

## Direct Investment Concepts

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This presentation of direct investment is divided into two parts. The first discusses, in an overview, the basic concepts, definitions, and country and industry classification of data used in BEA's surveys of direct investment. The second details the direct investment financial transactions recorded as U.S. direct investment abroad (line 51) and foreign direct investment in the United States (line 64). (Direct investment

income (lines 14 and 31) is discussed in the chapter "Direct Investment Income").

### Basic Concepts and Definitions

#### 1 Direct investment

**1.1 Direct investment.**—Direct investment exists when an entity or group of related entities in one economy makes an investment in another economy that gives control, or a significant degree of influence, over the management of an entity resident in another economy. Generally, direct investment indicates a long-term relationship with the management of a foreign enterprise, and the enterprise is usually linked with the real output of the country in which it operates. Other private investment (sometimes referred to as portfolio investment), on the other hand, generally reflects short-term activity in financial markets, where the ability to shift funds between countries or financial investments is a major consideration.

**1.2 Ten-percent ownership.**—Ownership or control by an entity of 10 percent or more of a nonresident entity's voting securities of an incorporated entity, or the equivalent interest for an unincorporated entity, is considered evidence of ownership or control.<sup>1</sup> Thus, U.S. direct investment abroad (outward investment) is the ownership or control, directly or indirectly, by one U.S. entity of 10 percent or more of the voting securities of an incorporated foreign business enterprise, or an equivalent interest in an unincorporated foreign business enterprise. Foreign direct investment in the

1. See International Monetary Fund, *Balance of Payments and International Investment Position Manual*, 6<sup>th</sup> ed. (Washington, DC: International Monetary Fund, 2009); and Organisation for Economic Co-Operation and Development (OECD), *OECD Benchmark Definition of Foreign Direct Investment*, 4<sup>th</sup> ed. (Paris: OECD, 2008).

United States (inward investment) is the ownership or control, directly or indirectly, by one foreign entity of 10 percent or more of the voting securities of an incorporated U.S. business enterprise, or an equivalent interest in an unincorporated U.S. business enterprise. Other private investment (sometimes referred to as portfolio investment) refers to less than 10 percent ownership or control.

**1.3 Single owner.**—Direct investment refers to ownership by a single entity, or group of related entities, not to the combined ownership of all entities in a country. An “entity” is broadly defined to include (1) any individual, branch, partnership, associated group, estate, trust, corporation or other business organization, (2) any government, including a foreign government, the U.S. government, a state or local government, or any division thereof, and (3) any government-sponsored agency or government sponsored investment fund, such as a sovereign wealth fund. An associated group is treated in this definition as a single entity.

**1.4** However, in the case of direct investment by the U.S. government, any positions or transactions of the U.S. government with such an enterprise abroad are excluded from the outward direct investment accounts and are included, instead, in the appropriate government or military accounts. In contrast, direct investment by foreign governments (including any of their agencies and corporations) in U.S. business enterprises is included in the inward direct investment account.

**1.5** An associated group consists of two or more entities who exercise their voting privileges in a concerted manner—by the appearance of their actions, by agreement, or by an understanding—in order to influence the management of a nonresident business enterprise. The following are deemed associated groups: (1) members of the same family, (2) a business enterprise and one or more of its officers or directors, (3) members of a syndicate or joint venture, and (4) a corporation and its domestic subsidiaries. Thus, direct investment is considered to exist as long as the combined ownership interest of all members of the group is at least 10 percent, even if no one mem-

ber owns 10 percent or more. The definition assumes, in effect, that the members’ influence over management is comparable with that of a single entity with the same ownership interest.

**1.6** Because direct investment is defined from a single-owner viewpoint, it excludes investment in enterprises in which ownership is so dispersed that no one owner in another economy has an interest of 10 percent or more and the owners do not, or cannot, act in concert to influence management.

**1.7** The single-owner viewpoint also means that investment by a U.S. entity of less than 10 percent in a foreign business enterprise is not considered direct investment, even if another U.S. entity has an interest of at least 10 percent in the enterprise. Thus, if one U.S. entity owns 11 percent and another owns 9 percent, the 11 percent interest is included, but the 9 percent interest is excluded. However, if two or more U.S. entities each hold an interest of at least 10 percent, and are not associated with each other, each such interest is included.

**1.8 Direct and indirect ownership.**—A direct investment ownership in a foreign business enterprise can result from direct or indirect ownership by a U.S. entity. For *outward investment*, it is *directly* held if the U.S. entity itself holds the ownership interest in the foreign business enterprise. It is *indirectly* held if one or more tiers of ownership exist between the foreign business enterprise and the U.S. entity. For example, a foreign business enterprise may be directly owned by another foreign business enterprise that is, in turn, owned by the U.S. entity. A U.S. entity’s percentage of indirect voting ownership in a given foreign business enterprise is equal to the direct-voting-ownership percentage of the U.S. entity in the first foreign business enterprise in the ownership chain, times the first enterprise’s direct-voting-ownership percentage in the second foreign business enterprise in the chain, times the corresponding percentages for all intervening enterprises in the chain, times the last intervening enterprise’s direct-voting-ownership percentage in the given foreign business enterprise. If more than one ownership chain exists, the percentages of direct and indirect ownership in all the chains are summed

to determine the U.S. entity's ownership percentage. For *inward direct investment*, the ownership percentage of a foreign entity in a given U.S. business enterprise is calculated in a parallel manner.

## 2 Direct investor

2.1 The direct investor is the entity that has a 10-percent or more direct or indirect ownership interest in a business enterprise located in another country. For *outward investment*, the direct investor is referred to as the "U.S. parent." If incorporated, the U.S. parent is the fully consolidated domestic U.S. enterprise that consists of (1) the U.S. corporation whose voting securities are not owned more than 50 percent by another U.S. corporation, and (2) proceeding down each ownership chain from that U.S. corporation, any U.S. corporation whose voting securities are more than 50 percent owned by the U.S. corporation above it in the chain. All other U.S. corporations and all foreign business enterprises owned by the U.S. parent are excluded from the full consolidation.

2.2 For *inward investment*, the direct investor is referred to as the "foreign parent," but the concept is defined much more narrowly than that of "U.S. parent" for outward investment. The foreign parent is the first foreign entity outside the United States in a U.S. affiliate's ownership chain that has direct investment in the affiliate. Thus, while for outward investment the parent includes all members of the fully consolidated U.S. enterprise, for inward investment it includes only the first foreign entity outside the United States and excludes all other affiliated foreign entities. However, the direct investment accounts include direct transactions of U.S. business entities with all of the affiliated foreign entities that, together with the foreign parent, constitute the "foreign parent group."

2.3 The foreign parent group, which is conceptually analogous to the U.S. parent for outward investment, consists of (1) the foreign parent, (2) any foreign entity, proceeding up the foreign parent's ownership chain, that owns more than 50 percent of the entity below it up to and including the ultimate beneficial owner (the entity that is not owned more than 50 percent by another entity), and (3) any foreign entity, proceeding down the ownership chain of each of

these members, that is owned more than 50 percent by the entity above it. Because the members of the foreign parent group may be located in different countries, transactions of a U.S. business entity with members of the foreign parent group are classified in the U.S. balance of payments accounts by the respective country of each member.

## 3 Affiliates

3.1 **Affiliates.**—Affiliates are enterprises that are directly or indirectly owned or controlled by an entity in another country to the extent of 10 percent or more ownership of the voting stock for an incorporated business, or an equivalent interest for an unincorporated business.

3.2 A business *enterprise* is any organization, association, branch, venture, or ownership of real estate that exists for profit-making purposes or to otherwise secure economic advantage. Therefore, by definition, a business enterprise excludes the ownership of real estate for personal use. A business enterprise may be either incorporated or unincorporated. Unincorporated business enterprises include branches, partnerships, and sole proprietorships.

## 4 Exclusions

4.1 Excluded from direct investment are intercompany debt transactions among certain affiliated nonbank *financial* corporations. These transactions are classified as nonbank claims and liabilities because the nature of the transactions is related to the underlying activity of financial intermediation rather than to activity typical of a direct investment relationship. These financial intermediary accounts consist of transactions between firms in a direct investment relationship (that is, between U.S. parents and their foreign affiliates or between U.S. affiliates and their foreign parent groups), where both the U.S. and foreign firms are classified in a finance industry (excluding insurance), but the firms are neither banks nor securities brokers. (Equity investments among these affiliated nonbank financial corporations remain in direct investment because these transactions are indicative of a direct investment ownership interest in the affiliate).

4.2 Transactions among banks and their affiliates, and among securities brokers and dealers and their affiliates, are also excluded from direct investment and combined with these institutions' transactions with unaffiliated entities as other private investment. The combination groups together transactions related to the underlying activity of financial intermediation, regardless of the affiliation of the enterprises.

4.3 Also excluded from direct investment, by definition, are transactions in financial derivatives and employee stock options; these transactions are included as a separate functional category in the international accounts. Even if transactions in financial derivatives are conducted by a direct investor or direct investment affiliate, they are considered as transactions in financial instruments rather than transactions between a direct investor and an affiliated or unaffiliated entity. No transactions in employee stock options are currently included in the international accounts because of the lack of appropriate source data.

4.4 Equity in international organizations is also excluded, even in cases in which voting power is 10 percent or more; these equity contributions are included in other private investment.

## **U.S. Direct Investment Abroad (USDIA)**

### **5 U.S. parent—USDIA**

5.1 A U.S. parent is a U.S. entity that has direct investment—that is, a 10-percent-or-more direct or indirect ownership interest—in a foreign business enterprise. Because a U.S. parent is an entity in the broad sense mentioned earlier, it may be a business enterprise, a religious, charitable, or other nonprofit organization, an individual, a government, an estate or trust, an investment fund, or another organization. In actuality, almost all U.S. parents are business enterprises.

5.2 Each U.S. parent that is an incorporated business enterprise is required to report to BEA on a fully consolidated domestic (U.S.) basis. The full consolidation includes the U.S. corporation with the direct investment ownership interest in a foreign business

enterprise and all other U.S. corporations in which the parent directly or indirectly owns more than 50 percent of the outstanding voting interests. The consolidation excludes all other U.S. corporations and all foreign business enterprises owned by the U.S. parent.

5.3 When a U.S. individual or other nonbusiness entity (such as a nonprofit organization or a government) owns more than 50 percent of a U.S. business enterprise that owns a foreign business enterprise, the U.S. business enterprise, not the individual or the other nonbusiness entity, is considered the parent. This treatment ensures that data on the transactions and positions of the U.S. business enterprise with the foreign business enterprise are included in the foreign-affiliate data reported to BEA and in the direct investment accounts.

5.4 The U.S. government may have equity investment in a foreign business enterprise, but such investments are not covered by BEA's direct investment surveys. Data on such investments are reported to other government agencies and are included by BEA in the U.S. government accounts, rather than in the direct investment accounts, of the U.S. international transactions accounts and the international investment position.

5.5 In the case of a U.S. estate, the estate itself, not its beneficiary, is considered the U.S. parent. However, for a U.S. trust, either the beneficiary or the creator of the trust may be considered the U.S. parent with respect to any investments of the trust, depending on the circumstances. The U.S. creator is considered the parent if there is a reversionary interest—that is, if the interest in the trust may be returned to the creator after a period of time—or if the creator is a corporation or other organization that designates its own shareholders or members as beneficiaries. In all other cases, the beneficiary is considered the parent.

### **6 Foreign affiliate—USDIA**

6.1 A foreign affiliate is a foreign business enterprise in which there is U.S. direct investment. The affiliate is called a *foreign* affiliate to denote that it is located outside the United States.

6.2 A business enterprise is any organization, association, branch, venture, or the ownership of real estate that exists for profitmaking purposes or to otherwise secure economic advantage. Therefore, by definition, a business enterprise excludes the ownership of real estate for personal use. A residence that is leased to others by an owner who intends to reoccupy it is considered real estate held for personal use and not as a business enterprise.

6.3 A foreign affiliate may be either incorporated or unincorporated. Unincorporated affiliates primarily take the form of branches and partnerships. They may also include directly held commercial property.

6.4 A foreign affiliate that is a branch consists of operations or activities in a foreign country that a U.S. parent conducts in its own name rather than through an entity separately incorporated abroad. By definition, a branch is wholly owned. If a company is incorporated in the United States but carries out substantially all of its operations abroad, its foreign operations are treated by BEA as a branch (and therefore as a foreign affiliate) even though the U.S. company itself may consider the operations to be an integral part of, and would normally consolidate them with, its own operations and accounts.

6.5 In general, the foreign operations or activities of a U.S. parent are considered to be a foreign affiliate if they are legally or functionally separable from the domestic operations or activities of the U.S. parent. In most cases, it is clear whether the foreign operations or activities constitute a foreign affiliate. If an operation or activity is incorporated abroad—as most are—it is always considered a foreign affiliate.

6.6 The situation is not always so clear with unincorporated foreign operations or activities. Most are legally or functionally separable from those of the U.S. parent and thus are considered foreign affiliates, but some are not clearly separable, and the determination of whether they constitute a foreign affiliate is made on a case-by-case basis, depending on the weight of the evidence. The following characteristics would indicate that the unincorporated operation or

activity is probably a foreign affiliate:

- The operation or activity is subject to foreign income taxes.
- It has a substantial physical presence abroad, as evidenced by plant and equipment or by employees that are permanently located abroad.
- It has separate financial records that would allow the preparation of financial statements, including a balance sheet and income statement. (A mere record of disbursements to, or receipts from, the foreign operation or activity would not constitute a “financial statement” for this purpose.)
- It takes title to the goods it sells and receives revenues from the sale, or it receives funds from customers for its own account for services it performs.

6.7 The following characteristics would indicate that the unincorporated operation or activity is probably not a foreign affiliate:

- The operation or activity is not subject to foreign income taxes.
- It has limited physical assets or few employees permanently located abroad.
- It has no separate financial records that allow the preparation of financial statements.
- It conducts business abroad only for the U.S. entity’s account, not for its own account. It engages only in sales promotion or public relations activities on behalf of the U.S. person.
- Its expenses are paid by the U.S. parent.

6.8 Consistent with these guidelines, the foreign stations, ticket offices, and terminals or port facilities of a U.S. airline or ship operator that provide services only to the airline’s or ship operator’s own operations are not considered foreign affiliates, because most of the revenues, such as passenger fares and freight

charges, collected by these facilities are generated by the travel and transportation services rendered by the airline or ship operator of which they are a part, not by the activities of these facilities. However, if the facilities provide services to unaffiliated persons, they are considered foreign affiliates.

6.9 In general, each foreign affiliate is required to report separately to BEA. However, consolidation of affiliates in the same country is permitted if the affiliates are in the same NAICS-based four-digit industry or are integral parts of the same business operation. (For example, if Mexican affiliate A manufactured automobile engines and a majority of its sales were to Mexican affiliate B, which assembled automobiles, then affiliates A and B can be consolidated.) Under no circumstances are affiliates in different countries permitted to be consolidated. (See the section “Classification by Industry—USDIA and FDIUS” for a statement of general principles.)

6.10 A majority-owned foreign affiliate (MOFA) is a foreign affiliate in which the combined direct and indirect ownership interest of all U.S. parents exceeds 50 percent. Data for MOFAs rather than for all foreign affiliates are required in order to examine the foreign investments over which U.S. parents exert unambiguous control. (In some instances, the U.S. parent(s) may be under the control of a foreign parent company.) Additionally, some aspects of affiliate operations can only be analyzed from the perspective of MOFA operations, because the necessary data items are not collected for other affiliates.

## Foreign Direct Investment in the United States (FDIUS)

### 7 Foreign owners—FDIUS

7.1 The existence of direct investment in a U.S. affiliate is determined solely on the basis of the voting shares (or the equivalent) held by its foreign parent. To more completely describe the foreign ownership of a U.S. affiliate, however, reference must be made to two additional entities—the ultimate beneficial owner and the foreign parent group. All three concepts are necessary to identify fully the owners of U.S. affiliates.

7.2 The *foreign parent* of a U.S. affiliate must be identified to establish that foreign direct investment does in fact exist. The *ultimate beneficial owner (UBO)* of each U.S. affiliate is identified to determine the entity that ultimately owns or controls and, therefore, ultimately derives the benefits from owning or controlling the U.S. affiliate. (UBOs that are individuals are not required to be identified by name; however, their countries of location are required to be reported to BEA.) Members of the *foreign parent group (FPG)* are identified to distinguish foreign enterprises that are affiliated with a U.S. affiliate from those that are not.

7.3 The U.S. affiliate’s transactions with all these entities are included in the goods, services, investment income, and financial accounts of the U.S. international transactions accounts, but are not always separately identified, and the direct investment positions in the U.S. affiliate that are held by all members of the foreign parent group, not just by its foreign parent, are included in the foreign direct investment position in the United States.

7.4 A given U.S. affiliate may have more than one ownership chain above it, if it is owned at least 10 percent by more than one foreign enterprise. In such cases, the affiliate may have more than one foreign parent, UBO, and foreign parent group.

7.5 A *foreign parent* is the *first* entity outside the United States in a U.S. affiliate’s ownership chain that has a direct investment interest in the affiliate. All other affiliated foreign entities are excluded.

7.6 The *ultimate beneficial owner (UBO)* of a U.S. affiliate is that entity proceeding up the affiliate’s ownership chain, beginning with and including the foreign parent, that is not owned more than 50 percent by another entity. The UBO excludes other affiliated entities. If the foreign parent is not owned more than 50 percent by another entity, the foreign parent and the UBO are the same. Unlike the foreign parent, the UBO may be either a U.S. entity or a foreign entity (though most are foreign).

7.7 Both the foreign parent and the UBO may be business enterprises, or they may be religious,

charitable, or other nonprofit organizations; individuals; governments; estates or trusts; associated groups; and so forth. In the case of a foreign estate, the estate, not its beneficiary, is considered the foreign parent or UBO. For the investments of a foreign trust, either the creator or the beneficiary of the trust may be considered the foreign parent or UBO, depending on the circumstances. The creator is considered the foreign parent or UBO if the creator is a corporation or other organization that designates its own shareholders or members as beneficiaries or if there is a reversionary interest—that is, the interest in the trust may later be returned to the creator. In all other cases, the beneficiary of the trust is considered the foreign parent or UBO.

7.8 A *foreign parent group (FPG)* consists of (1) the foreign parent, (2) any foreign entity, proceeding up the foreign parent’s ownership chain, that owns more than 50 percent of the entity below it, up to and including the UBO, and (3) any foreign entity, proceeding down the ownership chain(s) of each of these members, that is owned more than 50 percent by the entity above it.

## 8 U.S. affiliate—FDIUS

8.1 A U.S. affiliate is a U.S. business enterprise in which there is foreign direct investment. The affiliate is called a *U.S. affiliate* to denote that it is located in the United States.

8.2 A business enterprise is any organization, association, branch, venture, or the ownership of real estate that exists for profitmaking purposes or to otherwise secure economic advantage. Therefore, by definition, a business enterprise excludes the ownership of real estate for personal use. A residence that is leased to others by an owner who intends to reoccupy it is considered real estate held for personal use and not a business enterprise.

8.3 A U.S. affiliate may be either incorporated or unincorporated. Unincorporated affiliates primarily take the form of branches and partnerships. They may also include directly held commercial property.

8.4 A U.S. affiliate that is a branch consists of operations or activities in the United States that a foreign parent conducts in its own name rather than through an entity separately incorporated in the United States. By definition, a branch is wholly owned. If a company is incorporated abroad but carries out substantially all of its operations in the United States, its U.S. operations are treated by BEA as a branch (and therefore as a U.S. affiliate), even though the foreign company itself may consider the operations to be an integral part of, and would normally consolidate them with, its own operations and accounts.

8.5 In general, the U.S. operations or activities of a foreign parent are considered to be a U.S. affiliate if they are legally or functionally separable from the foreign operations or activities of the foreign parent. In most cases, it is clear whether the U.S. operations or activities constitute a U.S. affiliate. If an operation or activity is incorporated in the United States—as most are—it is always considered a U.S. affiliate.

8.6 The situation is not always so clear with unincorporated U.S. operations or activities. Most are legally or functionally separable from those of the foreign owner and thus are considered U.S. affiliates, but some are not clearly separable, and the determination of whether they constitute U.S. affiliates is made on a case-by-case basis, depending on the weight of evidence. The following characteristics would indicate that the unincorporated operation or activity probably is a U.S. affiliate:

- It is subject to U.S. income taxes.
- It has a substantial physical presence in the United States, as evidenced by plant and equipment or employees that are permanently located in the United States.
- It has separate financial records that allow the preparation of financial statements, including a balance sheet and income statement. (A mere record of disbursements to, or receipts from, the U.S. operation or activity would not constitute a “financial statement” for this purpose.)

- It takes title to the goods it sells and receives revenues from the sale, or it receives funds from customers for its own account for services it performs.

8.7 The following characteristics would indicate that the unincorporated operation or activity probably is not a U.S. affiliate:

- It is not subject to U.S. income taxes.
- It has limited physical assets or few employees permanently located in the United States.
- It has no separate financial records that allow the preparation of financial statements.
- It conducts business in the United States only for the foreign entity's account, not for its own account.
- It engages only in sales promotion or public relations activities.
- Its expenses are paid by the foreign parent group.

8.8 Consistent with these guidelines, the U.S. stations, ticket offices, and terminal or port facilities of a foreign airline or ship operator that provide services only to the airline's or ship operator's operations are not considered U.S. affiliates, because most of the revenues, such as passenger fares and freight charges, collected by these facilities are generated by the travel and transportation services rendered by the airline or ship operator of which they are a part, not by the activities of these facilities. However, if the facilities provide services to unaffiliated persons, they are considered U.S. affiliates.

8.9 Each U.S. affiliate is required to report to BEA on a fully consolidated domestic (U.S.) basis. The full consolidation includes all other U.S. affiliates of the foreign parent in which the affiliate directly or indirectly owns more than 50 percent of the outstanding voting interest. The consolidation excludes all other U.S. business enterprises and all foreign business enterprises owned by the U.S. affiliate.

8.10 There are two exceptions to this general consolidation rule. First, a given U.S. affiliate may be excluded from full consolidation because of the lack of effective control. Second, a U.S. affiliate in which a direct ownership interest is held by one foreign enterprise and an indirect ownership interest is held by another foreign enterprise is not permitted to be consolidated in the report to BEA of another U.S. affiliate; this rule ensures that data on transactions and positions of both owners can be obtained from the affiliate.

8.11 The general approach to classification by industry of U.S. affiliates for inward investment is the same as for foreign affiliates for outward investment. See the section "Classification by Industry—USDIA and FDIUS" for a statement of general principles.

## 9 Classification by country—USDIA

9.1 For *outward direct investment*, each foreign affiliate is classified by its country of location—that is, the country in which the affiliate's physical assets are located or in which its primary activity is carried out. In most cases, the country of location of a business enterprise is the same as its country of organization or incorporation. However, in some cases, a business enterprise is incorporated in one country, but part or all of its physical assets are located or its activities are carried out in a second country. If all its physical assets or operations are located in a single foreign country outside its country of incorporation, the enterprise is treated as an incorporated foreign affiliate in the country where its physical assets and operations are located. However, if an enterprise has some physical assets or operations in each country, it is considered two affiliates—an incorporated affiliate located in the country of incorporation and an unincorporated affiliate located in the other country.

9.2 These general rules have three exceptions. First, if a business enterprise that is incorporated in one foreign country has all of its physical assets or operations in more than one other foreign country, an incorporated foreign affiliate is deemed to exist in the country of incorporation, even though the enterprise may have no physical assets or operations in that

country. Unincorporated foreign affiliates are deemed to exist in the other foreign countries. In effect, the affiliate in the country of incorporation is considered a holding company whose assets are the equity it holds in the unincorporated affiliates in the other countries. Second, if a business enterprise that is incorporated abroad by a U.S. enterprise conducts its operations from, and has all of its physical assets in the United States, it is treated as an incorporated foreign affiliate in the country of incorporation, even though it has no operations or physical assets there. This treatment ensures that the foreign entity is reported to BEA. Third, affiliates that have operations spanning more than one country and that are engaged in petroleum shipping, other ocean transportation, or offshore oil and gas drilling are classified in the country of residence of the operator of the ship or the equipment.

9.3 Balance of payments transactions between parents and affiliates are recorded against the country of the affiliate with which the U.S. parent had a direct transaction, even if the transaction may reflect indirect claims on, liabilities to, or income from indirectly held affiliates in third countries. For example, if a U.S. parent company acquires all of the equity in a German manufacturer for \$100 million and channels the purchase through its holding-company affiliate in the Netherlands, then both the direct investment financial flow and the direct investment position would be recorded against the Netherlands, because that is the country of the affiliate with which the U.S. parent had a direct transaction.

9.4 Transactions with third-country transactors involving a given affiliate are classified in the affiliate's country of location. For example, if a U.S. parent purchases a Japanese affiliate's capital stock from a French resident, then the resulting direct investment financial flow would be classified in Japan because such flows change the U.S. direct investment position in that country. (However, the associated settlement flows, which would be included in other financial accounts of the U.S. international transactions accounts, would likely be classified in France.)

## 10 Classification by country—FDIUS

10.1 For *inward direct investment*, transactions and positions of U.S. affiliates are classified by country of each member of the foreign parent group, rather than strictly by country of the foreign parent, because a U.S. affiliate may have transactions and direct positions with members of the group other than its foreign parent. For example, the affiliate may borrow funds from, or lend funds to, another member of the group located in a country that is different from that of the foreign parent.

10.2 For U.S. affiliates that have more than one UBO or foreign parent, the data for a given affiliate are classified by the country of the UBO or the foreign parent that had the largest ownership share in the affiliate. For most affiliates, the country of the UBO is the same as that of the foreign parent. However, the patterns of transactions and of positions by country of the foreign parent versus the country of the UBO may differ significantly in some cases.

## 11 Classification by industry—USDIA and FDIUS

11.1 U.S. parents and their foreign affiliates and foreign parents and their U.S. affiliates are classified according to International Surveys Industry (ISI) classifications. The classifications and their code numbers are adapted by BEA from the 2007 North American Industry Classification System (NAICS). For the most part, the ISI classifications are equivalent to NAICS four-digit industries; at its most detailed level, NAICS classifies industries at a six-digit level. The ISI classification system is less detailed than NAICS because it is designed for classifying enterprises rather than establishments (or plants). A list and a description of the NAICS-based ISI codes are presented in *Guide to Industry Classifications for International Surveys, 2007*, available on BEA's web site at <http://www.bea.gov/surveys/pdf/be799.pdf>.

11.2 Because many direct investment enterprises are active in several industries, it is not meaningful to

classify all their data in a single industry if that industry is defined too narrowly. Each U.S. parent or foreign affiliate and each U.S. affiliate is classified by industry on the basis of its sales (or for holding companies, on the basis of its total income) in a three-step procedure. First, a given parent or affiliate is classified in the NAICS sector that accounts for the largest percentage of its sales.<sup>2</sup> Second, within the sector, the parent or affiliate is classified in the three-digit subsector in which its sales are largest; a three-digit subsector consists of all four-digit industries that have the same first three digits in their four-digit ISI code. Third, within its three-digit subsector, the parent or affiliate is classified in the four-digit industry in which its sales are largest. This procedure ensures that the U.S. parent or foreign affiliate is not assigned to a four-digit industry outside either its sector or its three-digit subsector.

11.3 The following example illustrates the three-stage classification procedure. Suppose the sales of an

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2. The sectors used were agriculture, forestry, fishing, and hunting; mining, quarrying, and oil and gas extraction; utilities; construction; manufacturing; wholesale trade; retail trade; transportation and warehousing; information; finance and insurance; real estate and rental and leasing; professional, scientific, and technical services; management of companies and enterprises; administrative and support, waste management, and remediation services; educational services; health care and social assistance; arts, entertainment, and recreation; accommodation and food services; and other services.

affiliate were distributed as follows:

Code	Percentage of total sales
All industries.....	100
Manufacturing .....	55
333 Machinery .....	30
3331 Agriculture, construction, and mining machinery .....	10
3332 Industrial machinery .....	15
3336 Engines, turbines, and power transmission equipment .....	5
334 Computers and electronic products .....	25
3344 Semiconductors and other electronic products...	25
Wholesale trade .....	45
423 Durable goods merchant wholesalers.....	45
4238 Machinery, equipment, and supplies merchant wholesalers.....	45

11.4 The affiliate’s major industry is manufacturing because 55 percent of the affiliate’s sales are in manufacturing and only 45 percent are in wholesale trade. Because the largest share of the affiliate’s sales in manufacturing is in the three-digit subsector 333, the affiliate’s three-digit subsector is 333 (machinery). Finally, because its sales within subsector 333 are largest in industry 3332, the affiliate’s four-digit industry is 3332 (industrial machinery). Thus, the affiliate is assigned to industry 3332, even though its sales in that industry are smaller than its sales in either industry 3344 or industry 4238.