E C O N O M I C S B U L L E T I N

Determinants and Impacts of the Relative Use of Depository Receipts and Euro Convertible Bonds by High-tech Corporations: An Empirical Study

Ming-Yuan Li
Department of Accountancy, National Cheng Kung University

Alan T. Wang
Department of Accountancy, National Cheng Kung University

Yu-Chen Lin
Department of Accountancy, National Cheng Kung University

Hsuan-Ho Cheng
TECO Electric Machinery Co.,Ltd

Abstract

This paper adopts Taiwan's high-tech companies as the sample to address and examine four new determinants of various foreign financing instruments and test their impacts on the issuing firms. Our empirical findings are consistent with the following notions. First, the firms with higher foreign holding and foreign investment will be likely to adopt foreign financing policy. Moreover, the firms with higher stock dividend payment in Taiwan will adopt both of ECB (Euro convertible bond) and DR (depository receipt). Firm managers with better education background will prefer DR. Second, the use of DR can effectively decrease the volatility of stock returns but also pronounce a negative influence on the mean of stock returns. In contrast, the use of ECB can effectively increase the mean but can not significantly decrease the volatility.

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I. Introduction

This paper adopts Taiwan's high-tech companies as the sample to analyze the determinants and impacts of various foreign financing instruments. Specifically, we build four determinant hypotheses and examine their significance. Moreover, we examine whether there are significant effects of return enhancements and/or volatility reductions on the stock prices for the firms which issued the foreign financing instruments.

Because of the rapid growth of integrations of global financial markets, firms can raise funds not only from the home markets but also from the foreign markets. According to the statistics from the database of Dealogic-Bondware, Taiwan's companies raised 167.8 hundred million U.S. dollars from the foreign markets in 2003. In detail, 83 hundred million is collected by issuing DR (depositary receipt) and 84 hundred million by issuing ECB (euro convertible bond). It is worth noting that such a remarkable amount is only next to that collected by Japan in Asian.

Moreover, examining the sources of funds for the Taiwan's firms, there was only 21% from foreign markets in 1997. Nevertheless, in 2000, it increased to 57% (over half). But, even though there was over half of funds from foreign capital markets for Taiwan's firms, quite a few number of firms in Taiwan adopted the foreign financing policy. Specifically, in 2001, not including the finance companies, there were only 59 Taiwan's companies, which adopted the overseas financing policy. The number was just about 9% of the whole listed companies in Taiwan. Besides, near half of them were the high-tech electronic companies. Due to the remarkable development of high-tech electronic industry in Taiwan during the recent years, the successful international financing policy should play an important role and is worth analyzing.

Review the prior studies on the determinants of international financing policy. Saudagaran (1988) analyzed the decision to list on the foreign stock exchanges and to establish several determinant factors including the relative sizes of firms on domestic exchange, dependence of foreign markets, proportion of foreign assets and the relative size of foreign workforce. Michael and Wilbricht (1989) used 137 American companies as the sample to discuss the reasons of ECB issuing. They concluded that the firms, which adopted the foreign financing policy, were for searching the funds with less cost. Chin (1998) used Japanese companies from 1990 to 1995 as the sample to discuss the underlying macroeconomic determinants in the use of ADR (American DR). He indicated that the devaluation of Japan Yen was one of key determinants. In contrast, Choi and Kim (2000) that indicated the exchange rates of currencies could not fully explain the behaviors of ADR issuing, but ADR issuing from those companies in the emerging markets could provide American investors an efficient international diversification channel.

Summarizing the above studies, most of them have used the macroeconomic variables to explain the companies' overseas financing behaviors. Specifically, the motivations of firms to raise funds from foreign markets may include seeking low interest rates and their exchange rate expectations. One of the features of our paper is from to discuss the characteristics of the issuing companies from an individual perspective. Particularly, for Taiwanese companies, even over 50% funds were raised from foreign markets, but less than 10% firms adopted the foreign financing policy. We believe that the characteristics of these companies are worth analyzing. Following the above line of thought, this paper uses a cross-sectional approach instead of the time series data to address and examine four new determinants of foreign financing policy.

The second part of our paper is to analyze the impacts of foreign financing strategy. Reviewing the prior studies about this topic, Boardman, Dark and Lease (1986) used the even study approach to analyze the cumulative abnormal return of the foreign common bond issuing. Smith (1986) as well as Eckbo and Masulis (1995) demonstrated that the common bond issuing (stock listing) in the foreign markets would make an insignificant (a significantly negative) impact on the stock prices for the issuing firms. In contrast with those prior studies, we not only discuss the impacts of foreign financing policy on the return mean but also the return volatility. Briefly, we announce that the foreign financing policy could also benefit the issuing firms by providing less price sensitivity to the local market conditions. Moreover, multinational firms could also use the foreign-denominated funds from the foreign markets to satisfy the demand of foreign-denominated payment and then decrease their foreign currency exposure[1]. Following the above line of thought, we use the mean (standard error) of firms' stock price returns as the dependent variable to examine the presence of return mean enhancement (volatility reduction) effects via the use of foreign financing policy.

In the following section, we establish four determinants in the use of foreign financing policy and their underlying hypotheses. Section 3 presents the empirical results of our study including both the determinants and impacts of foreign financing policy. We conclude this paper in the final section.

II. Hypotheses Development and Data Source

1. Hypothesis Development

This section develops four testable and interesting hypotheses about the determinants of the use of foreign financing policy. In contrast with the prior studies adopting macroeconomics variables including interest rate and exchange rate to serve

[1] Please refer to Burgman (1996) for the detailed discussions.

the determinants of foreign financing policy, this paper observes and summarizes several features of Taiwan's high-tech companies during the recent years and establishes the following hypotheses.

H1: Firms with higher stock dividend payment are most likely to adopt the foreign financing policy

One of the features of Taiwan's high-tech companies is their preference to pay stock dividend instead of cash. This is due to a remarkable development of Taiwan's high-tech industry during the recent years. Thanks to the stock dividend payment instead of cash, the high-tech firms can keep their profits and will be able to continuously expand and develop by using the reserved funds. On the other hand, stockholders can earn extraordinary capital gain from the raising of stock prices. In other words, the payment of stock dividend should signal investors that there is an investment opportunity of the firms in the near future. Besides, the demand for funds from future investment opportunity will make the firms more intentional to raise money. Furthermore, we infer that the signal of future growth would also make the firms much easier to propose their foreign financing policy. Following the above lines of discussions, we conclude that the dividend policy could provide an indication to the decision of foreign financing policy. The following ratio is used to measure the preference of individual firm's dividend policy:

Stock dividend payment ratio= specific firm's stock dividend payment/the average stock dividend payment of all companies in the high-tech industry

H2: Firms with higher foreign holding ratio are more likely to adopt the foreign financing policy

Reviewing the development of Taiwan stock market during the recent years, the foreign investment institutes always play an import role. Specifically, even though the foreign investments are nearly 10% on average of the daily trading volume of Taiwan stock market, many prior empirical studies indicated that the foreign capital could serve as a leading index to individual investors. They conclude that the foreign investment institutes are always able to use their professional analysis ability to find those valuable/invaluable firms which are worthy/unworthy investing. Moreover, in Taiwan, we also find those firms with higher foreign investment ratio act as the representative firms in their industry. To conclude, we hypothesize that the higher foreign holding ratio can help the firms to establish their name recognition, which

could allow them for access to raise their funds from the foreign markets. The following variable is used to measure the level of foreign holding of a firm:

Foreign holding ratio=the number of shares held by foreign capital/the number of total outstanding shares

H3: Firms with managers who have better education background are more likely to adopt foreign financing policy

Mason (2001) demonstrated that managers with various backgrounds will be associated with various decision making behaviors. He further denoted that the level of education and international experience of managers are two important underlying variables to their decision making behaviors. Moreover, because there will be several kinds of risks and barriers to enter the foreign markets, we expect that the professionalism of company managers should play as an important determinant to the foreign financing policy decision. Following the above line of thought, in this paper, we hypothesize that those firms with managers who have better educational background and international experience will have stronger ability to propose foreign financing strategy. Moreover, we create the following dummy variable to describe the education background level of firm managers:

Dummy variable of manager's education background=2, for those managers with college degree earned from foreign countries; =1, for those managers with college degree earned from home country; =0, for those managers without college degree.

H4: Firms with higher foreign investment ratio are more likely to adopt foreign financing policy

Many prior studies pointed out that a multinational corporation, which was defined by a firm with foreign investment, should be associated with a lower probability of bankruptcy because of the benefit of diversification. Besides, because of the cross-country trading and operating, we announce that a corporation with foreign investment would be accompanied with more frequent foreign-currency-denominated payments and expenses than the domestic one. Moreover, considering the perspectives of behavior finance, we announce that both foreign financing and investment are cross-country risky business activities, and expect that an active/passive company would/wouldn't adopt both of them simultaneously. Following the above line of thought, we hypothesize that those firms

with higher foreign investment ratio are more likely to adopt foreign financing policy. The following variable is to measure the level of foreign investment of a firm:

Foreign investment ratio=Asset value of foreign subsidiary/asset value of parent company and subsidiary

2. Data Selection and Data Source

We use Taiwan's public listed high-tech companies in 2001 as the sample for 180 observations. There were 27 companies, which adopted foreign financing policy to raise their funds from the foreign markets. Specifically, 13 of them used the DR only, 8 of them used ECB only and 6 of them used both DR and ECB. The data of managers' educational background are from the annual report of each company. The data of foreign investment are from the database of Taiwan's Market Observation Post System. The data of the use of various foreign financing instruments and the financial ratio data of each company are from the database of Taiwan Stock Exchange Corporation. Table 1 summarizes the definition of the measurements of four determinant factors for the four hypotheses built in this paper.

III. Empirical Results

1. Determinants of Foreign Financing Policy

(1) Use vs. Reject:

We use the binomial logit regression model to examine the four hypotheses built in this paper. The feature of the logit regression mode is to capture the discrete dependent variable. We let y_i denote the status of the use of foreign financing policy for the *i*-th firm. Specifically, y_i=1(=0) is for the *i*-th firm which adopts (rejects) the foreign financing policy. The variable, x_{ij} denotes the *j*-th determinant factor of the use of foreign financing policy for the *i*-th firm. The binomial logistic regression model is presented as

$$p_i(y_i = 1 \mid x_{ij}, j = 1,2...,k) = \frac{\exp(\beta_0 + \sum_{j=1}^{k} \beta_j x_{ij})}{1 + \exp(\beta_0 + \sum_{j=1}^{k} \beta_j x_{ij})} \quad (1)$$

,where p_i and (1-p_i) denote the probability of use and rejection of foreign financing policy for the *i*-th firm, respectively. We use the method of maximum likelihood function to estimate the above model.

It is worth noting that the sample size in this paper is small relative to number of parameters estimated. Specifically, there are only 27 observations for those companies adopting foreign financing instruments (13 for DR, 8 for ECB and 6 for both DR and

ECB), but we use 4 right-hand side variables. For avoiding the power problem of estimation, we follow a restricted regression framework from Nance, Smith and Smithson (1993) to create four univariate specifications for the logit regression. In detail, those univariate specifications include as right-hand side variables only one factor variable from each of those four classes of hypotheses-4 alternative univariate logit regression equations. Last, we adopt all the four factor variables to establish a multivariable logit regression equation.

Table 2 presents our empirical findings. First, let us examine the empirical findings of the univariate models. Except for the factor of stock dividend payment, other three factors that are established in this paper show significant and expected influences on the decision of foreign financing. Specifically, those firms with higher foreign holding ratio, with managers who have higher educational background and with higher foreign investment ratio will most likely adopt the foreign financing policy. In the last column of Table 3, we present the empirical results of the multivariable model. The two factors of foreign holding and foreign investment are still significant. Nevertheless, the factor of managers' educational background is not significant.

(2) DR vs. ECB:

The next question we want to test is that whether the four determinant factors built in this paper have different effects on the use of various foreign financing instruments including DR and ECB. For examining the problem, we use the multinomial Logit regression model. Specifically, we use y_i=0 to denote the *i*-th firm which adopts both the DR and ECB, y_i=1(=2) to denote the *i*-th firm which adopts the DR (ECB) only, y_i=3 to denote the *i*-th firm which rejects the foreign financing policy.

Table 3 presents the empirical results of the multinomial Logit model. Our empirical findings are consistent with the following notions. First, the two factors of foreign holding and foreign investment have significant effects on the three statuses of the use of foreign financing instruments regardless of the univariate/multivariate models[2]. These results are consistent with the notion that the firm with higher foreign investment and foreign holding ratios will adopt the foreign financing policy, but have no significant preference on the choice of various foreign financing instruments. In contrast, the effects of stock dividend policy just appear in the status of the use of both DR and ECB[3]. Briefly speaking, those firms with higher stock dividend payment

[2] It is worth noting that the significance of each factor in the multivariate model is less than the value in the univariate model. Specifically, by using the ECB as an example, the estimate of the factor of foreign holding and foreign investment have the p-values of 0.089 and 0.03 in the univariabe model, respectively. Nevertheless, in the multivariate model, their p-values are 0.129 and 0.128, respectively. One of possible reasons is that the two factors are positively correlated (please refer to Table 2).

[3] We can find that the factor of stock dividend policy has significant effects on the use of DR regardless

will prefer to adopt the DR and ECB instruments simultaneously. Moreover, the factor of managers' background is just significant on the status of the use of DR only[4]. This result is consistent with the notion that managers with better education background favor the DR instrument to raise their money from foreign markets.

2. Impacts of Foreign Financing Policy

The second part of this paper is to examine the impacts of foreign financing policy. Specifically, we want to test whether it can enhance the mean of stock price returns or/and reduce the volatility of stock price returns for the issuing firms.

(1) Use vs. Reject

In Table 4, we present the estimates of the following two specifications:

$$R_i(or\ \delta_i)=\gamma_0+\gamma_1\times z_{i1}+\gamma_2\times z_{i2}+\gamma_3\times z_{i3}+\gamma_4\times z_{i4}+e_i=\gamma_0+\sum_{j=1}^{4}\gamma_j\cdot z_{ij}+e_i \qquad (2)$$

,where R_i and δ_i are the mean and standard error of the i-th firm's daily stock price returns in 2001. The z_{i1} is a dummy variable, 1 (0) for the i-th firm which uses (rejects) the foreign financing policy. In other words, the parameter γ_1 denotes the measurement of the impacts of the use of foreign financing policy on the mean/volatility of the stock price returns for the issuing firms. Moreover, we use three financial variables including z_{i2} for the earning per share, z_{i3} for the natural log of dividend payment (stock and cash dividend) and z_{i4} for the debt ratio to control other things, which are related to the stock prices.

Reviewing our empirical results, the γ_1 estimates are significantly negative in the return mean and return standard error. The results are consistent with the notion that the use of foreign financing policy might provide the advantage of risk reduction, but it can also make a negative influence on the firms' stock prices.

(2) DR vs. ECB

In Table 5, we present the estimates of the following two specifications:

$$R_i(or\ \delta_i)=\gamma_0+\gamma_{1a}\times z_{i1a}+\gamma_{1b}\times z_{i1b}+\gamma_{1c}\times z_{i1c}+\gamma_2\times z_{i2}+\gamma_3\times z_{i3}+\gamma_4\times z_{i4}+e_i \qquad (3)$$

For examining whether there were different effects of various foreign financing instruments, we create three dummy variables instead of one in the above specification. Specifically, we create the first dummy variable, z_{i1a} which is 1 for the i-th firm using both ECB and DR, otherwise is 0. Moreover, the second dummy

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of the univariate and multivariate models.

[4] The parameter estimate of the effect of the factor of managers' education background on the status of the use of DR only is 1.224 with a p-value of 0.062 (0.951 with a p-value of 0.301) in the univaraite (multivariate) model.

variable is z_{i1b} which is 1 for the *i*-th firm using DR only, otherwise is 0, and the third dummy variable is z_{i1c} which is 1 for the *i*-th firm using ECB only, otherwise is 0. Besides, the definitions of the three financial variables for controlling other things, which are related to the stock prices, are similar in Equation 2.

First, let us discuss the impacts of various foreign financing instruments on the return means. Interestingly, our empirical results show that the γ_{1a} and γ_{1b} (γ_{1c}) estimates are significantly negative (positive)[5]. This result is consistent with the notion that the use of DR (ECB) will make a negative (positive) impact on the returns of stock prices for the issuing firms. Here we provide a potential explanation for this finding. When the managers consider their current stock prices are overpriced in the markets, we expect that they would prefer using DR instead of ECB to raise more money from the market. In contrast, when the managers decide to use ECB instead of DR, their firms' current stock prices are underpriced. Moreover, if stock markets are efficient, then the overpricing (underpricing) situation will be associated with the consequence of decline (raise) of the stock prices in the next period. We infer that this is why there is a negative (positive) effect on stock price returns in the use of DR (ECB).

Next, we examine the impacts of various foreign financing instruments on the return volatility. Our empirical results reveal that all the γ_{1a}, γ_{1b} and γ_{1c} parameter estimates are significantly negative. These findings are consistent with the notions that the foreign financing policy can benefit the issuing firms the volatility reduction effects. Moreover, the γ_{1b} (γ_{1c}) parameter estimate is -0.194 with a 1% significance level (-0.084 with a 10% significance level). These results show the risk reduction effects from the use of DR are more notable than ECB.

IV. Conclusion

There was a remarkable development in Taiwan's high-tech industry during the recent years and the success of foreign financing policy played an important role in such a development. We use Taiwan's high-tech companies as the sample to address and examine the determinants and impacts of foreign financing policy. Our empirical findings are consistent with the following notions. First, the four determinants built in this paper have significant effects on the decision of foreign financing policy for Taiwan's high-tech firms. Specifically, the firms with higher foreign holding and foreign investment would be more likely to adopt the foreign financing policy, but there are no significant differences in their preference for financing instruments. In contrast, the firms with higher stock dividend payment (managers whose education background are higher) would prefer adopting the DR and ECB simultaneously (the

[5] *Moreover, the* γ_{1b} estimate (-0.174) is negatively greater than the γ_{1a} estimate (-0.107).

DR only). Second, the use of DR (ECB) would be associated with a significantly negative (positive) impact on return means. The volatility reduction effects from DR are more remarkable than those from ECB.

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Table 1 Summary of Determinants of Foreign Financing Policy

Hypotheses	Factor	Proxy Variable	Definitions
H1	Stock Dividend Policy	Stock Dividend Payment Ratio	Firm's stock dividend payment/the average stock dividend payment of all companies in the high-tech industry
H2	Foreign Holding	Foreign Holding Ratio	The numbers of share held by foreign capital/the numbers of total outstanding share
H3	Manager's Background	Dummy Variable	2, for those managers with college degree and earn their degree the foreign countries; 1, for those managers with college degree but earn their degree in the home country; 0, for those managers without college degree.
H4	Foreign Investment	Foreign Investment Ratio	Firm's foreign investment /the average foreign investment of all companies in the high-tech industry

Table 2 Determinants Factors on Foreign Financing Policy Decision: Use vs. Reject

Hypothesis	Factor	Expected Sign	*Univariate Test*				*Multivariate Test*
H1	Stock Dividend Policy	+	0.217(0.308)				*0.052(0.855)*
H2	Foreign Holding	+		0.121(0.000)***			*0.116 (0.000)****
H3	Manager's Background	+			0.963(0.024)**		*0.491(0.379)*
H4	Foreign Investment Ratio	+				0.521(0.000)***	*0.374(0.008)****
Adjusted R^2			*0.6%*	20.9%	3.3%	13.5%	*26.9%*

*Note: Please refer to Equation 1 in the text for the model specifications. The value in the parenthesis denotes the p-value of the parameter estimate. The *. ** and *** denote the significance in 10%, 5% and 1% respectively.*

Table 3 Determinant Factors on Foreign Financing Instrument Selection: DR vs. ECB

(a) DR (Depository Receipt) Only

Hypothesis	Factor	Expected Sign	Univariate Test				Multivariate Test
H1	Stock Dividend Policy	+	-0.086 (0.797)				-0.583(0.246)
H2	Foreign Holding	+		0.156 (0.000)***			0.176(0.000)***
H3	Managers' Background	+			1.224 (0.062)*		0.951(0.301)
H4	Foreign Investment	+				0.527 (0.000)***	0.271(0.137)*

(b) ECB (Euro Convertible Bond) Only

Hypothesis	Factor	Expected Sign	Univariate Test				Multivariate Test
H1	Stock Dividend Policy	+	0.0704 (0.876)				-0.116(0.811)
H2	Foreign Holding Ratio	+		0.067 (0.089)*			0.007(0.129)
H3	Manager's Background	+			0.859 (0.297)		0.59(0.491)
H4	Foreign Investment	+				0.41 (0.030)**	0.292(0.128)

(c) DR and ECB Both

Hypothesis	Factor	Expected Sign	Univariate Test				Multivariate Test
H1	Stock Dividend Policy	+	0.664 (0.039)**				0.721(0.084)*
H2	Foreign Holding Ratio	+		0.116 (0.000)***			0.094 (0.013)**
H3	Manager's Background	+			.702 (0.309)		0.183 (0.833)
H4	Foreign Investment	+				0.593 (0.000)***	0.489 (0.002)***
Adjusted R^2			2.2%	23.5%	3.5%	14.3%	32.8%

*Note: The value in the parenthesis denotes the p-value of the parameter estimate. The *. ** and *** denote the significance in 10%, 5% and 1% respectively.*

Table 4 Impacts of Foreign Financing: Use vs. Reject

Parameters	Return Mean	Return Standard Error
γ_1	-0.121 (-1.574)*	-0.285 (2.205)***
γ_2	0.072 (0.450)	-0.254 (-1.280)*
γ_3	0.146 (0.925)	-0.017 (-0.092)
γ_4	-0.021 (-0.265)	0.036 (0.240)
Adjusted R^2	5.5%	11.3%

Note: Please refer to Equation 2 in text for the model specifications. The value in the parenthesis is the t value of the parameter estimate. The *, ** and *** denote the significance in 10%, 5% and 1% respectively.

Table 5 Impacts of Foreign Financing: DR vs. ECB

	Return Mean	Return Standard Error
γ_{1a}	-0.107 (-1.392)*	-0.165 (-2.398)***
γ_{1b}	-0.174 (-2.309)***	-0.194 (-2.859)***
γ_{1c}	0.126 (1.670)**	-0.084 (-1.239)*
γ_2	0.067 (0.428)	-0.459 (-3.239)***
γ_3	0.153 (0.986)	0.086 (0.615)
γ_4	-0.048 (-0.597)	0.085 (1.372)*
Adjusted R^2	9.7%	27.0%

Notes: Please refer to Equation 3 in the text for the model specifications. The value in the parenthesis is the t value of the parameter estimate. The *, ** and *** denote the significance in 10%, 5% and 1% respectively.