GLOSSARY OF FOREIGN DIRECT INVESTMENT TERMS

The purpose of this glossary is to provide additional information and clarifications to national compilers and users of FDI statistics.

A

Aggregate Basis

Data collected on this basis show the total transactions made by respondents during specified reporting periods, such as information obtained through enterprise surveys.

All-inclusive Concept

The application of this concept is one of the two main approaches to measuring earnings. The concept is explained in the *International Accounting Standard No.8,* "Unusual and Prior Period Items and Changes in Accounting Policy". When earnings are measured on the basis of this concept, income is considered to be the amount remaining after all items (including write-offs and capital gains and losses, and excluding dividends and any other transactions between the enterprise and its shareholders or investors) causing any increase or decrease in the shareholders' or investors' interests during the accounting period, are allowed for. (See also *Current operating performance concept.*)

Asset/Liability Principle

The *Financial Account* of the balance of payments records an economy's transactions in external financial assets and liabilities. The transactions are classified by (1) functional type of investment (*direct investment*, *portfolio investment*, *financial derivatives, other investment*, and *reserve assets*); (2) assets and liabilities or, in the case of direct investment, direction of investment; (3) type of instrument; and, in some cases, (4) domestic sector and (5) original contractual maturity. This distinction between external assets and liabilities is of primary importance for the functional types of investment other than direct investment. Transactions should be recorded on a straight asset/liability basis. Even when a net basis is used, transactions in financial assets should be shown separately from transactions in financial liabilities.

B

Balance of Payments

The terms refers to the statistical system through which economic transactions occurring during specific time periods between an economy and the rest of the world can be summarised in a systematic way. The fifth edition of the IMF *Balance of Payments Manual (BPM5)* provides conceptual guidelines for compiling balance of payments statistics according to international standards.

Bonds and Money Market Instruments

These include bonds, debentures, commercial paper, promissory notes, certificates of deposit, and other tradable nonequity securities (with the exception of financial derivatives). For the purposes of the SIMSDI survey, the category also includes Treasury bills.

Book Value

The value at which an equity or other capital asset or liability is recorded in the balance sheet of an entity is the book value. Book value can reflect one of the following valuation methods:

- historical cost;
- replacement cost;
- an interim adjusted price, which is not the current market price;
- fair market value; or
- current market price.

Business Register

This is a register of enterprises or establishments involved in foreign direct investment, which is maintained by countries to assist in the compilation of their direct investment data.

C

Compulsory Reporting Requirements

The term refers to a situation where legislation creates a legal obligation for reporters to provide the requested information (and usually an appropriate penalty for non-compliance).

Current Operating Performance Concept (COPC)

The application of this concept is one of the two main approaches to measuring earnings. The concept is explained in the *International Accounting Standard No.8, "*Unusual and Prior Period Items and Changes in Accounting Policy*".* When earnings are measured on the basis of this concept, such earnings consist of income from normal enterprise operations before non-recurring items (such as write-offs) and capital gains and losses are taken into accounted. (See also *All-inclusive concept.*)

D

Data Dissemination

The term encompasses all the means by which data are made available to the public, including dissemination on the Internet.

Debtor/Creditor Principle

There are two principles that may serve as the basis for geographic allocation of direct investment financial flows: the debtor/creditor principle and the transactor principle. Under the debtor/creditor principle, transactions resulting from changes in financial claims of the compiling economy are allocated to the country of residence of the non-resident debtor, and transactions resulting in changes in financial liabilities are allocated to the country of residence of the non-resident creditor, even if the amounts are paid to or received from a different country (See also *Transactor principle*.)

Debt Securities

These cover all tradable securities, except those classified as equity securities. Debt securities include bonds, debentures, notes, etc., money market or negotiable debt instruments.

Direct Investment

The term describes a category of international investment made by a resident entity in one economy (direct investor) with the objective of establishing a lasting interest in an enterprise resident in an economy other than that of the investor (direct investment enterprise). "Lasting interest" implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

Direct Investment Enterprise

The term refers to an incorporated enterprise in which a foreign investor owns 10 percent or more of the ordinary shares or voting power for an incorporated enterprise or an unincorporated enterprise in which a foreign investor has equivalent ownership. Ownership of 10 percent of the ordinary shares or voting stock is the criterion for determining the existence of a direct investment relationship.

Direct investment enterprises comprise those entities that are:

- subsidiaries (an enterprise in which a non-resident investor owns more than 50 percent);

- associates (an enterprise in which a non-resident investor owns between 10 and 50 percent) and;

- branches (unincorporated enterprises wholly or jointly owned by a non-resident investor);

and are either directly or indirectly owned by the direct investor.

When the 10 percent ownership requirement for establishing a direct investment link with an enterprise is met, certain other enterprises that are related to the first enterprise are also regarded as direct investment enterprises. Hence the definition of direct investment enterprise extends to the branches and subsidiaries of subsidiaries of the direct investor (so-called "indirectly owned direct investment enterprises"). The OECD *Benchmark Definition of Foreign Investment* and the IMF *Balance of Payments Compilation Guide* describe the scope of enterprises, both directly and indirectly owned, that should be included in the definition. The OECD's specification of this group of enterprises is referred to as the "Fully Consolidated System". (See also *Fully consolidated system.*)

Direct Investment Income

Comprises income on equity and income on debt. (See also the separate entries for these two elements.)

Direct Investment Relationship

A direct investment relationship is created when an enterprise resident in one economy owns 10 percent or more of the ordinary shares or voting power for an incorporated enterprise, or the equivalent for an unincorporated enterprise, that is resident in another economy. Direct investment enterprises that are considered to be in a direct investment relationship with a direct investor are also considered to be in direct investment relationships with each other.

Direct Investor

The term refers to an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises that has a direct investment enterprise (that is, a subsidiary, associate or branch) operating in an economy other than the economy or economies of residence of the foreign direct investor or investors.

Directional Principle

Unlike other financial investments, direct investment is not recorded in the balance of payments on a strict asset/liability basis. Direct investments are recorded on a directional basis (that is, as resident direct investment abroad, or nonresident direct investment in the reporting economy). Capital invested by the direct investment enterprise in its direct investor (reverse investment) is regarded as an offset to capital invested in the direct investment enterprise by a direct investor and its related enterprises. That is, such capital is regarded as disinvestment by the direct investor rather than as an asset of the direct investment enterprise, except when the equity participations are at least 10 percent in both directions and two direct investment relationships are therefore established. (See also *Reverse investment.*)

Dividends

Dividends are the distribution of earnings allocated to shares and other forms of participation in the equity of incorporated private enterprises, cooperatives, and public corporations. These can be recorded on the date they are payable, on the date they are paid, or at some other point in time.

E

Equity Capital

Equity capital comprises: (1) equity in branches, (2) all shares in subsidiaries and associates (except nonparticipating, preferred shares, which are treated as debt securities and included under direct investment, other capital), and (3) other capital contributions.

Exchange Rate Gains or Losses

These can be either realized gains/losses or unrealized gains/losses.

F

Financial Derivatives

Financial derivatives are financial instruments that are linked to another specific financial instrument or indicator or commodity, and through which specific financial risks (such as interest rate risk, foreign exchange risk, equity and commodity price risks, credit risk etc.) can be traded in financial markets in their own right. The value of a financial derivative is based on the price of an underlying item, such as an asset or index. No principal amount that has to be repaid is advance, and no investment income accrues. Financial derivatives are used for a number of purposes including risk management, hedging, arbitrage between markets, and speculation. In accordance with the 2000 revision of the fifth edition of the IMF's *Balance of Payments Manual (BPM5)*, income from financial derivatives (such as interest rate swaps) is no longer considered to be *Income on Debt (Interest)* in the balance of payments statistics.

Financial Intermediary

For the purposes of balance of payments statistics, financial intermediaries are defined as being: (1) other depository institutions (banks, other than the central bank); (2) other financial intermediaries, except insurance companies and pension funds; and (3) financial auxiliaries. The definition would therefore include Special Purpose Entities (SPEs), the sole function of which is financial intermediation, and enterprises, such as security dealers, that provide services auxiliary to financial intermediation.

[Note that with effect from 2002 the definition of financial intermediary SPEs has been amended to SPEs with the primary purpose of financial intermediation, not just those with the sole purpose of financial intermediation.] (See also *Special purpose entities.*)

Fully Consolidated System (FCS)

The fifth edition of the IMF's *Balance of Payments Manual (BPM5)* and the OECD's *Benchmark Definition of Foreign Direct Investment (Benchmark)* state that inward and outward direct investment statistics should, as a matter of principle, cover all directly and indirectly owned subsidiaries, associates, and branches. *BPM5* and the OECD's *Benchmark* recommend the following definition of these enterprises:

(1) *Subsidiary companies*

Company X is a subsidiary of Enterprise N if, and only if

(a) Enterprise N either

(i) is a shareholder in or member of X and has the right to appoint or remove a majority of the members of X's administrative, management, or supervisory body; or

(ii) owns more than half of the shareholders' or members' voting power in X; or

(b) Company X is a subsidiary of any other Company Y that is a subsidiary of N.

(2) *Associate companies*

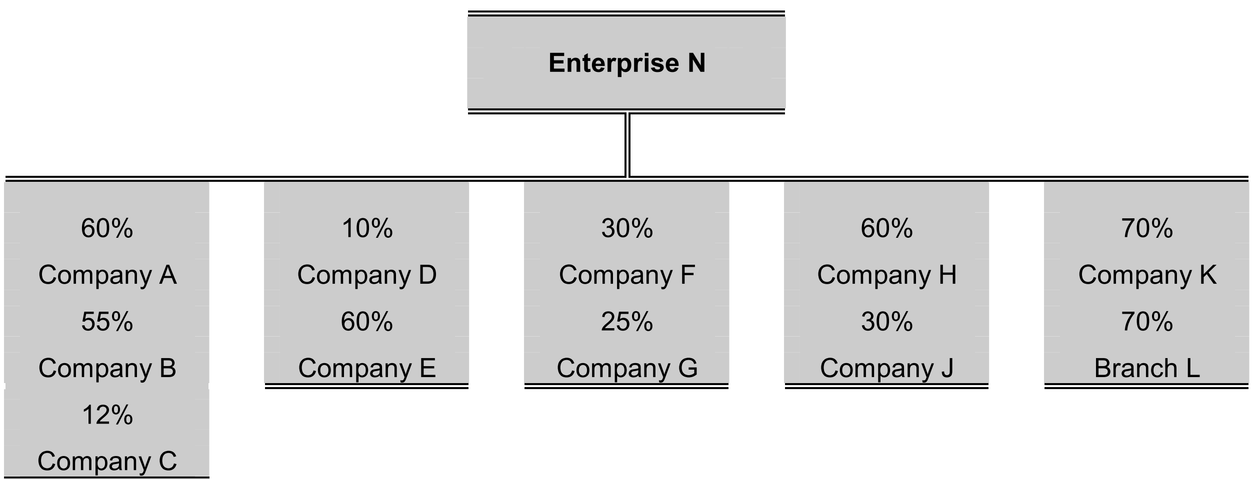
Company R is an associate of Enterprise N if N, its subsidiaries, and its other associated enterprises own not more than 50 percent of the shareholders' or members' voting power in R and if N and its subsidiaries have a direct investment interest in R. Thus Company R is an associate of N if N and its subsidiaries own between 10 and 50 percent of the shareholders' voting power in R.

(3) *Branches*

A direct investment branch is an unincorporated enterprise in the host country that
(a) is a permanent establishment or office of a foreign direct investor; or
(b) is an unincorporated partnership or joint venture between a foreign direct investor and third parties; or
(c) is land, structures (except those structures owned by foreign government entities), and immovable equipment and objects, in the host country, that are directly owned by a foreign resident. (Holiday and second homes owned by nonresidents are therefore regarded as part of direct investment); or
(d) is mobile equipment (such as ships, aircraft, and gas and oil drilling rigs) that operates within an economy for at least one year if accounted for separately by the operator and is so recognized by the tax authorities. (This is considered to be direct investment in a notional enterprise in the host country.)

Statistics based on those definitions should, as a matter of principle, cover all enterprises in which the direct investor has directly or indirectly a direct investment interest. For convenience, this approach is referred to as the Fully Consolidated System (FCS).

To illustrate the above definitions, assume Enterprise N has the following investments:



Under the FCS, Company A is a subsidiary of N. Company B is a subsidiary of A and thus a subsidiary of N even though only 33 percent of B is indirectly attributable to N. Company C is an associate of B and, through the chain of subsidiaries A and B, of N as well, even though only 4 percent of C is indirectly attributable to N. Company D is an associate of N, and Company E is a subsidiary of D and thus an associate of N even though only 6 percent of E is indirectly attributable to N. Company F is an associate of N, and G is an associate of F, but G is not an associate of N. Company H is a subsidiary of N, and Company J is an associate of H and thus an associate of N. Company K is a subsidiary of N, and L is a branch of K and thus of N. Thus direct investment statistics based on the FCS would cover A, B, C, D, E, F, H, J, K, and L, but not G.

Immediate Host/Investing Country

Geographic analysis of direct investment transactions is complicated by holding companies; that is, when the ultimate parent enterprise's investment in a foreign country is held through another subsidiary in a third country. Because the principle of classification used in balance of payments regional statistics is based on the change of ownership, direct investment flows should be compiled only in respect of the immediate host/investing country. The same rule applies for the international investment position statement; liabilities should be classified by the country of residence of the owner of the claim, and assets should be classified by the country of the liability holder. However, it is suggested that the stock of net assets of direct investment could also be compiled in respect of the ultimate host or controlling country, as supplementary information.

Income on Debt (Interest Accrued)

This consists of interest payable on intercompany debt to/from direct investors from/to associated enterprises abroad. It covers interest on the borrowing and lending of funds (including debt securities and suppliers' credits) between direct investors and direct investment enterprises.

Income on Equity

This comprises (1) dividends and distributed branch profits, and (2) reinvested earnings and undistributed branch profits. (See also *Dividends* and *Reinvested earnings and undistributed branch profits*.)

Indirectly Owned Direct Investment Enterprises

As a matter of principle, foreign direct investment statistics cover all enterprises in which direct investors have, directly or indirectly, a direct investment interest. The OECD's *Benchmark Definition of Foreign Direct Investment* and the IMF's *Balance of Payments Compilation Guide* describe the scope of enterprises, both directly and indirectly owned, that should be included in the definition. The OECD's specification of this group of enterprises is referred to as the Fully Consolidated System (FCS). (See also ***Fully consolidated system.***)

Individual Transactions Basis

Data collected on this basis consist of information collected for each of the transactions made by respondents, such as information collected from an international transactions reporting system (ITRS).

International Investment Position Statement

This comprises the balance sheet of the stock of external financial assets and liabilities of an economy. The concepts and guidelines for compiling international investment position data are set out in the fifth edition of the IMF *Balance of Payments Manual*.

International Transactions Reporting System (ITRS)

An ITRS measures individual balance of payments cash transactions passing through the domestic banks and may also measure (1) individual cash transactions passing through foreign bank accounts of enterprises, (2) noncash transactions, and (3) stock positions. Statistics are compiled from forms submitted by domestic banks to the compilers and may also be compiled from forms submitted by enterprises to the compiler.

Inward

The term refers to direct investment in the reporting economy.

L

Land and Buildings

All land and buildings located within an economy, except that owned by foreign governments (such as embassies) are, by convention, regarded as being owned by residents. If an actual owner is a nonresident, the owner is treated as if the ownership had been transferred to a resident notional institutional unit that is deemed to own the land and buildings. The nonresident has a financial investment in this notional unit, which is therefore treated as being a direct investment enterprise.

M

Market Price

This is the amount of money that willing buyers would pay to acquire a financial asset from a willing seller. The use of market prices for the valuation of assets and liabilities is one of the key principles of balance of payments compilation.

Most Comprehensive Data

This term refers to the direct investment statistics that are disseminated and based on the most comprehensive regularly available data sources. These data may be preliminary and subject to revision. If a country compiles and disseminates data that have the same periodicity and are based on the same sources and coverage, the “most comprehensive data” are the same as the “most timely data”.

Most Timely Data

The term refers to the direct investment statistics that are first disseminated; that is, the data with the shortest lapse of time between the end of the reference period (or the reference date) and dissemination of the data. Although disseminated, such data may be preliminary and subject to revision.

N

Natural Resources Exploration

When a direct investment enterprise is set up for the exploration of natural resources, inward direct investment flows provided to the direct investment enterprise by the direct investor located abroad that are used for exploration should be recorded as *Direct investment, Equity capital.*

Nomenclature générale des activités économiques dans les Communautés européennes (NACE)

This refers to the industrial classification as defined in Revision 1 that is used by Eurostat.

Non-voting Stocks

Equity/shares that do not give voting rights to the holder are called non-voting stocks. The category includes participating preference shares. (See also *Voting stocks*.)

O

Offshore Enterprises

In balance of payments statistics, the residency of so called “offshore enterprises” is attributed to the economies in which they are located without regard to the special treatment they may receive by the local authorities, such as exemptions from taxes, tariffs, or duties. This treatment applies to enterprises such as those engaged in the assembly of components manufactured elsewhere and in the processing of re-exported goods; those engaged in trade and financial operations; and those located in special zones (e.g., special trade zones, free-trade zones, or tax havens).

Other Capital

This term covers the borrowing or lending of funds between direct investors and subsidiaries, branches, and associates—including debt securities, suppliers’ credit, and nonparticipating, preferred shares (which are treated as debt securities), loans, trade credits, financial leases etc.

Outward

The term refers to direct investment abroad.

P

Periodicity

The concept refers to the period to which each data point relates, e.g., quarterly and annual data. Periodicity for transactions (flow) data is specified in terms of the interval represented by a single data point, while periodicity for position (stock) data is specified in terms of the interval between two data points. For example, quarterly periodicity for balance of payments data means that one quarter is the interval that is represented by a single estimate.

Perpetual Inventory Method

The process of deriving data on stocks from transaction data is known as the perpetual inventory method. Under this method, for which a stock estimate for some base point in time is required, the compiler may calculate the value of a stock at the end of a period as being equal to the value of the stock at the beginning of the period, plus the impact of transactions and nontransaction changes in the value of the stock during the period.

Q

Quasi-corporations

These are enterprises that produce goods and services in an economy other than their own but do not establish separate legal corporations in the host country. Quasi-corporations that are in a direct investment relationship with the parent enterprise are deemed to exist if:

- production is maintained for one year or more;
- a separate set of accounts is maintained for the local activities; and
- income tax is paid in the host country.

Quasi-corporations are often involved in construction or the operation of mobile equipment in another economy. The fifth edition of the IMF *Balance of Payments Manual (BPM5)* recommends that quasi-corporations be included in the direct investment data.

R

Reinvested Earnings and Undistributed Branch Profits

These comprise (1) direct investors' shares, in proportion to equity, held of earnings that foreign subsidiaries and associated enterprises do not distribute as dividends (i.e., reinvested earnings), and (2) earnings that branches and other unincorporated enterprises do not remit to direct investors (i.e., undistributed branch profits).

Reinvested Earnings of Indirectly Owned Direct Investment Enterprises

These are treated as follows under the Fully Consolidated System (FCS): assuming that: (a) Company A in country 1 owns 51 percent of Company B in country 2, which in turn owns 51 percent of Company C in country 3; and (b) the reinvested earnings of Company B are 500 and the reinvested earnings of Company C are 100, the income of Company A from reinvested earnings is 281, that is:

51% of the reinvested earnings of Company B: .51x500 = 255
51% of 51% of the reinvested earnings of Company C: .51(.51x100) = 26
Thus, 255 + 26 = 281.

(Table 4 of Annex I of the OECD *Benchmark Definition of Foreign Direct Investment* gives a more detailed example.)

Reverse Investment

The term refers to the acquisition by a direct investment enterprise of a financial claim on its direct investor. Because direct investment is recorded on a directional basis, capital invested by the direct investment enterprise in its direct investor (reverse investment) is regarded as an offset to capital invested in the direct investment enterprise by a direct investor and its related enterprises, except in instances when the equity participations are at least 10 percent in both directions.

When the claims are not sufficient to establish a second, separate direct investment relationship, the reverse investment transactions should be recorded according to the directional principle of the direct investment relationship as follows:

• As *Direct investment in the reporting economy: Claims on direct investors* in the data for the economy in which the direct investment enterprise is resident; and

• As *Direct investment abroad, Liabilities to affiliated enterprises* in the data for the economy in which the direct investor is resident.

When the equity participations are at least 10 percent in both directions, two direct investment relationships are established. In these circumstances, equity and other capital transactions between enterprises are recorded as direct investment claims and liabilities in both directions as follows:

- As *Direct investment abroad* for transactions on assets.
- As *Direct investment in the reporting economy* for transactions on liabilities.

S

Special Purpose Entities (SPEs)

These are: (1) generally organised or established in economies other than those in which the parent companies are resident, and (2) engaged primarily in international transactions but in few or no local operations. SPEs are defined either by their structure (e.g., financing subsidiary, holding company, base company, regional headquarters), or their purpose (e.g., sale and regional administration, management of foreign exchange risk, facilitation of financing of investment). SPEs should be treated as direct investment enterprises if they meet the 10 percent criterion. SPEs are an integral part of direct investment networks as are, for the most part, SPE transactions with other members of the group.

For SPEs that have the sole purpose of serving as financial intermediaries:

- all transactions, except those with affiliated banks and affiliated financial intermediaries, should be recorded in the direct investment data; and
- transactions with affiliated banks and affiliated financial intermediaries should be excluded from the direct investment data, except transactions in equity capital and permanent debt.

[Note that with effect from 2002 this recommendation has been amended to SPEs with the primary purpose of financial intermediation, not just those with the sole purpose of financial intermediation.]

T

Time of Recording

The time of recording for transactions and, hence, for holdings is governed by the principle of accrual accounting. For financial claims and liabilities, changes of ownership are considered to have taken place at (or be proxied by) the time that the parties to the transactions record them in their books or accounts. If no precise date can be fixed, the reporter may use the date on which the creditor received payment or the date on which some other financial claim was satisfied. For direct investment income data, dividends should be recorded as the date they are payable, reinvested earnings in the period in which they are earned, and income on debt as it is accrued.

Timeliness

This refers to the speed with which the data are disseminated; that is the lapse of time between the end of a reference period (or a reference date) and dissemination of the data. Note that if new data are disseminated only once a year, but the periodicity of the data is quarterly, the timeliness of the data refers to the lapse of time between the end of the first of the four newly disseminated quarters and the time of dissemination. For example, if at the end of March 2000 data are disseminated for the four quarters of 1999, the timeliness is "up to 12 months"; that is, the lapse of time between the first quarter of 1999 and end-March 2000.

Transactor Principle

There are two principles that may serve as the basis for geographic allocation of financial flows: the debtor/creditor principle and the transactor principle. Under the transactor principle, transactions resulting from changes in the claims and liabilities are allocated to the country of residence of the nonresident party to the transaction (the transactor), even if this is not the country of residence of the direct investment enterprise or direct investor. (See also *Debtor/creditor principle*.)

U

Ultimate Host/Investing Country

Geographic analysis of direct investment transactions is complicated by holding companies; that is, when the ultimate parent enterprise's investment in a foreign country is held through another subsidiary in a third country. The compilation of foreign direct investment statistics on income and financial flows based on the ultimate source of such flows would require a basis for the recording of transactions other than the change-of-ownership principle that is recommended in the fifth edition of the IMF *Balance of Payments Manual.* Therefore, direct investment flows should be compiled only in respect of the immediate host/investing country. The regional allocation of the international investment position statement should also be compiled on the basis of the immediate host or investing country. However, it is suggested that the stock of direct investment net assets could also be compiled in respect of the ultimate host or controlling country, as supplementary information.

United Nations International Standard Industrial Classification for all Economic Activities (ISIC)

This is the industrial classification as defined in the third version of ISIC.

V

Valuation of stocks

The fifth edition of the IMF *Balance of Payments Manual (BPM5)* and the OECD *Benchmark Definition of Foreign Direct Investment* recommend using market price as the basis for valuation. However, it is recognised that, in practice, book values from the balance sheets of direct investment enterprises (or investors) are often used to determine the value of the stock of direct investment. (See also *Book value* and *Market price*.)

Voluntary Reporting Requirements

The term describes situations where there is no legal obligation for reporters to provide the requested information.

Voting Stocks

These are equity/shares that give voting rights to the holder. They can either be “listed voting stocks” (that is, equity/shares that are listed on an official stock exchange), or “unlisted voting stock” (that is, equity/shares that are not listed on a official stock exchange). (See also *Non-voting stocks*.)