SESRIC-UNCTAD Webinar
FDI statistics in OIC countries

FDI concepts and definitions

(Video-conference)
28 June 2021

Division on Investment and Enterprise

UNCTAD

Contacts:

Astrit Sulstarova (Astrit.Sulstarova@unctad.org)
Isya Kresnadi (Isya.Kresnadi@unctad.org)

UNITED NATIONS
UNCTAD

Definition of Foreign Direct Investment (FDI)

I. FDI reflects the objective of:

- ✓ Establishing a lasting interest by a resident enterprise (the direct investor: DI)…
- ✓ …in an enterprise resident in an economy other than that of the investor (the direct investment enterprise: DIE)

II. The lasting interest:

- ✓ Long term and steady relationship between the DI and the DIE
- ✓ A significant degree of influence on the management of the FDI with or without a controlling interest
- ✓ Foreign investor owning directly or indirectly 10% or more of the ordinary shares or voting power of the DIE
- ✓ No choice: other criteria (subjective judgment) not accepted in order to ensure consistency in FDI recording by partners to the transaction

FDI (cont')

I. An entity or group of related entities that is able to exercise control or influence over another entity resident in another economy is called the **"direct investor" (DI)**

II. Entity subject to " being controlled" or "being influenced" is called the **"direct investment enterprise" (DIE)**

III. In some cases, an entity may be both a direct investor and a DIE

IV. **Fellow enterprises**

UNITED NATIONS
UNCTAD

Direct Investment Enterprise

A *direct investment enterprise* is an incorporated or unincorporated enterprise in which a direct investor, directly or indirectly, *owns* 10 percent or more of either:

- The voting power (for an incorporated enterprise), or
- The equivalent (for an unincorporated enterprise)

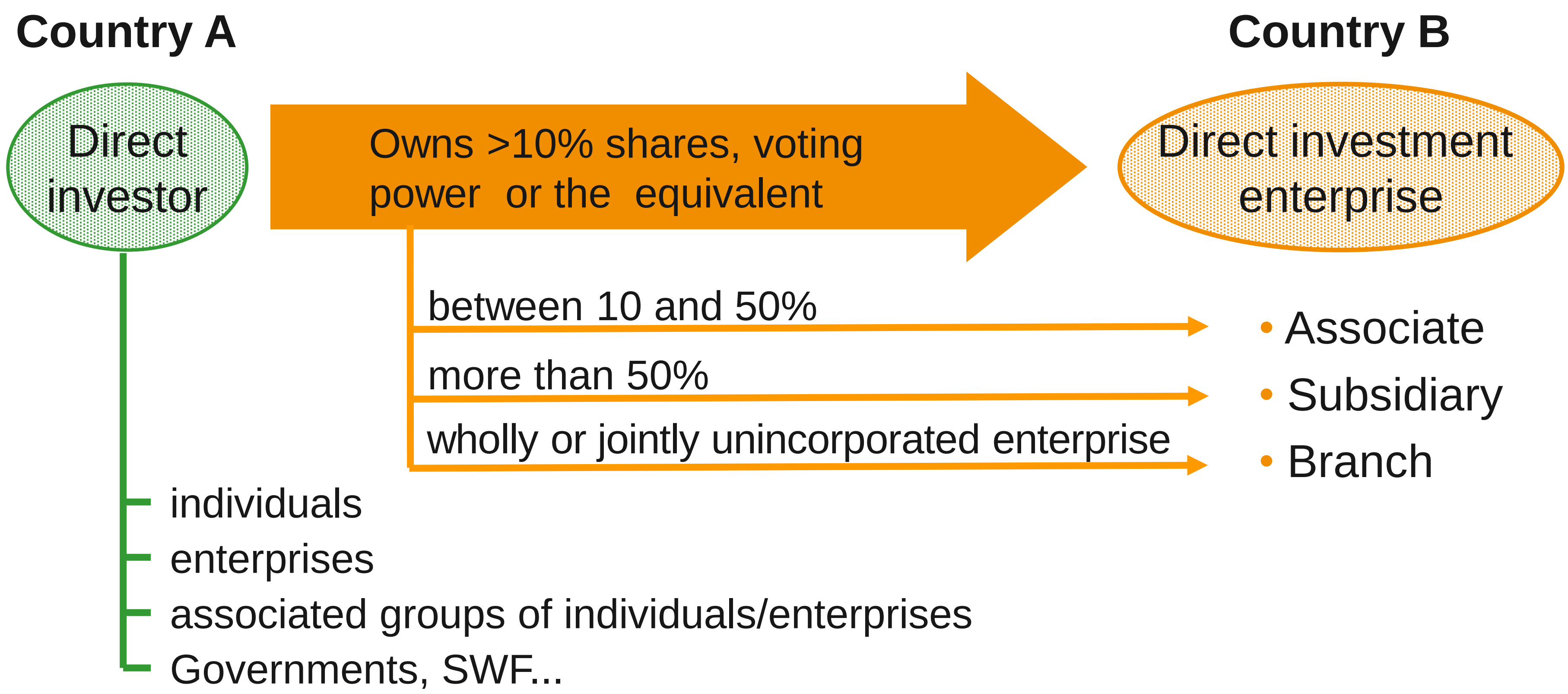
UNITED NATIONS
UNCTAD

Direct Investor

A *direct investor* is an entity (or group of related entities) that has a direct investment enterprise operating in an economy other than that in which the direct investor resides.

UNITED NATIONS
UNCTAD

Direct investors and direct investment enterprises



Fellow enterprises

Fellow enterprises are related enterprises (those in a direct investment relationship with each other) which have the common **Direct Investor** but neither holds 10 percent or more voting power in the other.

UNITED NATIONS
UNCTAD

The FDI relationship (FDIR)

- TNCs have **complex group structures**, including a number of DI and DIE: a DI could be the ultimate controlling parent or the intermediate parent of an enterprise
- Companies formulate their managerial, financial and tax strategies by taking into account their entire corporate group, including **indirectly owned enterprises**
- FDIR is a fully consolidated system: identification of all enterprises over which the direct investor exerts a **significant influence**, together with the types of direct investment relationships (up an ownership chain for inward FDI, down for outward FDI)

Summary of the FDIR process

A controls B	B controls C	A controls C
A influences B	B controls C	A influences C
A controls B	B influences C	A influences C
A influences B	B influences C	A no influence C

Alternative methods

FDIR is very demanding (information on groups structure): two alternative methods can be used in practice

- **The « Participation Multiplication Method » (US method)**
  - All enterprises with a participation of at least 10%
  - Based on a multiplication and summation of percentages
- **The « direct influence/indirect control method » (EU method)**
  - All directly owned enterprises with a participation of at least 10%
  - All indirect links with an ownership of more than 50%

Three sets of FDI accounts

- **Direct investment financial transactions (flows)**
  - ✓ Net inward and outward investments
    - with assets (acquisitions less disposals) and liabilities,
    - broken down by financial instrument (equity, debt and reinvested earnings),
    - for a given reference period (month, quarter, year)
- **Direct investment position (stocks)**
  - ✓ Total stock made abroad and received from abroad, broken down by financial instrument (equity including retained earnings, debt), for a given reference date
  - ✓ Close link between stocks and flows
- **Direct investment income**
  - ✓ Earnings of direct investment enterprises
  - ✓ Distributed (dividends) and undistributed earnings from equity
  - ✓ Interest from debt (interest from inter-company loans, trade credit)
  - ✓ Close link with both transactions (flows) and the position (stock)

FDI flows components

- **Acquisition or disposal of equity capital**
  - **Voting or non voting shares** in subsidiaries and associates
  - Equity in **branches**
  - **Other capital contribution**: provision of machinery or other capital equipment, raw materials, technical know-how (goods, services)
- **Reinvested earnings which are not distributed as dividends**
  - Direct investor's share of earnings not distributed as dividends
  - Including RE of indirectly-owned enterprises
- **Inter-company debt**
  - Marketable securities: bonds, debentures, commercial paper
  - Loans, trade credit, marketable securities, financial leases and Repo's, etc
  - NB: debt transactions between affiliated financial intermediaries not included

UNITED NATIONS
UNCTAD

Presentation according to the relationship between the DI and the DIE

- **Investment by the DI in its DIE (immediate or indirect relationship)**
  - ✓ Financing flows in the same direction as the influence or control, from the DI to the DIE
- **Reverse investment**
  - ✓ The financing flows in the opposite direction
  - ✓ Disinvestment: A way of withdrawing investment from DIE
  - ✓ Limited to cases where the 10% criterion is not met
- **Investment in other affiliated enterprise**
  - ✓ Involves fellow enterpises that have no direct influence upon one another, but with a common parent
  - ✓ Financing provided by or to fellow enterprises on behalf of the parent company

UNITED NATIONS
UNCTAD

FDI according to the assets/liabilities principle

Used for aggregate FDI data analysis by type of financial instrument (equity, debt)

- **All assets shown gross on the assets side**
  - ✓ Assets of resident DI in non-resident DIE
  - ✓ Assets of resident DIE in non-resident DI (reverse investment)
- **All liabilities shown gross on the liabilities side**
  - ✓ Liabilities of resident DIE to non-resident DI (reverse investment)
  - ✓ Liabilities of resident DI to non-resident DIE
- **Pros and cons**
  - ✓ Consistency with the other items in the BOP financial account , presented on an assets/liabilities principle
  - ✓ Does not take account of the nature of the enterprise
  - ✓ Possible overstatement of FDI amounts by pass-through funds

UNITED NATIONS
UNCTAD

FDI according to the directional principle

To be used for detailed analysis by partner country and economic activity and for economic impact

- **Recording of intercompany transactions dependent on the direction of the once established FDI relationship**
  - ✓ If the resident company is a DI, transactions recorded as **FDI outward** on the assets side
  - ✓ If it is a DIE, transactions recorded as **FDI inward** on the liabilities side

- **Reverse investment as an offset to the capital invested**
  - ✓ Outward FDI: liabilities of a DI to a DIE
  - ✓ Inward FDI: assets of a DIE in a DI

- **Pros and cons**
  - ✓ Specific to FDI, compared to the other items in the BOP financial account
  - ✓ Takes account of the nature of the enterprise (DI or DIE)
  - ✓ Netting

UNITED NATIONS
UNCTAD

Data by partner economy

- Special interest for FDI economic analysis and for quality checking using bilateral comparisons
- Based on the territory of **residence of the counterparty** to the FDI transaction or stock: country of source (inward) and destination (outward)
- Allocation acording to the **directional principle**, for inward and outward investments
- Based on the debtor/creditor principle
  - ✓ « With the **debtor/creditor principle**, the geographical allocation is based on the economy of the DIE (outward) or DI (inward), even if the funds are paid to or received from another economy »

UNITED NATIONS
UNCTAD

Activity allocation

- Activity allocation, important indicator for FDI monitoring policy and analysis of TNC’s activity (see the presentation on FATS statistics)
- **Each DI and DIE must be classified to a single industry, based on the primary activity**
  - ✓ International Standard Industry Classification **(ISIC4)**
  - ✓ Goods and services
  - ✓ Two classifications
  - ✓ According to the activity of the DIE (recommendation but difficult for outward)
  - ✓ According to the activity of the DI
  - ✓ The case of holding companies
- **Cross- classification by partner country / industry**
- Confidentiality problems may be encountered

UNITED NATIONS
UNCTAD

FDI by types

- Increasing interest in identifying FDI by its type, as different types (**M&A or greenfield investments**) are likely to impact differently the economies

- **M&A relate to existing company structures taken over fully or partially by other entities**

  Change of owners, but no direct impact in a first step

- **Greenfield FDI relates to investments projects that entail the establishment of new entities**

  Under greenfield FDI a DI provides resources to a DIE (contributing directly to capital formation) in exchange for a claim on the entity

- **BD4 recommends FDI by types be collected** as an extension of regular data collection: use of surveys

Special purposes entities (SPEs)

- **SPEs, legal entities part of a multinational group**
  - ✓ Established in another economy than the parent company,
  - ✓ **No strong links and limited physical presence within the host economy**
  - ✓ **Different structures** (holding company, regional headquarters) **or purposes** (administration, financing facilitation…)

- **Frequently established in offshore financial centers and motivated by tax incentives to foreign investors**

- **Is there a fundamental difference between SPEs transactions and « regular » FDI?**
  - ✓ Recorded in FDI but to be analyzed **as « pass-through » or capital in transit** entities with a limited influence in the host economy
  - ✓ To be distinguished with « genuine FDI »
  - ✓ SPEs interesting entities by themselves (financial crisis)

UNITED NATIONS
UNCTAD

Special purposes entities (SPEs)

- An SPE, resident in an economy, is a formally registered and/or incorporated legal entity recognized as an institutional unit, with no or little employment **up to maximum of five employees**, no or little physical presence and no or little physical production in the host economy.

- SPEs are directly or indirectly controlled by nonresidents.

- SPEs are established to obtain specific advantages provided by the host jurisdiction with an objective to (i) grant its owner(s) access to capital markets or sophisticated financial services; and/or (ii) isolate owner(s) from financial risks; and/or (iii) reduce regulatory and tax burden; and/or (iv) safeguard confidentiality of their transactions and owner(s).

- SPEs transact almost entirely with nonresidents and a large part of their financial balance sheet typically consists of cross-border claims and liabilities.

UNITED NATIONS
UNCTAD

FDI flows – special cases: financial intermediaries

Financial intermediaries are defined as:

Deposit-taking corporations (central bank, deposit-taking corporations other than central bank, MMFs, Non-MMFs, other financial intermediaries*, except insurance companies and pension funds)

- Transactions between affiliated financial intermediaries (i.e. financial intermediaries that are in a direct investment relationship) should be excluded from the DI data, except for transactions in the form of equity

* Such as securitizers, security and derivative dealers, finance leasing and consumer and commercial finance, specialized financial corporations involved in such activity as financing mergers and acquisitions, export and import financing, venture capital, development capital, prime brokerage.

FDI flows – special cases:

Purchases and sales of land by nonresidents

By convention, in the balance of payments all land within an economy, except that owned by foreign governments (such as embassies), is regarded as being owned by residents.

- If the actual owner is a nonresident, it is assumed that the ownership has been transferred to a resident notional institutional unit that is deemed to own the land and/or building
- The nonresident therefore has a financial investment in this resident notional unit, which is deemed to be a direct investment enterprise
- Purchases and sales of land (and any buildings on the land) by nonresidents should be included in the DI data as equity capital
- *Long-term leasing of land should be included in the FDI data*.

UNITED NATIONS
UNCTAD

FDI flows – special cases:

Natural resource exploration

Expenditure on the exploration of natural resources (e.g. oil) by nonresidents should be recorded in the DI data as equity capital

- Payments by a direct investor for the right to undertake natural resources exploration in the host economy should be recorded in the DI data as equity capital, if there is a clear intention to establish a direct investment enterprise in the host economy

- If exploration of natural resources proves unsuccessful (e.g. dry oil wells) and results in the shut-down of the direct investment enterprise:
  - ✓ No further entries should be recorded in the BOP DI data
  - ✓ Negative adjustments should be made to the Other Changes in Financial Assets and Liabilities Account DI data for the two countries, with flow through to the IIPs

UNITED NATIONS
UNCTAD

Three sets of FDI accounts

- **Direct investment financial transactions (flows)**
  - ✓ Net inward and outward investments
    - with assets (acquisitions less disposals) and liabilities,
    - broken down by financial instrument (equity, debt and reinvested earnings),
    - for a given reference period (month, quarter, year)
- **Direct investment position (stocks)**
  - ✓ Total stock made abroad and received from abroad, broken down by financial instrument (equity including retained earnings, debt), for a given reference date
  - ✓ Close link between stocks and flows
- **Direct investment income**
  - ✓ Earnings of direct investment enterprises
  - ✓ Distributed (dividends) and undistributed earnings from equity
  - ✓ Interest from debt (interest from inter-company loans, trade credit)
  - ✓ Close link with both transactions (flows) and the position (stock)

UNITED NATIONS
UNCTAD

FDI position

- **FDI stock, an important item of the International Investment Position (IIP)**

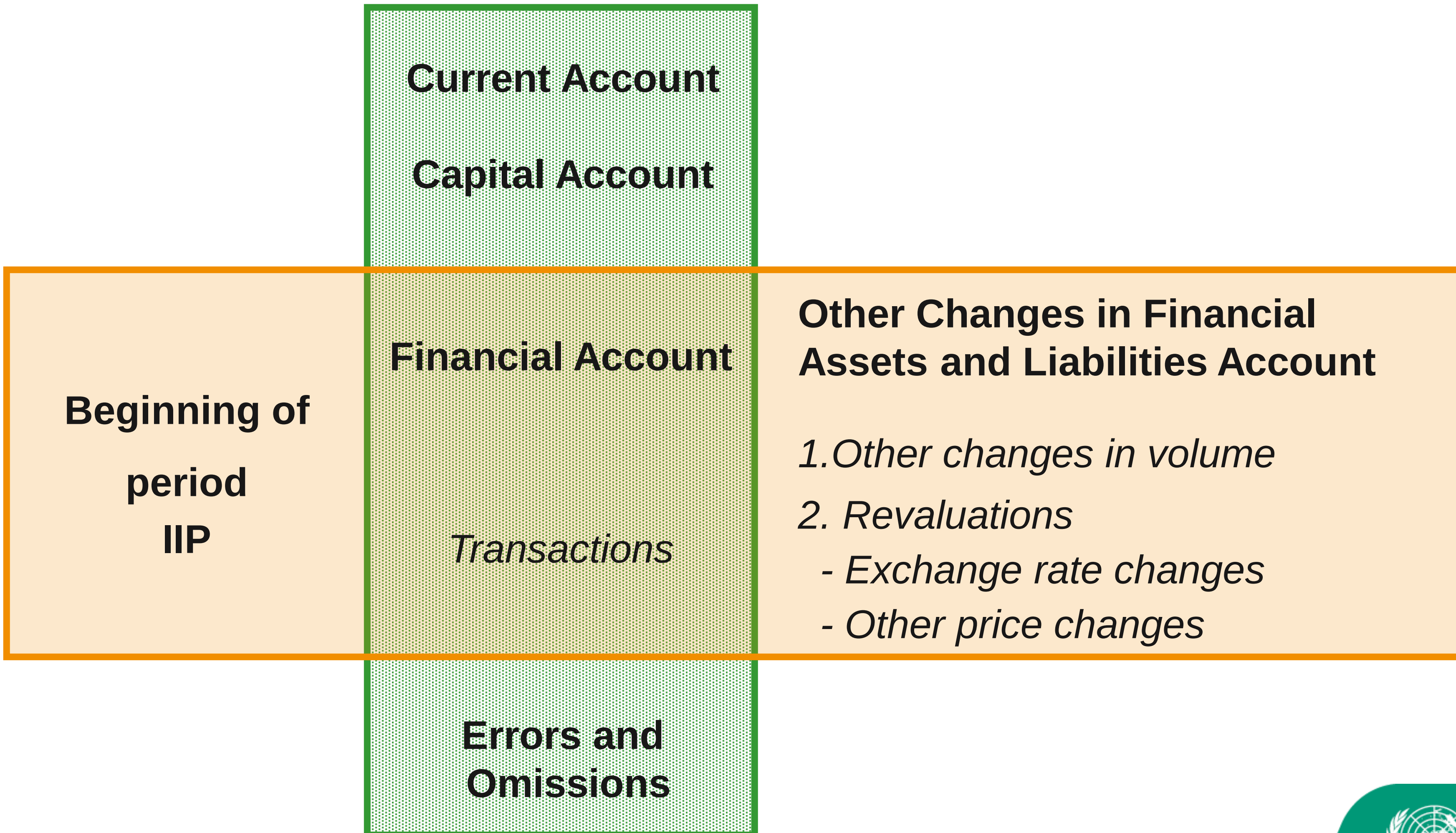
- **An indicator to be used for analyzing the economic and financial globalisation phenomenon**
  - ✓ Extent of foreign presence in one economy (inward)
  - ✓ Extent of presence abroad of resident companies (outward)
  - ✓ A tool for the analysis of the activity of TNCs, as a basis for FATS statistics
  - ✓ The importance is re-emphasized in BPM6

From FDI flows to FDI position

- FDI position, **summary of all past FDI flows** recorded in the BOP financial account, considered at a point in time
- **FDI flows and position are integrated**: all changes in position fully explained by the reported flows and other changes (exchange rates, holding gains and losses, debt write-offs…)
- As for FDI flows, a distinction is made between **equity capital** (including reinvested earnings) and **intercompany debt**

UNITED NATIONS
UNCTAD

Relationships between data items



Valuation of direct investment equity stocks

- Different valuation methods, as a major source of asymetries between countries

- Market price as the preferred concept
  - ✓ Promotes consistency of assets of different vintages
  - ✓ Promotes consistency when comparing flows, stocks, industries, countries

- Balance sheet or book value may be the only valuation available, on the basis of:
  - ✓ Original cost
  - ✓ A more recent revaluation
  - ✓ Current value (market price)

Exchange rate changes

- The exchange rate for conversion of FDI assets and liabilities denominated in foreign currencies into the unit of account
  - ✓ The market exchange rate prevailing on the date to which the FDI position relates (mid-point between buying and selling spot rates)

- Can be a significant factor of the variation in FDI position

UNITED NATIONS
UNCTAD

Other changes

- Reclassification
  - Example: from portfolio investment to direct investment
- Write-offs
- Expropriations
- Liquidation and failed exploration activities

Country allocation

- International standards require FDI statistics (flows and stocks) to be allocated geographically to the **immediate host, immediate investing country,** using the debtor/creditor principle

- Well adapted principle to a « one to one » relationship between a DI and a DIE but not to indirect investment, as it is more and more the case

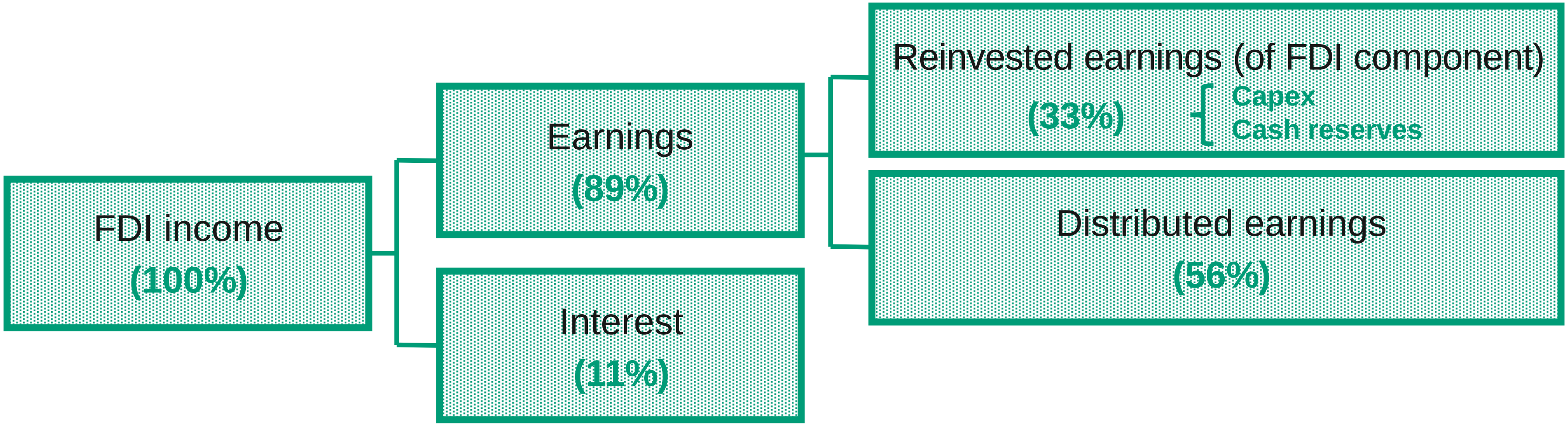
UNITED NATIONS
UNCTAD

Three sets of FDI accounts

- **Direct investment financial transactions (flows)**
  - ✓ Net inward and outward investments
    - with assets (acquisitions less disposals) and liabilities,
    - broken down by financial instrument (equity, debt and reinvested earnings),
    - for a given reference period (month, quarter, year)
- **Direct investment position (stocks)**
  - ✓ Total stock made abroad and received from abroad, broken down by financial instrument (equity including retained earnings, debt), for a given reference date
  - ✓ Close link between stocks and flows
- **Direct investment income**
  - ✓ Earnings of direct investment enterprises
  - ✓ Distributed (dividends) and undistributed earnings from equity
  - ✓ Interest from debt (interest from inter-company loans, trade credit)
  - ✓ Close link with both transactions (flows) and the position (stock)

UNITED NATIONS
UNCTAD

Structure of the FDI income account



Structure of the FDI income account

- The structure is very similar to the one of FDI flows and FDI position accounts (applying here the assets/liabilities principle)
- Receivables on assets and payables on liabilities
- Earnings on equity and interest on debt instruments
- Between direct investors and DIE and between fellow enterprises

Receivables (on assets)	Payables (on liabilities)
Of direct investors from DIE	**Of DIE to direct investors**
1. Earnings on equity	1. Earnings on equity
- Distributed earnings	- Distributed earnings
- Reinvested earnings	- Reinvested earnings
2. Interest on debt instruments	2. Interest on debt instruments
Of DIE from direct investors (reverse FDI)	**Of direct investors to DIE (reverse FDI)**
1. Distributed earnings from equity	1. Distributed earnings from equity
2. Interest on debt instruments	2. Interest on debt instruments
From fellow enterprises abroad	**To fellow enterprises abroad**
1. Distributed earnings from equity	1. Distributed earnings from equity
2. Interest on debt instruments	2. Interest on debt instruments

Earnings from current operations

Earnings of direct investment enterprises are reported using the (Current Operating Performance Concept (COPC) and needs to exclude:

- Any gains and losses arising from valuation changes
- Gains or losses on plant and equipment
- Writing-off of intangible assets
- Writing-off of R&D expenditures capitalised in a prior period
- Provisions for losses on long term contracts
- Exchange rate gains and losses from trading activities and holdings of foreign currency holdings assets and liabilities ….

Distributed earnings

Consist of dividends and distributed branch profits

- Dividends **include:** « those to shareholders, both common and participating preferred stock, whether voting or non-voting, according to the contractual relationship between the enterprises and the various types of shareholders » (BD4)

- Dividends **exclude:** liquidating dividends and bonus shares

Reinvested earnings

« Earnings accruing to foreign direct investors from the ownership of direct investment equity capital in an enterprise, in proportion to the direct investor equity participation »

- Current account (credit): imputed flows of undistributed income to the direct investor
- Financial account: offseting entry (debit) as additional equity capital to the direct invested enterprise
- Losses should be recorded as negative income

Return on FDI

- Competitiveness indicator of the direct investment
- Based on the ratio of equity income (dividends and branch profits plus reinvested earnings) to the FDI position
- A way for validating the data

UNITED NATIONS
UNCTAD

Thank you