

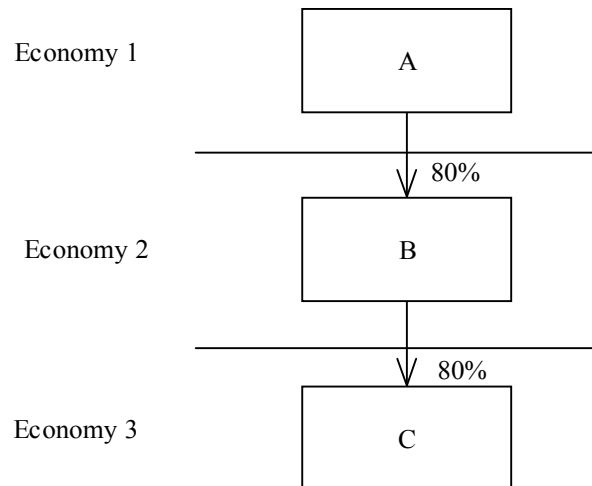
## FRAMEWORK OF DIRECT INVESTMENT RELATIONSHIPS (FDIR)<sup>1</sup>

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.

The FDIR identifies all enterprises affiliated with a direct investor. For example, within a group, it is possible that a direct investment enterprise itself owns 10% or more of the voting power of another enterprise, in which case the direct investment enterprise is itself a direct investor in a further direct investment enterprise. The question is – is there a direct investment relationship between the further enterprise and the original enterprise?

In Figure 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, 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 control over C. As a result, financial transactions between A and C cannot be considered to be disinterested, even though A directly holds no equity in C. It is reasonable to consider A and C to be in a direct investment relationship in which A indirectly is a direct investor in C. Financial transactions and positions between A and C should be included in direct investment.

**Figure 1. Continuation of Control**



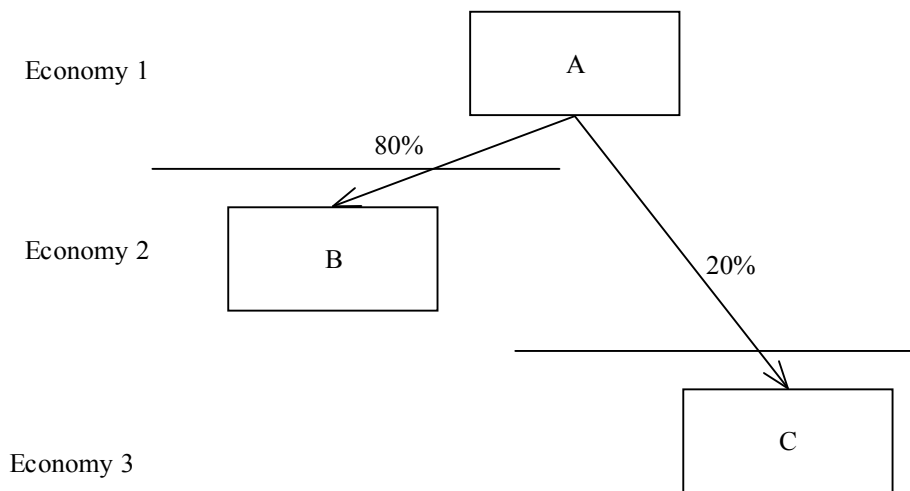
In relatively simple cases such as that in Figure 1, where each link in the ownership chain is a single equity holding and there is majority ownership (control) at each stage, it is clear that the direct investment relationship continues down the chain of ownership. However, when some links are non-controlling links and voting power of an enterprise is

<sup>1</sup> This paper draws extensively from the *OECD Benchmark Definition of Foreign Direct Investment*, fourth edition. See [http://www.oecd.org/document/33/0,3343,fr\\_2649\\_33763\\_33742497\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/33/0,3343,fr_2649_33763_33742497_1_1_1_1,00.html)

held by more than one member of a direct investment relationship, the extent of the relationship may be less obvious.

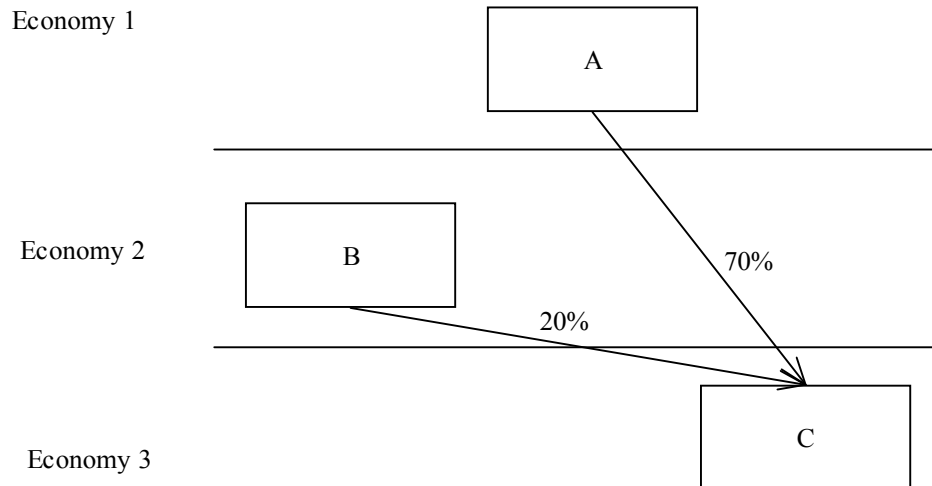
It is not uncommon for an entity to be a direct investor in more than one direct investment enterprise. In Figure 2, enterprises A, B and C are each in different economies. Enterprise A owns 80% of the voting power in enterprise B and is a direct investor in B. Enterprise A also owns 20% of the voting 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 cannot be considered at arm's length, 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 B and C to be in a direct investment relationship – B and C are considered 'other related enterprises' of one another.

**Figure 2. Other Related Affiliates**



Similarly, in Figure 3, there are two overlapping direct investment relationships, one with enterprise A as the direct investor and the other with enterprise B as the DI. The DIE, 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 considered to be in a direct investment relationship with each other.

**Figure 3. Multiple Direct Investors**



Under the FDIR, enterprises are identified as being (i) controlled affiliates, (ii) non-controlled affiliates, or (iii) non-controlled, non-influenced affiliates. A direct investment relationship then exists between the investor, all of its controlled affiliates and all of its non-controlled affiliates, but enterprises may be in a direct investment relationship even where no funds have been invested between the parties.

*A controlled affiliated enterprise* is an enterprise in which an investor owns more than 50% of the voting power.

Where an investor and its controlled affiliate(s) combined own more than 50% of the voting power of an enterprise, the owned enterprise is also regarded as a controlled affiliate of the investor.

(ii) *A non-controlled affiliated enterprise* is an enterprise in which an investor owns at least 10% of the voting power and no more than 50%.

(a) Where an investor and its controlled affiliate(s) combined own at least 10% of the voting power of an enterprise but no more than 50%, the owned enterprise is regarded as a non-controlled affiliate of the investor.

(b) Where an investor's non-controlled affiliate (and the affiliate's controlled affiliates combined) own more than 50% of an enterprise, the owned enterprise is regarded as a non-controlled affiliate of the investor.

(iii) *Non-controlled, non-influenced affiliated enterprises* may have no funds invested (either equity or debt) between them but they have a common direct investor (either directly or indirectly).

The controlled affiliates of an investor that are resident in an economy other than that of the investor are the same enterprises as those considered to be ‘foreign affiliates’ for the purposes of globalization statistics.

The FDIR principally identifies all enterprises over which the investor has significant influence. In this determination, three degrees of influence are recognised for each enterprise. They are categorised as controlled, influenced, and not influenced.

The degree of influence that may be exercised through controlling links (more than 50%) is not diminished by the existence of multiple links.

An enterprise controlled by a controlled affiliate or by a group of controlled affiliates (which may also include the investor) is itself regarded as a controlled affiliate.

An enterprise controlled by a non-controlled affiliate is also regarded as a non-controlled affiliate.

### **Box 1. Definition of Subsidiary and Associate**

If a direct investment enterprise is an incorporated enterprise then it will be either a subsidiary or an associate of the direct investor.

A **subsidiary** company is a direct investment enterprise that is incorporated in its country of residence and that is a controlled affiliate of the direct investor.

An **associate** company is a direct investment enterprise that is incorporated in its country of residence and that is a non-controlled affiliate of the direct investor.

This definition of a subsidiary avoids the use of subjective concepts or case-by-case review. The advantage of this absence of subjectivity is to eliminate a potential source of bilateral asymmetry. This recommendation is consistent with the OECD *Handbook on Economic Globalisation Indicators* (p104, Box 3.5).

The degree of influence that may be exercised through a single or cumulative influencing link (from 10% to 50%) is diminished by one degree.

Thus, an enterprise influenced by a controlled affiliate or the group of controlled affiliates (which may include the investor) is regarded as a non-controlled affiliate.

An enterprise influenced by a non-controlled affiliate is not influenced by the investor in question, i.e. it is not regarded as an affiliate of the investor within 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.

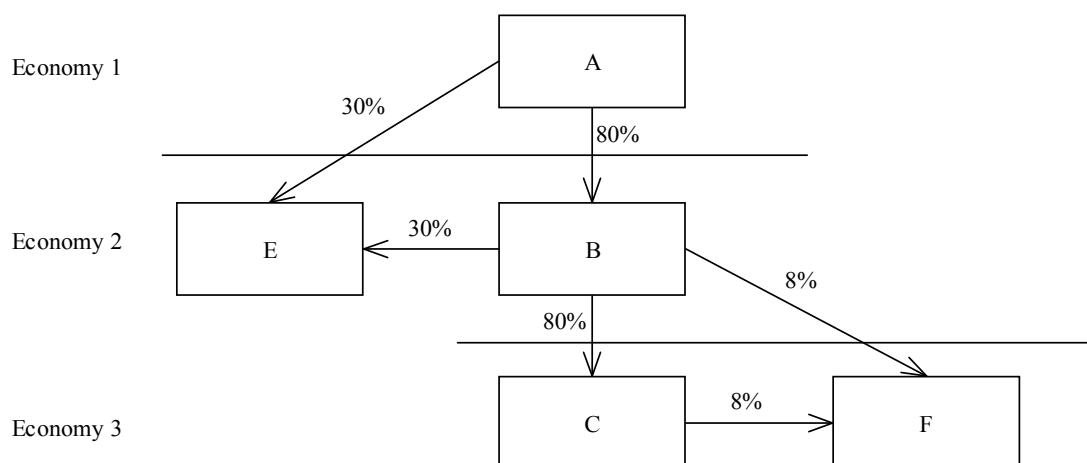
Under the FDIR, the direct investment relationship extends in both directions along an ownership chain from an investor to cover all of its controlled and non-controlled affiliates. It also covers ‘across chain’ relationships as described in Figure 2.

It should be noted that identifying the extent of a direct investment relationship from an investor, B, which is a non-controlled affiliate 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.

It should also be noted that the residence of units is not a feature of the definition of controlled and non-controlled affiliates. The FDIR may include within the relationship enterprises that are resident in the same economy. 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.

Figure 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.

**Figure 4. Joint Ownership**



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. See Annex VI. Should compilers choose to apply either of these alternate methods due to practical difficulties, they should include this information in their metadata. However, such countries should endeavour to apply the FDIR over time.

The box below summarises the principles and norms that determine the extent of a direct investment relationship.

### **Direct Investment Relationships**

#### *Basic types of affiliates:*

A controlled affiliate is an enterprise in which the investor has control of more than 50% of the voting power.

A non-controlled affiliate is an enterprise in which the investor has control of at least 10% of the voting power and no more than 50%.

A non-controlled, non-influenced affiliate is an enterprise that has a common direct investor with the other entity but the enterprises may be no funds invested between them.

#### *Principles for extending the relationship through indirect ownership:*

A series of controlled affiliates can continue as long as control exists at each stage in the ownership chain – a chain such as that in Figure 1 can continue indefinitely.

Any controlled affiliate can extend the relationship to a non-controlled affiliate by owning from 10% to 50% of the voting power of that enterprise.

A non-controlled affiliate can extend the relationship only to another non-controlled affiliate by owning more than 50% of the voting power of that enterprise. Such a chain of non-controlled affiliates can be extended as long as majority ownership of voting power exists at each stage.

*Basis for extending the relationship through joint ownership:*

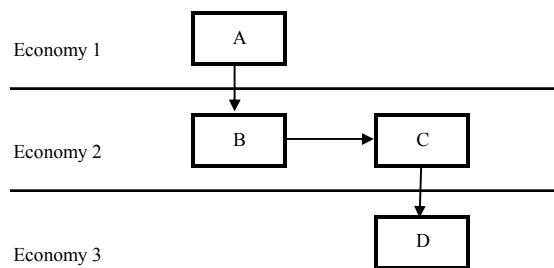
Where the investor and its controlled affiliates combined own more than 50% of the voting power of an enterprise, the owned enterprise is a controlled affiliate of the investor.

Where the investor and its controlled affiliates combined own at least 10% of the voting power of an enterprise but no more than 50%, the owned enterprise is a non-controlled affiliate of the investor.

Where an investor's non-controlled affiliate and its controlled affiliates combined own more than 50% of the voting power of an enterprise, the owned enterprise is a non-controlled affiliate.

For the purposes of identifying direct investment relationships, the FDIR does not exclude ownership links between enterprises resident in the same economy. While any transactions and positions between enterprises in the same economy are not included in international accounts, it is possible that a direct investor may have a chain of control or influence in which one link in the chain is resident-to-resident. Such a resident-to-resident relationship does not preclude a direct investment relationship between two enterprises that are resident in different economies from each other and that have a chain of control and/or influence between them that includes a resident-to-resident link. This case is illustrated below.

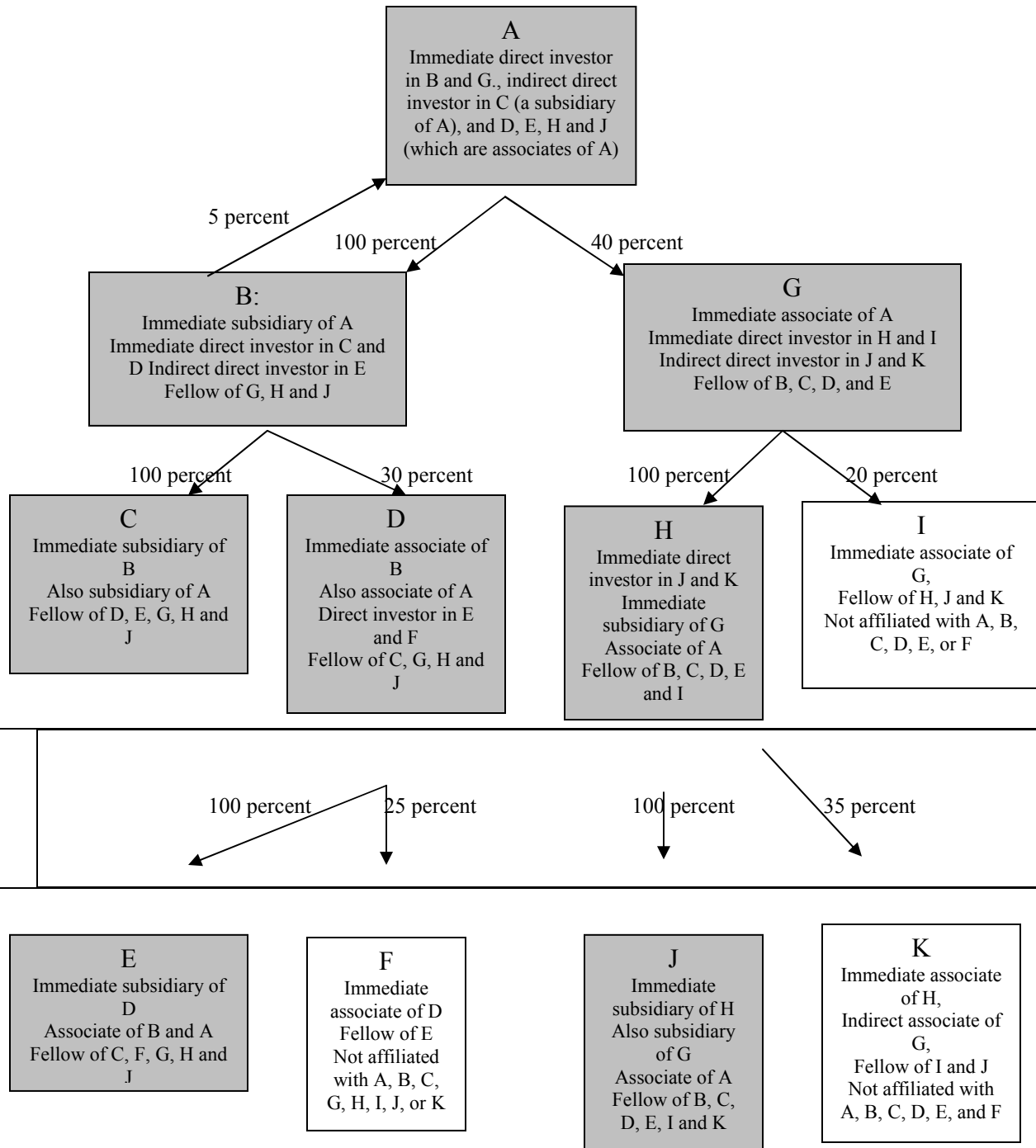
**Direct Investment Relationship Involving Domestic Link**



A wholly owns B, which wholly owns C, which wholly owns D.

In this example, A and B are each in a direct investment relationship with D. In some collections systems, B and C would be consolidated into a single “local enterprise group”. In this way, the link between A and D is clearer as it does not involve any apparent resident to resident linkages.

The diagram below, and the following description, set out to explain how entities may or may not be in direct investment relationships.

**Box 1 Example of Identification of Framework for Direct Investment Relationships**


This diagram sets out the direct investment relationships among the various entities. They are all in separate economies. The relationships are as follows:



A is in a direct investment relationship with all the entities that have shaded boxes. This is because these entities are either controlled or influenced by A.

B is a subsidiary of A as A owns more than 50 percent of the shares in B, making A the immediate direct investor of B.

C is also a subsidiary of A because it is a subsidiary of B which is subsidiary of A<sup>2</sup>, which makes A an indirect direct investor in C.

D is an indirect associate of A. D is an (immediate) associate of B (that is, B owns between 10 and 50 percent of the voting power in D) and B is a subsidiary of A.

E is an indirect associate of A as it is a subsidiary of an associate of A (D).

G is an immediate associate of A.

H and J are indirect associates of A, as H and J are either immediate or indirect subsidiaries of G.

This means that all the entities in shaded boxes are in a direct investment relationship with each other as they have a common direct investor (A). Any transactions or positions between any of them are direct investment transactions and positions.

B is an immediate direct investment enterprise of A, as it is a direct subsidiary of A. . It is also in a direct investment relationship with:

C is an immediate subsidiary of B, making B the immediate direct investor in C.

D is an immediate associate of B, making B an immediate direct investor in D.

E is an indirect associate of B as E is a subsidiary of D, which is an associate of B

G, H and J are all fellows of B: even though they hold no direct or indirect equity in each other, they have a common direct investor (A).

B is not in a direct investment relationship with F, I or K as they are associates of an associate of B and associates of associates break the direct investment chain as the influence is considered to have become too diluted to meet the criteria of direct investment.

As C is an immediate subsidiary of B, it is an immediate direct investment enterprise of B. Also, because C is a subsidiary of a subsidiary of A (B), it is, therefore, an indirect direct investment enterprise of A. C is also in a direct investment relationship with:

D, E, G, H and J. They are all fellows of C: even though they hold no direct or indirect equity in each other, they have a common direct investor (A<sup>3</sup>)

C is not in a direct investment relationship with F, I or K for the same reason that B is not in a direct investment relationship with them.

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<sup>2</sup> In other words, a subsidiary of a subsidiary is a subsidiary of the parent of the first subsidiary (as well as being a subsidiary of its immediate parent).

<sup>3</sup> B is also a common direct investor in C, D and E.

D is an immediate associate of B (and, therefore, an immediate direct investment enterprise of B), and, as B is a subsidiary of A, D is an indirect associate (an indirect direct investment enterprise) of A.

D also has direct investment relationships with:

E as it is an immediate subsidiary of D, thus making D the immediate direct investor in E  
 F as it an immediate associate of D, making D an immediate direct investor in F  
 C, G, H and J are all fellows of C: even though they hold no direct or indirect equity in each other, they have a common direct investor (A<sup>4</sup>)

D is not in a direct investment relationship with I or K as they are associates of an associate of D.

E is an immediate subsidiary of D, making it an immediate direct investment enterprise of D. E is also in a direct investment relationship with:

B, as B is an associate of D, making E an indirect direct investment enterprise of B.  
 A, as B is a subsidiary of A, making E an indirect direct investment enterprise of A.  
 C, as it is a fellow of E: even though they hold no direct or indirect equity in each other, they have a common direct investor (B<sup>5</sup>)  
 F, as it is a fellow of E: even though they hold no direct or indirect equity in each other, they have a common direct investor (D)  
 G, H, and J are also fellows of E: even though they hold no direct or indirect equity in each other, they have a common direct investor (A).

E is not in a direct investment relationship with I or K, as they are associates of associates of E.

F is in an immediate associate of D, making it an immediate direct investment enterprise of D. Because E is a subsidiary of D, F is a fellow of E, even though they hold no direct or indirect equity investment in each other.

F is not in a direct investment relationship with any other entity in the diagram.

G is an immediate associate of A, thereby making it an immediate direct investment enterprise. G is also in a direct investment relationship with:

H, as H is an immediate subsidiary of G, making H an immediate direct investment enterprise of G  
 J, as J is an immediate subsidiary of H, thereby making it an indirect subsidiary of G, as thus an indirect direct investment enterprise of G.

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<sup>4</sup> B is also a common direct investor in C and D.

<sup>5</sup> A is also a common direct investor in C and E.

I, as I is an immediate associate of G, making it an immediate direct investment enterprise of G.

K, as K is an associate of a subsidiary of G (H), making it an indirect direct investment enterprise of G.

B, C, D and E, as these are all fellows of G: even though they hold no direct or indirect equity in each other, they have a common direct investor (A)

H is a direct subsidiary of G, making it an immediate direct investment enterprise of G, and, as G is an associate of A, H is an indirect associate (an indirect direct investment enterprise) of A.

H is also in a direct investment relationship with:

J, as J is an immediate subsidiary of H, making J an immediate direct investment enterprise of H.

K, as K is an immediate associate of H, making K an immediate direct investment enterprise of K.

I, as I is a fellow: even though they hold no direct or indirect equity in each other, they have a common direct investor (G)

B, C, D and E are all fellows: even though they hold no direct or indirect equity in each other, they have a common direct investor (A)

H is not in a direct investment relationship with F.

I is an immediate associate of G, making it an immediate direct investment enterprise of G. I is also in a direct investment relationship with:

H, J and K as they are fellows: even though they hold no direct or indirect equity in each other, they have a common direct investor (G)

I is not in a direct investment relationship with any other entity.

J is an immediate subsidiary of H, making it an immediate direct investment enterprise of H and, as H is a subsidiary of G, J is an indirect subsidiary of G, making it an indirect direct investment enterprise of G. J is also in a direct investment relationship with:

A, as J is an indirect subsidiary of G, which is an associate of A, J is an indirect associate (an indirect direct investment enterprise) of A.

K, as K is a fellow: even though they hold no direct or indirect equity in each other, they have a common direct investor (H)

B, C, D, E as they are fellows: even though they hold no direct or indirect equity in each other, they have a common direct investor (A)

J is not in a direct investment relationship with F.

K is an immediate associate of H, making it an immediate direct investment enterprise. As H is a subsidiary of G, K is an indirect associate of G. K is also in a direct investment relationship with:

J, as J is a fellow: even though they hold no direct or indirect equity in each other, they have a common direct investor (H<sup>6</sup>).

I, as I is a fellow: even though they hold no direct or indirect equity in each other, they have a common direct investor (G)

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<sup>6</sup> G is also a common direct investor for J and K.