility among investors increasingly interested in ESG-based portfolios. These steps increase transparency, motivate companies to be more responsible in their operations and strengthen global competitiveness through sustainable business practices. The IDX is essential in driving the transformation towards Indonesia's greener and more sustainable economy.

This research aims to examine and evaluate the connection between the financial success of Indonesian businesses and sustainability practices as demonstrated by ESG disclosures. The obstacles experienced by nations that are only starting to enact rules linked to ESG disclosure can be used to interpret Indonesia's low level of ESG practices (Pulino et al., 2022). As a result, financial performance will improve. Second, the importance of non-financial disclosures the more critical in assessing performance and sustainability, the more it can influence investment decisions (Triyani et al., 2021).

This research focuses on all sectors except finance. The non-financial sector often faces its own ESG challenges, such as difficulties in managing extended supply chains or the social impact of business activities (Chopra et al., 2024). Research can identify innovations and solutions for ESG challenges by focusing on these sectors. In addition, companies in these sectors have closer relationships with suppliers and distributors at various levels of the supply chain, complicating their management compared to the financial sector, which relies less on similar physical assets (Khan, 2022). Research in the non-financial sector provides opportunities to explore innovations in ESG management that may not arise in the financial sector. For example, many companies in this sector have started to use technology to monitor carbon emissions across the supply chain or increase operational transparency through more detailed sustainability reporting (Lee et al., 2023). In addition, the sector also faces the challenge of greater social responsibility towards the communities in which it operates, making it essential to maintain social legitimacy and long-term sustainability.

This research examines the effects of sustainability policies on the financial performance of Indonesian firms, using ESG disclosures. The low level of ESG practices in Indonesia can be interpreted from the broader context of the challenges faced by countries just beginning to implement regulations related to ESG disclosure (Pulino et al., 2022). By adding to the body of knowledge already available on ESG and corporate performance, this study aims to support more sustainable company practices. ESG reporting should take a fresh tack and encourage corporate responsibility and transparency in several areas. Investors and other stakeholders can obtain a comprehensive understanding of the company's entire performance using ESG (Igbinovia & Agbadua, 2023). Long-term sustainability metrics, such as social contributions and environmental impacts, are critical, and ESG data provides deeper insights into how businesses manage these nonfinancial risks. This reporting makes it easier for investors to make more informed choices and allows stakeholders to assess corporate social responsibility more precisely. ESG is becoming a vital tool in evaluating the sustainability and competitiveness of companies in the increasingly open and complex modern business era.

Literature Review and Hypotheses Development

Stakeholder Theory

According to stakeholder theory, companies have duties not only to their shareholders but also to communities, employees, suppliers, and consumers affected by their activities. In the context of ESG, ESG disclosure serves as an instrument for companies to demonstrate compliance with their social and environmental responsibilities to stakeholders (Bhandari et al., 2022). This aligns with recent findings that ESG management can increase stakeholder support and trust, ultimately improving the company's long-term financial performance (Li et al., 2023). Recent research also shows that ESG disclosure can strengthen a company's relationships with key stakeholders, including employees and customers, and help it obtain stakeholder resources (Kim & Li, 2021). A study by Duque-Grisales and Aguilera-Caracuel (2021) also shows that ESG disclosure helps reduce the informational disparity between investors and corporations, thereby assisting companies in attracting more substantial investment and improving financial

performance. Companies may foster investor trust and assist them in investment decision-making by making information more open and readily available. This allows businesses to attract more capital, thereby improving their overall financial performance. A proactive approach to ESG disclosure creates value for the company and contributes to sustainability in the broader economy and society. In addition, companies that prioritize good ESG practices tend to be more responsive to changing regulations and market demands, thereby strengthening their competitive position in the long run. Thus, ESG disclosure is not only an obligation but also a core strategy that can support corporate success in an era that increasingly emphasizes sustainability and social responsibility.

Legitimacy Theory

Legitimacy theory argues that companies must gain social legitimacy to survive and be accepted by society. In this context, ESG disclosures are used to fulfil social expectations, where transparent companies demonstrate that society, investors, and regulators will more readily accept a commitment to environmental, social, and governance issues (Emalia & Shauki, 2023). Recent studies by Ren et al. (2023) emphasized that social legitimacy gained through ESG disclosure enhances corporate reputation, protects companies from regulatory risks and social pressures, and improves long-term financial performance. By complying with ESG-related social and regulatory expectations, companies can reduce reputational risks and increase public trust, contributing to increased profitability (Mervelskemper & Streit, 2017). This theory holds that companies that align with social expectations through ESG disclosure are likely to perform better financially because they can avoid conflicts with critical stakeholders and regulators. By meeting social expectations and complying with ESG-related regulations, companies can minimize reputational risks that can undermine public trust. This contributes to a positive image of the company among stakeholders and has the potential to increase customer loyalty and attract investor interest, which in turn supports profitability growth (Mervelskemper & Streit, 2017). This theory suggests that companies that actively align with social expectations through ESG disclosure perform better financially, as they can avoid conflicts with critical stakeholders and regulators and create a more stable, sustainable business environment. Therefore, ESG disclosure is a moral responsibility and a sound business strategy for achieving competitive advantage in a market increasingly focused on sustainability.

Implementing ESG principles in companies has attracted significant attention in the financial literature, with many studies showing its positive influence on financial performance, especially as measured through ROA. Research by Eccles and Strohle (2018) discovered that businesses with solid ESG policies often have better ROA than those without, suggesting that attention to sustainability and social responsibility can improve operational efficiency. In addition, Friede (2019) In their review of more than 2,000 studies, they concluded a consistent positive relationship between ESG practices and financial performance. This is consistent with the findings of Hartini et al. (2023) which revealed that companies with effective ESG management can reduce operational risk and increase investor confidence, thereby boosting profitability. The study bolsters the empirical evidence showing that ESG adoption benefits society and the environment and enhances business financial performance, as evidenced by metrics such as Return on Assets (ROA). This clarifies how well a company uses its resources to turn a profit. With exemplary ESG implementation, a company improves operational efficiency and strengthens its market position by building trust with stakeholders, including investors, regulators, and consumers. All these benefits confirm that sustainable management is not only a moral obligation but also a smart business strategy to maximize financial performance and gain a competitive advantage in an era increasingly focused on sustainability.

H₁: Positive Influence Between Environmental, Social, and Governance (ESG) Implementation on Company Performance as measured by ROA.

Empirical evidence indicates that applying ESG principles favours a company's financial performance, particularly when ROE is used as a proxy for equity. When a firm incorporates ESG principles into its business plan, it can outperform competitors in terms of financial performance, mainly ROE (Nguyen et al., 2022). From a corporate social responsibility standpoint, companies implementing good ESG practices tend to have better access to capital sources (Kuo et al., 2021). They can attract more investors, increasing profitability and higher shareholder returns. In addition, companies with good governance and adherence to environmental and social standards usually show superior financial performance (Khan, 2022). Thus, it can be concluded that the application of ESG principles has a positive impact on ROE, suggesting that commitment to ESG practices can strengthen the link between shareholder value and long-term corporate sustainability, as revealed in previous research (Nguyen et al., 2022; Kuo et al., 2021; Khan, 2022).

H₂: Positive Influence Between Environmental, Social, and Governance (ESG) Implementation on Company Performance as measured by ROE.

The positive effect of implementing ESG principles on corporate financial performance, especially as measured by Return on Invested Capital (ROIC), has become an important research topic in recent years (Wielechowski & Krasuski, 2024). Businesses that incorporate ESG principles into their strategy typically achieve higher ROICs and better financial performance because they can effectively manage risk and generate long-term value. Research by García-Sánchez et al. (2020) also confirms these findings, showing that companies with a strong commitment to sustainability often exhibit better capital efficiency, as reflected in higher ROIC. In addition, Cheng et al. (2024) found that investors increasingly value companies that implement ESG practices, as this is seen as an indicator of better management quality and the potential for higher investment returns. Thus, it can be concluded that applying ESG principles not only contributes to social and environmental responsibility but also positively affects capital utilization efficiency, as measured by ROIC, thereby increasing the business's appeal to potential investors.

H₃: Positive Influence Between Environmental, Social, and Governance (ESG) Implementation on Company Performance as measured by ROIC.

Method

The purposive sampling process began with 901 active companies listed on the Indonesia Stock Exchange (IDX) in 2023. From this population, the study initially identified 155 entities based on sector classification criteria. The next stage excluded companies that did not publish a Sustainability Report, which significantly refined the dataset. Subsequently, firms that failed to publish an Annual Report were also removed from the sample.

To ensure the analysis focused on economically significant firms with substantial market influence, the selection process further concentrated on companies with the largest market capitalization, reducing the number to 42. After applying all screening criteria and conducting additional data verification, the final sample comprised 64 companies that met all research requirements. This multi-stage filtering process ensures that the selected firms are not only compliant with ESG and financial disclosure requirements but also represent companies with strong market relevance.

Regarding sectoral distribution, the final sample of 64 companies is spread across eight major industry sectors listed on the IDX. The Basic and Chemical Industries sector accounts for the largest share, with 17 companies. The Various Industries sector and the Consumer Goods Industry each account for 7 companies. Infrastructure, Utilities, and Transportation, as well as Trade, Services, and Investment, each contribute 6 companies. The Mining sector comprises 7 companies, the Agriculture sector comprises 4 companies, and the Property, Real Estate, and Building Construction sector shall consist of 10 companies.

This cross-sectoral representation allows the study to capture variations in ESG disclosure practices across different industrial characteristics, risk profiles, and regulatory pressures. The distribution also strengthens the robustness of the findings by ensuring that the analysis does not rely on a single dominant sector but reflects broader non-financial industry dynamics in Indonesia.

Table 1 summarizes the elements used in the study to get the ESG score, business size, and organization performance. A company's success is measured using three main financial metrics: ROE, which is calculated by dividing equity by equity; ROA, which is calculated by dividing total assets by EBIT, and ROIC, which is calculated by dividing net operational profit by invested capital. Additionally, the ESG score, ranging from 0.1 to 100, reflects the organization's level of responsibility across ESG components. Then, the debt-to-equity ratio (DER), which is the ratio of total debt to business equity, and overall company size (size) are used to measure a corporation's size. Since each variable is measured on a ratio scale, the relationship between the variables can be quantitatively examined.

Table 1 Operational of Variable

Variabel	Indicator/Item
Company Performance	ROA = EBIT/Total Assets ROE = EAT/Equity ROIC=Nopat/Invested Capital
Environment, Social, and Governance (ESG) score	ROA = E ESG score between 0.1 and 100
Size	DER = Debt/Equity

Results

Table 2 presents descriptive statistics for five financial variables based on 64 observations. ROA averages 6%, indicating the efficient use of the company's assets with low variability. ROE shows an average of 10.11%, with slight variation. ROIC shows an average return on invested capital of 13.87%, with higher variation than ROA and ROE. Firm size as determined by taking the logarithm of the total assets, shows significant differences between large and small firms. The debt-to-equity ratio averages 0.78 but shows substantial variation, suggesting significant differences in firms' capital structures.

Table 2 Descriptive Statistics

	Mean	Std. Dev	Min	Max
Return on Asset	0.060	0.0222	0.03311	0.19217
Return on Equity	-0.1011	0.0207	0.06989	0.18808
Return on Invested Capital	0.1387	0.0515	0.04375	0.37183
Size	7.7236	2.3642	4.2787	13.1798
Debt to Equity	0.7842	0.8200	0.0009	4.39478
N = 64				

Regression Test

The regression analysis results in Table 3 indicate that this model explains 33.37% of the variability in ESG disclosure. The coefficient of -0.1979285 indicates that every one-unit increase in ESG disclosure is associated with a decrease in ROA of 0.1979285. This relationship is statistically significant (p -value=0.000). The control variable, the debt-to-equity ratio, shows a significant negative relationship with the level of ESG disclosure (coefficient=-0.003419; p =0.036), while firm size shows no significant relationship (coefficient=0.0006411; p =0.709).

Table 3 Regression of Return on Asset

	Independent Variable	Coefficient	t	p-value
Return on Asset	ESG Disclosure	-0.1979285	-6.24	0.000
	Debt to Equity Ratio	-0.00034196	-2.14	0.036
	Size	0.0006411	0.37	0.709
	Constant	0.2093168	12.56	0.000

Considering the outcomes of the regression analysis contained in Table 4, it is found that ESG disclosure has a positive and significant correlation with ROE ($F= 6.93$; $p<0.01$). That is, an increase in ESG disclosure is associated with an increase in ROE by 0.1154571 units. This finding suggests that the higher the level of ESG disclosure, the greater the company's profitability.

Table 4 Regression of Return on Equity

	Independent Variable	Coefficient	t	p-value
Return on Equity	ESG Disclosure	0.1154571	4.12	0.000
	Debt to Equity Ratio	0.0009529	0.28	0.778
	Size	0.0013649	-1.36	0.178
	Constant	0.0226526	1.01	0.316

The regression analysis presented in Table 5 shows that this model explains 31% of the variability in ESG disclosure. The coefficient of 0.4379041 indicates that every one-unit increase in ESG disclosure is associated with an increase in ROIC of 0.4379041. This relationship is statistically significant ($F=14.76$; $p<0.01$), indicating a strong positive correlation between ESG disclosure and ROIC.

Table 5 Regression of Return on Invested Capital

	Independent Variable	Coefficient	t	p-value
Return on Invested Capital	ESG Disclosure	0.4379041	6.45	0.000
	Debt to Equity Ratio	0.0034683	0.36	0.723
	Size	0.0039858	-2.55	0.013
	Constant	0.1682022	-3.17	0.002

Table 6 presents the R-squared values for the three main variables: ROA, ROE, and ROIC. This R-Square value indicates the extent to which the independent variables in the model can explain the variation of each company's financial performance variable. The R-squared value of 0.3337 for ROA indicates that the model explains 33.37% of the variation in ROA. Meanwhile, the R-Square value for ROE of 0.1414 suggests that only 14.14% of ROE variation is explained by the model, indicating that many other factors may contribute to ROE variation. As for ROIC, the R-square value of 0.3100 indicates that the model explains 31% of the variation in ROIC. A more considerable R-Square value improves the model's ability to describe the connection between the dependent and independent variables. However, a low R-Square value, such as for ROE, indicates that other factors may affect the variable not explained in the model.

Table 6 R-Square Construct Variable

Variable	R-Square
Return on Asset	0.3337
Return on Equity	0.1414
Return on Invested Capital	0.3100

Discussions

Hypothesis 1 (H_1) proposed that ESG disclosure would positively affect ROA. However, the findings indicate a significant negative relationship (p -value = 0.000; coefficient = -0.1971336). This suggests that higher ESG disclosure is associated with lower short-term profitability as measured by ROA. The adverse effect may stem from the substantial costs related to ESG implementation and reporting. Investments in environmental compliance, social initiatives, and governance restructuring may increase operational expenses in the short term, thereby reducing asset-based profitability. This finding aligns with Al Amosh et al. (2023), who argue that ESG impacts may vary depending on contextual and institutional settings. Similarly, Ellili (2022) suggests that without strong financial planning, ESG-oriented firms may experience temporary profit reductions.

Thus, while ESG practices may enhance long-term value, they may exert short-term pressure on asset efficiency if not supported by integrated financial strategies.

Hypothesis 2 (H_2) assumed a positive relationship between ESG disclosure and ROE. The results support this hypothesis (p-value = 0.000; coefficient = 0.115471). This positive association suggests that ESG transparency enhances shareholder value. Improved disclosure strengthens stakeholder trust, reinforces corporate social responsibility, and attracts sustainability-oriented investors. These mechanisms may improve equity returns by boosting investor confidence and reducing information asymmetry. This finding is consistent with Oncioiu et al. (2020), who emphasize that ESG transparency can enhance firm reputation and investor attraction. Marie et al. (2024) further highlight that sustainability commitment positively shapes investor perception of long-term growth potential. Therefore, ESG disclosure appears to contribute positively to shareholder profitability.

Hypothesis 3 (H_3) posited a positive relationship between ESG disclosure and ROIC. The empirical results confirm this (p-value = 0.000; coefficient = 0.4379041). The strong positive coefficient indicates that ESG disclosure significantly enhances capital efficiency. Firms that consistently manage and report ESG issues tend to achieve more stable and sustainable financial performance. Transparency in ESG reporting may reduce risk exposure, improve operational discipline, and strengthen long-term strategic positioning. This finding aligns with Rath et al. (2020) and Huang et al. (2023), who argue that effective ESG policies improve competitiveness and long-term profitability. Hence, ESG disclosure contributes positively to long-term capital returns.

The results support Stakeholder Theory, which posits that firms must maintain balanced relationships with investors, regulators, and society. ESG disclosure functions as a mechanism for transparency and accountability, strengthening stakeholder engagement. Additionally, governance plays a critical role in maximizing ESG benefits. Firms with strong governance structures are better positioned to manage ESG risks and leverage sustainability opportunities, reinforcing long-term financial performance.

Conclusion

This study concludes that ESG disclosure significantly affects the financial performance of Indonesian non-financial firms, although the direction of impact varies across performance indicators. First, ESG disclosure negatively affects ROA, indicating short-term cost pressures associated with ESG implementation. Second, ESG disclosure positively influences ROE, suggesting enhanced shareholder value through increased transparency and investor trust. Third, ESG disclosure strongly and positively impacts ROIC, underscoring its importance for long-term capital efficiency and sustainable financial performance. These findings confirm that ESG practices are strategically essential but must be integrated with sound financial management to avoid short-term profitability pressures. Governance quality emerges as a key enabler in maximizing ESG-related benefits.

From a policy perspective, regulators should strengthen ESG disclosure frameworks to ensure transparency and accountability, particularly in corporate governance practices. However, this study is limited to non-financial firms in Indonesia and does not differentiate between various types of ESG reporting. Future research should expand the scope to include financial sector firms, conduct cross-country comparisons, and examine specific ESG reporting types (e.g., sustainability reports, social impact reports, climate-related disclosures) to understand their differentiated impacts on financial performance better. Overall, this research provides a foundation for deeper exploration of the complex interplay between ESG disclosure, corporate governance, and economic performance, contributing to the development of more inclusive and sustainable corporate strategies.

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Conflict of Interest

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