ANNEX 4

# *Framework for Direct Investment Relationships*

483.   This annex presents the Framework for Direct Investment Relationships (FDIR) the preferred method for identifying the extent and type of direct investment relationships. It also provides information on two alternatives to the FDIR – the Participation Multiplication Method (PMM) and the Direct Influence/Indirect Control Method (DIIC). The methods are compared in terms of inclusions and exclusions from direct investment. Practical implementation of the FDIR for measuring investment income and classifying financial transactions and positions is also discussed.

1. Framework for Direct Investment Relationships

484.   The Framework for Direct Investment Relationships (FDIR) includes in direct investment all subsidiaries and associates of an investor.

- A *subsidiary* is an enterprise in which an investor owns more than 50% of the voting power. In Figure A.4.1, B is a subsidiary of A.
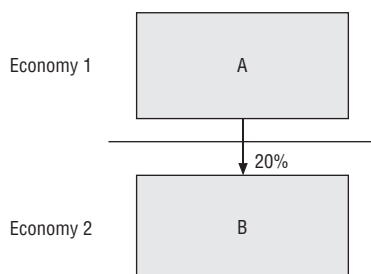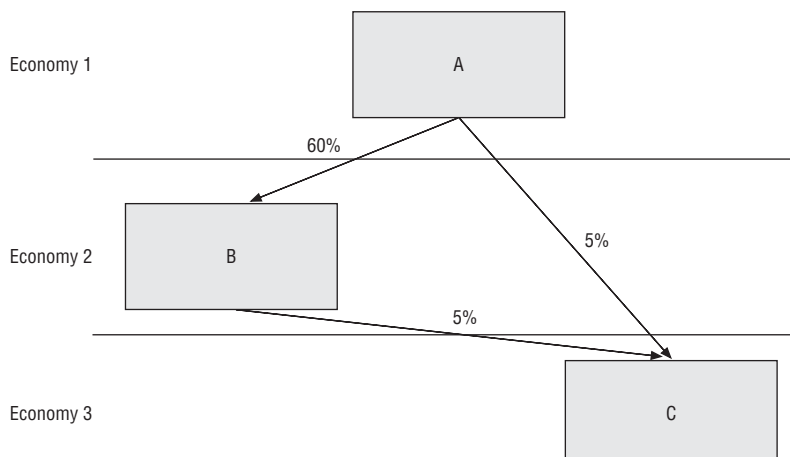
Figure A.4.1. **Subsidiary (example 1)**
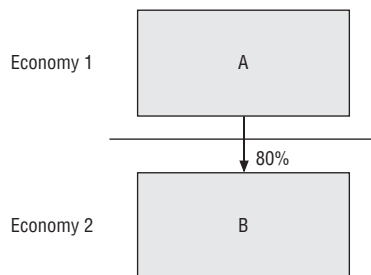
- Where an investor and its subsidiary(s) combined own more than 50% of the voting power of an enterprise, the owned enterprise is also regarded as a subsidiary of the investor. In Figure A.4.2, C is a subsidiary of A.

Figure A.4.2. **Subsidiary (example 2)**
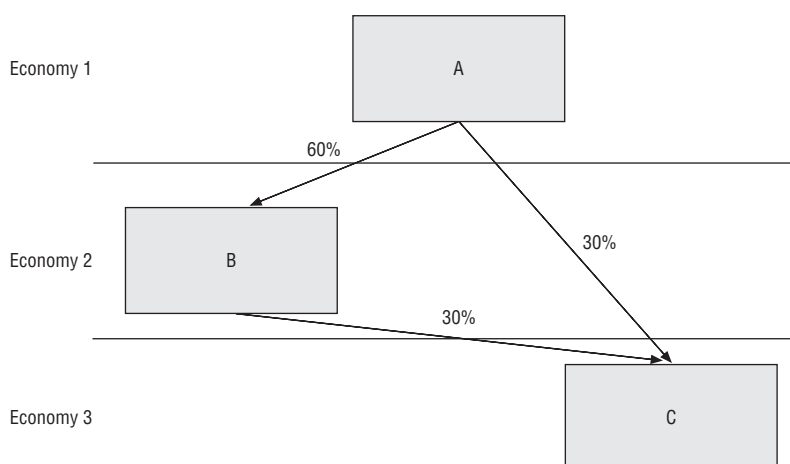
- An *associate* is an enterprise in which an investor owns at least 10% and no more than 50% of the voting power. In Figure A.4.3, B is an associate of A.

Figure A.4.3. **Associate (example 1)**

- Where an investor and its subsidiary(s) combined own at least 10% but no more than 50% of the voting power of an enterprise, the owned enterprise is regarded as an associate of the investor. In Figure A.4.4, C is an associate of A.

Figure A.4.4. **Associate (example 2)**

● Where an investor's associate (and its subsidiaries combined) own more than 50% of an enterprise, the owned enterprise is regarded as an associate of the investor. In Figure A.4.5, D is an associate of A.

Figure A.4.5. **Associate (example 3)**
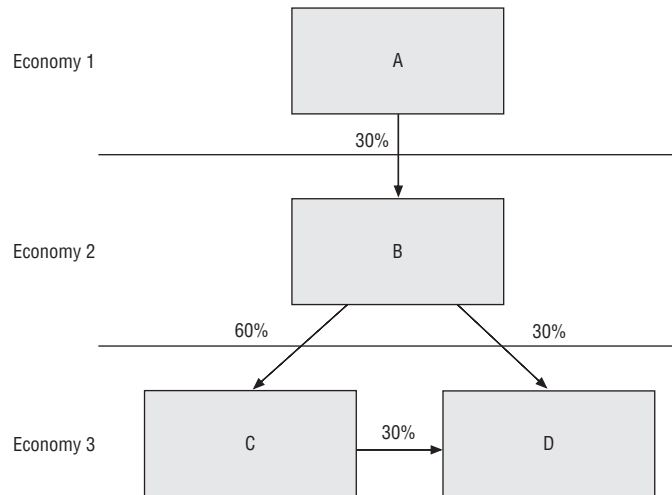
485.   The FDIR aims at identifying all enterprises over which the investor has significant influence under the 10% voting power criterion for FDI. In this determination, it is necessary to establish whether each enterprise under consideration is a *subsidiary* or an *associate* of the direct investor, or whether it is *not relevant to 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. The FDIR therefore identifies all enterprises over which the investor has significant influence in the context of FDI. For subsidiaries of the investor, the influence is a controlling one; for associates, it is non-controlling.

486.   It is considered that the degree of FDI influence that may be exercised through controlling links (where more than 50% of the voting power is held) is not diminished by the existence of multiple links. Thus, an enterprise controlled by a subsidiary or by a group of related subsidiaries (which may also include the investor) is itself regarded as a subsidiary. An enterprise controlled by an associate is also regarded as an associate. The degree of FDI influence that may be exercised through a single or cumulative non-controlling link (where from 10% to 50% of the voting power is held) is diminished by one degree. Thus, an associate of a subsidiary or a group of subsidiaries (which may include the investor) is regarded as an associate. An enterprise which is an associate of another associated enterprise is not, in any FDI sense, influenced by the investor in question, and, therefore, is not included in the FDIR. A chain of ownership is followed until the degree of influence that may be exercised by the investor is diminished to the point where an enterprise can be categorised as not influenced. Under the FDIR, the direct investment relationship extends from an investor to cover all of its subsidiaries and associates.

487.   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 in Chapter 3, sub-section 3.4.3 are fulfilled.

488.   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. 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.

489.   In identifying the extent of a direct investment relationship from an investor, B, which is an associate of another investor, A, other enterprises which are in a direct investment relationship with enterprise B but are not in a direct investment relationship with enterprise A may be identified.

490.   In summary, under the FDIR 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. Where more than one ownership chain originates from the same direct investor, all entities in all chains are in a direct investment relationship with one another. Note that some of the links in a chain may be within one economy.

491.   It must be stressed that in compiling FDI statistics, 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.

## 2. Participation Multiplication Method

492.   The Participation Multiplication Method (PMM) includes in direct investment all enterprises in which an investor has voting equity participation of at least 10%.[66] The calculation of participation percentage is based on a straight multiplication and summation of direct and indirect participation percentages.

493.   More specifically, an indirect participation in a given enterprise at the bottom of a chain of ownership is calculated by taking the investor's participation in the first enterprise,

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66. In the third edition of the *Benchmark Definition*, this method was referred to as the United States System.

multiplied by the first enterprise's participation in the next enterprise, multiplied by the corresponding percentages for all other intervening enterprises in the chain, multiplied by the last intervening enterprise's participation in the given enterprise. In Figure A.4.6 according to this method, A has a 16% participation in C (20% of 80%). Because this participation is at least 10%, A and C are regarded as being in a direct investment relationship.

Figure A.4.6. **Participation Multiplication Method (example 1)**
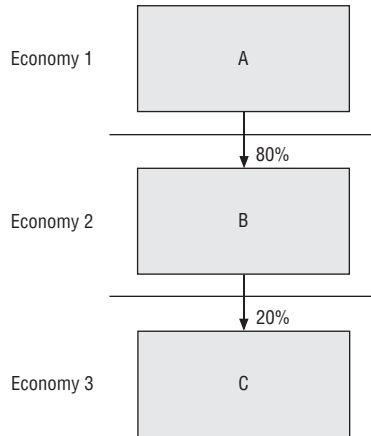
494.   If the investor's interest is held through more than one participation chain, then the percentages of direct and indirect participation in all chains are summed to determine the investor's total participation percentage. If the combined direct and indirect participation percentage is less than 10% in an enterprise in another economy, then that enterprise is not considered to be in a direct investment relationship with the investor. In Figure A.4.7, A holds 3% of D indirectly through B and 9% of D indirectly through C, so A holds a total of 12% of D from its combined holdings through B and C and as a result, D is a direct investment enterprise of A.

Figure A.4.7. **Participation Multiplication Method (example 2)**
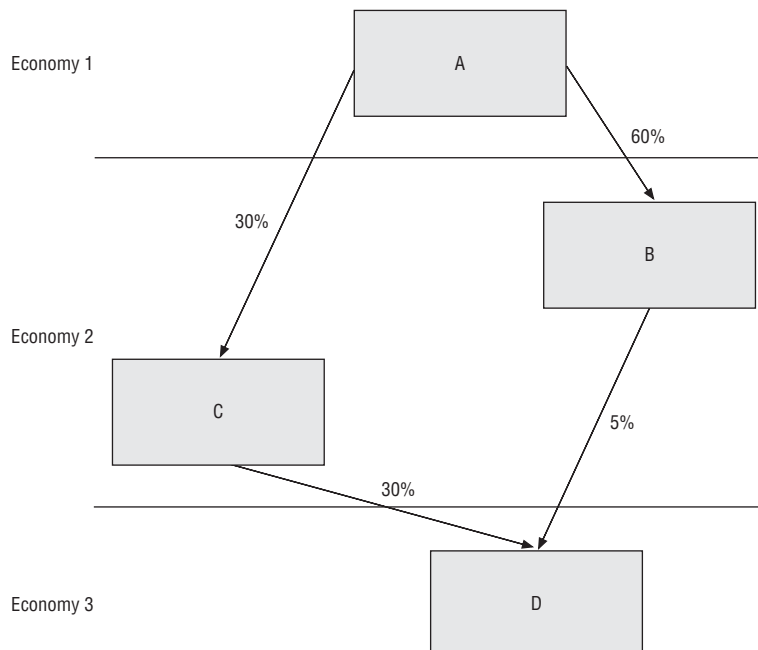
495.   It should be noted that under the FDIR, D would not be considered to be in a direct investment relationship with A.

3. Direct Influence/Indirect Control Method

496.   The Direct Influence/Indirect Control Method (DIIC) includes in direct investment all enterprises of which the voting power is 10% or more *directly* owned, plus all enterprises that are controlled by them (ownership of more than 50% of the voting power), plus all other enterprises in a continuous chain of majority ownership.[67]

497.   This method allows the first link in an ownership chain to be a non-controlling link, but all subsequent links must be controlling links. Thus the DIIC breaks the ownership chain at the second non-controlling link (as in the FDIR) where the first link from the investor is a non-controlling link. On the other hand (and contrary to the FDIR), the DIIC breaks the ownership chain at the first non-controlling link where the first link from the investor is a controlling link. As such, the DIIC will always identify the enterprises in a direct investment relationship as a subset of those identified by the FDIR. In Figure A.4.8 according to this method, B and C are in a direct investment relationship with A and with each other; E and G are also in a direct investment relationship with A (indirectly), B and C and with each other, while enterprise D is only in a direct investment relationship with B and E, and enterprise F is only in a direct investment relationship with C and G.

Figure A.4.8. n**Direct Influence/Indirect Control Method**
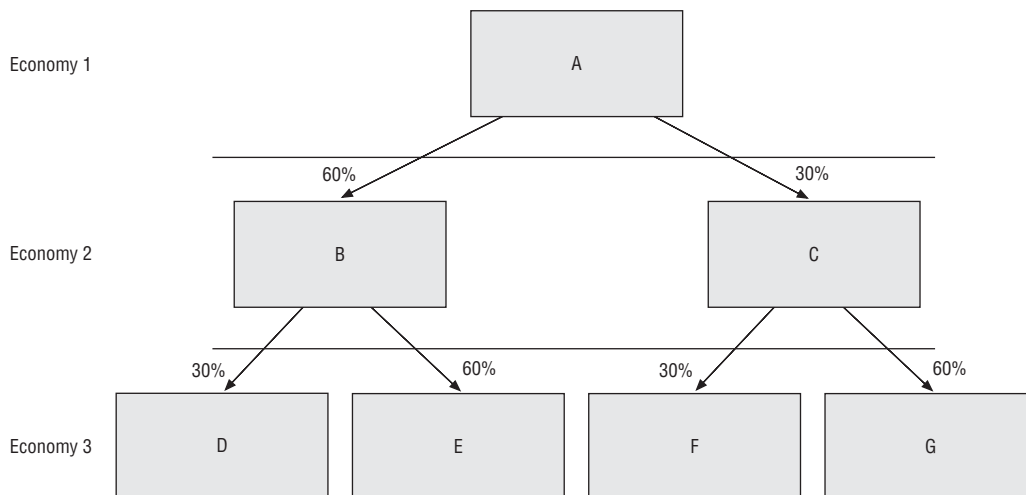
498.   It should be noted that under the FDIR, A would be in a direct investment relationship with all of the other enterprises except enterprise F.

499.   Consistent with the indirect control principles of the FDIR, the DIIC includes in the direct investment relationship cases where combined control is exercised by a number of affiliated enterprises when their first links are controlling links.

67. In drafting discussions for this edition of the *Benchmark Definition*, this method was initially referred to as the EU method.

4. Comparing the three methods

500. Figure A.4.9 presents six different relationships between an indirectly held enterprise and an ultimate investor. These relationships are analysed in Table A.4.1 in terms of whether the indirectly held enterprise is in a direct investment relationship with enterprise A.

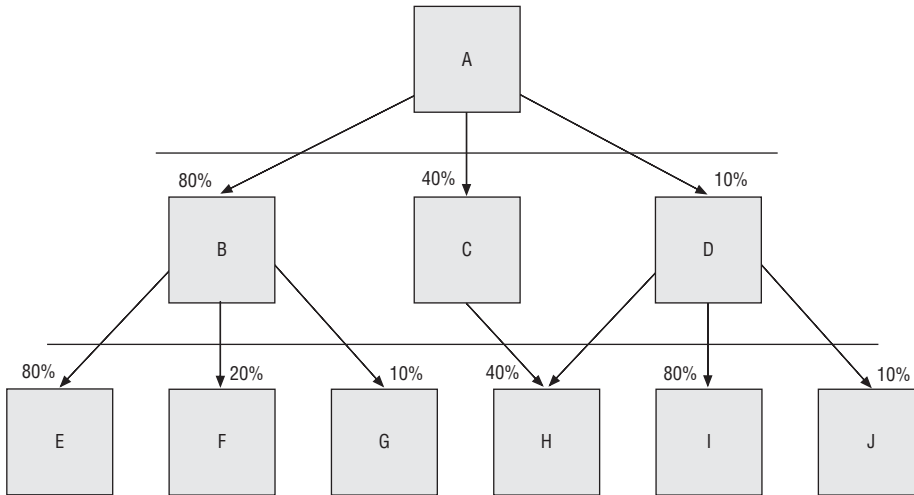Figure A.4.9. **Comparing the three methods**

Table A.4.1. **Comparing the three methods**

Relationship with A	E	F	G	H	I	J
FDIR	Direct	Direct	Direct	None	Direct	None
PMM	Direct	Direct	None	Direct	None	None
DIIC	Direct	None	None	None	Direct	None

501. From the above examples, it can be seen that the DIIC will always identify a subset of the enterprises in a direct investment relationship as being in that relationship. It does not recognise the relationship between enterprise A and enterprises F and G as being a direct investment relationship. The DIIC will never identify two enterprises as being in a direct investment relationship where none exists according to the FDIR.

502. The PMM may also fail to recognise a direct investment relationship where one exists according to the FDIR; for example, the PMM does not recognise the direct investment relationship between enterprise A and enterprises G and I. Even where a chain of control exists, the PMM may fail to recognise a direct investment relationship between enterprises sufficiently separated in the chain. Unlike the DIIC, the PMM may also identify enterprises as being in a direct investment relationship where none exists according to the FDIR; for example, the PMM considers enterprise H to be in a direct investment relationship with enterprise A.

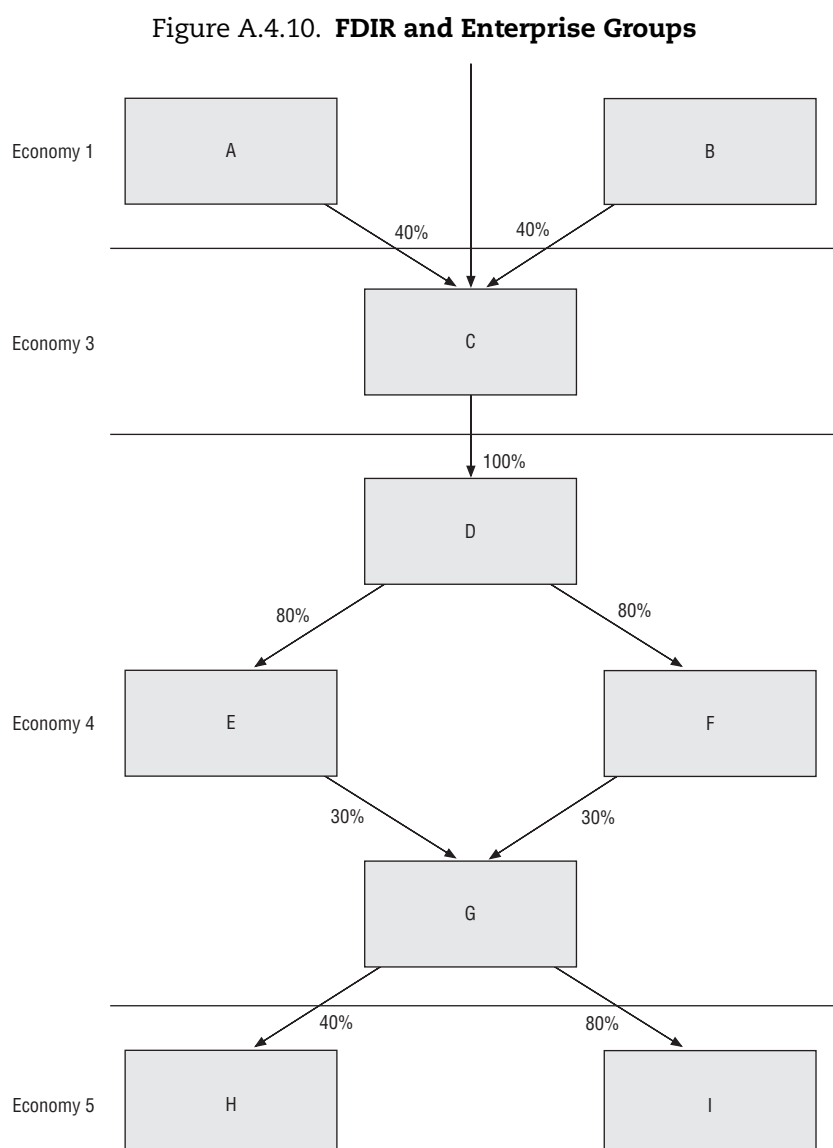## 5. Relationship with enterprise groups

503. Given that other related statistics are using the enterprise group as a basic unit, it is interesting to show how direct investment relationships may relate to enterprise groups. The example below in Figure A.4.10 is offered to help understand these relationships.

504.   In this example, there are three FDI relationships under the FDIR, one global enterprise group and one local enterprise group comprised of the following units:

- FDI Relationship based on A: A, C, D, E, F, G, I (= for PMM and DIIC).
- FDI Relationship based on B: B, C, D, E, F, G, I (= for PMM and DIIC).
- FDI Relationship based on C: C, D, E, F, G, H, I (= for PMM, DIIC excludes G).
- Global Enterprise Group: C, D, E, F, G, I.
- Local Enterprise Group: D, E, F, G.

505.   The following points may be noted:

- The purpose of the diagram and the FDI relationships described above is to show direct investment relationships based around different direct investors and how they overlap, but only looking down the investment chain (the "up-the-chain" relationship *e.g.* concerning the inclusion of enterprises A and B in the full FDIR based on enterprise C is ignored for this particular purpose (see Section 7 of this annex);

Figure A.4.10. **FDIR and Enterprise Groups**

- Enterprise H is not in a direct investment relationship with either A or B because, under the FDIR, C is an associate of A, so D is an associate of A, so E and F are associates of A, so G is an associate of A, and H, as it is an associate of an associate, is therefore not influenced by A and is not covered by the FDIR based on A (and similarly for the FDIR based on B).

506.   Economies 3 and 4 have to identify all three FDI relationships to fully articulate the potential FDI counterparties that need to be considered in measuring FDI. In the case of economy 4, it is important not to stop at enterprise C, but to also identify the two direct investors, A and B.

507.   From the terminology used in the *OECD Handbook on Economic Globalisation Indicators*, one could also note that:

- C is the Ultimate Controlling Parent for D, E, F, G and I.
- C is the parent of D, E, F and G.
- The local enterprise group (D, E, F and G) is the parent of I.

6. Measuring investment income on direct investment equity using the FDIR

508.   Income on direct investment equity is measured on the basis of current operating performance and accrues to the direct investor as it is earned. The operating performance of a direct investment enterprise includes the earnings accruing to it from any enterprises in which it holds equity which are also in a direct investment relationship with the direct investor, be it through direct or indirect ownership.

509.   When measuring income credits, the entity resident in the reporting economy that has a non-resident direct investment enterprise is treated as the direct investor in ownership chains. Any income accruing to the resident entity includes the proportional accrued income of all entities in chains of ownership with the resident as the direct investor. All income should be "equity -accounted" in accordance with accrual principles.

510.   When measuring income debits, the degree of influence recognised between the non-resident direct investor and the resident direct investment enterprise is the critical factor:

- If the resident direct investment enterprise is a subsidiary of the non-resident direct investor, ownership chains from the resident direct investment enterprise are followed past the first associate encountered in a chain and broken when the second associate is reached; while
- If the resident direct investment enterprise is an associate of the non-resident direct investor, ownership chains from the resident direct investment enterprise are broken when the first associate in a chain is reached.

511.   In some cases, it may be necessary to go further up the chain of ownership than the immediate investor to identify cases of cumulative ownership.

512.   The earnings accruing to the non-resident direct investor are its proportion of the accrued consolidated earnings of the resulting ownership chain.

7. Classifying financial transactions and positions

513.   In compiling FDI statistics, any financial transaction or position between entities in a direct investment relationship is classified as a direct investment transaction or position (with the exception of the exclusion from FDI statistics of debt transactions and positions

between financial intermediaries in a direct investment relationship and for financial derivatives). Only transactions and positions between FDI related enterprises which are resident in different economies are included in FDI statistics.

514. When classifying positions and transactions, all ownership chains of which the resident enterprise is a member have to be considered. The ownership chains are those for which the resident enterprise is treated as the direct investor, and any ownership chains in which the resident enterprise is an associate or a subsidiary. The latter chains are identified by moving up the chain from the resident enterprise, through the first non-controlling link, and stopping at the highest enterprise before the next non-controlling link above that point is encountered. The resident enterprise is then in a direct investment relationship with all enterprises that are in a direct investment relationship with any enterprise above it in an ownership chain. Note that there may be multiple chains and multiple direct investors identified in this process. This may also result in a number of fellow enterprises being identified through going up a chain and coming down another chain originating at the same investor *i.e.* "horizontal" or across-chain links between such fellow enterprises (which may invest in one another but for which such investment involves no voting power or, where it does, it is limited to less than 10% ownership).

515. For example, considering Figure A.4.8 above, direct investment positions and transactions for each economy would be recorded according to FDIR as shown in Table A.4.2.

Table A.4.2. **Classifying financial transactions and positions**

Economy	Resident Enterprise	Record direct investment with
1	A	B, C, D, E, G
2	B	A, D, E, G
	C	A, D, E, F, G
3	D	A, B, C
	E	A, B, C
	F	C
	G	A, B, C
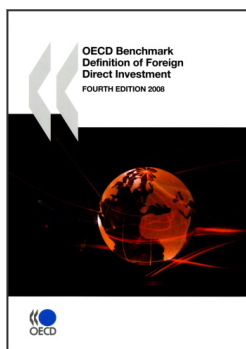
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