



CEO Trust and Performance of Small and Medium Size Enterprises in Western Kenya: The Moderating Role of Charismatic Leadership

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Abstract

Small and Medium Size Enterprises (SMEs) have an immense contribution on the economic growth and development of a given country. Nevertheless, existing researches in Kenya show that SMEs survival rate is low. To help address the constraints of SMEs performance, most practitioners and scholars have used innovation, technology and intellectual capital to increase performance among other variables with little emphasis on trust as a significant predictor of SMEs performance. Further, the moderating role of charismatic leadership in this relationship between trust and SMEs performance remains largely untested. The study employed explanatory research design and targeted a population of 2000 respondents (top managers and employees) from the 1000 SMEs in the four counties of Western Kenya. Stratified sampling technique was used to determine the sample size of SMEs from both service and manufacturing sectors and then simple random sampling was done to select the SMEs and respondents that participated in the study. A sample size of 150 SMEs corresponding to 300 respondents was drawn to participate in the study. Factor analysis was done to ensure content, construct and discriminant validity. Hierarchical multiple regression model was used to test the hypotheses. Results of our study support a direct positive effect of trust on performance of SMEs. However, charismatic leadership did not significantly moderate the relationship between trust and SMEs performance.

The results of this study therefore not only enriches literature on SMEs performance as pertains to trust but also contributes to knowledge by presenting contrary findings on the interaction between charisma and trust as not essential for SME performance. The results conclusively reveal that an SME's top manager trust is very important for SME performance but his/her interaction with charisma may not necessarily improve SME performance.

Keywords: Trust, Charismatic Leadership, Small and Medium Size Enterprises

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1. INTRODUCTION

Trust is a multifaceted research topic (1; 2) that has been seen the key element of effectiveness in organizations (3). According to (4), in the continual changes in business, the importance of trustworthy behavior is emphasized in effectiveness and work welfare in organizations. Trust increases cooperation and employees' willingness to commit to the organization and take care of their duties (4).

Trust has been seen as social capital of an organization that furthers innovativeness and creativeness (5). Trust has also been seen as a means of facilitating organizational functioning, as well as a valuable resource for increasing organizational effectiveness through leadership (6; 7). Trust in leadership increases the followers' willingness to accept the organizational goals (8). (5) in an annual report of SITRA1, point out that trust-based leadership has been seen as a source. Economists are specifically interested in trust as a success-maker of organizations. Trust within the organization is the basic element in a working relationship between the leader and the follower, which can be increased or decreased by individual behavior (9). Thus, trust building has been seen as one of the most important, albeit very challenging, parts of leadership (10; 11). Even though studies of trustworthiness have increased in number lately, especially concerning a leader's trustworthy behavior in a leader-follower relationship, there is a research gap in current research in understanding a leader's trustworthy behavior theoretically and empirically and how it impacts on performance. In the leadership context, trust is noted in many theories, but covered majorly in the leader-member exchange theory (LMX).

Leaders are therefore in continuous interaction with their followers. The quality of interaction depends on the relationship between them; some followers work closer to their leaders than others. According to the social exchange theory, the quality of a relationship

is based on the trust between two individuals, and each relationship is unique (10). The theory of leader-member exchange, LMX, has recently led the research on interdependency between managers and subordinates (12) even though the theory had its early roots in the works of (13) Considering the situational approach to leadership, and according to the LMX theory, leadership style, employee's motivation and the interaction between employees and managers, has a bias for managers' behavior (14).

But, why SME performance? SMEs performance can be seen as how the firm provides value to its stakeholders such as owners, customers, society and even government. In other words, it indicates how thriving the management manages the firm resources (15). (16) defined firm performance as the procedures of quantifying business firm actions in terms of accomplishing its objectives. Firms attain their objective if they succeed in satisfying their stakeholders' needs more than their rivals. Firm performance can be measured either by looking at economic variables or non-economic variables (17). In other words, it can be measured quantitatively or qualitatively (18).

In the global economy, SMEs are largely recognized as engines of growth and development and are the backbone of the economy in many developed nations (19). SMEs play significant role in the economic development by creating employment, wealth creation, poverty eradication and creation of new firms (20). In Kenya, the sector contributed about 70% of GDP in 2013 (21).

Past studies identified that a significant number of new SMEs fail within first five years of their business operation (22; 23). Several studies in Australia, USA and England showed that approximately 80% to 90% of SMEs fail within 5-10 years (22; 23). The collapse rate of SMEs is alarming for developing countries as well as developed countries (23).

In Kenya, despite having several SMEs startups, there is a high rate of failure and most enterprises are short lived and barely survive third anniversary (24). Sessional paper No. 2 of 2005 shows that despite the significant role by the SMEs, they have continued to experience many constraints like poor access to market and financial services and unfavorable policies. These have inhibited the realization of its full potential (25).

To help address the constraints of SMEs performance, most practitioners and scholars have used innovation, technology and intellectual capital to increase performance (26) among other variables with little emphasis on trust. This is because it is often emphasized that personal relations between economic entities have a role in creating trust, reciprocity and loyalty, which could represent a new source of competitiveness based on cooperation and hence boost performance.

Theoretical construction which includes common resources in the form of membership in associations, civic engagement, trust, reliability and reciprocity in social networks is the basis of the definition of trust which is viewed as a theory developed regarding a person's future behavior hence can have influence on SMEs performance. For business to thrive, it calls for a solid business relationship coupled with trust (27).

Scanty empirical evidence exists on how trust affects SME performance (28). This study therefore, examined the direct effect of trust on SME performance as hypothesis one (H_{01}) and the moderating role of charismatic leadership in effect of trust and SME performance as hypothesis two (H_{01}).

Hypothesis one (H_{01}) postulated that there is no significant relationship between trust and performance of SMEs. From a review of previous studies on trust, trust has been defined in different ways depending on the focal context. There is, however, a common core across most definitions of trust—a psychological state comprising a willingness to accept vulnerability based on positive expectations of the intentions or behavior of another (29). (30) defined trust as a “theory” developed regarding a person's future behavior. It falls back on how reliable the promises from the individual are and if the expected obligations can be guaranteed. Creating trust should be the basic step to build a long term relationship (31). Relationships based on trust foster dedication according to (32). Trust is what connects the parties of a relationship and lack of trust will destroy a relationship (27).

Both trust in a supervisor and trust in generalized others such as coworkers are of importance in maintaining workplace cooperation (33) and, thus, have meaningful implications. Whereas trust in one's supervisor and trust in coworkers are more specifically circumscribed foci, trust in management is more general. In a large and complex organization, management itself has been suggested as a referent of employee trust (34). “Employees carry images of the organization based on the decisions and actions of the executive group. These ‘images’ of the organization as an entity are separate from those which are formed based on the immediate contact the employee has on a daily basis with his or her supervisor” (35). For example, if an organization is keen to encourage more cooperation and collaboration among employees, then it might emphasize efforts in cultivating employees' trust in supervisors. If an organization sees the need to boost morale among employees so that they could have more loyalty to the organization overall, then it might focus efforts on establishing employees' affective trust in management.

People and organizations need to interact in order to create trust. According to (36), trust is developed from shared commitments and social norms of moral behavior (Wittgenstein, 1953). The main source of trust is repetitive maintenance in relationships. The personal knowledge of the people connected to you, the ones who are interlocked with you, develops trust (37). (36) argued for the importance of social solidarity and that people should hold common values to obtain trust. According to (38), trust is established on mutual interests and interdependence.

(39) also collected different perspectives of trust from various researchers within the field and found different concepts of trust. The most common used conceptualization types are: expectation, belief, willingness, confidence, and attitude. (39) argued that trusting someone include expectations on the other person's behavior to be coordinated and cooperative. (39) demonstrate the expectation of favourable outcomes of a trustworthy relationship. A relationship build on trust also includes expectations of prevention of anything which could exploit the position of the one trusting someone else.

Belief is an important concept of trust (39). Belief is not linked to a special context or situation. It is the belief that the person trusted is assumed to be available and ready to act in one's benefit. The conceptualization of trust as belief or expectation is generally agreed upon among rational choice theorist, psychologist and sociologists. However, the content of the belief or expectation strongly differs.

Willingness is also essential in trust relations considering the willingness to rely on someone else and the willingness to act on behalf of someone else. A relationship of trust is characterized by a feeling of comfort from both parties (32). Both parties are comfortable to continue an interaction with each other and doing business with each other.

(6) state that many researchers from various disciplines agree that trust has been recognized as the very essential factor behind the expansion of organizations. So the trust allows firms to expand through sustaining cooperation among other anonymous and people outside the narrow circle of family members and close friends for the large-size firm reflects a shift of the size distribution away from the smallest firms and toward the small-to-medium ones (40) cited in (41).

The economic exchange of a relationship is based on the level of trust between the parties involved (42). Trust is essential for entrepreneurs when building relationships to potential partners (43). Highly important for businesses, (27) argues that it is the value of a solid business relationship and the trust that exist as a result. Furthermore, trust together with the power of referrals can increase firm's sales. (37) claims that trust has the important function to enable people to collaborate. A business relationship based on trust is more efficient and can save time (44).

The idea that high-trust relations might improve economic performance has been widely theorized, but relatively little empirical evidence has been produced in its favour' (45). Trust is believed to increase the economic performance of individual transactions (46), organizations (47; 48), industrial regions (49) and societies (50). The empirical evidence on the relationship between trust and SME performance is more evident from a study by (28) who explored the link between social capital and economic performance. They used survey questions about trust and civic co-operation as a proxy for social capital. They found that trust and civic co-operation have significant impacts on aggregate economic activity. That is, they found that trust increased economic growth. Although the role of trust in the organizational context has been popular research topic and a widely recognized phenomenon, the literature on trust and performance with empirical evidence is not well integrated, scanty and lacks coherence.

We therefore tested hypothesis 1 (H_{01}) as shown in the conceptual model Figure 1 on the direct effect of trust on the performance of SMEs.

From the effects of charismatic leadership, we tested Hypothesis two which stated that charismatic leadership does not significantly moderate the relationship between social network and performance of SMEs.

Theoretical perspectives have been proposed to explain the link between CEO charisma and firm performance. A study by (51) focused on how charismatic CEOs develop relationships to ensure the effective implementation of strategic decisions. They proposed that charisma and inspirational leadership are relevant because of their association with the implementation of the strategic decisions, and not so much because of their relationship to the choice of strategies.

(52) argued that CEO charisma works through both "close" and "distant" relationships. The CEO's charismatic behaviors increase team cohesion within the top management team, with whom the CEO is closely and directly involved, when the environment is uncertain. This cohesion then results in increased role modeling of charismatic behaviors at lower levels of management, heightening intra-group and intergroup cohesion and effort at lower levels. CEO symbolic behaviors, trust, vision, and storytelling also increase cohesion and effort at lower levels when there is perceived environmental uncertainty. The increased

cohesion and effort from both the close and distant relationships lead to more coordinated performance of organizational units, resulting in higher organizational performance.

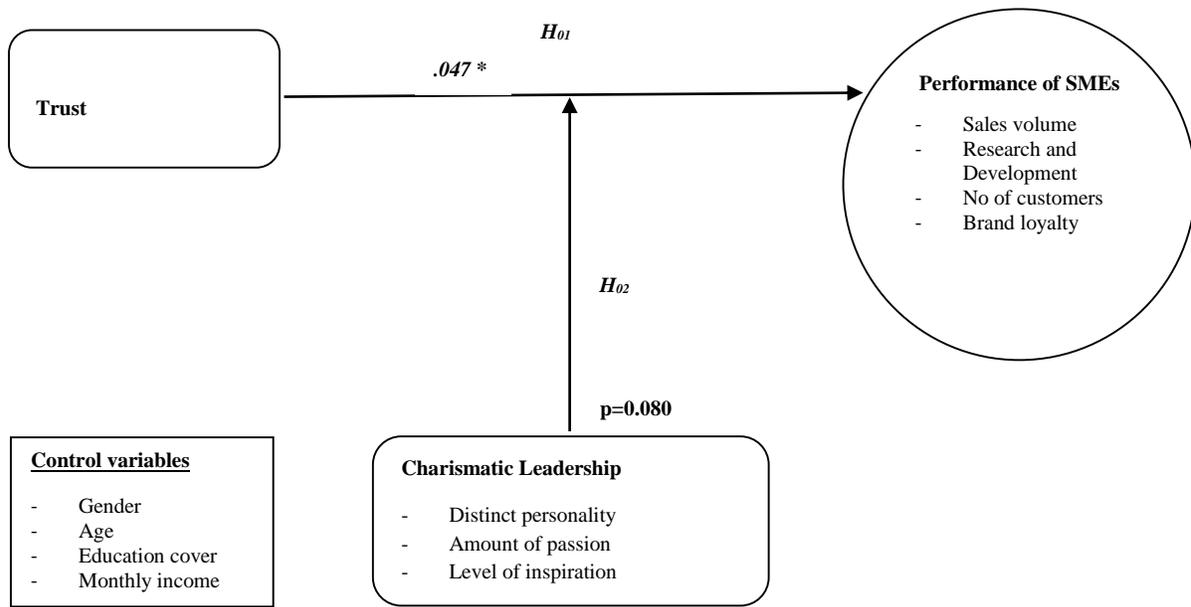


Figure 1. Model of Trust and SME Performance: Moderated by Charismatic Leadership (Source; Survey data, 2015).

(53) reported data from 69 U.S. and Canadian firms suggesting that CEO charismatic leadership measured at a point in time predicted subsequent firm performance. Thus, charisma was found to be related to both subjective and objective measures of strategic change. Further, (54) examined the relationships between charismatic leadership and multiple performance outcomes under different levels of environmental dynamism and per type of Chief Executive Officer (firm owner versus managing director). The study suggested that charismatic leadership enhances organizations profitability but not its liquidity and solvency.

More so, (55) examined the relationships among CEO perceived charisma, CEO compensation packages, and firm performance in a sample of Fortune 500 companies over a 10-year period. Using hierarchical regression model, the study found significant direct relationships between CEO charisma and firm performance. Further, under uncertain market conditions, charismatic CEOs were able to boost the stock price, even though there was no evidence that these firms were internally managed better, as measured by ROA. (56) also surveyed 128 CEO’s to establish whether CEO charisma affects performance. The results did not find a significant relationship. Similar findings were noted by (57).

From our reviewed literature, there exists inconsistency in the findings on the relationship between CEO charisma and firm performance. This necessitated us to introduce CEO charisma as a moderator in our research model hence hypothesis two (**H₀₂**) which stated that charismatic leadership does not significantly moderate the relationship between CEO trust and SME performance. To begin with, experimental studies have shown that charismatic leaders express positive affect which, in turn, results in positive affect experienced by followers and teams within a firm (58). Scanty literature depicts charismatic leadership as a moderator in firm performance related studies. For instance, (59) hypothesized that more frequent leader’s charisma interaction will make the positive relationship between leader and team optimism stronger which can thus influence firm performance.

Charismatic leadership theory describes how followers attribute extraordinary qualities (charisma) to the leader. The theory has been extended in formal organizations (60; 61; 62; 63). The theory emphasizes the need for a manager in an organization to articulate an appealing vision, emphasizing ideological aspects of the work, communicating high performance expectations, expressing confidence that subordinates can attain them, showing self-confidence, modeling exemplary behavior, emphasizing collective identity and exhibiting social network. Charismatic leaders are expected to infuse work with values by articulating an attractive vision and behave in ways that reinforce the values inherent in that vision, which will increase the meaningfulness of the work their subordinates do. This in turn will increase subordinates’ willingness to and enthusiasm for their work (64).

Trust has become into organizational and management research in two contexts; inter-organizational and extra-organizational trust. Inter-organizational trust is characterized by a dyadic relationship between a leader- a member and also between followers within a

team (65), and it focuses on *interpersonal trust*. Trust and leadership has been seen as a solution for different kinds of organizational problems (66).

Research on leadership suggests that trust is gained through a charismatic leadership style, primarily due to the positive effect of individualized support (67). Further, it is suggested that followers of charismatic leaders feel trust, and respect towards the leader, and they are motivated to do more than they originally expected to do (11).

(59) did an analysis of a longitudinal database of 137 bank branches in USA by means of hierarchical moderated regression and established that leader charisma had a stronger effect on team optimism. In addition, the leader's influence and the frequency of charisma-team interaction moderated the relationship between leader and affective climate. However, whereas the leader's influence enhances the relationship between leader charisma and positive affective climate, the frequency of interaction had counterproductive effects which could then affect team tension and firm performance. We can therefore deduce from the results that to better understand the impact of leader's charisma on team affective climate it is necessary to differentiate between positive and negative affect. Specifically, after controlling for the stability effects of team affective climate, leader charisma plays both a direct and moderating role on increasing team optimism which can affect firm performance.

2. MATERIALS AND METHODS

2.1 Respondents

Respondents included 322 individuals comprising top managers and employees of the 161 sampled SMEs in Western Kenya. Stratified sampling was used to get SMEs in the service and manufacturing sector from each County and Sub-county in the region. The respondents were the top managers and employees of the sampled SMEs. Simple random sampling was used to select employees from each sampled SME so as to ensure each employee had an equal chance of participating in the study. A total of 300 individuals completed the self-administered questionnaire, resulting in a response rate of 93.17 per cent.

2.2 Measures

All measures used a five point- Likert response scale. First, trust was measured with items from the modification of the Putnam's Social Capital Questionnaire (68). A response scale in which 1 was "strongly disagree" and 5 was "strongly agree" was used. Questions that were elicited for instance included; "I am basically honest and i can be trusted" "If I have a problem there is always someone to help me", "Most people are willing to help me if need it"

Secondly, charismatic leadership was designed to address strengths and weaknesses of the leaders from the point of view of their followers. The employees completed a 29-item measure of charismatic leadership from the Conger and Kanungo's "C-K" Charismatic Leadership Questionnaire (61; 69). A response scale used was one in which "1" denotes "never" and "5" denotes "always" as far as certain characteristics and behaviours of leaders are concerned. The items included; "This person uses non-traditional means to achieve organizational goals", "This person provides inspiring strategic and organizational goals", "This person has a vision; often brings up ideas about possibilities for the future", "This person inspires me to accept changes that come along", "person encourages me and my team to work in partnership", "This person inspires respect, trust and admiration".

Thirdly, SME performance was measured using the Firm Performance Questionnaire (an extension of (70) Questionnaire). The response scale used was in which "1" Decreased greatly "5" Increased greatly. Respondents were required to rate the SME performance compared to same time the previous year. The performance indicators that were rated include; "Change in the current estimated worth of the business", "Number of employees", "Sales volume", "Number of customers", "Product/service diversification", "Brand loyalty", "Distribution channels".

3. RESULTS

3.1 Reliability Analysis

It is very important to study the properties of measurement scales and the items that compose the scales. Usage of SPSS software was done in order to ensure the variables in the model are reliable. Most commonly used reliability test is Cronbach's Alpha Index. This is due to the interpretation as a correlation coefficient and it ranges from 0 to 1. Besides that, using the Cronbach's Alpha Index can determine whether the questionnaire is reliable and the data can be used for further analysis (71). According to (71), the acceptance level of Cronbach Alpha Index should exceed 0.7. Table 1 show the result of reliability statistics for the study variables which were all above the 0.7 threshold.

3.2 Correlation analysis

According to (72), Pearson correlation is used to examine the relationship between the variables. If the value of correlation coefficient ranges from 0.10 to 0.29 is considered weak. Meanwhile the value range from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong according to (73). There is also an indicator that the correlation coefficient should not go beyond 0.8 to avoid multicollinearity (74). Multicollinearity occurs when two or more variables in the model are correlated and provide redundant information. It is often confusing and lead to misleading results. As presented in Table 1, correlation coefficients are less than 0.8; therefore, multicollinearity problem does not exist.

The results of the correlation analysis reveal that trust has a positive and significant correlation with SME performance ($p < .01$). This result indicates that when people cultivate trust in an SME manager, performance of the SME is likely to increase. This finding agrees with the findings of (27) who found a positive correlation between trust and increase in firm's sales.

The study findings indicate that there was a statistically positive correlation between trust and charismatic leadership ($p < .01$). This implies that as more trust is inculcated in an SME manager, so is the increase in the level charisma.

There is a positive and significant correlation between charismatic leadership and SME performance ($p < .01$). This implies that an SME run by a charismatic manager is more probable to perform better. The results are consistent with (75) who studied on the relationship between leadership development and social capital and found a causal assertion that one leads to the other.

Table 1. Descriptive Statistics and Correlation Matrix for the Study variables ^a

| Variable | α | Mean | S.d | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---------------------------|----------|--------|--------|---------|---------|---------|--------|---------|------|------|
| 1. SME Performance | .917 | 4.2620 | .64193 | 1.00 | | | | | | |
| 2. Trust | .709 | 3.6104 | .45720 | .246** | 1.00 | | | | | |
| 3. Charismatic Leadership | .738 | 3.0031 | .53026 | -.045** | -.131** | 1.00 | | | | |
| 4. Age | .708 | 3.25 | .849 | .073** | -.026** | -.090** | 1.00 | | | |
| 5. Education Level | .797 | 2.39 | .809 | -.457** | .196** | -.022 | .115* | 1.00 | | |
| 6. Gender | .795 | 1.16 | .369 | -.001 | -.014 | .021 | .155** | .088 | 1.00 | |
| 7. Monthly Income | .756 | 1.58 | .553 | -.023 | -.179** | -.247** | -.100 | -.162** | .029 | 1.00 |

^an= 300 after list wise deletion of missing data, ** $P < .01$ and * $P < .05$

3.3 Hypothesis Testing

Hypothesis 1 postulated that CEO trust had no significant effect on SME performance. The results as indicated in Table 2 indicate a positive and significant effect of trust on SME performance ($P < .05$). H_{01} was therefore rejected. The results suggest that high level of trust in an SME manager can enhance performance of an SME. Examination of the hypothesis also revealed that the relationship was positive ($\beta = .106$) and that for every increase of one standard deviation in trust, there is a corresponding increase of 0.106 standard deviation in SME performance. These findings are consistent with a study by (6 and 28). The findings further support the notion by (37) that trust together with the power of referrals can increase firm's sales and (44) who posited that a business relationship based on trust is more efficient and can save time.

Hypothesis 2 was accepted as evidenced by the results in Table 3. The addition of a moderator variable significantly improved prediction of SME performance. However, with the introduction of the interaction term, the results indicate that charismatic leadership does not significantly moderate the relationship between CEO trust and SME performance ($p = 0.08$).

Table 2. Regression Results for Trust Predicting SME Performance

| Variables | Model 1 (Controls) | Model 2 (Direct Effects) |
|-------------------------|--------------------|--------------------------|
| Parameter | Estimate | Estimate |
| (Constant) | 4.929 (.122)*** | 4.588 (.281)*** |
| Age | .058 (.023)* | .051 (.022)* |
| Education Level | -.228 (.024)*** | -.232 (.023)*** |
| Monthly income | .010 (.035) | |
| Gender | .024 (.053) | |
| Trust | | .106 (.047)* |
| R | .266 | .233 |
| R ² | .071 | .054 |
| Adjusted R ² | .043 | .045 |
| R ² Change | .054 | .051 |
| F Statistic | 14.635*** | 18.715*** |

Values of unstandardized regression coefficients, with standard errors in parenthesis * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

4. DISCUSSION

In this study, we tested for the direct effect of trust on SME performance and the moderating effect of charismatic leadership on this relationship. Trust was found to have a positively significant influence on SME performance. Further examination revealed

that for every increase of one standard deviation in trust, there is a corresponding 0.106 increase standard deviation in SME performance. That is results found that trust significantly influences SME performance ($\beta=.106$; $p<0.05$). The results concur with trust theory (30), which states that a person's future behavior falls back on how reliable the promises from the individual are and if the expected obligations can be guaranteed. This assertion is supported by (32) that relationships based on trust foster dedication and (27) further maintained that trust is what connects the parties of a relationship and lack of trust will destroy a relationship. The study findings are consistent with (28) research on social capital in terms of trust that found that trust increased economic growth and subsequent increase in firm performance. The results further concur with the findings of (76) that trust is critical for an organization to grow. Trust in an SME manager is therefore a key factor that influences SME performance.

Table 3. Moderated Regression Results

| | Model 1 (Direct Effects) | Model 2 (Interaction Effects) |
|--------------------------------|--------------------------|-------------------------------|
| (Constant) | 4.675(.298)*** | 4.106 (1.314)** |
| Age | .050 (.022)* | .050(.022)* |
| Education | -.232(.023)*** | -.233(.023)*** |
| Trust | .106 (.047)* | .292(.227)* |
| Charismatic Leadership | -.031 (.035)* | .172 (.446)* |
| Charismatic Leadership x Trust | | -.067(.080) |
| R | .555 | .557 |
| R ² | .309 | .310 |
| Adjusted R ² | .283 | .281 |
| R ² Change | .003 | .003 |
| F Statistic | 22.916*** | 16.812*** |

Values of unstandardized regression coefficients, with standard errors in parenthesis, * $p<0.05$; ** $p<0.01$ *** $p<0.001$

Hypothesis two (H_{02}) stated that that there is no significant moderating effect of charismatic leadership on the relationship between trust and SME performance. The results indicate that there is a negative but insignificant interaction between trust and charismatic leadership ($\beta=-.134$; $p=.140$) hence hypothesis two is supported.

This suggests that a SMEs top manager's charisma may negatively impact on trust and thus SME performance. Our findings on Hypothesis two (H_{02}) contradict literature by revealing that charismatic leadership does not significantly moderate the relationship between trust and SME performance. This finding conflicts with (59) who found that if a firms' manager charisma interacts with his or her trust, the firm would be in a better position to realize high levels of performance. The findings therefore contradict research on leadership that suggests that; trust is gained through a charismatic leadership style, primarily due to the positive effect of individualized support and performance (67). This contradiction could be due to methodological, contextual and or nature of nature of SMEs in the studies. These findings therefore indicate that an SME manager need not necessarily possess both attributes of charisma and trust in order to enhance performance. Charisma therefore is just a sufficient but not an indispensable moderating attribute.

5. CONCLUSIONS

The findings of this research were able to show that CEO trust plays a prediction role in performance of SMEs. The findings are therefore invaluable to the SME sector in relation to development of trust in the SME manager which is critical in SME performance. To improve SME performance, SME managers should always ensure that they create a trusting environment thereby making their workplace an environment filled with innovation, creativity and ultimately higher profits.

The findings further complement empirical evidence on the moderating role of charisma on trust. The results of this study therefore not only enriches literature on SMEs as pertains to CEO trust but also contributes to knowledge by presenting contrary findings on the interaction between charisma and trust as not essential for SME performance. We therefore conclude that an SME's top manager's trust is very important for SME performance but its interaction with charisma may not necessarily intensify SME performance.

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