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Valuation of Direct Investment

by

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Valuation of Foreign Direct Investment Equity Capital

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Disclaimer: This note should not be reported as representing the views of the IMF. The views expressed in this note are those of the author and do not necessarily represent those of the IMF or IMF policy.
1. The IMF’s *Balance of Payments Manual*, fifth edition (*BPM5*) recommends that market price be used as the basis of valuation for both transactions and stocks (para. 91). Thus, transactions are generally valued at the actual prices agreed upon by transactors; stocks of assets and liabilities are valued at market prices in effect at the time to which the balance sheet relates. These principles are in accord with those presented in the *System of National Accounts 1993* (*1993 SNA*).

2. National compilers can generally implement the market price principle for foreign direct investment (FDI) transactions and for the stock of FDI capital of enterprises that are listed on a stock exchange. However, they have difficulties in implementing the principle for unlisted companies, that is, unquoted shares. Thus, it is not surprising that the results of the joint IMF/OECD Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI) for 2001 showed that only 21 countries valued their inward FDI equity capital at market values (even fewer valued their outward equity capital at market values).¹

3. At the international level, work is presently underway to revise the *BPM5* (issued in 1993) and to review the *1993 SNA*.² At the IMF, the work is being undertaken in conjunction with the work program of the IMF Committee on Balance of Payments Statistics (the Committee). The work on the revision of the *BPM5* guidelines for FDI statistics is being conducted in close collaboration with the OECD, which is revising the *OECD Benchmark Definition of Foreign Direct Investment*, third edition (*Benchmark Definition*) under the guidance of the OECD’s Workshop on International Investment Statistics.

4. The work on revision of the guidelines for FDI has largely been completed. The IMF and the OECD, together with FDI experts who participated in a Direct Investment Technical Expert Group, devoted considerable time deliberating the valuation of FDI equity capital, especially with respect to the valuation of unquoted shares.

5. Like the *BPM5*, the new balance of payments guidelines will recommend that market price is the basis for valuation of flows and stocks, including those for direct investment. Moreover, in reaffirming the market price principle, the Committee agreed to give it greater

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¹ The SIMSDI is a database that contains standardized information on country practices in compiling and disseminating FDI statistics. The results of the 2001 survey, which covered 61 countries, including all of the OECD countries, are available at: [http://www.imf.org/external/np/sta/di/mb97.htm](http://www.imf.org/external/np/sta/di/mb97.htm). Individual country metadata in respect of compilation practices in 2003 are also available for 54 countries. Cross-country comparison tables have not been prepared for the 2003 survey.

² A first draft of the chapters of the new balance of payments manual is planned for December 2006.
emphasis in the new balance of payments manual. Similarly, the new *Benchmark Definition* will reaffirm the market price principle.

6. At the same time, the Committee recognized that national compilers needed detailed guidance on how to implement the market price principle in practice. This was especially the case because accounting standards had not been harmonized internationally with respect to fair value accounting. For unquoted shares, therefore, the Committee considered several alternatives (depending on circumstances) as acceptable proxies for market valuation. These included: recent transaction price; net asset value (with or without intangibles); own funds at book value; and capitalization ratio. Each of the proxy methods is defined below.

*Recent transaction price:* unlisted companies are sometimes disposed of/acquired and thus recent transactions values may be used to derive the market value of the FDI equity positions. However, a drawback of this method is that it difficult to adjust over time.

*Net asset value:* with this method, all financial and non-financial assets and liabilities of the enterprise are valued at current period prices. Ideally, the valuations should be based on recent appraisals and, if feasible, include intangible assets. Although goodwill and other intangible assets may account for a large proportion of the current value, it may not be possible to estimate these assets.

*Own funds at book value (OFBV):* this method draws on data from the books of the direct investment enterprise, viz., capital stock, retained earnings, and reserves from equity. A major advantage of this method is that it promotes consistent valuations between the economies of the direct investor and the direct investment enterprise and the data can be gathered from enterprise surveys. Many of the large FDI-investing countries employ this method. A drawback is that it may not revalue non-financial assets.

*Capitalization ratio:* represents a ratio of the stock exchange price to OFBV for the same set of listed companies, at the economy level or industry groups. The ratios can be used to estimate the market value of equity in unlisted companies by multiplying OFBV of unlisted direct investment enterprises by the capitalization ratio(s).

7. Through its technical assistance program, the IMF’s Statistics Department will assist countries to implement these measures, as circumstances permit. Guidance will be provided in the new balance of payments manual, in the IMF’s *Balance of Payments Compilation Guide*, to be revised following release of the new manual, and in the *Benchmark Definition*. 