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OECD Benchmark Definition of Foreign Direct Investment
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Chapter 3

Main Concepts and Definitions of Foreign Direct Investment

3.1. Summary

77. This chapter provides an overview of statistical units and the *Framework for Direct Investment Relationships* (FDIR). Rigorous application of these fundamental aspects is central to the implementation of the Foreign Direct Investment (FDI) concepts and recommendations described in this *Benchmark Definition*. It is also important both for the interpretation and use of FDI statistics. Definitions of statistical units which underpin the concepts and treatment of FDI are in line with the general principles adopted in the System of National Accounts (SNA) and the Balance of Payments Manual (BPM) and, therefore, consistent with the concepts and definitions underlying most macro-economic statistics.

78. The first section which describes the statistical units has two main purposes. Firstly it identifies the economic territory to be covered by the FDI statistics and highlights its main features. Secondly, it describes the economic agents that are involved in direct investment, and stresses the importance of the institutional sectors making up the economy even though classification by institutional sector is not used in any of the presentations called for by this *Benchmark Definition*.

79. Thereafter, the FDI universe is described more specifically on the basis of statistical units. The concept of direct investment, direct investor, direct investment enterprise and the relationships between the various units based on the Framework for Direct Investment Relationships are described in detail. The recommended treatment of fellow enterprises is a new feature of the edition of the Benchmark Definition and this section includes details of their definition and treatment.

80. In addition, three principles underpinning the compilation and presentation of FDI statistics are described. They are:

- the debtor/creditor principle
- the *asset/liability* principle, and,
- the *directional* principle.

3.2. Statistical units

3.2.1. Economic territory and the concept of residence [16]

81. The concept of residence is a fundamental factor for direct investment statistics which measure cross-border investments between residents of two or more economic territories. Foreign direct investment includes transactions /positions between a resident and a non-resident institutional unit but excludes all transactions/positions between units that are residents of the same economy.

82. The concept of residence in the *Benchmark Definition* is identical to that adopted by the SNA and the BPM. The residence of an economic entity (or an *institutional unit*) is attributed to the *economic territory* with which it has the strongest connection, in other words its *centre*

16. For a more detailed discussion of these broad statistical concepts, see IMF BPM6.

of predominant economic interest . Each institutional unit is a resident of one and only one economic territory. While some units, mostly households, may have connections with more than one economy, for statistical consistency, there is a need to attribute a single economic territory to each based on objective and comprehensive criteria.

3.2.1.1. Economic territory

83. An *economy* consists of all the institutional units that are resident in its territory. Most entities have strong links with only one economy, so their residence is clear, but with increasing international economic openness, there is a growing number of institutional units that have connections to more than one economy.

Box 3.1. **The *economic territory*[17]**

The *economic territory* includes the following:

i) Land area, airspace, territorial waters, including jurisdiction over fishing rights and rights to fuel or minerals. In a maritime territory the economic territory includes islands that belong to the territory (BPM6 4.5).

ii) Clearly demarcated territorial enclaves that are located in the rest of the world such as embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, central bank representative offices, etc. They are established with the formal political agreement of governments of the territories where the land areas are physically located. Such enclaves are used by governments that own or rent them for diplomatic military, scientific or other purposes.

iii) Territorial enclaves used by foreign governments and physically located within a territory's geographical boundaries are not included in that economic territory but included in the territory of the governments that use them.

iv) When a territory has a separate physical or legal zone that is under its control, but to which, to some degree, separate laws are applied (*e.g.* off-shore financial centres), these special zones should be included in the economic statistics of the territory.

v) In cases of disputed zones, effective economic control may be unclear. In such cases, compilers make a decision on the inclusion or exclusion of the zone based on the particular circumstances and preferably include a description in the metadata.

vi) In addition to economic territories under the effective control of a single government, the economic territory of a currency or economic union is also considered as a type of economic territory.

Source: BPM6: Chapter 4.

84. Even though there is often close correspondence, the statistical definition of the *economic territory* (or the *economy* – see Box 3.1) is not identical to the concept of a country or to any other legal definition (such as nationality). In many cases, but not always, a country indeed constitutes the economic territory. The existence of an institutional unit and the economic territory in which it is resident are determined by a number of criteria including physical presence and being subject to the jurisdiction of the government of the territory.

17. The importance of economic territories described under *iii)* and *iv)* relates to the fact that they reflect the usual scope of macroeconomic policymaking.

In this *Benchmark Definition*, the term "country" is alternately used as a substitute to "economic territory (and economy)" but not according to any legal framework.

85. Most commonly, an economic territory has the dimensions of physical location as well as legal jurisdiction and is under the economic control of a single government. Economic and currency unions constitute another type of economic territory which is discussed at more length in Annex 11.

3.2.1.2. Centre of predominant economic interest

86. Economic interests[18] include current production, consumption, acquisition of assets and incurrence of liabilities, asset-holding, place of incorporation or registration, and the origin of applicable taxation and regulation.

87. An institutional unit is considered to have a *centre of predominant economic interest* in an economic territory:

i) when there exists, within the economic territory, some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale;

ii) if the location, even if it is not fixed, remains within the economic territory;

iii) if the unit has already engaged in economic activities and transactions on a significant scale in the territory for one year or more, or if the unit intends to do so. The choice of one year as a specific period is somewhat arbitrary and is used as an operational guideline to avoid uncertainty and to facilitate international statistical consistency.

88. While actual or intended physical presence for a year or more is the main criterion, other criteria apply in some special cases such as for corporations having little or no physical presence or individuals that move in such a way that that they do not stay in any territory for more than a year.

89. There are cases where the institutional unit has little or no physical presence in a territory. This arises with some categories of special purpose entities (SPEs) and similar units. Some cases of restructuring or outsourcing could also result in residual units with little or no physical presence. Moreover, these units might not undertake significant production. In such cases, the jurisdiction where the unit has its legal domicile and/or which regulates its activities is considered to be that unit's predominant centre of economic interest while location and production criteria may not be meaningful.

3.2.2. Institutional units

90. An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities (*SNA, 2008, § 4.2*) (see Box 3.2).

91. Institutional units of an economy are classified by the SNA under two main categories: *i)* households (formed by persons or group of persons); *ii)* legal and social entities – corporations (including quasi-corporations), non-profit institutions, and government units – whose existence is recognized by law or society independently of the persons, or other

18. Citizenship and plans for future location are non-economic connections.

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Box 3.2. **SNA: Classification of institutional units**[19]

The definition of institutional units covered in this *Benchmark Definition* is fully in line with the concept of the SNA (1993 and subsequent updates) whereby an institutional unit *is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entitie* [SNA, 2008, Chapter 4].

The main attributes of an institutional unit are:

a) it is entitled to own goods or assets in its own right; it is, therefore, able to exchange the ownership of goods or assets through transactions with other institutional units;

b) it is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;

c) it is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts; and

d) either a complete set of accounts, including a balance sheet, exists for the unit, or it would be possible and meaningful, from an economic viewpoint, to compile a complete set of accounts if they were to be required.

As classified by the SNA, there are basically two types of institutional units:

a) ***Households*** are defined in the *SNA* as a small group of persons who share the same living accommodation, who pool some, or all, of their income and wealth and who consume certain types of goods and services collectively, mainly housing and food… (*SNA, 2008,* §4.4) A person who pools income with the household in one economic territory, but is resident of another economic territory, is not classified as a member of that household. Households can be direct investors but not direct investment enterprises.

b) ***Legal and social entities*** are recognised by law or society independently of the persons or other entities that may own or control them. (*SNA, 2008*, §4.6) Such entities include *corporations*, *non-profit institutions* and *government* units. Some unincorporated enterprises belonging to households or government units may behave in much the same way as corporations, and such enterprises are treated as quasi-corporations when they have complete sets of accounts, or such a set of accounts can be constructed (*SNA, 2008,* §4.6). Only business enterprises can be both direct investors and direct investment enterprises; governments and non-profit enterprises can be direct investors but not direct investment enterprises.

entities, that may own or control them. While the *Benchmark Definition* follows the general principles of the SNA to identify institutional units, the treatment of some specific issues concerning cross-border direct investment transactions/positions also need to be addressed.

92. Institutional units are defined by the SNA in the context of a single economy and to identify the residents of that economy. However, a legal entity may have to be split into separate institutional units, resident in different economies, to address the statistical treatment of entities which have strong links with more than one economy. As a result, some arrangements that are not legal entities in their own right may be recognised as being institutional units, *i.e.* quasi-corporations.

19. Only a summary of SNA and BPM concepts are included in this section. For a more detailed discussion of the items therein, the reader should refer to SNA, 2008 and BPM6.

93. A ***quasi-corporation*** is an unincorporated business that operates as if it was an entity separate from its owners. Examples are *branches*, *land ownership*, *partnerships* (both of limited and unlimited liability), *trusts*, and resident portions of *multi-territory enterprises*. These quasi-corporations are treated as if they were corporations, *i.e.* as separate institutional units from the units to which they legally belong. For example, quasi-corporations owned by households or government units are grouped with corporations in the non-financial or financial corporate sectors. The purpose of this treatment is to separate from their owners those unincorporated enterprises which are sufficiently self-contained and independent that they behave in the same way as corporations (*SNA,* 2008, § 4.42-48).

94. The requirement for having (or the potential to produce) a set of accounts is essential in the definition of institutional units because it provides a recognised indication of the existence of an economic decision-making unit. The definitions do not require that the unit be autonomous. Therefore, wholly-owned subsidiaries have legal identity and are separate institutional units from their parent units, even when all decisions are effectively made by another unit.

95. An *ancillary* corporation is a wholly-owned subsidiary whose productive activities are ancillary in nature: that is, confined to providing services to the parent corporation and/or other ancillary enterprises owned by the same parent corporation. The kinds of services which may be produced by an ancillary unit are transportation, purchasing, sales and marketing, various kinds of financial or business services, computing and communications, security, maintenance, and cleaning. In some cases, the ancillary unit is located in a different economy from the companies it serves. An ancillary corporation is recognized as a separate institutional unit when it is resident in a different economy from that of any of its owners, even if it is not, in practice, autonomous.

3.2.2.1. Enterprises

96. An ***enterprise*** is a sub-group of the broad SNA category *legal and social entities*. It is defined as an institutional unit engaged in production. An enterprise may be *a corporation* (including *quasi-corporations)*, *a non-profit institution*, or an *unincorporated enterprise*. Incorporated enterprises and non-profit institutions are complete institutional units. An unincorporated enterprise, however, refers to an institutional unit – a household or government unit – only in its capacity as a producer of goods and services. It covers only those activities of the unit which are directed towards the production of goods or services (*SNA,* 2008, §5.1).

97. Institutional units that have the sole function of holding financial assets on behalf of their owners provide a service to their owners, so they are enterprises, even though there may be no explicit service charges. For example, some mutual funds, holding companies, trusts, and special purpose entities may not receive payment from their owners for the services they provide. However, in these cases, a service is recognised as being provided to the owner, payable out of the property income or assets.

3.2.2.2. Quasi-corporations

98. An unincorporated enterprise is a producer unit which is not a legal entity separate from the owner (household, government or foreign resident); the fixed and other assets used in unincorporated enterprises do not belong to the enterprises but to their owners, the enterprises as such cannot engage in transactions with other economic units nor can

Box 3.3. **Structures related to enterprises**

An enterprise group consists of all the enterprises under the control of the same owner. When a group of owners has control of more than one enterprise, the enterprises may act in a concerted way and the transactions between them may not be driven by the same concerns as "arm's length" transactions. The Framework for Direct Investment Relationships can be used to determine which enterprises are under control or influence of the same owner.

There are two concepts of enterprise groups:

- A multinational enterprise group consists of all the enterprises located in different economies and under the control or influence of the same owner wherever located.
- An economy-specific enterprise group consists of all the enterprises located in the same economy and under the control or the influence of the same owner also located in the same economy. Ownership links that are external to the economy are not recognised in the formation of local enterprise groups.

A joint venture is a contractual agreement between two or more parties for the purpose of executing a business undertaking in which the parties agree to share in the profits and losses of the enterprise as well as the capital formation and contribution of operating inputs or costs. It is similar to a partnership (see Glossary), but typically differs in that there is generally no intention of a continuing relationship beyond the original purpose. A joint venture may not involve the creation of a new legal entity. Whether a quasi-corporation is identified for the joint venture depends on the arrangements of the parties and legal requirements. The joint venture is a quasi-corporation if it meets the requirements for an institutional unit, particularly by having its own records. Otherwise, if each of the operations is effectively undertaken by the partners individually, then the joint venture is not an institutional unit and the operations would be seen as being undertaken by the individual partners to the joint venture. Because of the ambiguous status of joint ventures, there is a risk that they could be omitted or double-counted, so particular attention needs to be paid to them.

they enter into contractual relationships with other units nor incur liabilities on their own behalf. In addition, their owners are personally liable, often without limit,[20] for any debts or obligations incurred in the course of production. (*SNA, 2008, §4.42, 4.48)* An unincorporated enterprise attached to a non resident is always considered as a quasi corporation.

99. Even though a ***branch*** is not a separate legal entity, it is statistically identified as a quasi-corporation if it operates in an economy separate from that of its owner and has operations over a significant period in that economic territory.[21]

100. To avoid the multiplication of artificial units, the definition of branches requires several indicators of substantial economic activity and separate accounts.

101. The identification of branches has implications for the statistical reporting of both the branch and the legal entity from which the branch has been created. The operations of

20. However, some unincorporated enterprises may have limited liability such as a limited liability partnership.
21. The common usage of the term branch is broader, where a "branch" may also mean establishments, incorporated subsidiaries, or industrial classification group.

the branch should be excluded from the institutional unit of its head office in its home territory and its activities should be reported consistently in both of the economies to which it is connected. Each branch is a direct investment enterprise if the FDI criteria are satisfied.

102. Construction of major specific projects (bridges, dams, power stations, etc.) may take several years to complete and be carried out and managed by non-resident enterprises through site offices in the territory of location. In most instances, the operations managed from the site office satisfy the criteria to be a branch. In other cases, for example, for a short-term project (less than one year) or one based from the home territory rather than a local office, the work provided to customers resident in the territory of those operations is classified as international trade in construction (*i.e.*, an import to the territory of operations).

103. Some production processes may involve mobile equipment that operates in more than one economic territory, such as ships, aircraft, drilling rigs and platforms, and railway rolling stock. Some of these operations may take place outside any territory, such as ships operating on the high seas. Moreover, services such as consulting, maintenance, training, technical assistance and healthcare can also be delivered on-site with sufficient presence to amount to a branch. The criteria for recognition of a branch apply in these cases. In many instances, the activity can be seen as having been undertaken from a base of operations, so that the operations are attributed to that unit, and the recognition of an additional unit for non-resident operations is not appropriate. However, in some cases, the operations in a territory outside the home base could be substantial enough to meet the definition of a branch. For example, the existence of a branch would be recognised if a shipping company has a secondary base for servicing its fleet that is substantial, permanent, and has its own accounts.

104. Similarly to mobile equipment, a multi-territory pipeline that passes through a territory, but is not operated by a separate legal entity in that territory would be recognized as constituting a branch or not, depending on whether there is substantial presence, availability of separate accounts, etc. Where such operations are not separate entities, there may be a multi-territory enterprise as described below.

105. When a branch is identified, there are direct investment flows to and from the territory of its location, but the provision of goods or services to customers in that territory are resident-to-resident transactions. In contrast, if the operations are not substantial enough to qualify as a branch, the provision of goods or services to customers in that territory are imports of that territory.

106. Prior to its incorporation a resident enterprise is imputed when preliminary expenses such as those associated with mining rights, license fees, local office expenses and legal costs are first incurred as steps prior to establishing a legal entity. Those preparatory expenses are recorded in the economy of the future operations as being resident-to-resident transactions that are funded by a direct investment inflow, rather than as sale of non-produced assets to non-residents, exports of legal services, etc. Many of these operations would qualify as a branch. Because of the limited scale of these activities, the assembly of the data for these enterprises is feasible prior to incorporation.

107. A resident ***notional unit*** (a kind of a quasi-corporation) is identified for statistical purposes for direct non-resident ownership of immobile non-financial assets such as land and buildings. Land and buildings can only be used for production in the territory in which

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they are located. Therefore, the land and buildings and other structures owned by a non-resident are always treated as being owned by a resident notional institutional unit that is in turn owned by a non-resident unit(s) holding the legal title.

108. Consistent with this treatment, a notional unit is imputed for the ownership by non-residents of natural resources such as subsoil assets, non-cultivated biological resources, and water, and long-term rights to use these assets. The notional unit is nearly always a direct investment enterprise.[22]

109. ***Multi-territory enterprises*** operate as a seamless operation over more than one economic territory. Such an enterprise, even though it has substantial activity in more than one economic territory, cannot be separated into a parent and branch(es) because it is run as a seamless operation and cannot supply separate accounts for each territory. Multi-territory enterprises are typically involved in cross-border activities and include shipping lines, airlines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels, and undersea cables.[23] Some non-profit institutions serving households (NPISH) may also operate in this way.

110. It is preferable that a parent and branch(es) be identified separately in the case of a multi-territory enterprise. If possible, enterprises should be identified in each territory according to the principles for identification of branches. If that is not feasible because the operation is so seamless that separate accounts could not be developed, it is necessary to prorate the total operations of the enterprise into the individual economic territories. The factor used for prorating should be based on available information that reflects the contributions to actual operations. The prorating of the enterprise implies that every transaction needs to be split into each component economic territory, a process which may be difficult to implement by compilers. Hence, for the country of residence, each apparently/ostensibly domestic transaction would be split into resident and non-resident components. Equally, non-resident entities of those economies outside the territories of the multi-territory enterprises that have transactions and positions with such entities need to make the same split, so as to capture the counterparty claims in a consistent manner. Bilateral agreements between compilers will help to minimise possible asymmetries.[24] This treatment has implications for other macroeconomic statistics and its implementation should always be co-ordinated with other statistical interests for consistency. Compilers in each of the territories involved are encouraged to co-operate in order to develop consistent data, avoid gaps, and minimize respondent and compilation burden.

111. Analogous treatments can be applied to enterprises operating in zones of joint jurisdiction – the enterprise will need to be split into entities that are resident in each economy having jurisdiction over the zone, with flows into and out of the enterprise pro-rated between these entities. Positions and flows between the entities may also need to be developed.

22. Instances may occur when land and buildings are owned (wholly or in part) by unrelated non-residents, wherein some (or all) of the non-resident owners hold less than 10% of the equity in the (notional) unit. In those cases, the 10% threshold is still applicable so that some (or all) of the owners may not be direct investors.
23. Similar issues may arise for a *societas europaea*, that is, a company created under European Union law that is able to operate in any member state.
24. The identification and allocation of income flows within a multi-territory enterprise, and the treatment of changing the identification of the "parent" over time are on the research agenda.

112. *Estates, other trusts, and partnerships* are treated as separate institutional units if they are constituted in a different territory from that of their owners or beneficiaries.

113. *Special corporate structures*, such as those with little or no physical presence, holding companies, nominees, etc., are discussed more in detail in Chapter 6.

3.2.3. Institutional sectors

114. The *Benchmark Definition* does not require as part of the standard data components a classification of direct investment statistics by institutional sectors: the emphasis is given instead to industry classification.[25] However, identifying the institutional sector of the resident party and the non-resident counterparty is important information for the compiler in determining whether or not a transaction/position should be included in direct investment statistics. Classification principles for resident and non-resident institutional sectors are based on the enterprise's primary activity, which is determined by its principal product or group of products produced or distributed, or services rendered.

115. These institutional sectors are: non-financial corporation sector, financial corporation sector, general government sector, non-profit institutions serving household sector (NPISH), and the household sector. Any of the five sectors identified by the SNA to cover all the activities of an economic territory may include enterprises that are direct investors, because any resident unit may own or control a non-resident unit that qualifies as a direct investment enterprise. On the other hand, all direct investment enterprises are classified either in the non-financial corporation sector or the financial corporation sector. This is because governments and households cannot be owned by non-residents units. Also, although NPISHs can be established or owned by non-residents, financial transactions/positions involving NPISHs are generally not driven by investment considerations and, therefore, they are generally not regarded as direct investment enterprises unless they qualify under the direct investment criteria.

116. Annex 3 Box A.3.1 provides further information on institutional sectors and, in particular, the subsectors of the financial corporation sector. For the purposes of collecting and compiling FDI statistics, it is important to collect and compile information from local enterprise groups, for those parts of the local enterprise group that are classified to the financial intermediaries subsectors separately from those parts that are not classified to the financial intermediaries subsectors. Box 3.3 provides further information for compilers for structures related to enterprises such as enterprise groups and joint ventures.

3.3. Foreign direct investment

117. *Foreign direct investment* reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power [26] of

25. In contrast, the *Balance of Payments and International Investment Position Manual* uses sector classification, rather than industry breakdowns, as the primary disaggregation of an economy's structure for all its functional categories.

26. In general, ordinary shares are the same as voting power. However, there may be instances that the voting power is not represented by ordinary shares. In such cases, compilers must determine the voting power.

an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does *not* allow any qualification of the 10% threshold and recommends its strict application to ensure statistical consistency across countries.

118. Direct investment includes the initial equity transaction that meets the 10% threshold and all subsequent financial transactions and positions between the direct investor and the direct investment enterprise, as well as qualifying FDI transactions and positions between incorporated and unincorporated fellow enterprises included under the FDIR (see Section 3.4). Direct investment is not solely limited to equity investment but also relates to reinvested earnings and inter-company debt (see Chapter 4).

119. Direct investment includes inward and outward financial transactions/positions between directly and indirectly owned incorporated and unincorporated enterprises.[27] The extent of the direct investment relationship is determined according to the Framework for Direct Investment Relationships (see Section 3.4.3).

120. Some relationships may exist between enterprises which may exhibit the characteristics of direct investment even though there are no links which qualify as direct investment. Such borderline cases should not be treated as direct investment (see Annex 3).

3.4. The direct investment relationship

121. The classification of financial positions and flows to direct investment requires that the two institutional units directly involved be resident in different economies and that they be in a direct investment relationship. This section presents the framework that has been developed to establish when two or more institutional units are in a direct investment relationship. While direct investment measures a wide variety of instruments as described in Chapter 4, direct investment relationships are determined using the voting power criterion only.

3.4.1. Foreign direct investor

122. A foreign direct investor is an entity (an institutional unit) resident in one economy that has acquired, either directly or indirectly, at least 10% of the voting power of a corporation (enterprise), or equivalent for an unincorporated enterprise, resident in another economy. A direct investor could be classified to any sector of the economy and could be any of the following:

i) an individual;

ii) a group of related individuals;

iii) an incorporated or unincorporated enterprise;

iv) a public or private enterprise;

v) a group of related enterprises;

27. Direct investment enterprises are also referred to as "foreign affiliates" (subsidiaries, associates, unincorporated business) that are either directly or indirectly owned by the direct investor or their non-resident branches. See glossary for a definition of affiliates.

vi) a government body;

vii) an estate, trust or other societal organisation; or

viii) any combination of the above.

123. In the case where two enterprises each own 10% or more of each other's voting power, each is a direct investor in the other.

3.4.2. Foreign direct investment enterprise

124. A direct investment enterprise is an enterprise resident in one economy and in which an investor resident in another economy owns, either directly or indirectly 10% or more of its voting power if it is incorporated or the equivalent for an unincorporated enterprise.

125. The numerical threshold of ownership of 10% of the voting power determines the existence of a direct investment relationship between the direct investor and the direct investment enterprise. An ownership of at least 10% of the voting power of the enterprise is regarded as the necessary evidence that the investor has sufficient influence to have an effective voice in its management. In contrast to some other statistical measures such as those on the Activities of MNEs, direct investment does not require control by the investor (*i.e.* more than 50% owned by the investor and/or its related enterprises). Direct investors may have direct investment enterprises in one economy or in several economies.

126. To facilitate international comparisons and to achieve global consistency of FDI statistics, the *Benchmark Definition* recommends a strict application of the 10% rule. Therefore, compilers should not qualify the 10% threshold further by applying other criteria. The *Benchmark Definition* does not recommend the use of other considerations such as representation on the board of directors; participation in policy-making processes; material inter-company transactions; interchange of managerial personnel; provision of technical information; and provision of long-term loans at lower than existing market rates.

3.4.3. Framework for direct investment relationships (FDIR)

127. The definitions of direct investors and direct investment enterprises above highlight the immediate relationship between two enterprises. As noted earlier, the legal structures of related enterprises can consist of many enterprises linked through complex ownership chains.

128. The Framework for Direct Investment Relationships (FDIR) is a generalised methodology for identifying and determining the extent and type of direct investment relationships. In other words, the FDIR allows compilers to determine the population of direct investors and direct investment enterprises to be included in FDI statistics.

129. For a compiling economy, the FDIR identifies all enterprises related to a particular enterprise whether it is a direct investor or a direct investment enterprise or both. For example, within a group, it is possible that a direct investment enterprise itself owns 10% or more of the voting power of another non-resident enterprise, in which case the direct investment enterprise is itself a direct investor in a further direct investment enterprise. The question is therefore whether there is a direct investment relationship between the further enterprise and the original enterprise.

130. In Figure 3.1, enterprises A, B and C are in different economies. Enterprise A owns 80% of the voting power in enterprise B and is a direct investor in B. Enterprise B, in turn,

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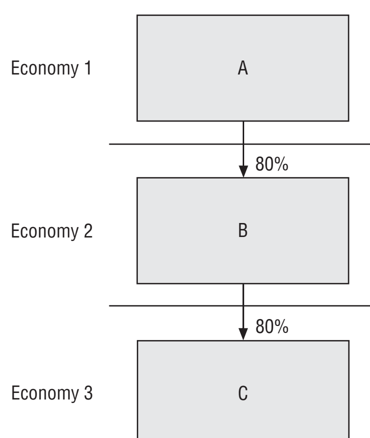
Figure 3.1. **Continuation of Control**

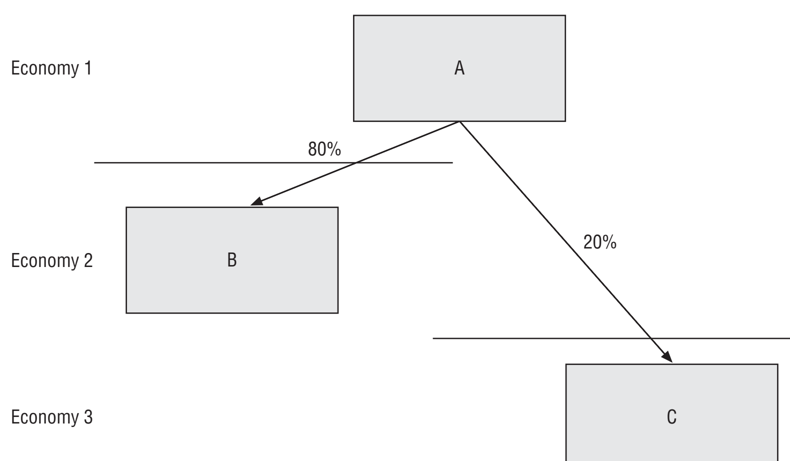


owns 80% of the voting power in enterprise C and is a direct investor in C. A has control over B, and through its control over B, has indirect control over C. As a result, financial transactions between A and C are also relevant to FDI, even though A directly holds no equity in C, and A and C are therefore considered to be in the direct investment relationship which embraces A, B and C. Financial transactions and positions as well as associated income flows between A, B and C should be included in direct investment statistics.

131. In relatively simple cases such as that in Figure 3.1, where each link in the ownership chain is a single equity holding and there is majority ownership (control) at each stage, it is clear that the direct investment relationship continues down the chain of ownership. However, when some links are non-controlling links and voting power of an enterprise is held by more than one member of a direct investment relationship, the extent of the relationship may be less obvious.

132. It is not uncommon for an entity to be a direct investor in more than one direct investment enterprise. In Figure 3.2, enterprises A, B and C are each in different economies. Enterprise A owns 80% of the voting power in enterprise B and is a direct investor in B.

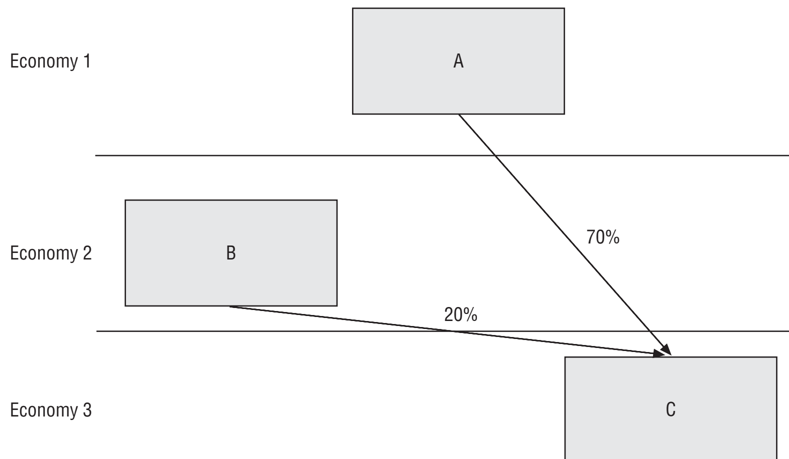
Figure 3.2. **Fellow enterprises**



Enterprise A also owns 20% of the voting power in enterprise C and is a direct investor in C. Enterprise A controls B and has significant influence over C. As a result, financial transactions and positions between B and C are also relevant to FDI statistics even though there is no equity participation between them. For example, B may raise capital which it lends to C at a concessional rate due to the control by A. It is reasonable to consider A, B and C to be in the same direct investment relationship – B and C are considered "fellow enterprises" of one another.

133. In Figure 3.3, there are two overlapping direct investment relationships, one with enterprise A as the direct investor and the other with enterprise B as the direct investor. The direct investment enterprise, C, is in a direct investment relationship with both A and B. Enterprise C is controlled by direct investor A, which owns 70% of the voting power of C, and C is significantly influenced by direct investor B, which owns 20% of the voting power of C. Despite their common ownership of C, enterprises A and B are not in a direct investment relationship with each other.

Figure 3.3. **Multiple direct investors**



134. The FDIR aims at identifying all enterprises over which the investor has significant influence under the 10% voting power criterion for FDI. In this determination, it is necessary to establish whether each enterprise under consideration is a *subsidiary*, an *associate*, or is *not relevant in FDI* – all three categories when combined being exhaustive and individually mutually exclusive. Those enterprises which are subsidiaries or associates are included in the direct investment relationship, while those categorised as *not influenced* are not included.

3.4.3.1. Subsidiaries in FDI

135. Subsidiaries in FDI are described as follows:

i) A subsidiary is an enterprise in which an investor owns more than 50% of its voting power *i.e.* it is controlled by the investor;

ii) Where an investor and its subsidiaries combined own more than 50% of the voting power of another enterprise, this enterprise is also regarded as a subsidiary of the investor for FDI purposes;

iii) In determining the scope of a direct investment relationship, the degree of influence that may be exercised through controlling links (more than 50% of voting power) is not diminished by the existence of multiple links in an ownership chain.

- ❖ An enterprise controlled by a subsidiary of an investor or by a group of subsidiaries (which may also include the investor) is itself regarded as a subsidiary for FDI purposes.
- ❖ However, for clarification, it should be stressed that an enterprise controlled by an associate or any group including an associate is regarded as an associate in the context of FDI.

3.4.3.2. Associates in FDI

136. Associates in FDI are described as follows:

i) An associate is an enterprise in which an investor owns directly at least 10% of the voting power and no more than 50%;

ii) Where an investor and its subsidiaries combined own at least 10% of the voting power of an enterprise but no more than 50%, the enterprise is regarded as an associate of the investor for FDI purposes;

iii) Where an associate, either as an individual or in combination with its subsidiaries, own more than 50% of an enterprise, this enterprise is regarded for FDI purposes as an associate of the higher level investor;

iv) In determining the scope of a direct investment relationship involving associates, the degree of influence that may be exercised through a single or cumulative influencing link (from 10% to 50%) along an ownership chain is diminished by one degree. Thus, an enterprise which is an associate of a subsidiary – or of a group of the investor's subsidiaries (which may include the investor) is regarded as an associate of the investor for FDI purposes.

3.4.3.3. Not relevant in FDI

137. The following are not relevant in FDI:

i) An enterprise in which an investor owns less than 10% of its voting power is regarded as not influenced by the investor and is therefore out of the scope of the FDIR. However, it should be stressed that a particular investor in a chain of ownership within the FDIR may indirectly hold less than 10% (but more than 0%) of an enterprise's voting power; this enterprise should be included in the FDIR as a subsidiary or an associate of the investor if the relevant criteria described earlier in sub-section 3.4.3 are fulfilled *e.g.* as in the description of associates in the preceding section;

ii) It should be also noted that an enterprise which is an associate of an enterprise associated to an investor is not influenced by this investor in the context of FDI, *i.e.* it is not regarded as an associate of the investor within the FDIR.

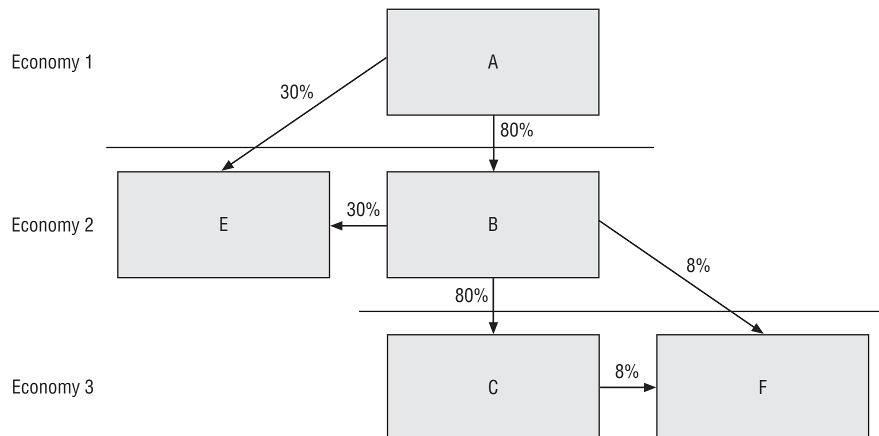
3.4.3.4. Fellow enterprises in FDI

138. The coverage of subsidiaries and associates within the FDIR along what might be termed vertical FDI ownership chains is generally relatively straightforward. However, an enterprise in one economy may be related through the FDIR to another enterprise in the

same economy, or in a different economy, without either being a direct investor in the other, but through both being directly or indirectly influenced by the same enterprise in the ownership hierarchy. This "common parent" must be a direct investor in at least one of enterprises in question. Such enterprises can be considered to be related through a horizontal' linkage within the FDIR – not involving FDI equity of 10% or more – and are called fellow enterprises. It should be noted, however, that for FDI statistics, only cross-border transactions and positions between FDI-related enterprises should be recorded. Where there is no voting power acquired in a fellow enterprise, or where less than 10% of the enterprise's voting power is obtained, all the investment made by one fellow enterprise in one economy in its fellow in another economy is included in FDI statistics but needs to be distinguished in compiling the data to facilitate the preparation of FDI data on both the asset/liability and directional presentational bases referred to in Section 2.4. Therefore, for a particular compiler, fellow enterprises may be considered as those resident and non-resident enterprises related within the FDIR other than those which have a direct investor-direct investment enterprise relationship (*i.e.* under the 10% or more voting power criterion) with one another. It is likely that many fellow enterprises will be direct investment enterprises in their own right but, clearly, some will not. For example, if a resident direct investor, A, has a direct investment enterprise abroad, B, as well as a resident subsidiary, C, then C, by definition, is not a direct investment enterprise of A, but B and C are fellow enterprises within the FDIR covering A, B and C.

139. Therefore, the direct investment relationship extends in both directions along an ownership chain from an enterprise to cover all of its subsidiaries and associates and all of the investors within the FDIR for which the enterprise is a subsidiary or an associate. It also covers "across chain" relationships as described below and in Figure 3.4 (see also Annex 4).

Figure 3.4. **Joint ownership**



140. It should be noted that identifying the extent of a direct investment relationship from an investor, B, which is an associate of another investor, A, may identify enterprises in a direct investment relationship with enterprise B that are not in a direct investment relationship with enterprise A. Determining the existence of one or more direct investment relationships under the FDIR depends largely on whether a common parent exists for enterprises in different ownership chains.

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141. It must be stressed that direct investment is only recorded when there is a financial transaction or position between entities in different economies that are in a direct investment relationship (including fellow enterprises). However, it should also be noted that the residence of units is not a feature of the definition of subsidiaries and associates for FDI purposes. The FDIR may include within the relationship enterprises that are resident in the same economy.

142. Figure 3.4 also highlights that equity positions within one economy may be important in determining the extent of a direct investment relationship. Despite being resident-to-resident positions, the equity positions between enterprises B and E and between enterprises C and F are part of the equity determining the relationship between enterprises A and E and between enterprises A and F.

143. Box 3.4 below summarises the principles and norms that determine the extent of a direct investment relationship.

Box 3.4. **Direct investment relationships**

Basic types of enterprises:

- A *subsidiary* is an enterprise in which the investor has control of more than 50% of the voting power;
- An *associate* is an enterprise in which the investor has control of at least 10% of the voting power and no more than 50%;
- *Fellow enterprises* are enterprises which do not have enough (or any) voting power in each other to constitute FDI influence but have a common parent.

Principles for extending the relationship through indirect ownership:

- A series of subsidiaries can continue as long as control exists at each stage in the ownership chain – a chain such as that in Figure 3.1 can continue indefinitely;
- Any subsidiary can extend the FDI relationship to an associate by owning from 10% to 50% of the voting power of that enterprise;
- An associate can extend the FDI relationship to another associate of the higher level investor only by owning more than 50% of the voting power of that enterprise. Such a chain of associates can be extended as long as majority ownership of voting power exists at each stage.

Basis for extending the relationship through joint ownership:

- Where the investor and its subsidiaries combined own more than 50% of the voting power of an enterprise, this enterprise is a subsidiary of the investor;
- Where the investor and its subsidiaries combined own at least 10% of the voting power of an enterprise but no more than 50%, this enterprise is an associate of the investor;
- Where an investor's associate and the associate's subsidiaries combined own more than 50% of the voting power of an enterprise, the enterprise is an associate of the investor.

144. Recognising practical difficulties compilers may encounter in fully applying the FDIR, two alternative methods may be applied: the "participation multiplication" method, and the "direct influence/indirect control" method. Should compilers choose to apply either of

these alternative methods due to practical difficulties in implementing the FDIR, they should include this information in their metadata. However, such countries should endeavour to move towards applying the FDIR over time.

145. Annex 4 provides more information and further examples concerning the determination of the extent of the direct investment relationship under the FDIR along with the two alternative methods. It also describes the practical implementation of the FDIR for measuring investment income credits and debits, and for classifying financial account transactions and international investment positions.

3.4.4. The debtor/creditor principle

146. In compiling and presenting FDI statistics, account must be taken that information on the funding received or provided or on the associated FDI income flows may be collected by different means and from different sources. The geographical allocation of the amounts involved, firstly determining whether they are between residents and non-residents and then, for the latter, determining the specific economy involved, depends on the allocation method used. This *Benchmark Definition* strongly recommends the use of the *debtor/creditor* principle. A *debtor* is a person or an entity which has a financial obligation to another person or entity. Conversely, a *creditor* is a person or entity which has a financial claim on another person or entity. Therefore, a debtor has a financial liability to a creditor and a creditor has a financial claim (an asset) on a debtor. For FDI statistical purposes, under the debtor/creditor principle, the FDI assets (both transactions and positions) of the compiling economy are allocated to the economies of residence of the non-resident debtors; its FDI liabilities are allocated to the economies of residence of the non-resident creditors allocated on the basis of the debtor/creditor principle. Therefore, adherence to this principle – although in some cases it may be difficult to implement – results in a complete and conceptually consistent set of flows and stocks data at a country or regional level. Use of other allocation approaches (such as the economy of the transactor) can lead to incorrect results between transactions and positions at bilateral (country or regional) level.

3.4.5. The asset/liability principle and the directional principle

147. This *Benchmark Definition* recommends that FDI data be presented in two ways: on a straightforward asset/liability basis (*i.e.* under the *asset/liability* principle) and reflecting the direction of direct investment influence within the context of the FDIR (*i.e.* under the *directional* principle). The two principles are described as follows:

- ***Asset/Liability principle.*** Under this approach, a compiling economy reports for resident institutional units classified under the FDIR as direct investors, direct investment enterprises or as fellow enterprises, all FDI financial claims on and obligations to non-residents using the normal balance sheet data showing gross assets and liabilities for positions, and net transactions for each category. The data presented on this basis, while compiled distinguishing the nature of the relationship between the FDIR counterparts, do not incorporate any offsetting of reverse direct investment transactions or positions in equity or debt between a direct investment enterprise and its direct investor. Similarly, the asset/liability presentation does not incorporate any offsetting of any transactions or positions between fellow enterprises (see *directional principle*).
- ***Directional principle.*** Presentation of the FDI data on a directional basis is designed to provide users with information reflecting the direction of influence underlying

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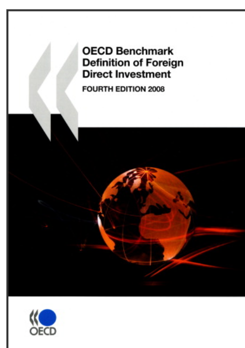
the direct investment. This requires a compiling economy to determine whether the investment was *inward* (labelled as *inward foreign direct investment*) *i.e.* that the influence giving rise to it originated abroad, and that it resulted in the establishment by a non-resident direct investor of a direct investment enterprise resident in that economy; or that it was *outward* (labelled as *outward foreign direct investment*) *i.e.* that the influence giving rise to it originated within the compiling economy, and that it resulted in the establishment by a resident direct investor of a direct investment enterprise abroad. This was also the recommendation in the previous edition of the *Benchmark Definition*. In the latest edition, the application of the directional principle has been extended to cover transactions and positions between fellow enterprises covered by the FDIR. In this context, the determination by a compiling economy of the direction of the investment (inward or outward) transactions and positions between a resident fellow enterprise and a non-resident fellow enterprise is made by reference to the broad residency of the ultimate controlling parent (*i.e.* whether it is resident or non-resident) of the fellow enterprises. If the ultimate controlling parent is a resident of the compiling economy, then the transactions and positions between the two fellow enterprises are categorised as *outward foreign direct investment*; if the ultimate controlling parent is not a resident of the compiling economy, then the transactions and positions between the two fellow enterprises are categorised as *inward foreign direct investment*. Where reverse investment exists or where investment occurs between fellow enterprises, this treatment is very likely to result in the overall inward direct investment position for an economy being lower in magnitude than the overall direct investment liability position presented on an asset/liability basis. The equivalent outcome to that for overall inward direct investment will also result for the overall outward direct investment position data compared to the overall direct investment assets. Depending on the particular investment circumstances which may exist in a reference period, similar, or indeed opposite, effects may arise when comparing the two presentations for FDI transactions data.



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