

CHAPTER IV

INVESTOR NATIONALITY: POLICY CHALLENGES



A. INTRODUCTION: THE INVESTOR NATIONALITY CONUNDRUM

1. Complex ownership and investor nationality

Firms, and especially affiliates of multinational enterprises (MNEs), are often controlled through hierarchical webs of ownership involving a multitude of entities. More than 40 per cent of foreign affiliates are owned through complex vertical chains with multiple cross-border links involving on average three jurisdictions. Corporate nationality, and with it the nationality of investors in and owners of foreign affiliates, is becoming increasingly blurred.

Complex corporate structures have become increasingly notorious in recent years. They feature prominently in the debate on tax avoidance by MNEs, because investment schemes involving offshore financial centres, special purpose entities and transit FDI have proved to be an important tool in MNE tax minimization efforts (WIR15). They are also central to the discussion on illicit financial flows because they enable, channel or launder the proceeds of tax evasion, corruption or criminal activities. As a result, complex ownership structures are at times portrayed as suspect and contrary to good corporate governance practices.

At the same time, with the increasing integration of the world economy and the growth of global value chains (GVCs, see WIR13) the international production networks of MNEs have become more and more complex. This growing complexity is inevitably reflected in corporate structures.

- MNEs see continued *growth*. They exploit economies of scale and scope and competitive advantages over smaller rivals to expand, enter new markets, and add new businesses, often at a rapid pace.
- The increasing *fragmentation* of production in GVCs leads MNEs governing such chains to break up their business in smaller parts in order to place each part in the most advantageous location, or to dispose of certain parts deemed non-core and focus on others.
- Modern production methods require component parts of production networks to be nimble and to engage with third parties in non-equity relationships, joint ventures, or other forms of *partnership*.
- The dynamics of global markets are further causing MNEs to frequently reassess their portfolio of activities and engage in *mergers and acquisitions* (M&As), often causing affiliates to change hands, moving from one corporate structure to form part of another.

The result is ever “deeper” corporate structures (with affiliates ever further removed from corporate headquarters in chains of ownership), dispersed shareholdings of affiliates (with individual affiliates being owned indirectly through multiple shareholders), cross-shareholdings (with affiliates owning shares in each other), and shared ownerships (e.g. in joint ventures).

It follows that complexity in corporate structures is often the result of growth, fragmentation, partnerships, and M&As, and not necessarily in and of itself a sign of corporate malfeasance. Nonetheless, MNEs will endeavour to affect any change in ownership structures in the most advantageous manner possible, especially from a fiscal and risk management perspective. They may thus add further elements of complexity to any transaction. Thus, business- and non-business-driven elements of complexity in corporate structures often go hand in hand and can be difficult to separate.

Whether elements of complexity in corporate structures are motivated by legitimate business considerations or are rather a sign of excessive tax planning, of deliberate attempts to obfuscate beneficial ownership, of opaque governance or of any other not strictly business-driven consideration is not the primary concern of this chapter. Whatever the reasons for the increasing complexity in the internal ownership structures of MNEs, it is undeniably the case that more and more entities residing in more and more countries are ultimately involved in owning and controlling more and more foreign affiliates.

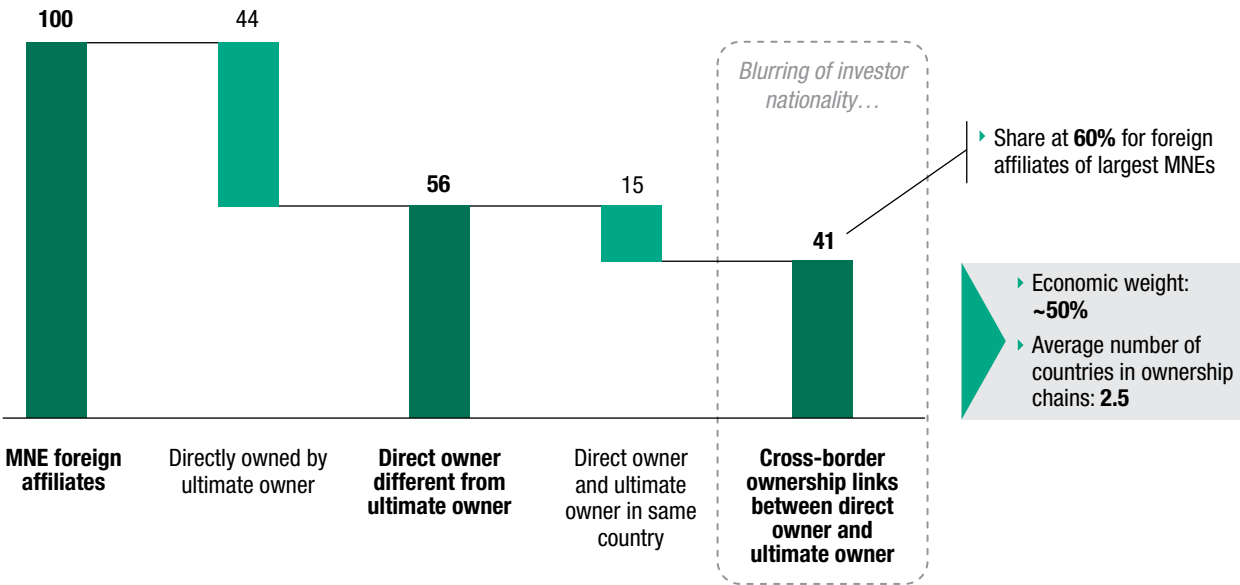
To illustrate the point, figure IV.1 shows how about 41 per cent of foreign affiliates worldwide are ultimately owned by their corporate parent through an ownership chain with at least one intermediate affiliate based in a country different from that of the ultimate owner. Moreover, these affiliates tend to be larger than directly owned affiliates (which are often part of smaller MNEs) and account for almost 50 per cent in revenue terms. On average, the same foreign affiliates are owned by entities located in three jurisdictions. Corporate nationality, and with it the nationality of investors in and owners of foreign affiliates, is becoming increasingly blurred.

2. The importance of ownership and nationality in investment policy

The blurring of investor nationality has important implications for national and international investment policies. Most countries have investment rules and promotion tools that are conditional on ownership and nationality. Almost 80 per cent of countries worldwide prohibit majority foreign ownership in at least one industry. Bilateral and regional investment agreements aim to provide benefits only to investors originating in the jurisdictions of treaty partners.

Investment policy deals with the attraction and retention of foreign investors through promotion and facilitation, with degrees of openness to foreign investment and the regulation of investor behaviour, and with standards of protection and treatment of foreign investors. Each of these aspects, in national investment policies and in international investment agreements (IIAs), is premised on policymakers and their agents being able to establish clearly and unequivocally

Figure IV.1. Complex ownership of MNE foreign affiliates
(Share of foreign affiliates, per cent)

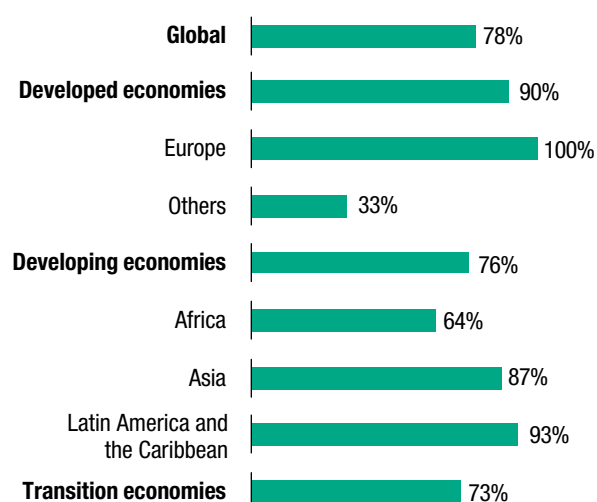


Source: ©UNCTAD analysis based on Orbis data (November 2015).
 Note: Analysis based on a global sample of 720,000 foreign affiliates. The economic weight is computed using reported revenues. The share at 60 per cent for the largest MNEs is calculated based on foreign affiliates of UNCTAD's Top 100 MNEs (the largest MNEs ranked by transnationality, i.e. foreign assets, foreign sales and foreign employment).

the “foreignness” of an investment, in the context of national policy rules that discriminate between foreign and domestic investors (positively or negatively), and the specific *nationality* of the investor, in the context of eligibility for treaty benefits.

Moreover, in considering the foreign origin of investors, investment policy tends to focus on the direct owners of an affiliate, (a) because a perspective on ownership at this level has traditionally been sufficient in light of its primary concern with the attraction of foreign capital, and (b) because concrete investment policy measures – e.g. ownership restrictions, joint venture requirements, or eligibility criteria for facilitation – tend to operate at the direct ownership level.

Figure IV.2. Foreign ownership restrictions
Share of countries with foreign equity limitations below 50 per cent in at least one industry, by region



Source: ©UNCTAD analysis based on the World Bank’s Investing Across Borders database, covering 104 countries.

Investment policies “triggered” by nationality and ownership are ubiquitous. Looking at national investment policies, for example, almost 80 per cent of countries worldwide prohibit majority foreign ownership in at least one industry (figure IV.2). In international investment agreements, 90 per cent of the more than 3,000 existing treaties are bilateral, and the remainder regional, with treaty benefits clearly reserved to investors originating in the jurisdictions of treaty partners.

The fact that corporate structures are complex and that consequently investor nationality is becoming less and less clear in practice has important implications for national and international investment policies. The effectiveness of foreign ownership restrictions, for example, is called into question if a domestic majority owner is itself owned by other foreign investors; international agreements negotiated based on one bilateral dimension lose focus if treaty benefits de facto accrue to many nationalities.

3. A new perspective on MNE ownership structures for investment policymakers

In designing national investment policies and in negotiating investment agreements, policymakers need to consider carefully the effectiveness and suitability of ownership-based measures, as well as the practical implications for their application and enforcement.

This chapter aims to provide insights on the global “map” of ownership and control in the international production networks of MNEs, and to distil relevant implications for national and international investment policy. The key questions the chapter aims to answer are as follows: What types of “complex” cross-border ownership structures do MNEs employ? Why do MNEs create complexity in ownership structures, and what trends does this imply for the coming years? How widespread are complex ownership structures, and what are the implications for the global map of investments by investor origin or nationality? How do the concepts of ownership and control feature in national and international investment policies today? What are the implications of increased complexity in MNE corporate structures for investment policymaking?

The following points delimit the scope of the analysis and discussion in this chapter:

- The chapter focuses on the internal ownership structures of MNEs, i.e. the ownership links between the parent or headquarters of the MNE and its subsidiaries and affiliates. It does not consider so-called ultimate beneficial ownership, i.e. the ownership by individuals, financial institutions or funds “above” the MNE parent entity.¹

Past editions of *WIR* have dealt with various aspects of governance in international production by MNEs, including integrated international production networks (*WIR93*) and GVCs (*WIR13*), and with governance modalities, including numerous non-equity modes (*WIR11*). Governance in international production refers to the ability of MNEs to coordinate activities, flows of goods and services, and access to tangible and intangible assets across disparate networks of firms, including their own affiliates as well as partners, suppliers and service providers.

A common approach to studying control in such networks revolves around the question of what to own (and what not to own). Which tangible and intangible assets should be held strictly under MNE control through ownership, and which can be shared. Which activities should be done in-house, which can be outsourced (make or buy). These questions are at the heart of the concepts of ownership and internalization advantages in the economic theory of international production.

Different governance levers (including non-ownership levers) in international production and GVCs, such as contracts, licenses and technology, access to markets, bargaining power, and the like have important implications for investment and development policy. However, the focus in this chapter is not on the question of *what* to own, but *how* to own it. Given the affiliates that an MNE owns, how do MNEs structure the ownership of affiliates, i.e. through direct shareholding by the parent company, through indirect shareholdings and intermediate subsidiaries, through multiple ownership links, or through joint or cross-shareholdings.

The chapter thus examines ownership and imputed control as concepts in investment rules and in IIAs, focusing on formal shareholdings and control as a corporate governance concept, i.e. the legal rights to an asset and the income derived from it, the right to make strategic and capital allocation decisions, and the right to dispose of the asset.

Source: ©UNCTAD.

- The chapter distinguishes ownership and control to indicate the difference between direct shareholdings in foreign affiliates and ultimate ownership or control within MNE corporate structures, taking into account indirect ownership links and chains, and joint and cross-shareholdings. The focus is therefore on control within the boundaries of MNEs. Clearly, looking more broadly at the concepts of ownership and control in international production networks there are other, non-equity levers of control, which have been the subject of past *WIRs* (see box IV.1, as well as *WIR11* and *WIR13*). The common theme of these past research efforts concerns the governance of international production and the separation of ownership and control. This chapter focuses on formal equity ownership links and refers to past *WIRs* for policy implications regarding the governance of international production.
- The chapter focuses specifically on those aspects of ownership and control in MNEs that are relevant from an investment policy perspective, i.e. on elements of complexity in corporate structures that alter perspectives on the origin of investors (or that make it more difficult to establish origin), and the attendant consequences. It does not aim to provide an exhaustive account of the implications of different types of ownership structures for tax, illicit financial flows or competition policies (although some investment-related policy areas are discussed).

The structure of the remainder of the chapter is as follows:

Section B provides a glossary of ownership complexity and insights on ownership structures in MNEs taking a “top-down” perspective, looking at entire corporate structures from the parent company down. This section also aims to identify the drivers and determinants of MNE ownership structures, i.e. the key factors behind management decisions regarding shareholding structures within corporate groups. The determinants of ownership structures also allow some inferences about the likely future evolution of MNE ownership complexity.

Section C changes the perspective and takes a “bottom-up” approach, looking at ownership chains from foreign affiliates up to their ultimate owners or parents, in order to show how investor nationality can become blurred if complex ownership of investments is taken into account. This section contains the key analytical results from a detailed study of firm-level data on some 4.5 million companies and more than 700,000 foreign affiliates, using Bureau

van Dijk's Orbis database. It presents indicators of complexity in MNE structures, a "mismatch index" of complex investor origin, and facts and figures for various geographical areas and industries.

Section D discusses current investment policies for which investor nationality and ownership and control issues are important. It provides an overview of ownership-conditioned national investment policies, such as foreign equity restrictions, joint venture requirements, operational restrictions or requirements applicable only to foreign investors, and incentives or facilitation schemes accessible only to foreign investors. It includes examples of how investment authorities apply such rules, and how they determine the ownership structure of investors. The section also discusses how ownership and control issues feature in IIAs, what impact they have in investor-State dispute settlement (ISDS), and what approaches have been adopted by IIA negotiators to tackling the challenges posed by complex ownership structures.

Section E assesses the wider systemic implications of complex corporate structures for investment policymaking. Policy recommendations revisit the overall purpose and objectives of national rules and regulations on foreign ownership. They also point at the multilateralizing effect of ownership complexity on IIAs, highlight the need for greater predictability for States and investors about the coverage of IIAs, and indicate scope for greater international collaboration.

B. COMPLEXITY IN MNE OWNERSHIP STRUCTURES

1. Mapping MNE ownership structures

Common types of complexity in internal MNE ownership structures are lengthy ownership chains with multiple cross-border links, ownership hubs and shared ownership structures. Ownership of affiliates is expressed in shareholdings, which provide cash flow rights and voting rights. Control is the ability to exercise voting rights to affect strategic management decisions. In the internal ownership structure of MNEs, control generally coincides with (direct or indirect) majority ownership. However, MNEs can exercise control over affiliates even when they have a minority stake.

MNE ownership structures are made up of a parent entity and its affiliate companies, which can be in the MNE home country or in host countries, and ownership links with varying levels of equity ownership that determine the degree of control that the parent entity can ultimately exercise over each affiliate. Figure IV.3 shows a hypothetical ownership structure of an MNE that illustrates the most important building blocks that are referred to throughout the analysis in this chapter.

The parent company A in the example is the ultimate owner of affiliates B through M. The jurisdiction of incorporation of the parent company determines the nationality of the corporate group. All affiliates in the example can, of course, be located in different jurisdictions, which is what defines the group as an MNE (i.e. at least one of the affiliates must be outside the home country of the parent).

At the first hierarchical level in the example, the parent company directly owns affiliates B, C, D and E. The affiliates are fully owned by the parent, i.e. the parent owns 100 per cent of their equity. (For simplicity and to maintain consistency in terminology, this chapter uses the term affiliate rather than subsidiary; the latter applies to majority-owned affiliates and could therefore be substituted here.)

Affiliate B is a straightforward example of an affiliate directly and fully owned by its parent company, with no further ownership links. This simple structure is by far the most common type across the universe of MNEs and characterizes most small and medium-sized MNEs.

Elements of complexity in MNE ownership structures

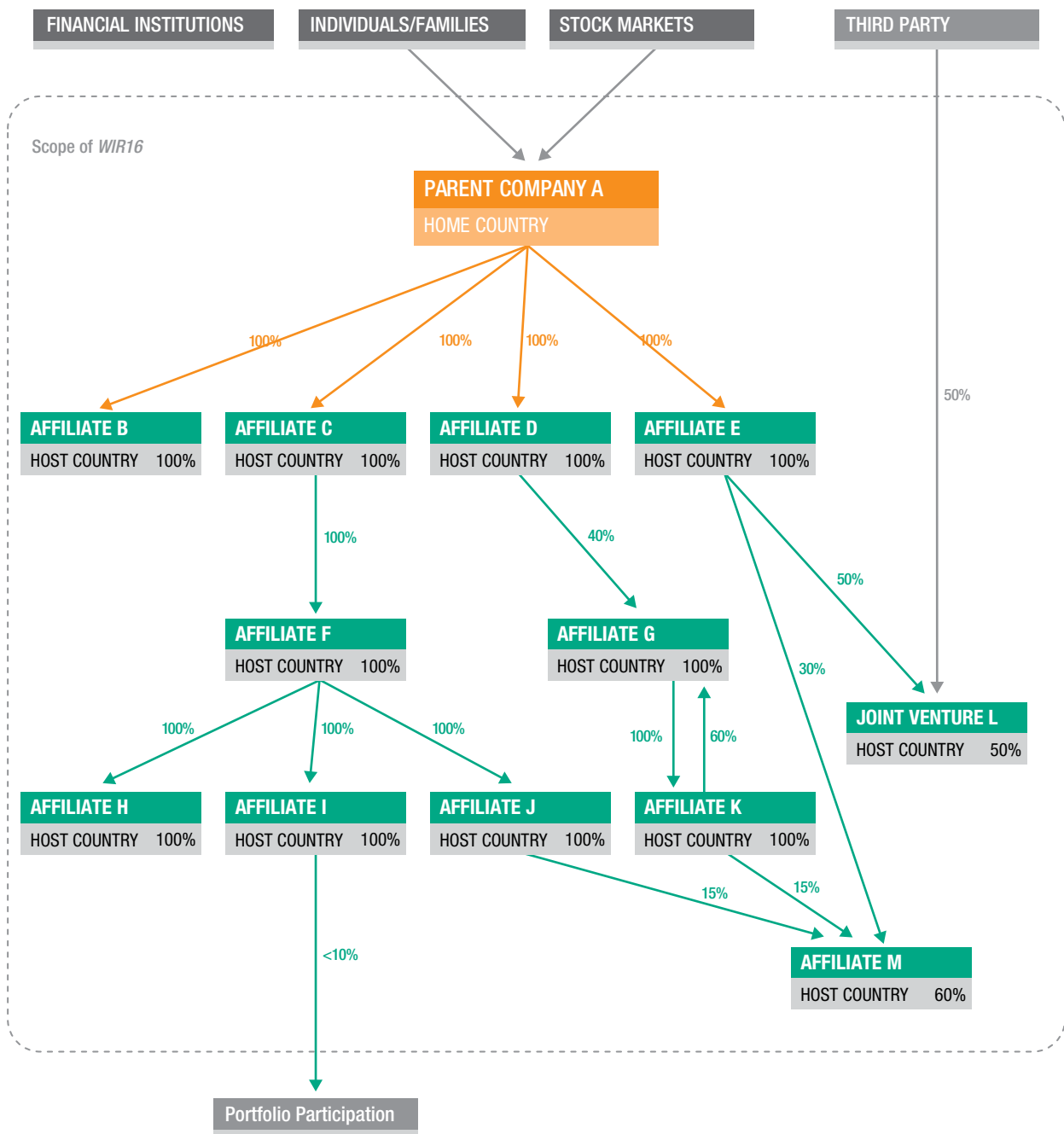
Vertical complexity and cross-border ownership chains. At lower levels in the hierarchy, company A owns affiliates F through M. The *hierarchical depth* of the group (or the maximum *hierarchical distance* between affiliates and parent) in this example is three levels, as in the case of C-F-H or D-G-K (affiliate M is owned through affiliate E, which is the shorter ownership chain). This allows for a critical element of complexity in the stylized example – particularly relevant from an FDI and investment policy perspective – which is multiple cross-border ownership links between affiliate and parent, and thus different locations of the direct owner of an affiliate and its ultimate owner.

Horizontal complexity or multiple direct ownership links. Affiliate M is an example of a company that is controlled through multiple ownership links at the direct shareholder level. Through the

equity shares held by E, J and K the parent company ultimately owns a majority stake in affiliate M of 60 per cent and thus fully controls it. (The remaining equity in M is held by outside investors.)

Shared ownership or joint ventures (JVs). Affiliate L is an example of a partnership with an independent outside company. It is not fully controlled by parent company A in this example, as both partners hold 50 per cent of the shares. JVs do not necessarily have an equal division of shares (one partner can be the controlling partner), and they can involve more than two partners.

Figure IV.3. | A stylized example of an MNE ownership structure



Source: ©UNCTAD, based on the T-Rank visualization methodology.

Note: The percentages with the arrows show equity shares. The percentages inside the affiliate boxes show the extent to which the affiliate is controlled by the subject of analysis (the parent company A in this example).

Ownership hubs. Affiliate F in the example is an “ownership hub”, or an affiliate that controls several other affiliates. Such a hub can be a holding company in a host country controlling several operating companies in the same host country; it can be a regional headquarters controlling companies in neighbouring countries; it can be a divisional headquarters controlling companies in the same line of business; or it can be an intermediate entity performing specific functions for its controlled entities, often financing functions in offshore financial centres (OFCs).

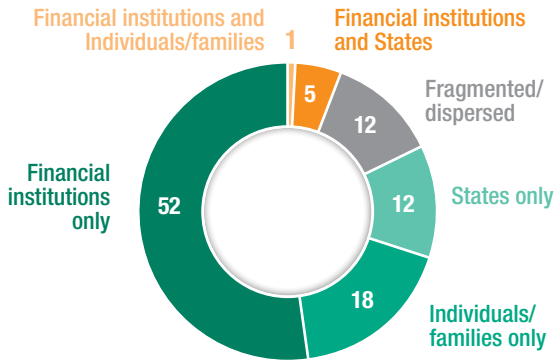
Cross-shareholdings. Affiliates D, G and K show an example of cross- or circular shareholdings, where G owns a stake in K, and K owns a stake in G. As a result, although D nominally owns only 40 per cent of the equity in G, it fully controls both G and K. Cross-shareholdings can also be found among more than two companies in highly complex networks.

Table IV.1 summarizes the key elements of complexity in the internal ownership structures of MNEs. Vertical complexity stands out as the most common type. It is also the most relevant type of complexity from an investment policy perspective, as it often results in multiple cross-border ownership links between affiliate and parent, and thus in different locations of the direct owner of an affiliate and its ultimate owner. For these reasons, while this section provides a general overview of all types of complexity in MNE ownership structures, section C focuses entirely on vertical complexity and cross-border ownership chains.

In the example, affiliate I owns a non-controlling stake of less than 10 per cent in an outside company, which must be considered a portfolio investment. For the purpose of the discussion here, in line with definitions commonly adopted for FDI, all stakes below 10 per cent are considered portfolio investments and fall outside the scope of the analysis.

As parent company A is a legal and not a natural person it must, in turn, be owned. Publicly listed MNEs have relatively dispersed shareholdings with shares traded on stock markets. Most MNEs will have large blocs of shares held by financial institutions, institutional investors and governments. And many MNEs are partly owned by individuals or families, often founders who maintain a stake in the business. Individual and family shareholders, governments and institutional investors are the so-called ultimate beneficial owners, the owners to whom the income generated by the MNE ultimately accrues in the form of dividends and capital gains. Figure IV.4 shows the predominant ultimate beneficial owners in UNCTAD’s Top 100 MNEs (the largest MNEs ranked by transnationality, i.e. foreign assets, foreign sales and foreign employment). However, for the purpose of this chapter the analysis stops at the parent company or corporate headquarters; ultimate beneficial ownership is not considered.

Figure IV.4. Predominant ultimate beneficial owners in UNCTAD’s Top 100 MNEs (Per cent)









Source: ©UNCTAD analysis based on Orbis data and various sources.

Mapping ownership versus control

Section A narrowed the scope of analysis to ownership and ownership-based control (excluding non-equity forms of control). Control does not always map directly to ownership. Ownership of affiliates is expressed in shareholdings, which provide not only the rights to the dividends distributed by the affiliate (cash flow rights), but also voting rights. Control is the ability to exercise the voting rights associated with the shares to affect strategic management decisions. The degree to which companies higher up in the ownership hierarchy, including the ultimate

Table IV.1. Elements of complexity in internal MNE ownership structures

Types of complex structures		Description	Impact	Relevance	
				Overall	Large MNEs
Vertical complexity	Ownership chains	Long ownership chains; multiple steps between affiliate and ultimate owner (hierarchical distance >1)	Direct owner differs from ultimate owner		
	Cross-border ownership chains	Long ownership chains with multiple cross-border steps and entities in multiple jurisdictions	Jurisdiction of the direct owner differs from that of ultimate owner: nationality mismatch	55% of FAs are not directly owned by their ultimate owner; 40% of FAs have direct owners and ultimate owners in different jurisdictions	75% of FAs of large MNEs are not directly owned by their ultimate owner; 60% of FAs have direct owners and ultimate owners in different jurisdictions
Horizontal complexity	Multiple ownership within MNE	Affiliate is controlled through multiple stakes held by other group entities that add up to a majority stake	MNE parent control over affiliates based on complex network relationships between affiliates		
	Joint ventures with external partners	Two or more shareholders from different groups jointly own all or a majority of shares of an entity	Definition of a unique controller is challenging; control can be achieved through dominant stakes or voting coalitions	90% of FAs have a single majority shareholder	75% of affiliates of large MNEs have a single majority shareholder; 25% are controlled through multiple entities within the group
Other elements of complexity	Ownership hubs	One entity in the MNE structure directly owns multiple affiliates	Ownership hubs create nodes within ownership structures or networks		
	Cross-shareholdings	One entity is participated by the same entity in which it owns a stake	Presence of loops makes it difficult to define a unique control path; control can be exerted through very limited stakes	65% of MNEs have only one FA; almost 90% of MNEs have fewer than 5 FAs	The largest MNEs have on average more than 500 affiliates, including 20 holding companies (hubs); cross-shareholdings limited even in the largest MNEs (fewer than 1% of affiliates)

 High relevance  Low relevance

Source: ©UNCTAD.

Note: The estimates in the right-hand columns anticipate some key results of the empirical analysis showing the relevance of the various complexity elements. The estimates are not directly comparable as they employ different analytical approaches that will be elaborated in the rest of this chapter, but at this stage they are useful to provide a first prioritization of the complexity elements (percentages rounded to 5 percentage points). FA = foreign affiliate.

owner, actually control affiliates can be higher or lower than the number of shares held. In the stylized example above, nominal ownership percentages differ from actual control of voting rights only in one case (D, G, K) owing to a relatively simple cross-shareholding structure. However in extreme cases, complex cross-shareholding links may confer control even with very limited nominal stakes, as shown in figure IV.5.

Beyond cross-shareholdings, there are principally two other cases in which ownership-based control can differ from nominal equity stakes:

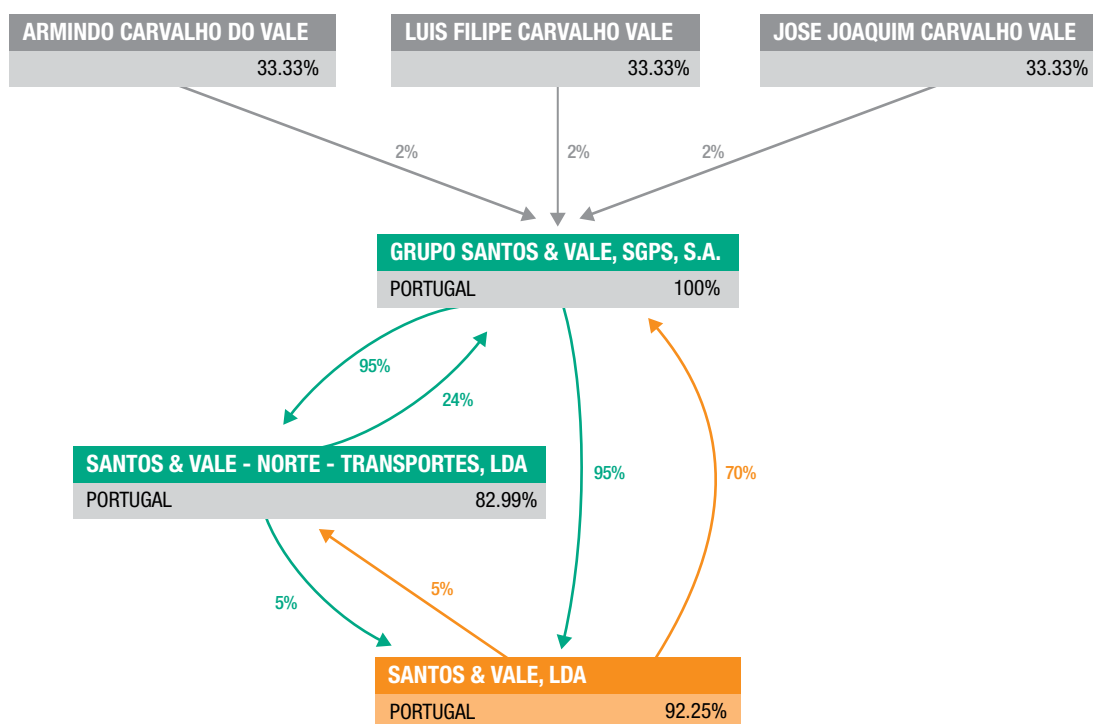
- Departures from the one-share-one-vote principle. Actual degrees of control can be made completely independent of the distribution of shareholdings through the use of nonvoting shares, preferential or dual classes of shares, multiple voting rights, golden shares, voting-right ceilings and similar constructions.² This phenomenon is difficult to include in the analysis in this chapter, as data on preferential shares is not systematically available.

However, studies have shown that the use of preferential shares is mostly restricted to the level of beneficial ownership (e.g. with individuals or families aiming to maintain management influence disproportionate to their actual shareholdings) and is relatively rare inside MNE ownership structures.³

- Coalition-dependent majorities or dominant shareholdings. MNEs can exercise a degree of control in affiliates in which they own a minority of the shares through the use of voting blocs or coalitions that may depend on the structure and level of concentration of remaining shareholders. If, for example, an MNE owns a dominant minority stake that cannot be excluded from any viable coalition of voting shares in order to come to a decision, it exercises de facto control. Conversely, if an MNE owns 40 per cent of a company that has two other shareholders each with 30 per cent, its de facto level of control is only one third, i.e. lower than its equity stake. (This finds a specific application in the next subsection.)

Combinations of cross-shareholdings, preferential shares and the use of voting blocs are not common inside most MNEs (i.e. below the parent company level).⁴ They are used relatively more in MNEs where founding individuals or families are actively engaged in management, as an instrument to increase their voting power. They are also more common in conglomerates or business groups, such as the keiretsu in Japan, the chaebol in Korea or the grupos economicos in Latin America.⁵ These are networks of companies maintaining long-term business relationships, usually including a web of cross-shareholdings around a financial institution. However, the phenomenon of asymmetrical ownership and control is generally restricted to the beneficial ownership level and higher levels in ownership hierarchies. In practice, within MNE ownership structures, lines of control map directly to ownership links in the vast majority of cases.

Figure IV.5. Control with minority stakes through cross-shareholding loops



Source: Orbis, T-Rank visualization (March 2016).

Note: The percentages with the arrows show equity shares. The percentages inside the boxes show the accumulated (direct and indirect) stake that each entity owns in the target company (Santos & Vale, LDA). Santos & Vale, LDA indirectly owns 92.25 per cent of itself. Each of the three individuals at the top indirectly controls 33.33 per cent of Santos & Vale LDA (collectively they fully control it), through a mere 2 per cent direct stake in Grupo Santos & Vale, SGPS, S.A.

2. Characteristics of highly complex MNEs

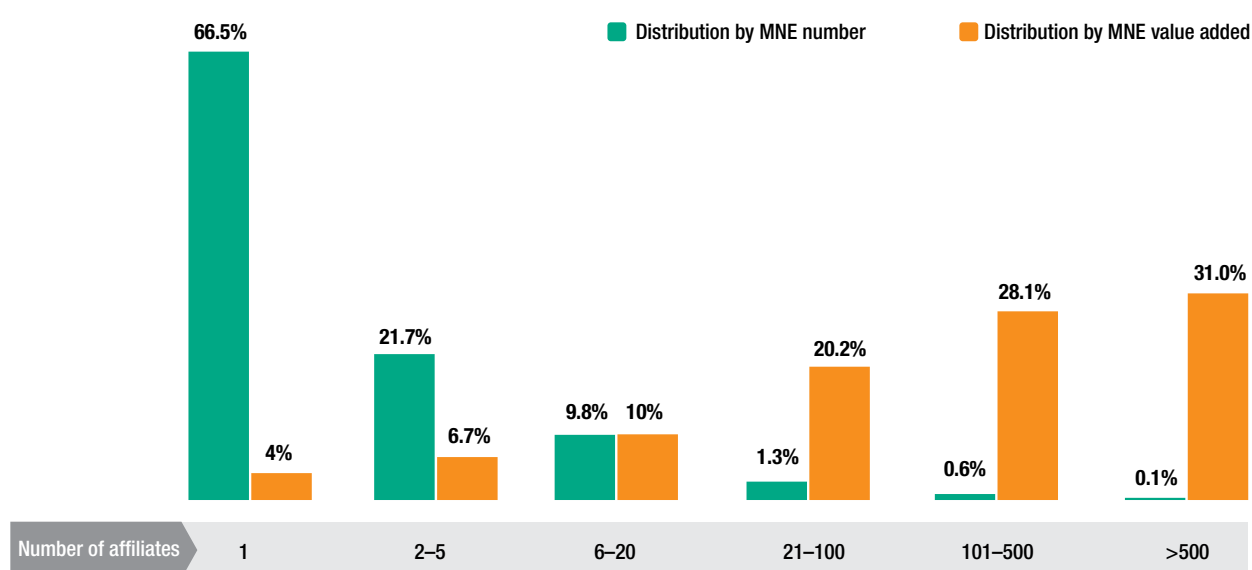
The universe of MNEs is highly skewed: a very large group of MNEs is simple, with few affiliates directly and fully owned by the parent company. A very small group of MNEs accounts for a large share of foreign affiliates. Less than one per cent of MNEs have more than 100 affiliates, but these account for more than 30 per cent of all foreign affiliates and almost 60 per cent of global MNE value added. The top 100 MNEs in UNCTAD's Transnationality Index have on average more than 500 affiliates across more than 50 countries.

The public attention to convoluted and often opaque corporate structures in the media leaves the impression that all MNEs employ complex ownership schemes. This is not the case. Most MNEs are simple, with direct full or majority ownership links between parents and affiliates. This is especially true for the vast majority of MNEs, in number, which have only very few foreign affiliates. Empirical analysis performed on a very large sample of MNEs shows that almost 70 per cent of MNEs have only one foreign affiliate, and almost 90 per cent of MNEs have fewer than 5 affiliates (figure IV.6).

Clearly, the scope for complexity in MNE ownership structures increases exponentially with the number of affiliates. The larger MNEs with more affiliates where complex ownership structures play out in full are relatively few in number. However, they account for an important share of foreign affiliates, and an even more disproportionate share in value terms, as each individual affiliate is on average larger (in value added terms) than those of smaller MNEs. Less than 1 per cent of MNEs have more than 100 affiliates, but this group accounts for more than 30 per cent of the total number of foreign affiliates, and more than 60 per cent of total MNE value added.

Figure IV.6 suggests that, for the purpose of studying complex internal MNE ownership structures, a focus on the largest MNEs is justified. The UNCTAD Top 100 MNEs is thus a relevant sample of MNEs, representing a category that accounts for a significant share of international production. Table IV.2 provides key complexity indicators for this group.

Figure IV.6. Distribution of MNEs by size class (Per cent)



Source: ©UNCTAD analysis based on Orbis data (November 2015); adapted and updated from Altomonte and Rungi (2013).

Note: Based on a sample of 320,000 MNEs with at least one affiliate abroad: total affiliates are 1,116,000, of which 774,000 foreign. Estimates for value added are based on 220,000 affiliates and unconsolidated financial accounts. The perimeter of 320,000 MNEs is a globally representative universe resulting from a massive extraction of firm-level information from Orbis (based on an initial sample of 22 million firms reporting ownership information) after several computational and cleaning steps. The identification of the MNE corporate boundaries, and the computational effort of mapping a total of nearly 40 million ownership links, uses the algorithmic approach developed in Rungi et al. (2016).

On average, the Top 100 have more than 500 affiliates, more than two thirds of which are overseas. The average hierarchical depth of the largest MNEs is 7 levels, with peaks for some MNEs up to 15 levels. This does not imply that all affiliates of the Top 100 MNEs are at such extreme hierarchical distances from their parents. The average hierarchical distance for affiliates is at three steps from the parent.

The number of countries in which MNEs in the Top 100 are physically present ranges from fewer than 10 to more than 130, with an average of more than 50 countries; the Top 100 MNEs tend to be truly global MNEs. Among these, about 50 jurisdictions are OFCs, including tax havens and investment hubs that route FDI flows from their origin to a third destination country (see *WIR15* for a full analysis of investment hubs and transit FDI). On average, 70 of the more than 370 foreign affiliates of these MNEs (or about one fifth) are located in OFCs.

The use of ownership hubs is also common. The average MNE in the Top 100 list has almost 20 holding companies that perform investment-related activities on behalf of the group. Holding companies are often used to create international ownership structures, in which case they tend to be located in jurisdictions that provide certain fiscal benefits to investors or that offer other regulatory or institutional advantages. Holding companies are also used as bridgeheads in large economies to create local networks of foreign affiliates.

The total number of some 55,000 affiliates for the Top 100 MNEs that can be derived from table IV.2 includes all affiliates that are either directly or indirectly majority owned (i.e. with an equity stake above 50 per cent) by the 100 parent companies. About 75 per cent of these affiliates can be identified following a direct ownership chain (with a majority owner at each step) from the affiliate to the parent. The other 25 per cent are ultimately controlled through a majority stake that is the result of multiple ownership links where the aggregate shareholding exceeds 50 per cent (figure IV.7).⁶

It is possible to identify an additional set of affiliates that is theoretically controlled by parents in the Top 100, through dominant shareholdings or voting blocs. In an expansive interpretation of corporate boundaries, a further 3,000 companies could be considered as within the control perimeter of the Top 100 MNEs, because one of these MNEs owns a dominant stake and the remaining shareholdings in these companies are fragmented in such a way that it would be unlikely that any viable voting coalition could be formed without the participation of the MNE parent.⁷

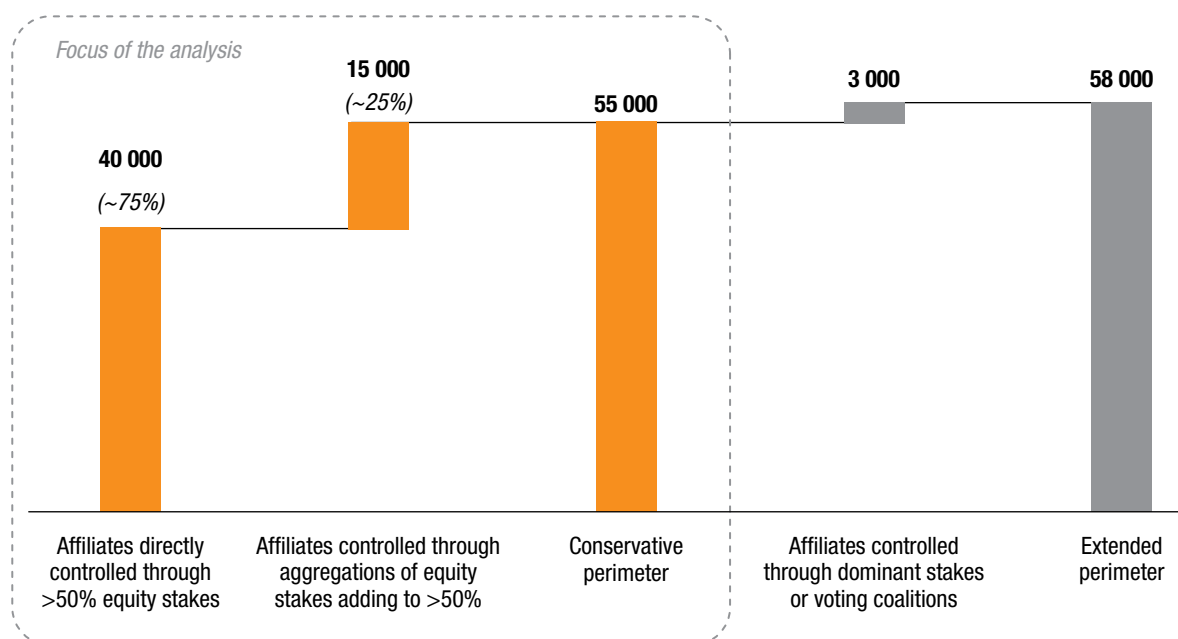
These figures are a first indication that complexity in the ownership structures of the largest MNEs is generated mostly by vertical depth, i.e. multiple steps, often across multiple borders, from the parent to the affiliate, but through relatively straightforward full or majority ownership links. Multiple ownership “paths” from affiliates to parents, where the aggregate ownership adds up to a controlling stake, are a minority, albeit a sizeable one.

Table IV.2. Ownership complexity in the UNCTAD Top 100 MNEs		Key indicators			
Indicators at the group level	Average	Minimum	Median	Maximum	
Number of affiliates					
- all	549	118	451	2 082	
- foreign affiliates	370	41	321	1 454	
Hierarchical depth (number of hierarchical levels)	7	3	6	15	
Number of countries in the network	56	8	54	133	
Number of affiliates in OFCs	68	7	55	329	
Number of holding companies	19	0	15	155	

Source: ©UNCTAD analysis based on Orbis data (November 2015).

Note: The identification of the corporate boundaries of the 100 MNEs, and the computational effort, uses the algorithmic approach developed in Rungi et al. (2016). The perimeter of jurisdictions qualifying as OFCs includes tax havens and major offshore investment hubs (see *WIR15* on OFCs and offshore investment hubs).

Figure IV.7. Ownership-based control types in the UNCTAD Top 100 MNEs (Number of affiliates and per cent)



Source: ©UNCTAD analysis based on Orbis data (November 2015).

Note: Figures rounded.

Because the scope for complexity is highest in the largest MNEs with the most affiliates, it can be assumed that the level of complexity found in the Top 100 represents the extreme end of the scale.

3. Determinants of complexity in MNE ownership structures

MNE ownership structures are often the result of historical accident or haphazard growth patterns. Where MNEs deliberately incorporate elements of complexity (e.g. lengthy ownership chains, multiple owners at the direct shareholder level, or different locations of direct versus ultimate owners), these are most often dictated by governance rules and risk management, financing, tax, and other institutional or policy-related considerations. Investment policy is one of several policy drivers behind complex ownership structures.

Section A distinguished MNE decisions on what to own in their international production networks from decisions regarding how to own it; it explained that this chapter concerns itself with the study of complex ownership structures of MNE assets, not with the choice of assets or the way they are managed and deployed.

Similarly, the study of MNE ownership structures should be clearly distinguished from that of organizational structures. The use of the term *hierarchies* in this chapter to denote layers of ownership does not imply that mid-level affiliates in ownership chains necessarily direct the affiliates they own at the next level, with those in turn directing the level immediately below. There may be logic to this, as each level will consolidate financial accounts of the level below, and for reasons of governance, accounting simplicity and the incentivization of managers involved at each level it may make sense for MNEs to establish direct lines of management along ownership paths. But there is no inherent reason why this should be so; a manager at a higher hierarchical level can choose directly to instruct managers of affiliates several levels down; a manager of a large and strategically important affiliate at the bottom rung ranks higher than a manager of a functional financing hub that formally owns his company. The difference

between formal ownership structures and operational logic is one of the reasons for the parallel existence of financial and management reporting.

That is not to say that operational logic does not play a role at all in ownership structures as they are found in MNEs. However, even where they do, ownership structures can be changed, if there is a compelling reason to do so, without significant impact on operational structures. (Box IV.2 illustrates a special case of opportunistic adaptations of an MNE ownership structure in anticipation of restrictive measures.)

Table IV.3 provides an overview of the determinants of complexity in MNE ownership structures. The table distinguishes two groups of determinants. First, it lists “endogenous” determinants that are specific to MNEs and the implicit result of MNE growth patterns, either because they are underpinned by operational logic or because they are based on governance or risk management decisions. Second, it lists “exogenous” and location-specific determinants that are ultimately based on policy or institutional factors, such as fiscal and financial governance rules and investment policies. Whereas the former group of determinants drives, for the most part, elements of complexity that are the natural or necessary result of the development of a business, the latter group is mostly responsible for complex ownership structures that are purposely created to incorporate entities in specific jurisdictions in the ownership chain between affiliates and parents.

The two sets of determinants cannot be seen in isolation. Different determinants tend to operate simultaneously. For example, when MNEs create affiliates or engage in mergers or acquisitions to expand their operations, they consider options to structure such transactions in the most favourable manner from a fiscal and financial perspective. Similarly, when an MNE needs to set up an entity as a vehicle to attract outside financing or as an umbrella entity to house a JV with a third party, where possible, it will aim to do so in a jurisdiction that provides an attractive institutional environment.

Table IV.3.		Determinants of complexity in MNE ownership structures	
Determinants		Mechanism	Elements of complexity affected
MNE-specific drivers	Growth patterns and historical accident	Ownership links resulting from older affiliates setting up or acquiring new affiliates at the next hierarchical level, and from cumulative "administrative heritage"	Mainly affects vertical complexity
	Operational logic	Ownership links between affiliates that transact with each other in supply chains and/or that are part of regional or industry sub-groups within MNE structures	Mainly drives vertical complexity and hubs; can affect shared ownership of affiliates
	Governance	Ownership structures created as levers of control, to manage business combinations (mergers) or JVs, or structures aimed at limiting MNE liability	Drives all types of complexity, including cross-shareholdings
Location-specific drivers: <i>policies and institutions</i>	Financial rules and institutions	Entities and ownership links created to facilitate or enable outside financing, often in jurisdictions that provide better access to finance	Drives all types of complexity
	Tax and tax treaties	Ownership links created to incorporate an entity in a jurisdiction to benefit from favourable tax treatment or a tax treaty	Drives all types of complexity
	National investment policy and IIAs	Shared ownership of affiliates as a result of foreign ownership restrictions, or incorporation of entities in the ownership chain to gain access to an IIA	Mostly drives vertical complexity and shared ownership structures

Source: ©UNCTAD; see also Lewellen and Robinson (2013).

Note: Elements of complexity refer to the elements discussed in section IV.B.1.

In reaction to the Russian Federation's policy on the Ukraine, the EU, the United States and other countries adopted restrictive measures against several Russian individuals and entities in order to restrict investment and business owned or controlled by blacklisted Russian persons (individuals/entities).

Bank Rossiya (Russian Federation) was put on the list of those companies to which the restrictive measures would apply on 20 March 2014. Before March 2014, 51 per cent of the insurance company Sogaz belonged to Rossiya through a wholly owned subsidiary called Abros. Therefore, under the rules, Sogaz would have fallen under the restrictive measure as an entity that is majority-owned by an affected party. But Rossiya transferred a 2.5 per cent stake to Sogaz Realty, a subsidiary of Sogaz itself, the week before the restrictive measures were imposed. With Rossiya's stake now below 50 per cent, Sogaz announced that it was not subject to restrictive measures. The transaction let Sogaz avoid restrictive measures because a firm controlled by several affected entities was not itself subject to restrictive measures if none of them individually owned 50 per cent of it.

Subsequently, the United States issued a new rule on 13 August 2014, which provides among other things that a firm is blacklisted if the stakes of affected individuals add up to 50 per cent or more. The EU has a similar rule. Under the new rules, Sogaz should have been subject to restrictive measures because of its links to both Bank Rossiya and Kordeks, a 12.5 per cent shareholder reportedly controlled by another person, whom the United States had blacklisted several months earlier. However, Rossiya cut its stake two days before the issuance of the new rules, to the effect that Sogaz avoided restrictive measures once more.

Sogaz announced in late August 2014 that Abros held only 32.3 per cent of its stake, following a transaction which had taken place on 6 August and been registered on 11 August, just before the issuance of the new rules on 13 August. Gazprom, on its part, offloaded 16.2 per cent of its stake in its subsidiary. This brought Sogaz's total stake in the affected parties to 44.8 per cent (Abros 32.3 per cent, Kordeks 12.5 per cent), well below the threshold.

Source: The Economist, 14 February 2015.

MNE-specific drivers

Many MNEs grow haphazardly and opportunistically. Early in the development of an MNE, affiliates are more likely to be established in the home and neighbouring countries. Affiliates in those neighbouring countries might grow and, being familiar with their surrounding markets, might capture opportunities in those markets. The MNE might spread at a regional level, before spreading its wings in other regions in the world. At each level, it is likely to be nearby affiliates that play a role in identifying opportunities for growth (whether through greenfield investment or by acquisition), in setting up the new operation, in arranging financing and legal status, and in supplying initial-phase directors. As a result, a series of pictures taken over time of an MNE's ownership structure might resemble the growth of mushrooms, first in a nearby circle, and then expanding in intersecting circles. (The same logic of geographical expansion might be applied to business lines in divisional structures.)

Despite the fact that ownership structures, especially at the affiliate level, can be changed over time – and as MNEs grow larger and more complex, they do change them – growth patterns and historic coincidence do appear to explain a significant part of the ownership complexity story. For example, the median age of affiliates of the Top 100 MNEs decreases at each rung of the hierarchy ladder.⁸ This is most likely explained by the fact that affiliates at each level are involved in setting up affiliates at the next level. Therefore, hierarchical levels are not generally constructed artificially with new affiliates being inserted mid-way, or multiple affiliates being created simultaneously according to a pre-planned scheme.

Administrative heritage is a well-researched phenomenon that can explain the gradual “sedimentation” of layers of ownership in MNEs.⁹ Systematic restructuring and rationalization of the ownership structure of an MNE can be costly, mostly because changes in ownership structures would normally require actual transactions (the sale and purchase of shares) to take place, potentially triggering capital gains taxes in addition to other taxes and transactions costs.

Such restructurings are thus carried out only if there are significant financial benefits to be gained. Complexity caused by M&A transactions can often not be unwound at all because of legal and tax constraints, and arrangements with banks and financiers. Thus, even where MNEs attempt so-called “entity reduction programmes”, they are rarely successful in simplifying complex ownership structures.

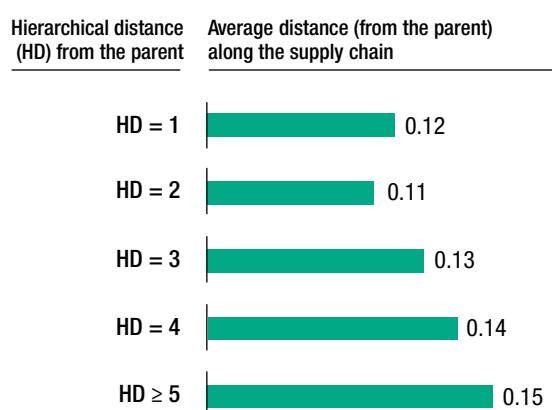
Where ownership chains are deliberately created to correspond to organizational and management structures or operational logic, it must be the case that the hierarchical structure *itself* confers a benefit to the MNE. Any consideration of operational logic as a driver for ownership structures is therefore, again, largely correlated with vertical ownership chains, and in some (far fewer) cases with shared ownership structures where the parent wishes to push formal collaboration between affiliates or with outside partners. It is unlikely to find reflection in more intricate complexities such as cross-shareholdings or fragmented shareholdings with small stakes shared among many affiliates.

As determinants of ownership complexity, historical growth patterns and operational logic are closely related. Affiliates that transact with each other in supply chains, with one affiliate supplying intermediate products to be incorporated by another in final goods, might grow as the natural result of the gradual fragmentation of production processes. The same process that explains the rapid growth of GVCs (see *WIR13*) also explains how MNE affiliates in certain industries may set up or buy their own suppliers when they consider it convenient to own that supplier rather than outsource the process, or to spin out a part of their production process into a separate company in which they maintain ownership. This process would naturally lead to vertical ownership chains mirroring the supply chain.

As stated above, nothing obliges an MNE to maintain the ownership structure resulting from such a process. Ownership of all affiliates could be put directly in the hands of the ultimate parent, or of any holding or financing company, without affecting the supply relationship between the respective affiliates. However, there is some evidence that supply chains are reflected in vertical ownership chains. Figure IV.8 shows a relationship between hierarchies in vertical ownership and position along the supply chain for affiliates of the UNCTAD Top 100 MNEs; affiliates closer to the parents in the vertical structure (lower hierarchical distance) tend to perform activities closer to the parent in the supply chain.

Growth patterns of MNEs naturally require raising financial resources from third parties or on the market, engaging in partnerships and joint ventures, and entering new markets with varying degrees of risk. These factors often lead MNEs to create ownership structures tailored to solving specific governance issues where, for example, cross-shareholdings are used to achieve levels of control disproportionate to nominal shareholding levels or as levers of control in partnerships with minority shareholdings. They might tailor structures to financing needs, for example, where shared ownership and minority shareholdings are accepted to enable financing structures supported by outside investors – this is often the case in structures

Figure IV.8. Vertical ownership hierarchies and supply chains in the UNCTAD Top 100 MNEs



Source: ©UNCTAD analysis, based on the approach developed in Del Prete and Rungi (2015).

Note: The distance along the supply chain between parents and affiliates is calculated as the difference in absolute value between the “downstreamness” of the affiliate’s economic activity and its parent’s activity; the downstreamness indicator measures the relative distance of an economic activity or industry from the final consumer (Antràs and Chor, 2013).

resulting from M&As. And they might create legal entities for risk management purposes where the desire to limit legal and financial liabilities might induce an MNE to insert intermediate “firewall” companies.

Whereas business development and operational logic are determinants that are generally decided by the strategy and operations part of MNE management structures, governance issues are for the most part the domain of legal and finance departments. Thus, where vertical ownership chains may have some bearing on operational management, other complexities in ownership structures tend to be decided separately. Often, the optimal structures recommended by finance departments and legal counsel depend on location-specific institutions, rules and regulations.

Location-specific drivers: policies and institutions

Whatever the business driver for the setting up of new affiliates or the creation of new ownership links as a result of M&As, partnerships and joint ventures, these operations take place against the backdrop of country-specific institutional and policy environments. These environments by themselves often determine the shape of ownership structures, as MNEs will aim to design such structures in such a way as to incorporate specific jurisdictions and their associated advantages in ownership chains.

When MNEs set up financing vehicles or financial holding companies in ownership chains, they tend to place such activities in jurisdictions with strong institutions, highly developed financial systems and investor friendly legislation. Analysis of the affiliates of the Top 100 MNEs shows that 65 per cent of financial holding companies are placed in jurisdictions that rank in the top decile of the World Bank’s Rule of Law Index; 92 per cent of holding companies are located within the first quartile of the Index. This compares with an overall distribution of affiliates of 37 and 86 per cent, respectively.

Fiscal advantages offered in individual jurisdictions are among the most important determinants of complex ownership structures. Table IV.2 showed that large MNEs, on average, own almost 70 affiliates in OFCs. A number of studies have shown that MNEs with affiliates in OFCs pay lower effective corporate tax rates at the group level than other MNEs.¹⁰ *WIR15* detailed how certain well-known tax avoidance schemes (for example the notorious “Double Irish-Dutch Sandwich”) operate through ownership structures that are tailored around OFCs. These jurisdictions act as major investment hubs, typically featuring as intermediate locations in ownership structures and acting as investment conduits. A significant part of profit shifting by MNEs takes place by means of direct investment links, including equity participation, to and from OFCs.

In cross-border mergers, decisions on the ownership structure of the resulting entity often depend on tax considerations; for example, the choice of which of the merging firms becomes the parent company of the combined entity may depend on the approach to taxation of foreign dividends in the countries involved.¹¹ Tax has even become a driving force of M&A transactions per se (in addition to the resulting ownership structures), as witnessed by inversion deals in which United States MNEs redomicile through a transaction with a foreign company, making the foreign company the new parent entity. Such inversions – of which there have been 23 since 2012 according to the United States Congressional Research Service – can provide access to significantly lower corporate taxes than the United States rate, and allow utilization of retained earnings held outside the United States. The recent cancellation of pharmaceutical firm Pfizer’s \$160 billion merger with Allergan (based in Ireland), after the introduction of new rules designed to undercut tax inversion deals, is proof of the fundamental role of fiscal policy in driving ownership structures.

Tax treaties are also important factors behind ownership links between affiliates. More than 80 per cent of ownership links (both direct and ultimate ownership) are covered by double-

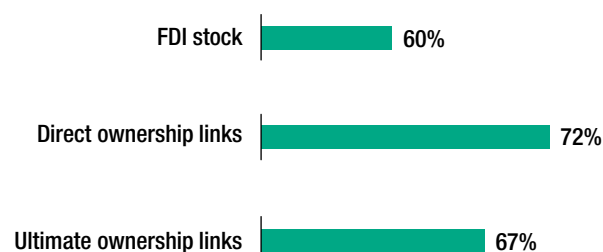
taxation treaties (DTTs). Investments in countries with relatively high withholding tax rates are often structured through intermediate entities in jurisdictions that have a DTT in place with the intended host country (see *WIR15* for a detailed discussion).

Finally, investment policies, at both the national and international levels, also play a role in determining ownership structures. National investment policy may dictate certain structures through ownership limitations or JV requirements, making shared ownership of foreign affiliates with domestic shareholders a necessity.

Similarly, the coverage of investment treaties can drive ownership structures. Figure IV.9 shows that IIAs cover 60 per cent of FDI stocks, but more than 70 per cent of direct ownership links. This can be explained by the fact that countries where MNEs deem IIA coverage more important tend to be less developed countries that receive lower absolute amounts of investment. Interestingly, the coverage of ultimate ownership links is somewhat lower (at 67 per cent) than the coverage of direct ownership links, suggesting that MNEs gain in coverage through the use of indirect ownership links, often through major investment hubs, such as the Netherlands, Luxembourg, Singapore or Hong Kong, China, which have extensive networks of BITs.¹²

The relationship between MNE ownership structures and national and international investment policies is examined in detail in section D.

Figure IV.9. Coverage by IIAs of FDI stock, direct ownership links, ultimate ownership links (Per cent)



Source: ©UNCTAD analysis; UNCTAD bilateral FDI database; Orbis data (November 2015); IIA database.

4. Looking ahead: trends in ownership complexity

The long-term trend that causes an increasing share of international production to be concentrated in the largest MNEs is also likely to bring continued growth in MNE ownership complexity worldwide, because complexity is disproportionately present in the corporate structures, and especially the foreign operations, of the largest MNEs. The growing importance of digital-economy MNEs is likely to further accelerate this process. Policy and institutional determinants might act as a brake on growing ownership complexity.

The key determinants of MNE structures can provide some insight into the possible future evolution of ownership complexity. Section A highlighted a number of factors that have caused complexity in MNE ownership structures to increase to its current level, including the growth of international production and with it the growth of MNEs; the increasing fragmentation of production that is causing MNEs continuously to reconfigure international supply chains; and the modalities of MNE growth through mergers and acquisitions and through JVs and partnerships between firms. These factors are still at play, affecting in particular the MNE-specific determinants discussed above.

Given the finding in this section that complex ownership structures are disproportionately present in a relatively small group of very large MNEs, i.e. they concentrate at the extreme end of the MNE distribution curve, one important factor that has contributed to increasing ownership complexity in the universe of MNEs is the increase in the relative importance of the largest MNEs in that universe. This is compounded by the fact that ownership complexity, and in particular the length of ownership chains, is higher for foreign affiliates than for the domestic part of MNEs (for example, the average hierarchical distance from the parent of foreign affiliates of the Top 100 is 3.0, compared with 2.4 for their domestic affiliates). Therefore the increasing level

of internationalization of MNEs and the relative size of their foreign business is an additional important factor behind the growing ownership complexity.

Basic statistics of international production for the Top 100 MNEs, published every year in the *WIR*, show how the size and level of internationalization of the largest MNEs have significantly increased over the last 20 years (table IV.4).¹³ The assets of the largest MNEs have grown far more rapidly than the overall economy and stayed ahead of international production indicators, and the share of foreign assets, sales and employees has increased from less than half to about 60 per cent over the last two decades.

The growth of very large MNEs, and the level of internationalization of MNEs, does not appear to have reached saturation point. The pace of growth in internationalization of the largest MNEs is not slowing down. At most, there is a shift in balance between, on the one hand, the growth rates of international (physical) assets and employees, which may slow down earlier, and on the other hand, international sales, which will continue to grow as new technologies make it possible to reach international markets with fewer physical operations. (In fact, assets overseas include a growing share of intangible assets.) However, in most cases, this will not diminish the need to create legal entities and ownership links.

The opposite is probably true. New technologies and the growing importance of e-business pervade each of the factors behind increasing complexity highlighted above. They cause new types of MNEs to grow to international scale at faster speed than ever; they provide new opportunities to separate production from consumption and to break up value chains; and they accelerate the process of creation and renewal of enterprises that form technology partnerships and engage in deal making at unprecedented levels.

Paradoxically, digital-economy firms are often regarded as potentially flatter in their organization structures than traditional companies. Judging from an analysis of digital-economy firms in the Top 100 MNEs (e.g. Alphabet, Apple, Microsoft), this can be mostly ascribed to the fact that they are younger and have not yet developed lengthy ownership chains to the same extent as older MNEs. However, they do not obviously make less use of complex elements, especially ownership hubs, than traditional MNEs. The frequent confrontations between digital-economy companies and public authorities in numerous countries related to their indirect ownership of affiliates through entities in OFCs are an indication that, if anything, these companies have more opportunities to design fiscally and financially optimal ownership structures, almost unconstrained by physical operating structures. Alphabet's recent corporate restructuring, overlaying a holding structure on top of the Google business, is further evidence that the same forces of growth and governance apply to traditional as well as digital-economy MNEs.

Table IV.4.

Evolution of internationalization statistics for the top 100 MNEs
(Index 1995 = 100)

	1995	2000	2005	2010	2015
Total assets	100	151	212	291	314
Foreign as % of total	41%	50%	54%	61%	62%
Total sales	100	113	158	184	187
Foreign as % of total	48%	50%	57%	63%	65%
Total employment	100	118	126	134	144
Foreign as % of total	48%	48%	53%	58%	58%
Memorandum					
World GDP	100	109	153	213	252
World Gross Fixed Capital Formation	100	108	154	213	265

Source: ©UNCTAD analysis.

Note: Trends on Top 100 MNEs are derived from UNTAD's *WIR* (different years); data on GDP and GFCF are from IMF (2015).

The institutional and policy determinants of MNE ownership structures can provide further incentives for increasing ownership complexity, but they can also slow down ownership complexity (or even push towards simplification). Looking back at the past decade, there is clear evidence of an explosion in cross-border tax planning and transit investment schemes. *WIR15* showed that the share of global FDI through tax havens doubled from 5 per cent to 10 per cent between the beginning and the end of the 2000s. The share of global investment flows through offshore hubs including special purpose entities, often used for cross-border financing structures, increased from 19 to 27 per cent over the same period. Differences in the fiscal and institutional environments between economies and specific advantages offered by individual jurisdictions can be exploited by MNEs through the incorporation in ownership chains of intermediate entities. To date, these differences and location-specific advantages have acted to vastly increase ownership complexity.

Differences between jurisdictions will not disappear any time soon. However, the extent to which they can be exploited with relative ease by MNEs is being curtailed through initiatives such as the OECD's Base Erosion and Profit Shifting (BEPS) plan, the Agreement on Exchange of Information on Tax Matters, and legislative action at national and regional levels (e.g. the European Union's amended Parent Subsidiary Directive, and other legislative initiatives such as the recently proposed anti-avoidance package).¹⁴ The increased attention by authorities and the public to overly complex corporate structures designed solely for the purpose of obtaining certain institutional or policy benefits (especially fiscal benefits) is likely to drive further policy initiatives aiming to simplify corporate structures and to render them more transparent.

C. COMPLEX OWNERSHIP OF AFFILIATES AND THE BLURRING OF INVESTOR NATIONALITY

1. A new “bottom-up” perspective on ownership structures

Insights on the ownership structures of MNEs as a whole (top-down perspective) are useful to show overall complexity. However, for investment policymakers, a bottom-up perspective looking at the ownership chain starting from the foreign affiliate, through its direct owners, up to its ultimate owner can be more helpful. For WIR16, UNCTAD has developed a firm-level dataset based on Orbis including some 4.5 million companies that enables a bottom-up approach.

Affiliates at lower levels in ownership hierarchies can have one or more direct shareholders and numerous indirect shareholders in addition to the ultimate owner or parent company; these companies may be located in as many countries (see figure IV.1 in section A).

The distinction between the direct and the ultimate shareholder levels is important when examining ownership structures through an investment policy lens. The traditional approach to studying ownership structures is a top-down approach, looking at all possible ownership links in a given corporate group, i.e. starting from the parent company.¹⁵ The stylized structure in figure IV.3 in the preceding section is an example of a top-down perspective on the ownership “pyramid” of an MNE.

For the investment policymaker, starting from the affiliate – the foreign participated company in the host country – is a critical perspective. It is not necessary to see the full complexity of all affiliates within a corporate group; the focus is primarily on the direct owner and the ultimate owner and, for some specific purposes, the ownership chain. For that reason, this Report introduces an innovative approach to the analysis of MNE ownership structures, the “bottom-up” perspective.

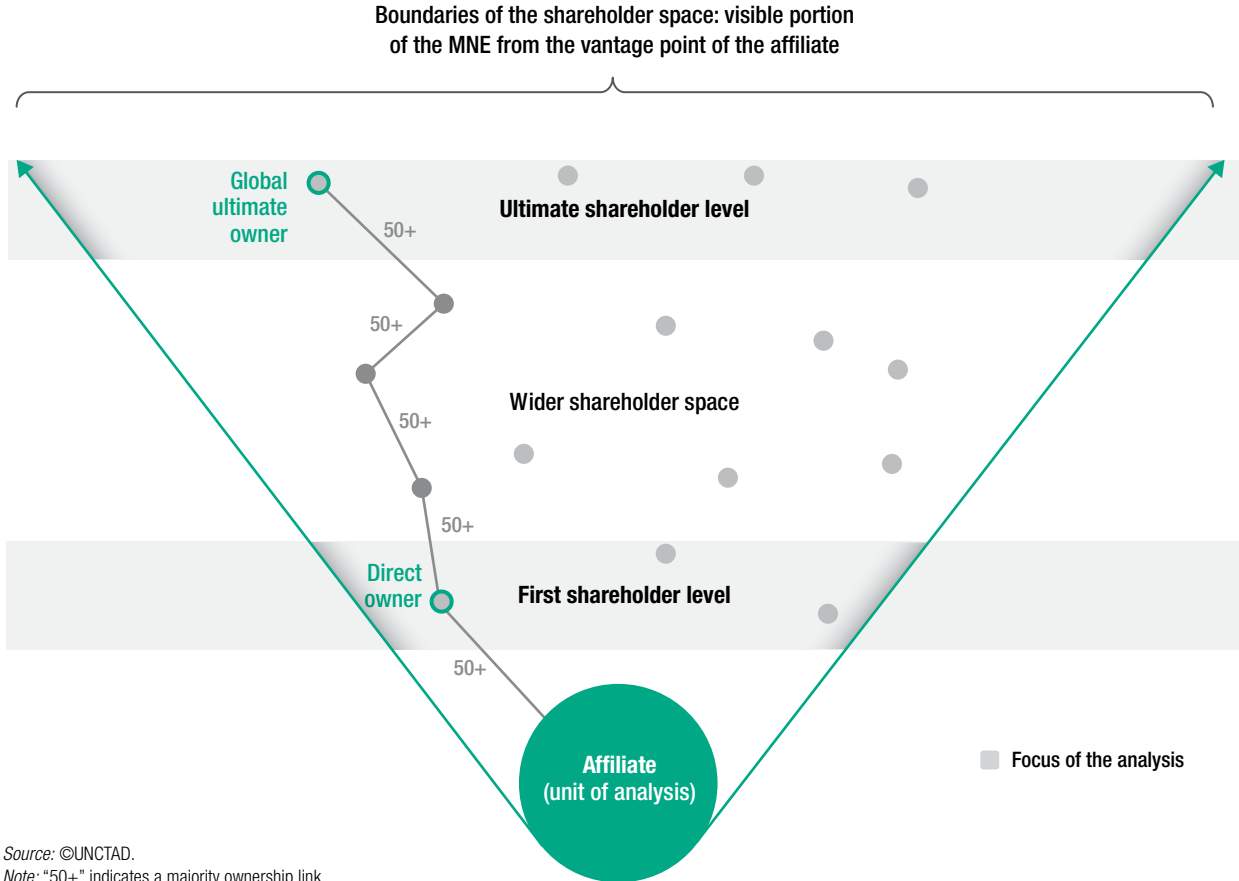
The two approaches have different entry points and answer different questions. The top-down approach is helpful in describing the ownership structure of individual MNEs, in illustrating elements of complexity in corporate structures, and in exploring the drivers and determinants of ownership structures. The bottom-up approach is helpful in describing the shareholder space for individual affiliates, in mapping the ownership chain from the direct shareholder level to the ultimate owner, and in assessing the “depth”, “width” and “transnationality” of ownership networks for large aggregates of companies (e.g. by country, by region, by industry). The two approaches present different analytical challenges, but both rely on detailed firm-level data.

The bottom-up approach starts from the individual affiliate and analyses its shareholder space (see figure IV.10). Unlike in the top-down (parent-driven) approach employed in section B, the perimeter of analysis is defined by the affiliate: it includes all the companies that directly or indirectly own a stake in the target affiliate. Since it is computationally unfeasible to map the wider shareholder space for a globally representative sample of firms, the bottom-up approach focuses on the analysis of the two layers that are more relevant from a policy perspective: (i) the direct shareholder level, and (ii) the ultimate shareholder level. The path that leads to the identification of the ultimate owners (grey path in the figure) is a chain of majority shares, where the first element in the chain is the direct owner and the last element is the global ultimate owner (or GUO – adopting Orbis terminology). As the analysis focuses on corporate

shareholders, the GUO is a corporate entity (including corporate industrial, corporate financial, foundations/nonprofit and public entities); specifically it is defined as the highest corporate shareholder in the shareholder space of the subject company such that each link from the subject company to the GUO has a qualified share above 50 per cent.¹⁶ Despite the focus on direct and ultimate shareholder levels, it is possible to compute some indicators of vertical complexity of the wider shareholder space, including the number of links from the affiliate to its GUO (hierarchical distance) and the number of jurisdictions transited by the majority ownership chain.

The bottom-up analysis developed for *WIR16* required a massive extraction of firm-level ownership information from Bureau van Dijk's Orbis database, followed by a number of cleaning and elaboration steps to create a workable dataset. Box IV.3 describes the construction of the database.

Figure IV.10. A "bottom-up" perspective on MNE ownership structures: the view from the host country



Source: ©UNCTAD.
 Note: "50+" indicates a majority ownership link.

Box IV.3. The firm-level ownership database used in *WIR16*

The firm-level database constructed for the bottom-up analysis of MNE ownership structures in *WIR16* is based on Bureau van Dijk's Orbis database, the largest and most widely used database of its kind, covering 136 million active companies (at the time of extraction, in November 2015) across more than 200 countries and territories, and containing firm-level data sourced from national business registries, chambers of commerce and various other official sources.

The overall Orbis dataset was narrowed down to various subsets needed for different analytical purposes, and to a final dataset on 4.5 million companies, through a series of steps (see box figure IV.3.1).

/...

Step 1: Extraction of companies with ownership information. This step (the initial data extraction from Orbis) captures all companies that have at least one reported shareholder with a non-zero stake. In the process, it removes *branches* and nearly all *sole traders and proprietorships*, as well as filtering out companies for which information is missing.

Step 2: Companies with full shareholder information. This step cleans the dataset to include only companies with complete information on location and stakes of direct shareholders, and a sum of direct shares above 50 per cent (for about 80 per cent of selected companies the aggregate share is 100 per cent).

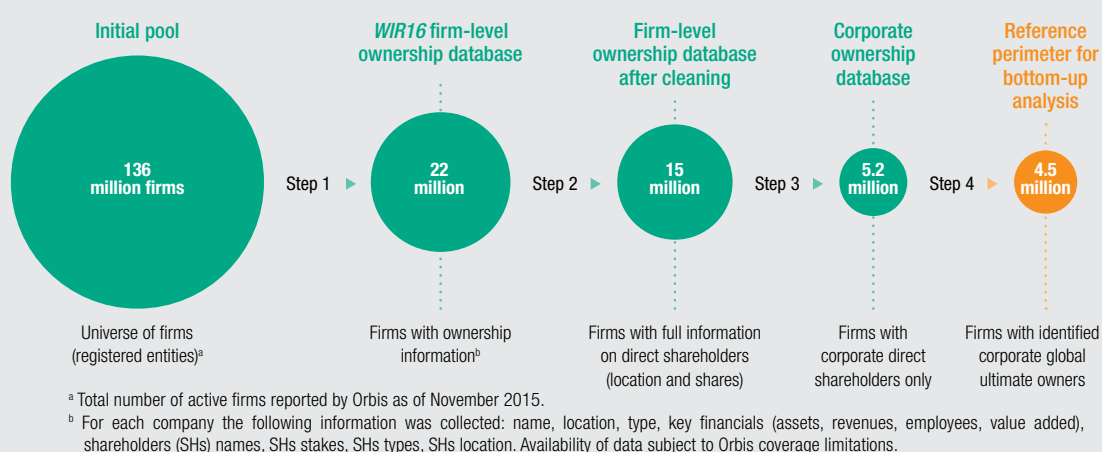
Step 3: Companies belonging to corporate groups. This step selects companies that have shareholders of the following types only: corporate industrial, corporate financial, foundations/nonprofit, and public entities. It removes companies with individual or family shareholders and any remaining self-employed and marginal groups.

Step 4: Companies with a clear corporate global ultimate owner. This step narrows the dataset down to companies that have complete and consistent information on the GUO and on the path to the GUO (controlling shareholders). The resulting database thus includes a relatively homogeneous set of companies that have (i) direct corporate shareholders and (ii) full information on direct shareholders and global ultimate owners. These conditions restrict the perimeter to affiliates of corporate groups, in line with the scope of the *WIR*. (Foreign affiliates are a subset of the 4.5 million companies, with direct or ultimate foreign ownership.)

There are some objective limits to the coverage of firm-level information. Despite the fact that Orbis is acknowledged as the most comprehensive provider of global firm-level information, the coverage in some developing countries, in particular in Africa, is poor, both in terms of the number of companies reported and in terms of the information available for each company. Some features of the dataset and analyses employed in this chapter mitigate such coverage issues:

- Unlike most firm-level studies that focus on financials or operating performance, the analysis here focuses on shareholder information, for which Orbis coverage is significantly better. For developing countries, almost 1 million companies report complete shareholder information (shares and location). Of these, only some 150,000 report all key financials (revenues, assets and employment). For Africa, the most problematic region for data availability, about 40,000 companies report complete shareholder information, only 5,000 of which report any information on financials.
- Coverage of shareholder information is much better for companies with corporate shareholders than those with individual and/or family shareholders. Almost 95 per cent of the corporate-owned companies (with known shareholders) also report information on shares and location of the shareholders. The share decreases to 60 per cent for family-owned companies.
- Coverage of companies with foreign shareholders is relatively higher for developing countries than for developed countries (about 50 per cent of the sample against a global average of 15 per cent). Foreign affiliates are more prominent in the sample of reporting firms in developing countries because they are generally larger, and because thresholds for reporting tend to be higher (i.e. relatively fewer domestic companies report). This suggests that the coverage of the database for the purpose of studying foreign affiliates is generally good.

Box figure IV.3.1. Construction of the *WIR16* firm-level ownership database based on Orbis



To fully exploit these advantages, the descriptive statistics in this chapter are based mainly on numbers of firms, and carefully calibrated to avoid interpretations influenced or biased by coverage. For the key results, a revenue-weighted version is also provided, based on the subsample of companies that report revenues (about 940,000 firms out of the 4.5 million firms in the perimeter of analysis). Revenue figures used for calculations are in general unconsolidated; consolidated figures are employed only for those firms where unconsolidated ones are not reported.

Source: ©UNCTAD.

2. The ownership matrix and the investor nationality mismatch index

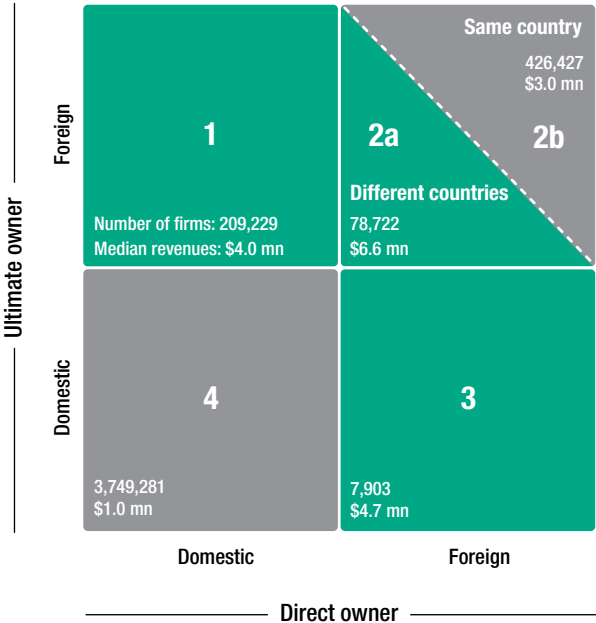
Comparing domestic and foreign direct owners and ultimate owners (in a two-by-two ownership matrix) leads to the identification of ownership scenarios relevant to investment policy in which the direct owners and ultimate owners of an affiliate are based in different jurisdictions. These nationality “mismatch” cases account for 41 per cent of all foreign affiliates, and 50 per cent when measured by revenues. About 29 per cent of foreign affiliates are indirectly foreign owned (through a domestic entity); 11 per cent are owned through an intermediate entity in a third country; about 1 per cent are ultimately owned by a domestic entity (round-tripping investment). The investor nationality “mismatch index” is considerably higher for the largest MNEs: 60 per cent of their foreign affiliates have multiple cross-border ownership links to the parent company.

The focus on direct versus ultimate ownership, facilitated by the bottom-up analytical approach, is a helpful simplification tool to illustrate the “investor nationality conundrum” facing investment policymakers. Comparing the location of the direct and the ultimate owners for all companies (i.e. including domestic ones) yields a two-by-two matrix that contains all possible investor-nationality scenarios (figure IV.11).

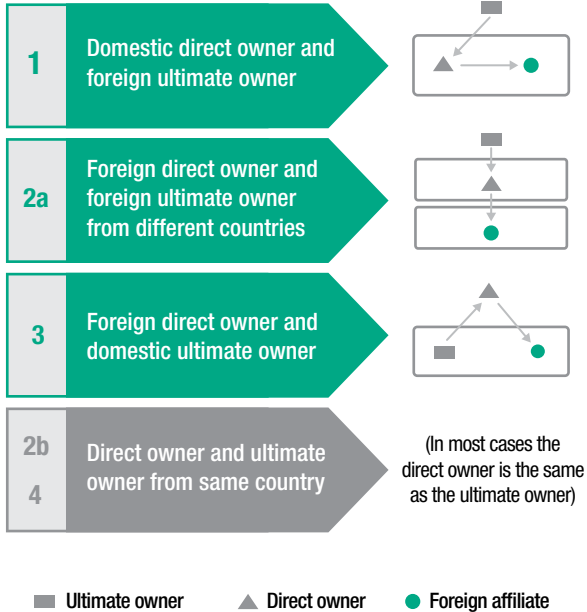
In the figure, the bottom-left quadrant (4) contains purely domestic companies. Although all companies can be plotted in the matrix, making the sample very large (4.5 million), and although the *WIR16* dataset specifically focuses on the relevant perimeter of corporations (excluding companies owned by individuals, sole proprietors, etc.), the distribution across the quadrants may still be influenced by the relative coverage of different types of firms in the sample.

Figure IV.11. | The ownership matrix

Direct vs. ultimate owner and foreign vs. domestic



Cases



Source: ©UNCTAD analysis based on Orbis data (November 2015).
 Note: All the firms mapped in the matrix report one direct shareholder with a majority stake above 50 per cent (the *direct owner* on the x-axis). The *ultimate owner* on the y-axis coincides with the direct owner when the direct owner does not report a majority direct shareholder (hierarchical distance 1). Otherwise the ultimate owner is the last corporate entity of the *majority ownership chain*, i.e. the chain of majority shareholders with the direct owner as first node. mn = millions.

This affects in particular the large number of purely domestic firms. The remainder of the analysis here focuses on foreign affiliates. For the purpose of this chapter, the companies in the remaining three quadrants of the matrix (1, 2 and 3), i.e. with either a foreign direct owner or a foreign ultimate owner, are considered foreign affiliates.¹⁷

Within the group of foreign affiliates, a distinction should be made between the companies labelled 1, 2a and 3, on the one hand, and 2b on the other. The 2b companies either are directly owned by their ultimate owner (the majority of cases), or have a direct owner that is located in the same country as the ultimate owner. This case is less interesting, from an investment policy perspective, than the others, where there is a “mismatch” between the nationality of the direct owner and the ultimate owner. (In the matrix, the mismatch cases are contained in the green sections.)

The top left quadrant of the matrix (1) contains companies that are directly owned by another affiliate in the same host country, which is ultimately owned by an MNE parent in another country. This group contains many companies that are part of host-country corporate structures in which the foreign investor owns a holding company which in turn owns various operating companies in that market. It also contains cases in which a foreign investor may have acquired a host-country firm with its own (pre-established or subsequently created) affiliates.

The half-quadrant 2a includes companies that are part of vertical ownership chains in MNEs, with intermediate and ultimate owners in different countries. As observed above, this structure is very common, for example, where MNEs make use of ownership hubs.

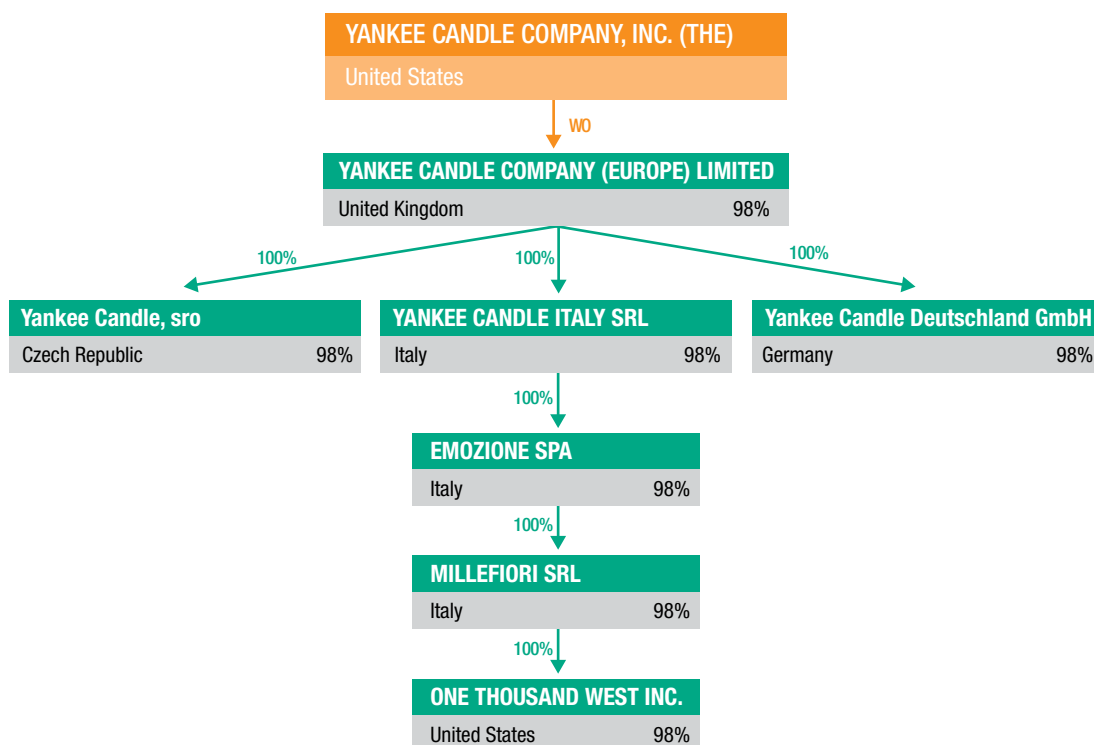
The bottom-right quadrant contains cases of round-tripping. It may occur where MNEs acquire or merge with another MNE based overseas that itself already owned affiliates in the home country of the acquirer (see figure IV.12). Or it may occur where MNEs deploy ownership structures organized on a divisional basis, with a divisional headquarters based outside the home country owning companies belonging to its line of business inside the home country. Or it may be driven by non-business reasons, e.g. where domestic companies use offshore locations to channel investments back to their own country.

The policy-relevant cases (1, 2a and 3) can often be found in the same MNE, as shown in the example in figure IV.13. Whereas in a traditional top-down approach all affiliates in the example belong to the same analytical object (the business group as defined by the parent), in the bottom-up approach each affiliate defines a shareholder space that can result in a different positioning in the ownership matrix. From the point of view of the host countries where each affiliate operates this is, in general, the perspective with more relevant policy implications.

The shared characteristics of cases 1, 2a and 3 are an ownership chain containing at least two steps (i.e. hierarchical distance equal to or greater than 2), and multiple countries (and in the case of 2a and 3, multiple border crossings) between the affiliate and its ultimate owner. Affiliates at hierarchical level one, i.e. directly owned by the parent company, cannot manifest situations of divergence between the direct owner and the ultimate owner (and their respective jurisdictions), that present a challenge for nationality-based investment policies. Figure IV.1 already illustrated the relative importance of these complex cases. They represent about 41 per cent of the universe of MNE foreign affiliates, but about 50 per cent of the revenues generated by foreign affiliates (figure IV.14).

The relative weight of the three cases varies significantly. The most common case is 1, about 29 per cent of all foreign affiliates, particularly relevant in large, developed countries where MNEs tend to create in-country ownership networks. Case 2a involving at least two foreign countries corresponds to 11 per cent of foreign affiliates, whereas case 3 (round-tripping) is confined to only 1 per cent of foreign affiliates. The relative importance of the cases does not change significantly if weighted by revenues.

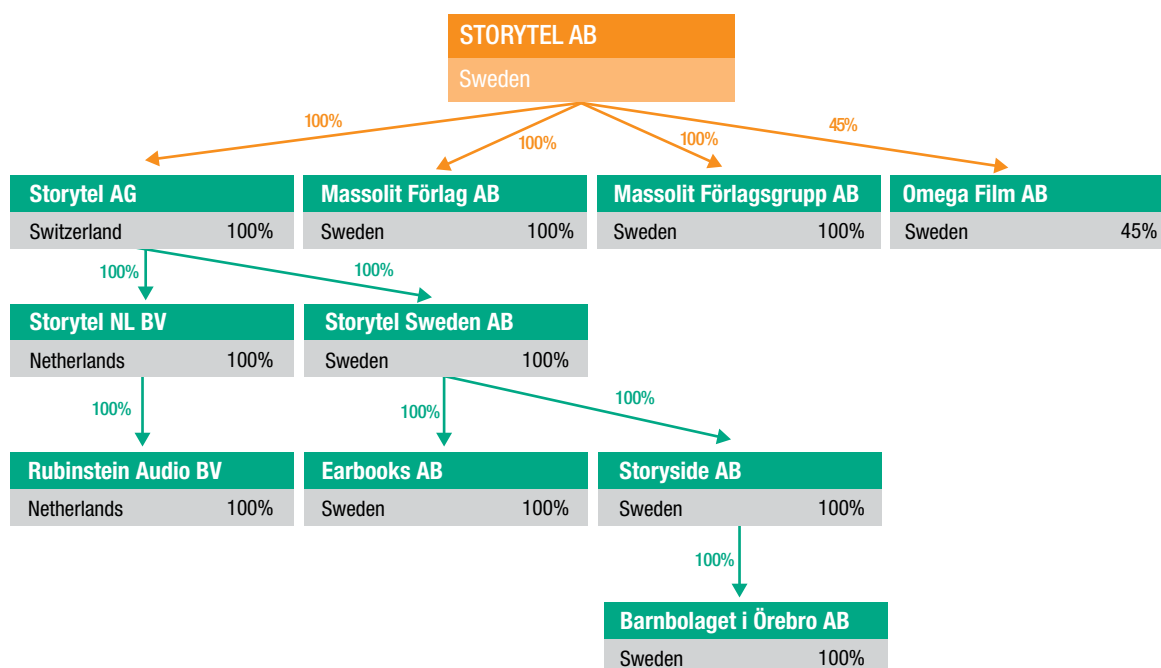
Figure IV.12. Round-tripping through M&A growth



Source: Orbis, T-Rank visualization (March 2016).

Note: The example shows a case of round-tripping by means of an M&A operation. In 2014, YANKEE CANDLE ITALY srl, subsidiary of US YANKEE CANDLE COMPANY, INC, and part of United States consumer good giant Jarden corporation, bought from private equity APE sgr the Italian candle company MILLEFIORI spa through its holding Emozione srl. As part of the acquisition Yankee Candle absorbed One Thousand West Inc, United States subsidiary of Millefiori srl, giving rise to a United States–United States round-tripping case through Italy. This example shows a case of round-tripping through (inorganic) growth, very different in nature from round-tripping motivated by financial and tax planning reasons. WO = wholly owned.

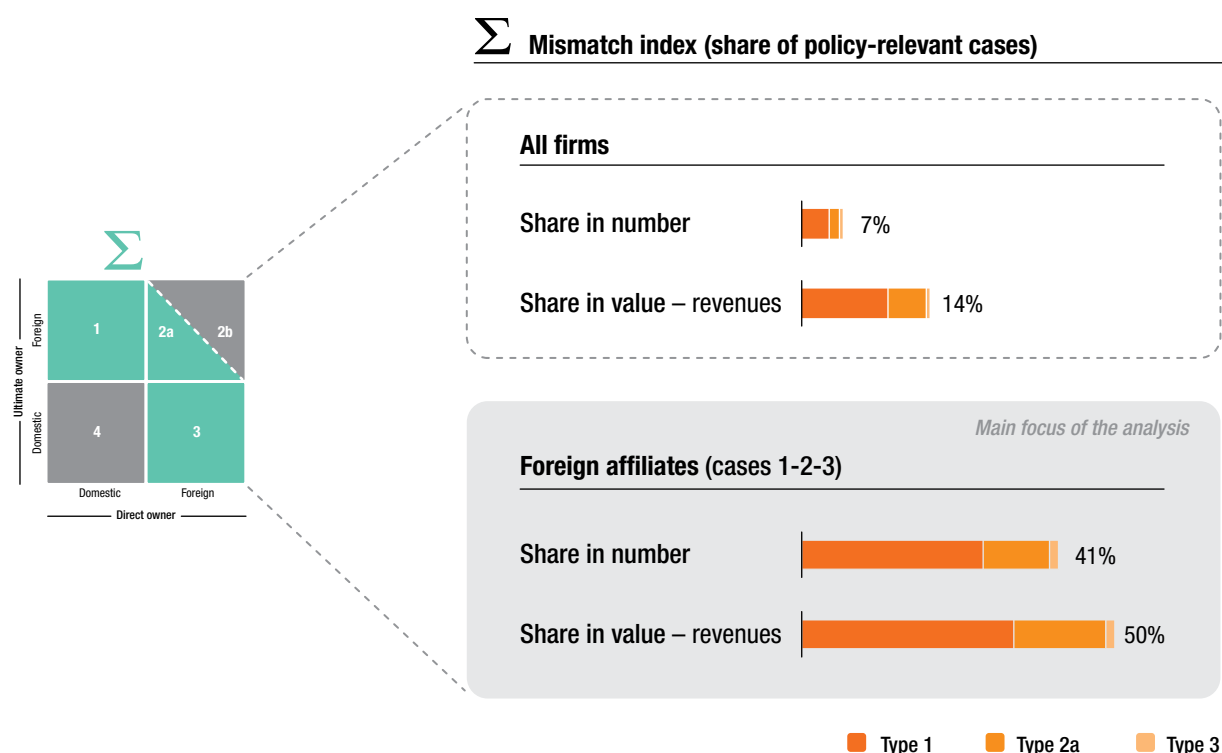
Figure IV.13. Combination of all mismatch cases in one MNE



Source: Orbis, T-Rank visualization (March 2016).

Note: The example shows a common MNE ownership structure that combines all three relevant cases (1, 2a and 3) of figure IV.11. Case 1. Rubinstein Audio B.V. is incorporated in the Netherlands with a domestic direct owner (Storytel NL BV) but a foreign ultimate owner (STORYTELL AB) from Sweden. Case 2a. Storytel NL B.V. has foreign direct owner (Storytel AG) and a foreign ultimate owner (STORYTELL AB) from different countries, Switzerland and Sweden respectively. Case 3. Storytel Sweden AB has a foreign direct owner from Switzerland (Storytel AG) and a domestic ultimate owner (STORYTELL AB). Note that all four affiliates at the first hierarchical level in the ownership structure (at hierarchical distance 1 from the parent) belong to the cases that are less relevant from a policy perspective (either 2b or 4).

Figure IV.14. | The investor nationality mismatch index



Source: ©UNCTAD analysis based on Orbis data (November 2015).

Note: Shares in number are based on 4,471,562 companies for the main sample and on 722,281 companies for the group of foreign affiliates, corresponding to cases 1, 2 and 3. Shares in value are based on the subset of companies that report revenues (or sales if revenues unavailable); this includes 937,812 of which 257,242 are foreign affiliates.

Clearly, complex structures are more frequently found in larger MNEs, and their affiliates on average are larger. The fact that complex structures are a phenomenon of larger MNEs, with larger affiliates, is clearly illustrated in figure IV.15.

This figure further breaks down the complex cases (1, 2a and 3) in groups ranked by hierarchical distance from the ultimate owner. The longer the ownership chain from each company to its ultimate owner, the larger the incidence of complex cases. By definition, the 41 per cent of complex cases are all found in foreign affiliates with a hierarchical distance higher than 1. As expected, while the number of companies decreases rapidly with hierarchical distance, the share of complex cases increases, from an average 74 per cent for foreign affiliates with a hierarchical distance higher than 1 to 93 per cent of cases for foreign affiliates with a hierarchical distance above 5. At the same time, the average revenues increase significantly, which explains why the revenues-weighted average share of complex cases in figure IV.14 is higher. This appears to belie the notion that the bottom of MNE ownership pyramids would be populated mostly by smaller companies; the effect (in the data) of belonging to a large corporate group is evidently stronger than the effect of being placed low in the hierarchy.

The distribution of companies by hierarchical distance indicates that the universe of affiliates is highly skewed. There is a large number of affiliates with simple ownership links to their parents. There is an exceedingly small number of affiliates with highly complex ownership paths to their ultimate owner, with hierarchical depths of more than five levels, but these affiliates account for a disproportionate share of economic value. This is a general feature of the distribution of complexity in business groups observed also in other analysis (see for example the distribution of MNEs by number of affiliates in figure IV.6).

The number of countries transited in the ownership chain is not particularly sensitive to increases in the hierarchical distance. The average number of countries passed through from affiliate to ultimate owner is 2.5 on average and, with exceptions, it does not tend to increase much beyond that even as the space for additional intermediate countries grows at the same pace as the hierarchical distance. This indicates that even within complex chains, multiple ownership links often take place within a single country, be it the host country, a conduit jurisdiction or the home country of the parent. The case examples above (figures IV.12 and IV.13) clearly show how the number of countries crossed from the bottom to the top is often significantly lower than the number of steps.

Figure IV.15 also contains the same data for foreign affiliates of the largest MNEs (UNCTAD's Top 100 MNEs). The share of foreign affiliates with a nationality mismatch between direct and ultimate owners increases from 41 per cent in the overall sample to 60 per cent. This is mostly driven by a different distribution of the affiliates by hierarchical distance; for larger MNEs the distribution is smoother and less skewed toward simple cases. The share of foreign affiliates with multiple links to the ultimate owner is higher (at 75 per cent against 56), and this remains the case systematically at all levels of hierarchical distance. Interestingly, the incidence of complex cases by level of hierarchical distance is substantially the same for the two samples. However, the revenue data show the opposite of the picture for all foreign affiliates. As the hierarchical distance increases the average size of affiliates decreases, in line with the idea that *within* each group companies at the bottom of the hierarchy tend to be smaller; in the context of the largest MNEs, the effect of belonging to a large group observed in the main sample, does not play a role. Finally, also for the largest MNEs, the average number of countries transited along the ownership chain does not change significantly with hierarchical distance; for each level of hierarchical distance it is substantially the same as for the average group.

Figure IV.15. Breakdown of MNE foreign affiliates by hierarchical distance

	All foreign affiliates				Foreign affiliates of the largest MNEs (UNCTAD Top 100)			
	Share of FAs	Mismatch index	Average number of countries	Average revenues (indexed to 100)	Share of FAs	Mismatch index	Average number of countries	Average revenues (indexed to 100)
All	100	41%	2.5	100	100	60%	2.5	100
HD >1	56	74%	2.5	114	75	77%	2.5	83
HD >2	30	82%	2.6	125	53	82%	2.6	69
HD >3	16	88%	2.8	136	33	87%	2.8	56
HD >4	9	91%	2.9	152	18	93%	2.9	51
HD >5	5	93%	3.1	157	9	96%	3.1	60

Source: ©UNCTAD analysis based on Orbis data (November 2015).

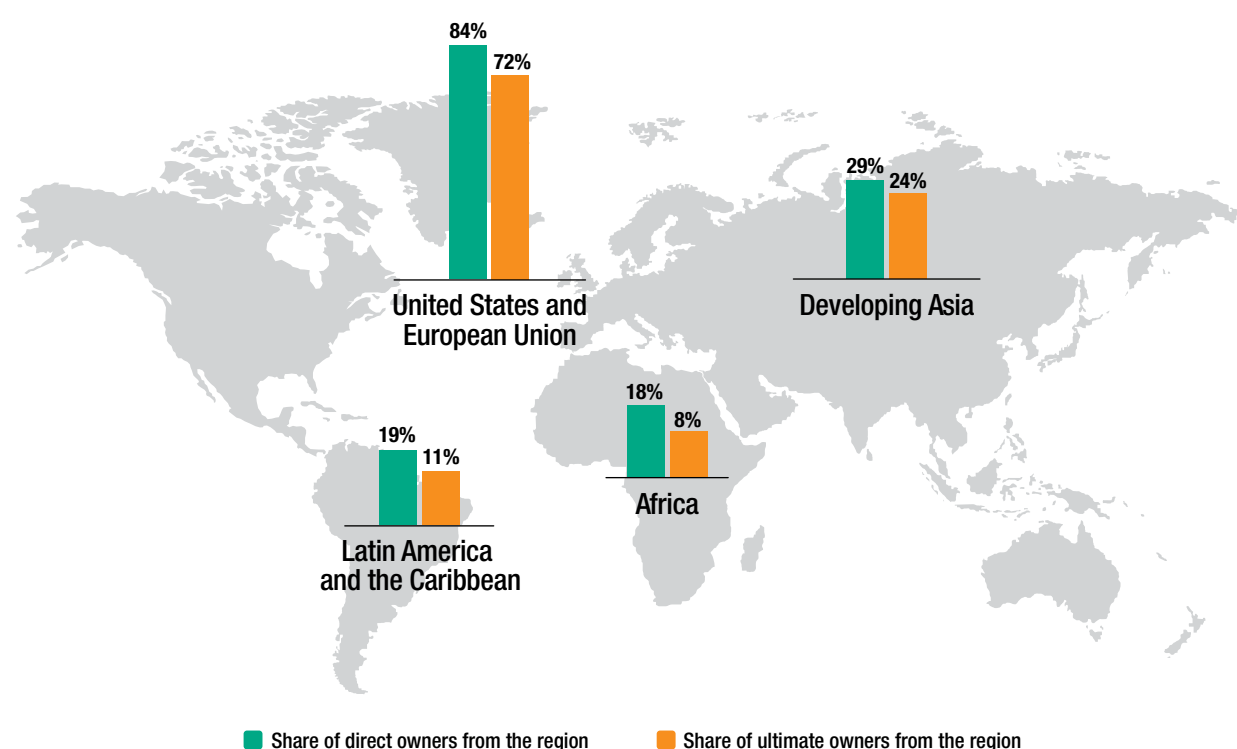
Note: The calculation of the average number of countries crossed is based on the sub-set of affiliates corresponding to the mismatch cases (direct and ultimate owners from different countries). HD = hierarchical distance from affiliate to the parent.

The blurring of investor nationality does not only impact investment policies at the firm-level; it also affects global patterns of corporate ownership. Figure IV.16 shows how intraregional ownership figures may change depending on the perspective adopted, from the direct owner or from the ultimate owner. This is particularly true for African and Latin American foreign affiliates, where the share of direct owners from the region (at 18 and 19 per cent, respectively) is much higher than the share of ultimate owners (8 and 11 per cent). This divergence between the direct ownership and ultimate ownership of foreign affiliates in developing regions may have important development implications. The picture of intraregional FDI and South-South FDI that emerges at first sight from macro data, which focuses on direct links, may be overstated when taking into account ultimate ownership.

The complexity indicators reported in figure IV.15 (the mismatch index and other related complexity indicators) are conservative. Their purpose is to illustrate the relevance of the issue of the blurring of investor nationality by setting a lower bound. Actual MNE ownership complexity is likely to be higher, for two main reasons:

- *The role of OFCs.* It is well known that OFCs usually play a conduit role in complex MNE structures (see also *WIR15*). However in the bottom-up analysis they often feature as GUO jurisdictions. This is because many of them do not report shareholder information, thus breaking the ownership information flow along the chain. This de facto excludes a portion of the relevant shareholder space (above the OFCs) from the ownership analysis, returning an overly simplified picture.
- *The role of individual and/or family GUOs.* The bottom-up exploration of the shareholder space stops at the corporate GUOs. This is due to a methodological choice to focus on corporate headquarters of MNEs as ultimate owners or parents. However there may be further levels of complexity at the beneficial shareholder level and through individual or family owners.

Figure IV.16. | Direct versus ultimate ownership of foreign affiliates by region (Per cent)



Source: ©UNCTAD analysis based on Orbis data (November 2015).

The phenomenon of round-tripping provides an example of how the bottom-up approach may underestimate ownership complexity. Round-tripping typically involves setting up companies in offshore jurisdictions to channel domestic capital back labelled as foreign investment. In the majority of cases, this capital consists of private wealth or is directly controlled by individuals (rather than companies). Such practices are often used to conceal the ultimate beneficial ownership of assets and to benefit from fiscal and other types of advantages. Many of the schemes exposed by the recent revelation of the Panama Papers fall in the category of round-tripping of private wealth.

Because of both limitations indicated above – the lack of transparency on ownership in OFCs, and the methodological choice to focus on corporate groups rather than individuals – the complexity of these cases is not captured by the bottom-up approach. This explains the marginal weight of round-tripping in the ownership matrix and its limited contribution to the mismatch index (at about 1 per cent for foreign affiliates). However, the relatively low significance of round-tripping in this picture is probably an accurate reflection of reality within MNE ownership structures.

3. A bottom-up map of affiliate ownership

At the direct shareholder level, 90 per cent of foreign affiliates are simply majority or fully owned by a direct owner. About 7 per cent of affiliates are mixed domestic-foreign joint ventures. Such partnerships are more common in countries with foreign ownership restrictions. Given the relative simplicity of the ownership structures of individual affiliates, most nationality mismatch cases are generated by vertical ownership chains. Mismatches involve almost half of foreign affiliates in developed economies, and more than a quarter in developing economies. Whereas in developed countries most mismatches are caused by multi-layered ownership structures within host countries, in developing countries they are more often the result of investments transiting through third countries.

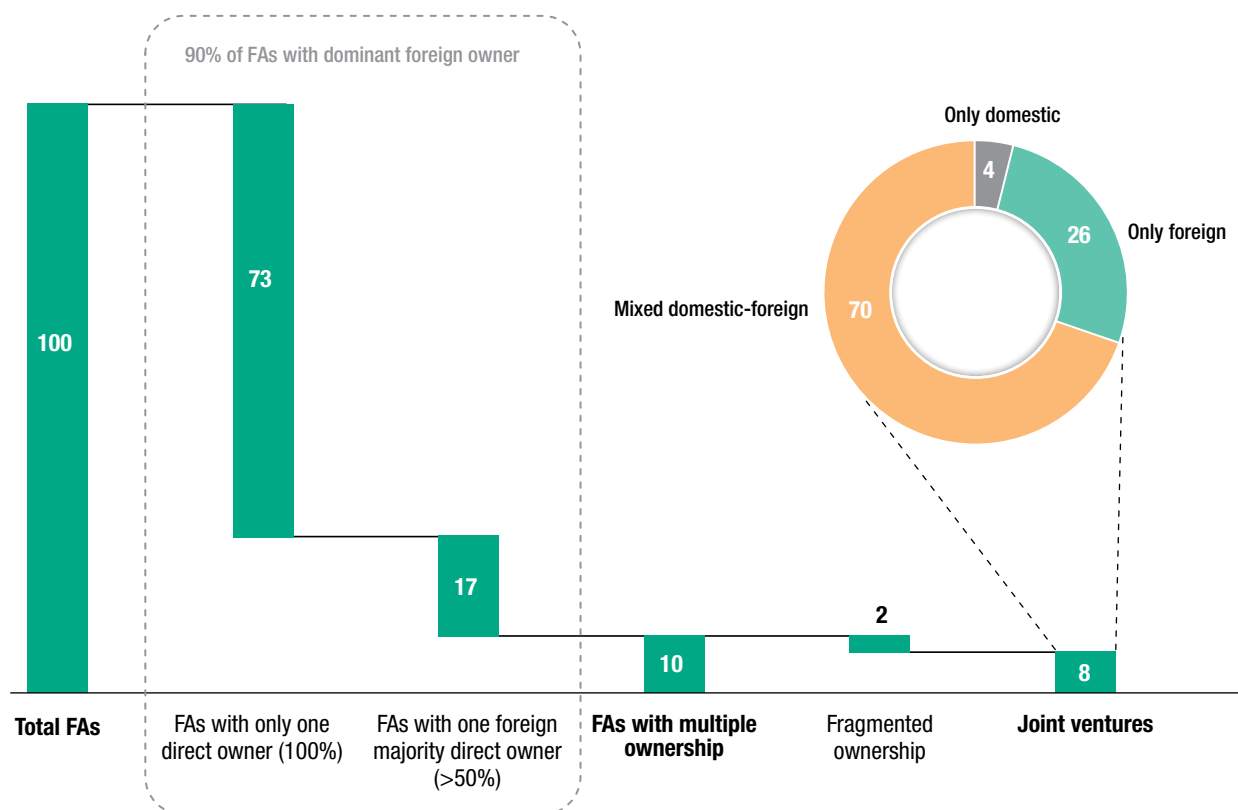
As discussed above, the focus of the bottom-up approach is the direct shareholder level, the ultimate shareholder level, and the comparison between the two. This section focuses on insights that can be distilled from the bottom-up analysis that are particularly relevant for the blurring of investor nationality: (i) dispersed ownership at the direct shareholder level and (ii) nationality mismatches between direct and ultimate owners.

Mapping the direct shareholder level

The total number of countries involved in the ownership structure of foreign affiliates does not depend solely on the vertical ownership chain leading to the ultimate owner. The number can increase where affiliates have multiple direct shareholders or even multiple ownership chains leading to the ultimate owner. The “horizontal complexity” of the direct shareholder space of foreign affiliates is thus potentially interesting. The analysis in this subsection is part of the bottom-up approach; it stops at the first level and explores it in all its “width” (as opposed to following the ownership path up to the ultimate shareholder level).¹⁸

The structure of the direct shareholder level appears exceedingly simple. Fully 73 per cent of foreign affiliates have an ownership structure with one direct shareholder owning 100 per cent of the affiliate (figure IV.17). Another 17 per cent have a direct majority (foreign) shareholder owning more than 50 per cent of shares. Only about 10 per cent of foreign affiliates have more complex direct shareholding structures. It appears that, for the vast majority of foreign affiliates, the complexity in ownership structures derives from the vertical ownership chain up to the parent, not from horizontal complexity.

Figure IV.17. Mapping the direct shareholder level of foreign affiliates (Per cent)



Source: ©UNCTAD analysis based on Orbis data (November 2015).

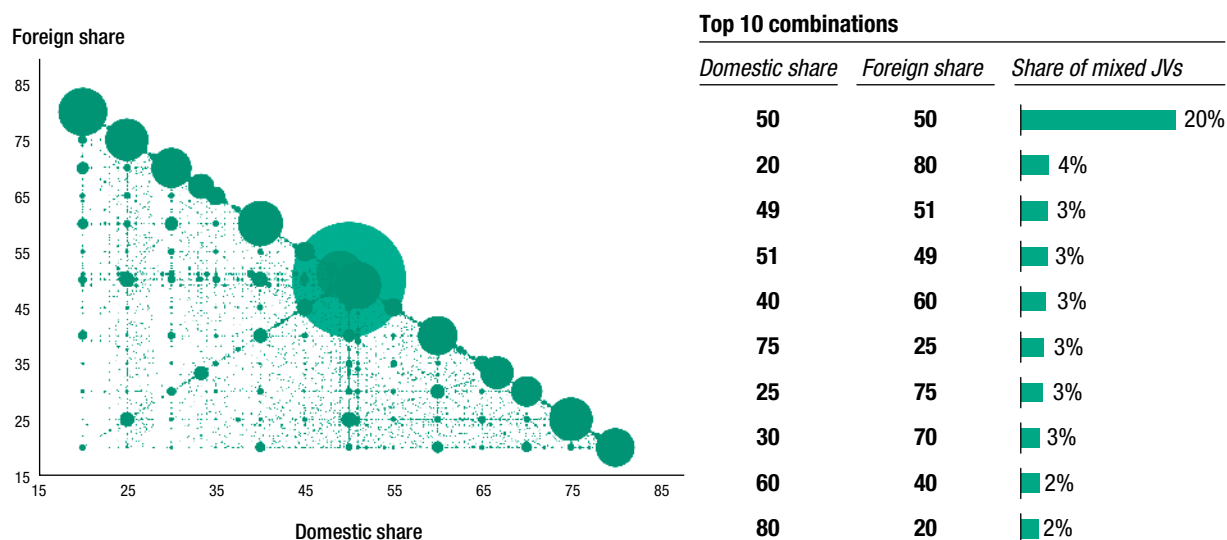
Note: Joint ventures: companies with at least two direct shareholders with a share of 20 per cent or higher. By this definition, some joint ventures (about 25,000 firms) can be found also in the subset of foreign affiliates with one foreign majority owner (second component in the waterfall). Adding this group, the total number of joint ventures is some 80,000 companies, or just over 10 per cent of the total number of foreign affiliates. FA = foreign affiliate.

Among the foreign affiliates with fragmented ownership at the direct shareholder level, the majority would conform to a definition of JVs as at least two partners, each owning a minimum equity stake of 20 per cent.¹⁹ Some 70 per cent of the JVs identified in this manner are partnerships between host-country firms and foreign investors.

Figure IV.18 maps the group of domestic-foreign JVs according to the shareholding distribution. By far the largest category of these JVs are 50-50 partnerships between foreign investors and domestic firms. The 49-51 combinations are the next most relevant, likely driven by either partner insisting on a controlling stake or by foreign equity limitations in investment policy rules. Other combinations also occur frequently, especially at round numbers.

Figure IV.19 shows the countries with the highest shares of mixed domestic-foreign JVs in the set of foreign affiliates, by economic grouping. The penetration of mixed JVs is highest in transition economies, while it is relatively limited in developing economies. Among developing economies, countries with a heavier presence of mixed JVs are concentrated in West Asia and in South-East Asia, and are often characterized by a significant numbers of investment policy restrictions and JV requirements.

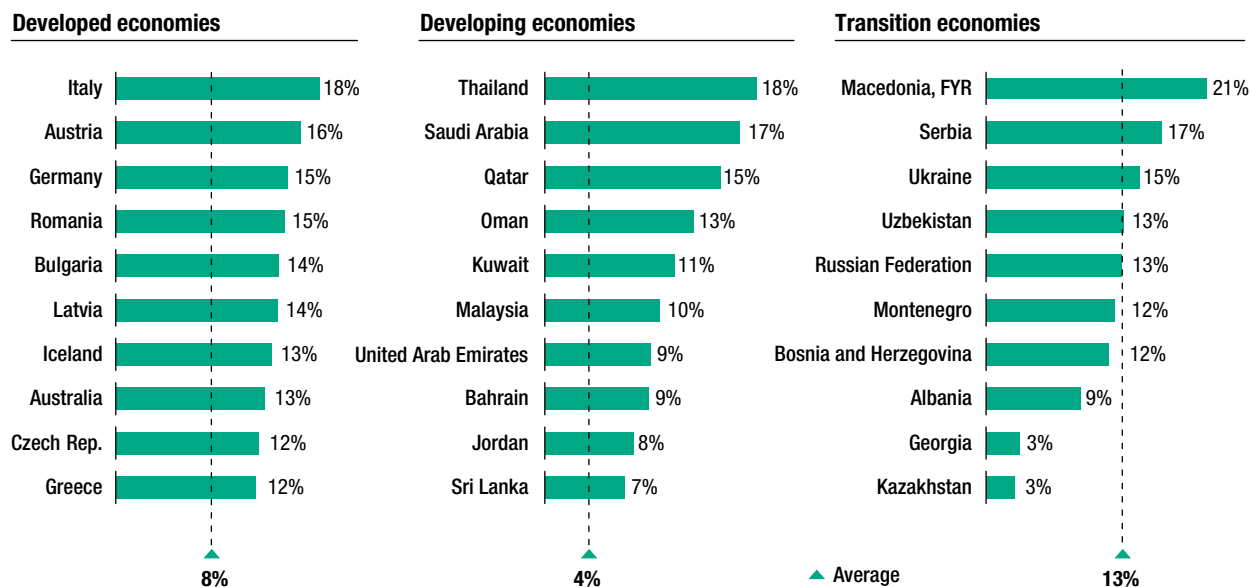
Figure IV.18. Mapping mixed domestic-foreign joint ventures (Per cent)



Source: ©UNCTAD analysis based on Orbis data (November 2015).

Note: Analysis based on some 52,000 foreign affiliates, corresponding to the mixed domestic-foreign joint ventures in the sample.

Figure IV.19. Countries with the highest share of mixed joint ventures
Top 10 countries by economic grouping, share of domestic-foreign JVs in total number of FAs (Per cent)



Source: ©UNCTAD analysis based on Orbis data (November 2015).

Note: FA = foreign affiliate.

Mapping direct shareholders to ultimate owners

The largest group of global ultimate owners consists of industrial companies (86 per cent of GUOs). Financial companies (companies engaged in financing activities) correspond to 9 per cent, while banks and institutional investors cover 4 per cent of foreign affiliates. The remaining marginal part is shared between public authorities and foundations.²⁰

For the sample of 720,000 foreign affiliates there are 173,000 GUOs, corresponding to an average number of foreign affiliates per GUO slightly above 4. However, the size of GUOs varies significantly by type, from an average of 3.7 foreign affiliates per GUO for industrial companies to 45 for public authorities, States or governments, for which the ratio is influenced by few very large global State-owned MNEs.²¹

The geographic distribution of GUOs roughly reflects the macro picture of global investment patterns. The vast majority of GUOs are in developed economies, about 80 per cent, which corresponds almost exactly to the share of developed countries in global outward FDI stock. GUOs from developing economies (19 per cent) are prevalent in Asia (8 per cent). GUOs from developed countries are also larger, controlling on average 4.3 foreign affiliates against 3.7 controlled by GUOs in developing countries. In particular the size of GUOs from Japan and the United States stands out, with an average number of controlled foreign affiliates of 11 and 6, respectively.

Mismatch cases with different nationalities between direct owner and GUO concern almost half of the foreign affiliates in developed economies and more than a quarter in developing economies (figure IV.20). The composition is different. Developed economies see a strong predominance of cases with a domestic direct owner and foreign GUO (case 1 in the ownership matrix, figure IV.11), accounting for more than 75 per cent of mismatch cases. This type implies the establishment of a local network of affiliates and it is more common in mature and large economies, such as those of the larger EU members and in particular the United States. It can also emerge as the result of M&A operations whereby local affiliates of an MNE acquire companies operating in the host country.

In developing economies, mismatch cases mainly involve foreign direct owners and foreign ultimate owners from different countries (case 2a in the ownership matrix; almost 60 per cent of cases). This situation arises as a result of transit investments, e.g. when an MNE establishes a presence in a developing country through a global financial hub, often for tax reasons; foreign direct investment in Africa through the regional hub of Mauritius is an example. M&A operations are also relatively less common in developing countries, which have a higher incidence of greenfield investment.

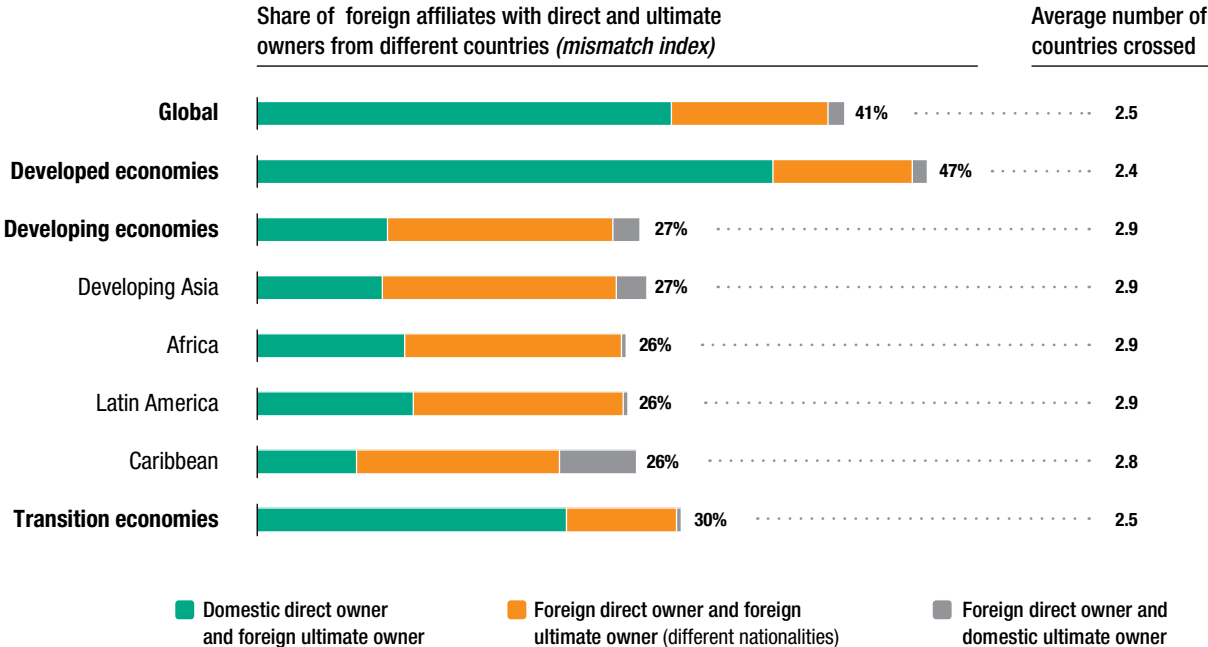
On average, the cases with foreign direct owners and foreign GUOs from different countries involve a larger number of countries along the controlling chain (at least three). Instead, cases with domestic direct owners and foreign GUOs may be simple, with only two countries involved: the country of the GUO and the host country of the foreign affiliate (where the direct owner also operates). As a consequence, the average number of countries involved in complex cases is higher in developing economies (2.9) than in developed economies (2.4). Finally, as already observed at the aggregate level, the weight of cases of round-tripping (case 3 in the ownership matrix) is very limited, at 3 per cent of the total number of mismatch cases. As expected, the Caribbean represents an exception, with the share of round-tripping at 20 per cent; this share could be larger if entities in OFCs consistently reported shareholder information.

The analysis of the mismatch index for G-20 countries confirms the pattern observed at the regional level (figure IV.21). Developed economies are relatively more affected by cases of domestic direct owners and foreign ultimate owners, while developing economies are more exposed to investment involving an intermediate third country. In the comparison of the G-20

economies, a few countries, in particular Australia and the United States, stand out for high shares of mismatch cases (more than 70 per cent), almost all falling in case 1 of the ownership matrix (domestic direct owner and foreign ultimate owner).

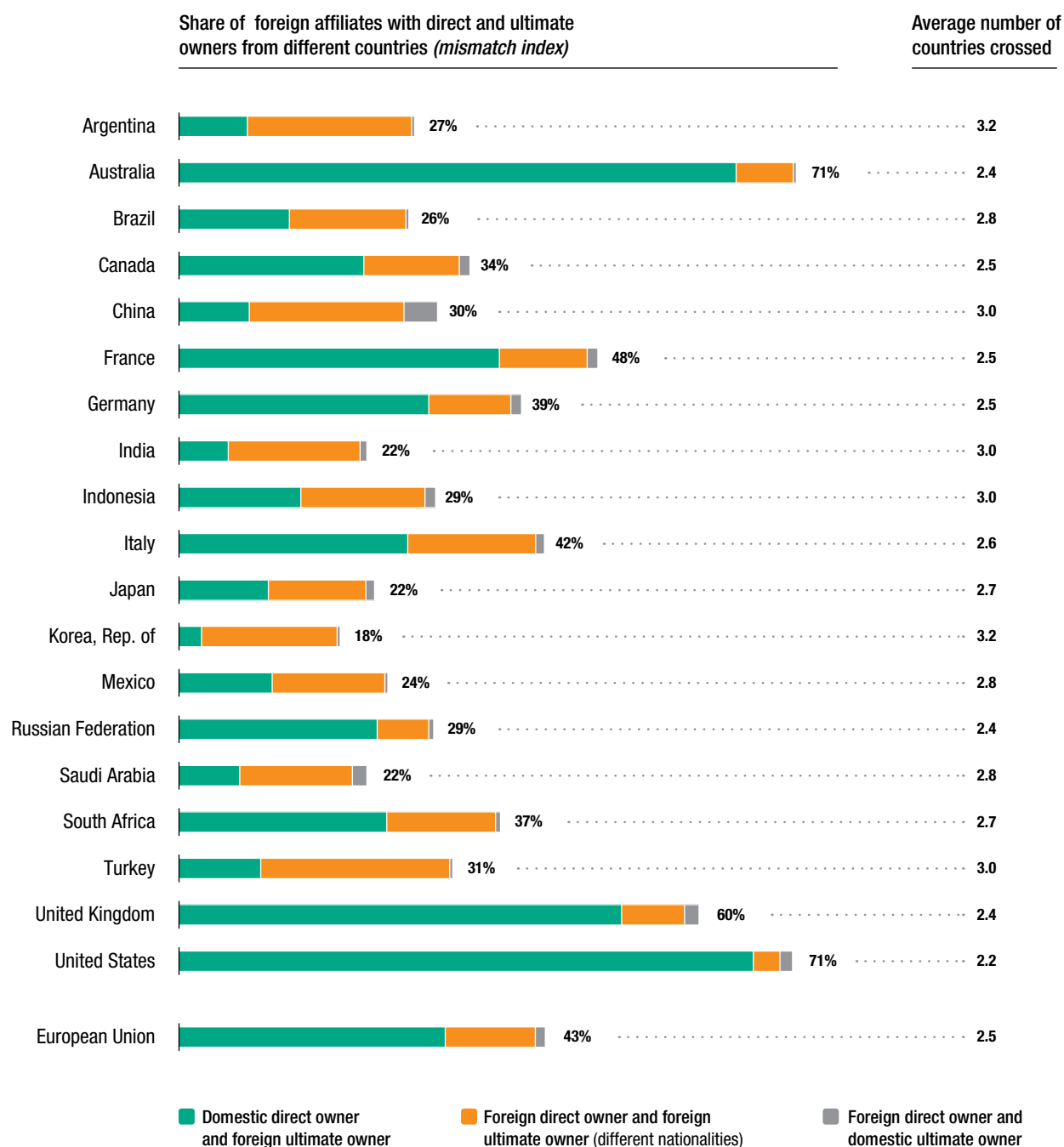
The mismatch index at the industry level reveals significant variability. The industry with the highest share is mining, where 57 per cent of foreign affiliates exhibit a mismatch between the nationality of the direct owner and that of the ultimate owner. At 47 per cent the manufacturing sector is slightly above the average (44 per cent) while the share of the services sector varies with the specific industry; it is high in accommodation and food services (55 per cent), electricity (54 per cent) and financial services (49 per cent), and low in information and communication (40 per cent), construction (40 per cent) and wholesale and retail (34 per cent).

Figure IV.20. The investor nationality mismatch index by region



Source: ©UNCTAD analysis based on Orbis data (November 2015).

Figure IV.21. | The investor nationality mismatch index by country, G20



Source: ©UNCTAD analysis based on Orbis data (November 2015).

D. COMPLEX OWNERSHIP: INVESTMENT POLICY IMPLICATIONS

1. Complex ownership and investor nationality: policy implications

a. The role of ownership and control in investment policy

National and international investment policy measures that differentiate between domestic and foreign companies or between foreign investors of different nationality include entry restrictions and ownership caps, operating restrictions or performance requirements, investment facilitation and incentives, and investment protection. These measures are most often driven by national security concerns; protection of national and strategic assets; industrial development and competition policies; social, cultural or political concerns; and regional integration policies.

Ownership and control matter in investment policymaking because they are an instrument for the assessment of investor nationality. What matters in investment policy is

- *Foreign ownership* (of a company or investment project) – for national investment policy measures that discriminate, positively or negatively, between domestic and foreign investors
- *Nationality* of the investor – where legal consequences or benefits are applicable only to investors from specific jurisdictions, as in the case of investment treaties and regional economic integration agreements (or economic sanctions on specific countries)

Investment policy measures that differentiate between domestic and foreign investors, or between foreign investors of different nationality, include the following:

- Entry restrictions and ownership caps that limit the amount of equity that foreign investors can hold in domestic companies, often applying to specific industries or assets
- Operating restrictions, levies or performance requirements applying specifically to foreigners
- Investment facilitation and financial, fiscal or regulatory incentives applying specifically to foreign investors
- Investment protection, as set out in national law or in international treaties, conferring rights and allowing access to a dispute settlement mechanism for foreign investors (or foreign investors of certain nationalities) only.

There are different reasons or rationales for investment policy measures to differentiate between domestic and foreign companies, or between foreign investors of different nationality:

- National security concerns: e.g. limitations on foreign involvement in defence industries, in critical infrastructure or in strategic sectors
- Natural resources: e.g. limitations or restrictions applying to foreign investors with respect to land acquisitions or in extractive industries
- Industrial development: e.g. limitations on foreign investment to support the build-up of domestic productive capacity; entry restrictions for foreign investors to prevent dominant market positions of large MNEs, or crowding out of small domestic firms
- Social concerns: limitations on foreign investment in sectors with a public service responsibility (e.g. critical infrastructure, transportation, water or energy supply), or in sectors critical for livelihoods (e.g. employing large segments of the population) or food security (e.g. agriculture)

- Cultural concerns: e.g. limitations on foreign involvement in media or filmmaking
- Geopolitical reasons: limitations connected to economic sanctions or embargos against certain foreign countries
- Regional integration: e.g. liberalization for investors from member states of a region (e.g. EU, NAFTA) or parties to free trade agreements that provide for investment liberalization

These drivers of rules and regulations on foreign ownership are relevant for both national and international policies. Ownership-based rules and regulations, as well as promotion and facilitation measures, are generally in the domain of national investment policies. They translate into international investment agreements (IIAs) mostly as carve-outs or reservations through which treaty partners aim to retain the option to keep in place sector-specific measures in their national policy frameworks.

b. Complex ownership: key investment policy challenges

Complex ownership structures and investor nationality mismatches make the application of rules and regulations on foreign ownership more complex. They also raise important questions about the coverage of IIAs. For national investment policies, the distinction between domestic and foreign investment is important. Therefore, the most relevant nationality mismatches are investments that are indirectly foreign owned through a domestic entity, and round-tripping investments. For IIAs the distinction between different nationalities of investors is important. Therefore, the most relevant mismatch cases are transit investments through third countries and, again, round-tripping investments.

Complex ownership of investment projects or of foreign participated companies – i.e. multiple cross-border ownership links to the ultimate owner through intermediate entities – requires regulators (or arbitrators in the case of investor-State dispute settlement (ISDS) procedures) to decide where along the ownership chain to stop for the purpose of determining investor nationality. At a minimum, they make the application of rules and regulations on foreign ownership more challenging.

Table IV.5 shows the direct relevance of complex ownership structures and the investor nationality mismatches described in the preceding section for various investment policy areas that rely on the identification of investor origin. For national investment policy, the most critical nationality mismatch types (quadrants in the ownership matrix) are indirect foreign ownership through domestic companies and, to a lesser degree, round-tripping. For international investment policy the most critical quadrants are transit investments through third countries and, again, round-tripping.

The challenges arising from complex ownership structures for investment policymakers are often found at the level of practical implementation and enforcement. In national investment policies, they raise these questions:

- How to implement ownership restrictions (and rules and regulations applying specifically to foreigners) effectively, given the complexity of ownership of foreign-invested companies (investments) and investors; i.e. how to assess direct and indirect ownership links adequately?
- Where the objective of any ownership restriction is to prevent foreign control over national assets, how to avoid foreign investors exercising effective control even with minority shareholdings that might comply with foreign equity limitations, e.g. through preferential shares, company by-laws or non-equity forms of control?
- Where specific benefits are granted to foreign investors, such as incentives or certain standards of protection in investment laws, how to avoid nationals gaining access to such benefits through indirect ownership links?

Table IV.5. Nationality mismatches: investment policy implications

		Investment policy implications	
		National	International
	<p>1 Domestic direct owner and foreign ultimate owner</p>	<p>Renders the application of foreign ownership restrictions more complex; may lead to circumvention of ownership restrictions</p>	<p>No effect on treaty coverage or application</p>
	<p>2A Foreign direct owner and foreign ultimate owner from different countries</p>	<p>Limited relevance, as the focus is on “foreignness”, not nationality</p>	<p>Leads to important questions of treaty coverage and jurisdiction of arbitral tribunals in investor-State disputes</p>
	<p>3 Foreign direct owner and domestic ultimate owner</p>	<p>Relevant only to the extent that nationals gain access to benefits (e.g. incentives) reserved for foreign investors</p>	<p>Leads to important questions of treaty coverage and jurisdiction of arbitral tribunals in investor-State disputes, specifically related to nationals bringing claims against their own State</p>
		<p>● High relevance</p>	<p>● Low relevance</p>

Source: ©UNCTAD.

In international investment policies, the challenges for IIA negotiators include these questions:

- How to effectively define treaty coverage, or how to avoid granting treaty benefits to investors that were not intended to be covered by the treaty, including investors from the host State (in round-tripping arrangements)?
- How to avoid investors using artificial entities (mailbox companies) that legally own an investment to unduly gain access to treaty benefits?
- How to avoid MNEs, with their multitude of entities worldwide, restructuring ownership of assets solely for the purpose of gaining access to treaty benefits?

This section first provides an overview of the role of ownership and control in national investment policies and summarizes how policymakers across the world are dealing with the challenges raised by ownership complexity. It then looks at challenges for IIA negotiators.

The impact of the growing complexity in MNE ownership structures on the effectiveness of rules and regulations on foreign ownership at the national level and on the coverage of IIAs has wider, systemic implications beyond the operational level. These are discussed in section E.

2. Ownership and control in national investment policies

In national investment policy, an assessment of the relevance of ownership and control – and ownership-based policies – naturally focuses on foreign ownership restrictions, for which the ownership chains and nationality mismatches identified in the previous sections are critical. Restrictions can potentially be circumvented or made ineffective through indirect foreign ownership and domestic intermediate entities, or through mechanisms that allow foreign investors to exercise a level of control disproportionate to their nominal equity stakes in domestic companies.

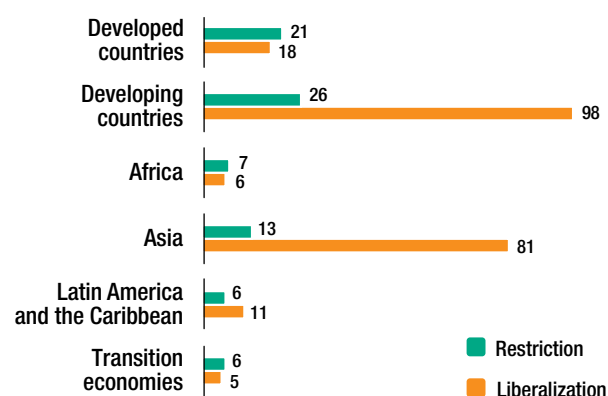
An additional issue is domestic investors round-tripping through a foreign location to obtain benefits reserved for foreign investors. The empirical findings in the preceding sections indicate that such round-tripping is relatively rare for corporates (more common for family-owned or individual-owned entities) and mostly confined to a limited number of countries. (Policy concerns related to round-tripping are examined in more depth in the section on international investment policies.)

a. Rules and regulations on foreign ownership

At the national policy level, rules and regulations on foreign ownership are widespread. Services are relatively more affected by foreign equity limitations, in particular in media, transportation, communication, utilities, and financial and business services. Extractive industries and agriculture are also frequently regulated through ownership restrictions. The trend since 2010 in ownership-related measures is towards liberalization, through the lifting of restrictions, increases in allowed foreign shareholdings, easing of approvals and admission, and greater access to land for foreign investors. However, many ownership restrictions remain in place in both developing and developed countries.

According to data from the World Bank, only about a quarter of countries around the world have few or no sector-specific restrictions on foreign ownership of companies.²² Developing countries tend to have ownership restrictions covering a wider range of sectors compared with developed economies but, as noted in the introduction to this chapter, almost all developed economies also restrict foreign investment in a selected set of industries (see figure IV.2).

Figure IV.22. Investment policy measures related to ownership restrictions, 2010–2015 (Number of measures)



Source: ©UNCTAD National Investment Policy database.

Note: Asian measures include 41 measures in India alone (other measures distributed across more than 20 countries).

UNCTAD's monitoring of investment policy measures indicates that ownership-related policies since 2010 have moved in the direction of liberalization.²³ The majority of measures, especially in developing countries, have concerned increases of foreign ownership percentages allowed, easing of approvals or admission procedures, or greater access to land for foreign investors. UNCTAD identified 98 such measures in developing countries, compared with 26 measures in the direction of restriction or regulation (figure IV.22).

Despite the trend towards greater openness, many restrictions remain in place. By region the picture is varied, based on World Bank data:

- *Developed economies* have relatively fewer limitations on foreign equity ownership, although limitations on foreign ownership of companies in specific services industries are widespread, in particular in transportation. Foreign ownership of airlines is capped below 50 per cent in most developed countries (see box IV.4). Utilities and media also have restrictions in a number of developed economies.
- *Developing countries* have more foreign ownership restrictions, across a broader range of sectors. However, many limitations on foreign equity participation do allow majority foreign ownership and foreign control, effectively translating into JV requirements. East and South-East Asian economies have the highest number of limitations.
- *Transition economies* tend to be relatively open to foreign equity ownership. Many countries in the group allow full foreign ownership of companies even in sectors considered sensitive elsewhere, such as banking, health care, retail, tourism and waste management. Media ownership is relatively more restricted.

In the United States, an authorization from the Department of Transportation is needed to provide air transport services. The applicant must establish that it is owned and controlled by United States citizens. Qualifying as United States citizens are corporations of which the president and at least two thirds of the board of directors and other managing officers are citizens of the United States, which are under the actual control of citizens of the United States and in which at least 75 per cent of the voting interest is owned and controlled by persons who are citizens of the United States.

When filing for an authorization, applicants must list all persons who own or control at least 10 per cent of the company's stock, indicating for each the number of voting shares and the corresponding percentage of the total shares outstanding that are held, along with address, citizenship, and principal business. If there are several layers of ownership (e.g. holding or parent companies), information must be provided for each layer until the ultimate individual shareholders are reached. If the applicant's stock is held for the benefit or account of a third party, the name, address, and principal business of that person must be provided.

In evaluating the degree of foreign involvement, the Department of Transportation considers the total amount of voting stock and equity interest in the air transport company. In some instances, up to 49 per cent of total foreign equity ownership has been approved, provided that, by statute, foreigners cannot own, individually or in the aggregate, more than 25 per cent of the voting stock. The Department also examines to what extent the foreign interests have power to veto or control the management structure, or if there is a United States citizen's interest that can vitiate the foreign control. The Department also considers whether the foreign investor has the right to name members of the board, if there are provisions in the agreements that would permit the foreigner to cause a reorganization of the carrier, and if the agreements include buy-out provisions of the United States investor and/or owner by either the carrier or the foreign investor. Finally, the Department may examine whether there are any significant business relations between the foreign investor and the air carrier (e.g. whether the foreign investor has loaned or guaranteed loans to the air carrier).

In the *European Union* (EU), regulation (EC) No. 1008/2008 governs the licensing of air carriers. In order to obtain an air transport license, all undertakings established in the Community must satisfy certain operational, corporate and financial requirements. In particular, all undertakings' principal place of business (head office or registered office within which the principal functions and operational control are exercised) must be located in the member State issuing the licence. In addition, member States and/or nationals of member States must own more than 50 per cent of the undertaking and effectively control it, whether directly or indirectly through one or more intermediate undertakings, except as provided for in an agreement with a third party to which the Community is a party. "Effective control" is defined as the ability to exercise a decisive influence on an undertaking, in particular by (1) the right to use all or part of the assets of an undertaking, or (2) rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking.

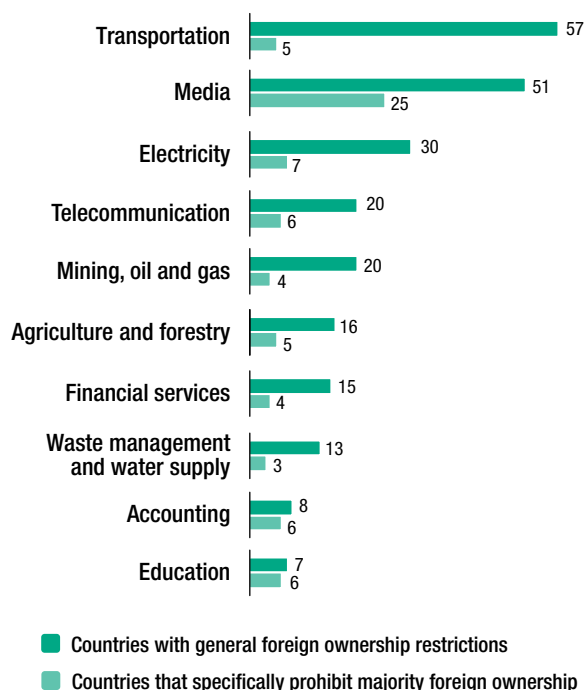
An air carrier licensing request must be submitted to the competent licensing authority of an individual member State. Investor information disclosure requirements in front of the competent licensing authority include: shareholder details (including nationality and type of shares to be held); articles of association; if the undertaking is part of a group, information on the relationship between the different entities; details of existing and projected source of finance; and internal management accounts. In addition, the Community air carrier must notify the competent licensing authority (1) in advance of any intended mergers and acquisitions; and (2) within 14 days of any change in the ownership of any single shareholding which represents 10 per cent or more of the total shareholding value of the Community air carrier or of its parent or ultimate holding company. The competent licensing authority is also authorized to suspend or revoke an operating license, if any of the operational, corporate or financial requirements are not complied with.

Source: ©UNCTAD, based on information published by the United States Department of Transportation and Regulation EC No. 1008/2008.

The use of ownership-related policies varies significantly by sector and industry. Although the services sector accounts for more than two thirds of global FDI, foreign ownership of companies is more restricted in that sector than in the primary and manufacturing sectors. Worldwide, restrictions on foreign ownership are most common and severe in the transportation, media, electricity, and telecommunications industries (see figure IV.23).

UNCTAD's monitoring of policy measures indicates that, over the 2010–2015 period, more than half the newly introduced measures in transportation, mining and oil and gas, and agriculture and forestry were in the direction of restriction. Other industries moved in the direction of liberalization; in particular wholesale and retail trade and financial services (despite the recent financial crisis) saw a significant amount of policy measures lifting or easing foreign ownership restrictions.

Figure IV.23. Ownership restrictions by industry
Number of countries with foreign equity limitations



Source: ©UNCTAD analysis based on the World Bank's Investing Across Borders database, covering 104 countries.

b. Ownership screening and investment approval procedures

Determination of investor nationality is part of foreign investment registration and approval procedures; sector-specific licensing (when foreign ownership restrictions apply); and national security–related foreign investment reviews. Approval procedures covering all sectors, including those without ownership restrictions, exist in many countries. Disclosure requirements for investors vary by country; not all regulators and authorities require disclosure of ultimate ownership. National security reviews tend to examine the full ownership structure of MNEs.

Ownership-based rules and regulations, in particular foreign ownership restrictions, require administrative procedures for the registration and approval of investments that can be both onerous for investors and costly to implement for governments. Approaches to determining investors' ownership structures differ significantly by country, largely depending on the general degree of openness to investment of the country involved. Broadly, three levels of intensity can be distinguished.

FDI approval processes

Many developing countries, in particular those with a significant number of sectoral restrictions, have specific laws and regulations governing administrative procedures for FDI registration and approval. They also tend to have a dedicated national authority that approves and monitors FDI. In most cases, special authorization requirements are triggered if an investment is planned in restricted sectors or above a certain threshold, sometimes followed by screening procedures that evaluate the impact of the investment and/or the compliance with sector-specific regulations.

The investment law may contain provisions covering both the establishment and the post-establishment phase of investments. Any potential modification of the investment – for example, an increase in the share of foreign participation – may require further submissions to the government authority. Some countries may require foreign companies to send a list of shareholders on a periodic basis after the initial investment (see the example of Algeria, box IV.5); others require only a description of the corporate structure of foreign investor companies at the time of applying for an authorization and subsequently when changes in the corporate structure take place.

When screening procedures are triggered in restricted sectors, investment authorities may assess not only the observance of the maximum percentage of foreign participation, but also the overall economic viability of proposed investment projects, contributions to local employment and potential technology transfers. This is then reflected in the information requested from foreign investors. In addition to the basic information (on the identity of the direct foreign investor and shareholders of the company, extracts of the articles of incorporation or association, the location of the project and a description of the foreign investor's existing economic activities), a significant number of host countries require the disclosure of detailed financial and operating information. Further information disclosure may consist of copies of JV or business cooperation contracts, trademarks and technology transfer agreements (see box IV.6 on India's FDI approval process).

Such information is generally requested to assess the economic and fiscal impact of the investment; it also provides an indication of the degree of non-ownership-based control that a foreign investor may exert over the investment project or company.

Registration and approval mechanisms for foreign investment and dedicated investment authorities are very common in developing countries. The vast majority of developing countries and transition economies also have dedicated foreign investment laws. Many require foreign investment approval across all sectors, including sectors that may not be subject to specific foreign ownership restrictions.

UNCTAD's review of 111 investment laws in 109 countries shows how nationality and ownership and control issues are principally addressed in the definition of "investor", and "investment" contained in such laws. Most laws (87) include a broad definition of "investor" or "foreign investor", in which legal persons qualify if they are registered or incorporated in the immediate home country. Some countries specify that foreign investors must have their real seat, or effective place of management, in their home country (where they are also incorporated). Another

Box IV.5. The FDI approval process in Algeria

Foreign investments in Algeria must be declared to the National Investment Development Agency. This agency is an autonomous government body tasked with promoting foreign investment; it ensures that foreign investment is undertaken through a partnership with domestic investors, who must always conserve a majority interest in the capital of the project (minimum of 51 per cent). The 51/49 rule applies to all economic activities for the production of goods or services. It must also be observed by Algerian public companies that engage in partnerships with foreign investors.

The declaration to the National Investment Development Commission includes a detailed description of the proposed investment project together with information on shareholders (identity, nationality and address) and source of finance. Any subsequent change of information in the original declaration, or any change in the commercial register, must be submitted to the Agency. Importantly, foreign investor companies that hold shares in Algerian companies must communicate, every year, the list of their shareholders as identified in the foreign trade register. In addition, when a foreign investor or a domestic partner wishes to sell its stake in the company to foreigners, its offer must first be presented to the Government of Algeria, which has three months to exercise its pre-emption rights. Finally, the Government of Algeria must also be consulted for the sale to foreigners of shares in Algerian companies that hold shares in domestic-foreign partnerships.

Source: Ordonnance n° 2001-03.

Box IV.6. The FDI approval process in India

FDI is permitted in Indian companies, partnership firms, venture capital funds and limited liability partnerships. These entities may receive FDI under the automatic route or the government route, depending on the economic activity/sector.

FDI in activities not covered under the automatic route requires prior Government approval. Investment proposals are considered by the Foreign Investment Promotion Board (FIPB), a Government body that offers single-window clearance for foreign investments in the country that are not allowed access through the automatic route.

Information disclosure requirements with the FIPB include the name and address of the Indian company, a description of the existing and proposed activities of the company and a description of the capital structure of the company, as well as its proposed borrowings, export commitments, employment opportunities, amount of foreign equity investment and foreign technology agreements. Additional documents to be submitted to the FIPB include descriptions of Indian JV partners indicating their percentage share, group companies and affiliates; information on the activities of the downstream companies; copies of the JV and/or shareholders agreement and technology transfer and/or trademark agreements; pre- and post-investment shareholding structure of the investee and the investing companies; and, in cases of indirect investment through Indian companies, details on the indirect investment and its shareholders.

The consolidated FDI Policy stipulates that in all sectors with sectoral caps, the balance equity, i.e. beyond the sectoral foreign investment cap, has to be beneficially owned by resident Indian citizens and Indian companies owned or controlled by resident Indian citizens.

Source: "Consolidated FDI Policy 2015", Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.

possible limitation to the definition of investors includes a minimum level of foreign participation in the company in order for investors to be eligible for protection under the investment law. None of the laws reviewed requires that covered investors have real economic activities in their home country (i.e. so-called mailbox companies are not excluded from the coverage of the law). With respect to the definition of investments, eight laws require that the investor own or control the investment, while only one law specifies that this control can be either direct or indirect.

Sector-specific licensing

Where countries impose sector-specific licensing requirements, the process of determining investor origin is generally carried out by the sector regulator, which may require detailed information on the full ownership structure up to the ultimate beneficial owners of the investing entity.

Most developed countries, and developing countries with relatively few foreign ownership restrictions, may not have a dedicated FDI authorization procedure or an investment authority. The establishment of companies with foreign investment tends to follow the normal business registration and/or licensing process, and any subsequent modification of the value of FDI in the company through the purchase or sale of shares is treated as an ordinary commercial transaction.

The absence of a formal administrative procedure for the monitoring of FDI in such relatively open countries means that foreign investor disclosure requirements are reduced in scope and detail. Legislation tends to refer to the normal company registration process which does not seek to determine ultimate investor identity, nor does it require detailed financial analysis of the investment project. However, for sectors in which foreign ownership limitations do apply, the procedures to determine nationality and ownership links of foreign investors, as implemented by sectoral authorities, are often more demanding. In addition to basic information on the identity and nationality of the direct and ultimate owner or investor (e.g. through the disclosure of business relationships, the investing group's structure, links with foreign governments), countries seek further information, such as the origin of funds, members of the board of directors, or agreements to act in concert.

National security reviews

Countries conducting national security-related investment reviews – a cross-sectoral or sector-specific review – demand particularly detailed information from foreign investors during the screening process. The extent, nature and timing of these information requirements vary considerably between countries (for details, see the dedicated section in chapter III), but investigations tend to reconstruct the full ownership structure of investing corporations in order to assess intermediate ultimate controllers.

c. Challenges arising from complex ownership and policy responses

Ownership complexity has made the effective implementation and enforcement of ownership restrictions and ownership-based rules and regulations difficult and burdensome. Key challenges for national investment policymakers are (i) how to assess aggregate direct and indirect ownership, (ii) how to prevent de facto foreign control, and (iii) how to avoid undue access to benefits reserved for foreign investors by host State nationals. Policymakers in some countries have developed a range of mechanisms to safeguard the effectiveness of foreign ownership rules, including anti-dummy laws, general “anti-abuse” rules to prevent foreign control, and disclosure requirements aimed at monitoring ownership- and non-ownership-based control.

The importance of indirect ownership of foreign affiliates and the increasing complexity of MNE ownership structures is leading to significant challenges for national investment policymakers concerning the effective implementation and enforcement of ownership restrictions and ownership-based rules and regulations. Table IV.6 summarizes the challenges and indicates policy measures that various countries have developed in response.

Table IV.6.

Complex ownership structures: national investment policy challenges and policy responses

Challenges	Policy responses
Indirect foreign ownership	Methods to assess aggregate direct and indirect ownership
De facto foreign control	Methods to prevent effective foreign control through minority stakes
Round-tripping	Methods to check ultimate ownership by host State nationals

Source: ©UNCTAD.

(i) Assessing aggregate direct and indirect ownership

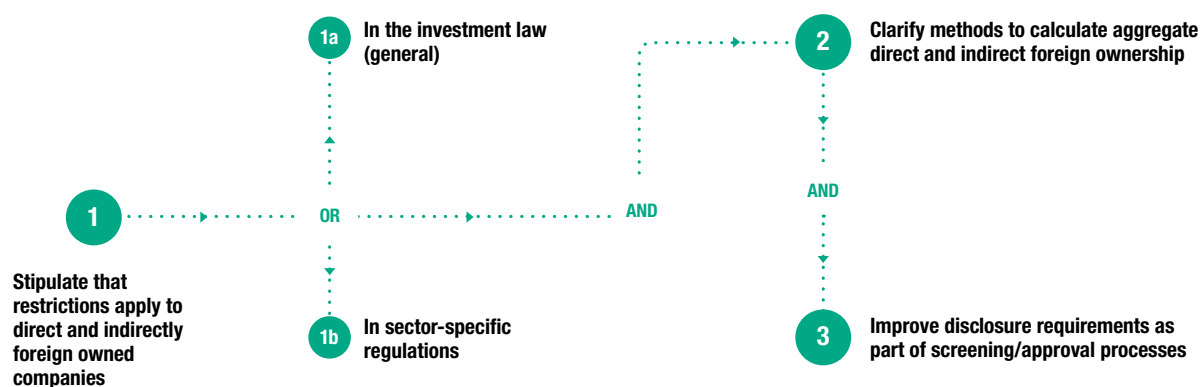
Methods to determine the ownership chain and ultimate ownership of investors differ by country, mostly depending on the specific objectives of foreign ownership restrictions.

Countries have adopted a range of mechanisms to avoid circumvention of sector-specific foreign ownership limits by foreign investors through indirect ownership structures. Most countries that maintain specific laws governing foreign investment and foreign ownership restrictions distinguish direct FDI (through a foreign entity) from indirect FDI (through a domestic entity). When screening investment proposals, these countries will equate indirect FDI to direct FDI in cases in which foreigners control the investing domestic enterprise, typically if foreigners have more than 50 per cent of voting shares. The Russian Federation explicitly prohibits any investments from domestic companies in the media sector if the investing company itself has more than 20 per cent of foreign shares. In Indonesia, resident companies with foreign participation are named, or labelled, differently from purely domestic companies, and companies with the foreign-ownership label are considered as foreign investors in any approval procedures for new investments. In Turkey, legal ownership limits in media are modified depending on whether there is only direct foreign investment (50 per cent foreign ownership allowed) or whether there is also indirect participation (less than 50 per cent foreign ownership allowed). Similar approaches are taken in general investment laws and in sector-specific regulations, as applicable (see figure IV.24 for a common approach).

As a second step, a number of countries have explicitly clarified how aggregate ownership – direct plus indirect shareholdings – is calculated for the purpose of foreign ownership restrictions and regulations. In most cases, such clarifications indicate when domestic investments are considered indirect foreign investments (when the domestic investor is itself majority foreign owned). They may also detail whether foreign shares should be considered in aggregate (for multiple foreign investors) or separate (which may involve different thresholds), and whether they should consider all equity or voting stock only.

Finally, countries generally impose disclosure requirements as part of screening and approval procedures, in the investment application. The extent to which disclosure requirements enquire into full ownership chains, ultimate ownership and ultimate beneficial ownership varies significantly. As indicated above, national security-related reviews tend to investigate full corporate ownership structures. Sectoral reviews also tend to require disclosure of full ownership structures. General FDI screening and approval procedures do so in some countries; in others they remain at the level of directly investing companies (direct owners).

Figure IV.24. Assessing direct and indirect foreign ownership: policy practices



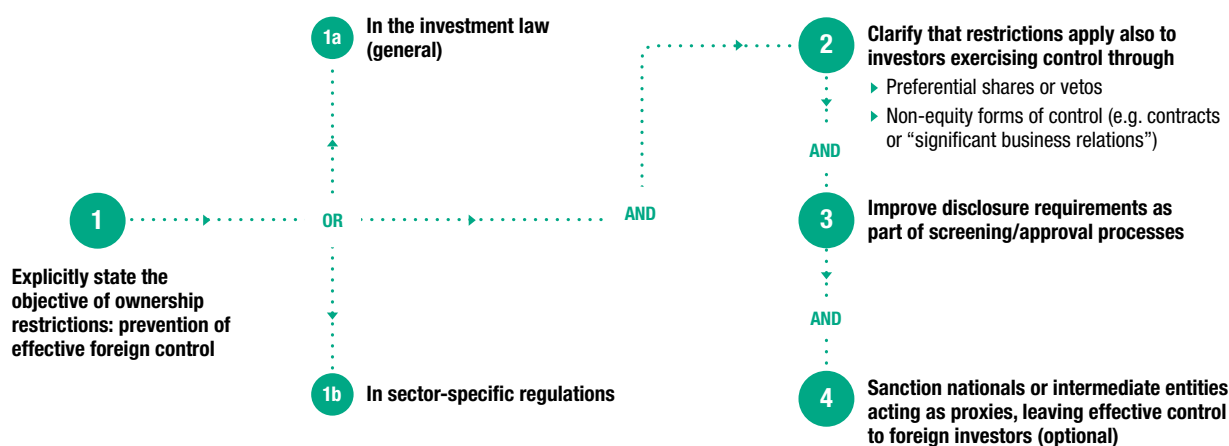
Source: ©UNCTAD.

(ii) Preventing effective foreign control through minority stakes

Where countries consider it sufficient that domestic businesses own a stake in a venture, they may impose JV requirements but allow majority foreign ownership (i.e. foreign control) to minimize the potential negative effect on foreign investment attraction. For the enforcement of rules guaranteeing a degree of domestic ownership it may be sufficient in investment approval processes to examine the direct ownership level of investment projects. For example, Oman, which has a uniform foreign ownership limitation allowing a maximum of 70 per cent foreign participation, prevents the circumvention of ownership rules through very general approval criteria for FDI proposals (e.g. “adequate” domestic participation).

Where countries aim to prevent *foreign control*, more stringent requirements are set; at a minimum, these take the form of foreign equity limitations to less than 50 per cent. Again, the specific objective of ownership limitations is set out in general investment laws as well as in sector-specific legislation (as shown in figure IV.25). However, these countries may go beyond the assessment of aggregate direct and indirect shares to verify compliance with foreign equity limitations.

Figure IV.25. Preventing effective foreign control: policy practices



Source: ©UNCTAD.

Given the many levers that international investors have to exert higher levels of control than their nominal equity stake in investment projects, as a second step some countries have clarified that restrictions or regulations also apply to investors exercising control through other means, including preferential shares and non-equity modes of control. A number of countries have included in their investment laws general “anti-abuse” provisions stipulating that foreign participation limits cannot be surpassed through mechanisms such as trusts, contracts, partnerships or by-law agreements granting higher levels of control than those established (e.g. see Mexico’s investment law, box IV.7). Other countries go further and collect information to assess the capacity of domestic partners to effectively control a venture (e.g. see India’s investment law, box IV.6).

Reference to non-equity modes of control is also made in a number of cases. For example, the United States air transport authorities examine “significant business relations”, including loans or loan guarantees, that would give the foreign investor decisive influence over a venture. EU air transport regulations define “effective control” of a foreign investor as the ability to exercise a decisive influence on an undertaking, including through “rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking”.²⁴

Finally, as a fourth step, additional policy measures and mechanisms can be put in place to prevent the circumvention of majority ownership limitations, such as so-called “anti-dummy laws”, which prevent nationals from posing as controlling shareholders while leaving actual control to foreign investors (see box IV.8 on the Philippines anti-dummy law).

(iii) Checking ultimate ownership by host-State nationals

As demonstrated in section C, round-tripping investments are relatively rare in the internal ownership structures of MNEs; only about 1 per cent of affiliates with a direct foreign owner are ultimately owned by a parent company in the same country as the affiliate. Round-tripping is generally more relevant as a means for investors to gain access to investment and tax treaties. However, it can be an issue in national investment policy for countries that provide

Box IV.7. FDI restrictions and approval processes in Mexico

Mexico’s Foreign Investment Law subjects FDI to prior approval when the foreign investor (1) aims to own or acquire a stake higher than 49 per cent in an economic activity in selected industries, or (2) aims to own or acquire (directly or indirectly) a stake higher than 49 per cent in a Mexican company in any sector when the value of the assets of that company, at the date of acquisition, exceeds a threshold set by the National Foreign Investment Commission (\$262 million in 2014).

The National Foreign Investment Commission, under the Secretariat of the Economy, is the government authority that determines whether an investment in restricted sectors may move forward. It comprises various federal ministries and agencies, including the Secretariats of Internal Affairs, Finance, Social Development, Environment and Natural Resources, Energy, and Communications and Transport. The Commission has 45 business days to make a decision; otherwise the transaction is considered to be automatically approved. Information disclosure requirements for foreign investors include their name, domicile and date of incorporation; the percentage of their proposed interest; the amount of subscribed or payable capital stock; details of the investment project; and a detailed description of the existing or future corporate structure, including ultimate ownership and all affiliates.

The Foreign investment Law imposes several supplementary sectoral foreign ownership limitations (e.g. 10 per cent in cooperative companies, 25 per cent in domestic air transport, 49 per cent in arms manufacturing). These foreign investment participation limits cannot be surpassed directly nor through trusts, contracts, partnerships or by-law agreements, or other mechanisms granting any control or a higher participation than the one established. Nevertheless, the Ministry of Economy may authorize Mexican companies to issue “neutral investment instruments”, which are not taken into account for the calculation of the percentage of foreign investment in the capital stock of Mexican companies. Neutral investments solely grant pecuniary or corporate rights to their holders, without granting their holders voting rights in regular shareholder meetings.

Source: Foreign Investment Law 1993, last amended in 2014.

Box IV.8. The “anti-dummy” law in the Philippines

Philippine law prohibits foreign control of public utilities, the exploitation of natural resources and the practice of a number of professions. The Anti-Dummy Law (or Commonwealth Act No. 108, as amended) prohibits Philippine nationals from participating in evading national ownership laws. It also prohibits foreigners from intervening in the management, operation, administration or control of any nationalized activity.

Dummy status is indicated by the following criteria:

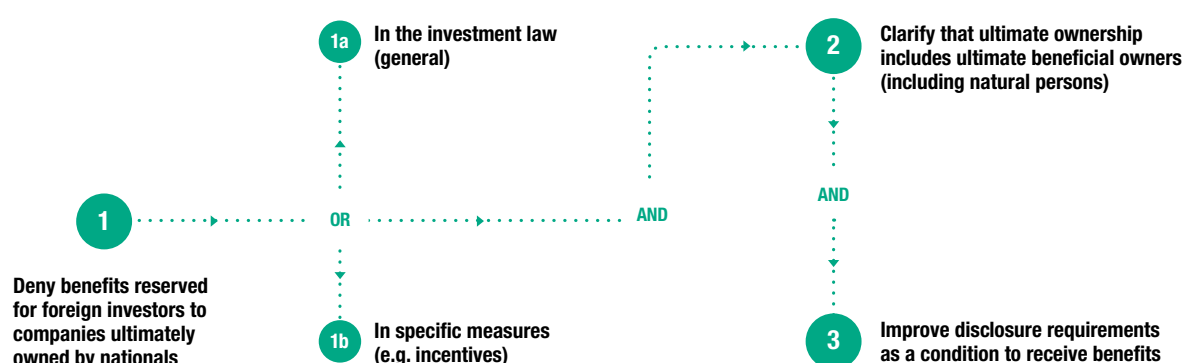
- Where the foreign investor provides practically all the funds for a joint investment undertaken with a Philippine national
- Where a foreign investor undertakes to provide practically all the technological support for the joint venture
- Where foreign investors, while minority stockholders, in practice manage the company

Source: “Understanding the Anti-Dummy Law”, <http://news.abs-cbn.com/>.

specific treatment to foreign investors, such as protection standards under an investment law, or specific benefits reserved for foreign investors, such as fiscal incentives. In most cases, these countries experience round-tripping investment by their own nationals at the level of individuals or families, which set up entities offshore and channel investment back to their home State. (Such ownership links were excluded from calculations in section C as part of the methodological choice to focus on MNEs.)

In countries where round-tripping is a concern, the focus of countermeasures is generally on tax policy measures (and revisions in tax treaties). Investment laws and regulations can contain specific measures to prevent nationals from gaining unwarranted access to benefits reserved for foreign investors. They can explicitly deny such benefits to nationals or to companies ultimately owned by nationals, either in investment laws or in the qualifying criteria for incentives. They may clarify that the exclusion specifically applies to ultimate *beneficial* owners (individuals and families), and they can improve disclosure requirements on full corporate structures and beneficial owners as part of investment or incentive application processes (figure IV.26).

Figure IV.26. | Checking undue access to investor benefits by nationals: policy practices



Source: ©UNCTAD.

3. Ownership and control in international investment policies

a. Complex ownership, IIA coverage and ISDS exposure

In international investment policymaking, ownership chains have the potential to significantly expand the reach of IIAs. About one third of investor-State dispute settlement (ISDS) claims are filed by claimant entities that are ultimately owned by a parent in a third country (not party to the treaty on which the claim is based). More than a quarter of these claimants do not have substantial operations in the treaty country – this share can increase to up to 75 per cent when considering claims based on treaties concluded by major ownership hub locations.

MNE ownership structures affect the coverage and reach of IIAs, which aim to protect investments and investors from the contracting parties. Complex indirect ownership structures, combined with the broad protection of indirect investments offered in IIAs, have the potential to significantly expand coverage and provide access to treaty benefits to investors from other countries by means of indirect ownership through legal entities within the contracting parties.

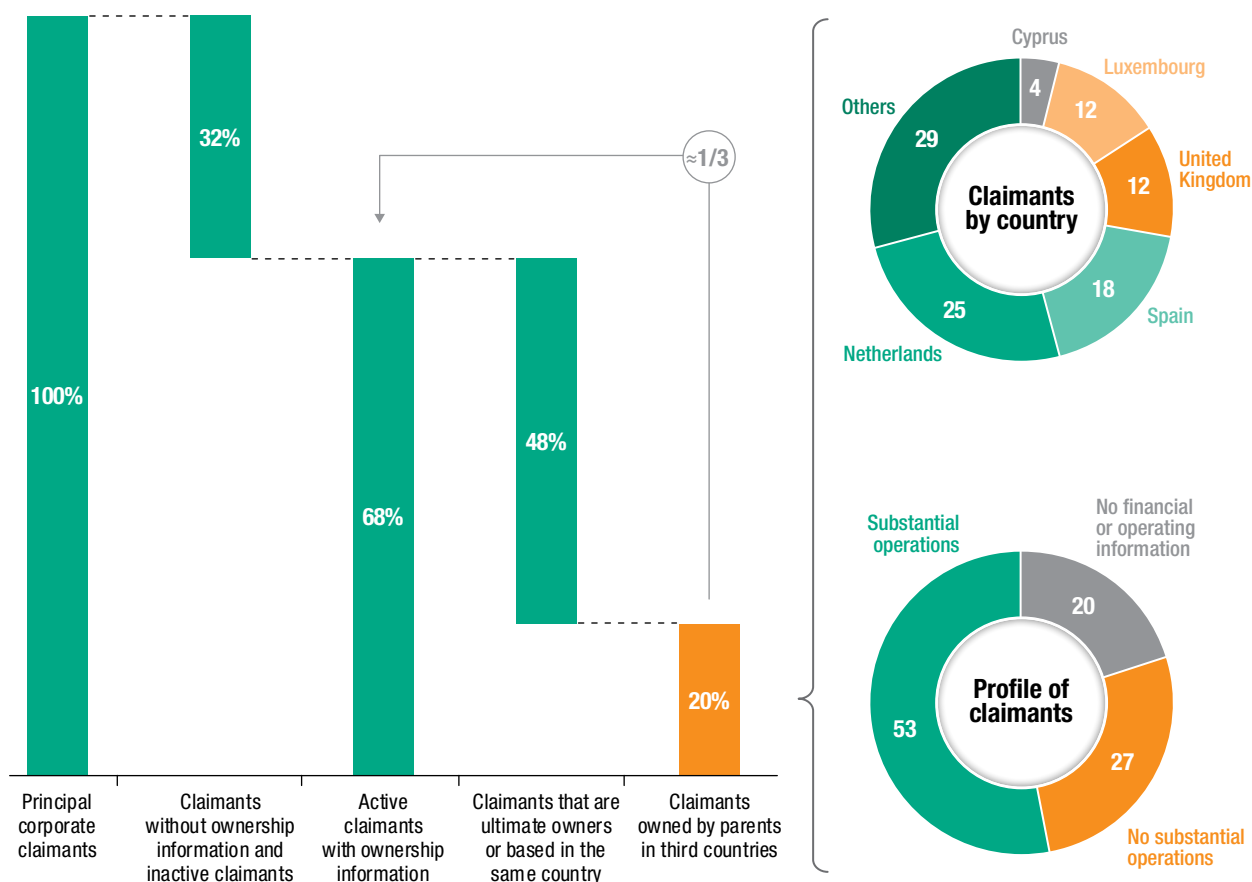
Nationality mismatch cases are highly relevant in ISDS. Since 2010, about one third of claims for which relevant information is available were filed by claimant entities that are ultimately owned by a parent in a third country (i.e. not party to the treaty on which the claim is based) or in the respondent State (figure IV.27). The share of intermediate entities acting as claimants increases significantly for cases based on treaties with countries that are major ownership hubs and offshore investment hubs: in such cases, up to 75 per cent of claimant companies are ultimately foreign owned.²⁵

In international investment policy, the terms “ownership” and “control” take on meanings that are different from their use in the analysis of ownership complexity in the preceding sections. First, in IIAs, the meaning of the term “ownership” is usually limited to direct (legal) ownership of the investor. Where the preceding sections refer to indirect ownership, IIAs typically refer to (indirect) control. Over time, arbitral tribunals have given comparatively less attention to the question of ownership and more to control (where they have also discussed issues of indirect ownership). Second, in international investment policy, to date, relatively little attention has been paid to ultimate ownership or control.²⁶ Usually, for an entity to benefit from treaty coverage, direct or indirect (but not necessarily ultimate) control of the investment by a national of a contracting State is sufficient. Thus, an intermediate entity anywhere along an MNE ownership chain may well qualify for treaty protection.

Moreover, on the rare occasions that IIAs or ISDS tribunals specify the meaning of control, they stipulate conditions that can frequently be met by the direct owner (e.g. majority shareholding in the investment or the right to select directors of the foreign invested company). Even where IIAs use the concept of “effective” control, this generally does not require the ultimate controller to be based in a contracting party. ISDS tribunals address these issues in jurisdictional decisions (i.e. deciding whether they have competence to adjudicate the dispute) (box IV.9). Only a few tribunals have investigated ultimate control (see box IV.11). Conditioning treaty protection on the nationality of the ultimate controller of a qualifying investment has not been a policy priority for IIA rule-making.

Over time, complex MNE ownership structures and growing numbers of ISDS claims brought by intermediate entities in ownership chains have raised important policy questions. Policymakers have started to tackle the most pressing questions by means of issue-specific solutions. Initial policy responses are emerging, to different degrees, for (i) claims brought by nationals of the host State of the investment aiming to qualify through round-tripping, (ii) the use of mailbox companies to bring claims and (iii) occasions when investors engage in corporate restructuring specifically for the purpose of qualifying for protection under a treaty.

Figure IV.27. ISDS claimants and their ultimate owners
Breakdown and profiles of claimants in known treaty-based ISDS cases, 2010–2015 (Per cent)



Source: ©UNCTAD analysis based on UNCTAD's ISDS Navigator and Orbis for ownership data.

Note: Based on 254 known treaty-based ISDS cases initiated during the 2010–2015 period. Corporate claimants only; individual claimants are excluded. In cases brought by more than one claimant company, a principal claimant company was identified where possible. Non-substantial operations are defined as companies with fewer than 10 employees or with zero assets where employee numbers are not available.

b. Ownership and control in IIAs: relevant treaty clauses

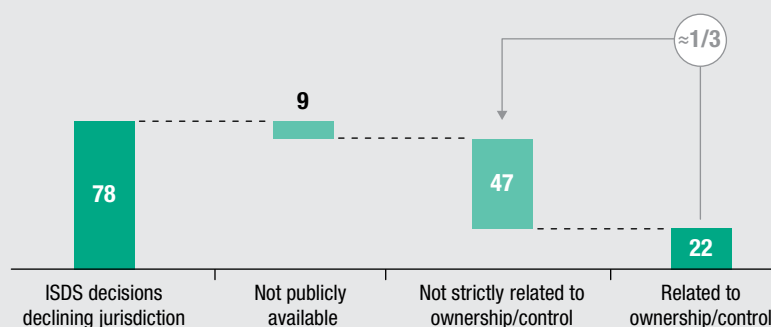
IIAs typically refer to ownership and/or control (and to direct and indirect ownership) in four types of treaty provisions that determine the range of protected investments and investors (“investor standing”) along a corporate ownership chain. More specifically:

- (i) The “definition of investor” sets out criteria that entities must meet in order to qualify for treaty protection.
- (ii) These entities must not fall within one of the categories of investors to whom benefits can be denied by means of a “denial of benefits” (DoB) clause (should the IIA have such a clause).
- (iii) These entities need to have made a qualifying investment; the manner in which this should be done can be part of the IIA’s “definition of investment”.
- (iv) At all these stages, the meaning of the terms “ownership” and/or “control” determine whether a given entity qualifies for protection.

A treaty-specific combination of options determines whether a treaty covers a broad or narrow category of corporate entities.

In about one third of the available decisions denying jurisdiction (rendered between 2000 and 2015), this outcome was explicitly due to issues related to ownership and control and corporate structures (box figure IV.9.1.). (Questions of ownership and control have also been addressed in a significant number of decisions in which the tribunal decided to assume jurisdiction.) In their decisions, tribunals have arrived at settled approaches to some of these questions; decisions on others remain inconsistent, creating legal uncertainty for host States and foreign investors alike. In recent IIAs, there has been a growing tendency to clarify relevant clauses and concepts with a view to circumscribing treaty coverage.

Figure IV.9.1. Ownership and control in jurisdictional decisions
Known treaty-based ISDS cases, decisions declining jurisdiction, 2000-2015



Source: ©UNCTAD analysis.

(i) Definition of investor

IIAs use a number of approaches to defining qualifying corporate investors (the definition of natural persons is excluded here):

- *Incorporation approach*: The treaty protects corporate entities that are legally constituted or incorporated in a contracting party. Such treaties offer a broad scope, extending protection to investors by the mere fact of incorporation. This is the most common approach in the IIA universe.
- *Control approach*: The treaty protects corporate entities, wherever established, that are controlled (directly or indirectly) by nationals of a contracting party. Such treaties provide protection to legal entities – incorporated in the host State or in a non-contracting party – whose controllers are natural or legal persons holding the nationality of the other contracting party.²⁷
- *Seat approach*: The treaty protects corporate entities that have their seat in a contracting party (where they are typically also incorporated). Such treaties extend protection only to investors that have their effective place of management or principal place of business in the contracting party whose nationality they claim.

The control approach refers to controlling entities and also considers indirect ownership. However, rather than *narrowing* the scope of a treaty to grant protection only to investors whose ultimate owner is based in a contracting party, the control approach is generally used to *broaden* the scope of treaties (i) by including it *in addition* to the incorporation approach (or more rarely in addition to the seat approach), and (ii) by providing the option to arbitral tribunals to examine the full ownership chain of an investment until a qualifying controlling entity is found (i.e. the control approach does not impose the obligation to continue the enquiry into the nationality of the controller up to the level of the ultimate owner) (UNCTAD, 2011).

When understanding “seat” as the MNE’s corporate headquarters, the seat approach would appear to limit treaty coverage to controlling entities and require tribunals to enquire into investor nationality up to the ultimate ownership level. In practice, however, seat is understood in the legal manner as the seat of the entity in question (including an intermediate entity). Accordingly, the seat approach merely requires intermediate entities to demonstrate significant management engagement with the foreign invested company and has not shifted the focus towards ultimate ownership. Moreover, in treaty practice this approach is becoming less common (ILA, German Branch, 2011).

Some more recent treaties add another criterion: they require the covered investor to have *substantial business activities (SBA)* (or sometimes “real economic activities”) in the contracting party whose nationality it claims. This approach is typically combined with the incorporation approach or the seat approach. The SBA requirement is much more common in recent treaties (see figure IV.28).

(ii) Denial of benefits clauses

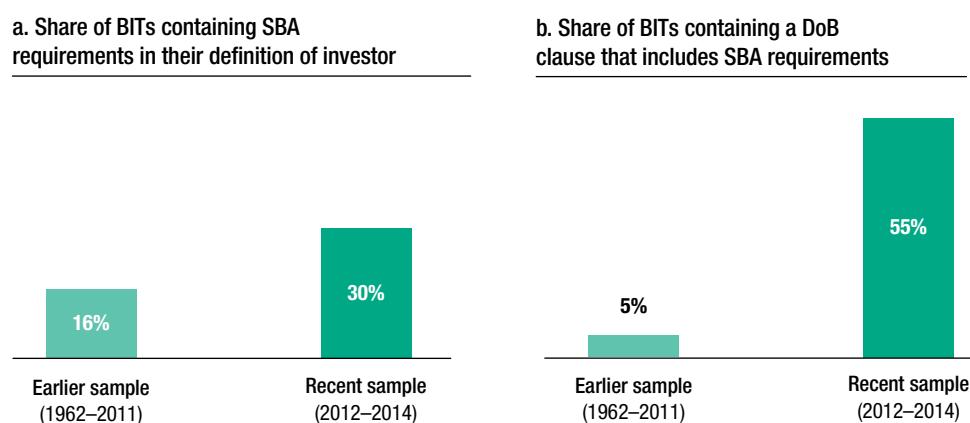
DoB clauses, which are becoming widely used in modern treaty practice, allow the host State to deny the benefits of the treaty to certain corporate entities incorporated in the other contracting party. Specifically, a DoB clause may come into play when the investor is owned or controlled by nationals of a third State or of the host State itself. In DoB clauses this is typically one of a number of cumulative requirements (e.g. the claimant must also lack substantial business activities in the contracting party, i.e. be a “mailbox” company).

(iii) Definition of investment

In addition to describing or listing assets covered, the definition of investment in IIAs typically specifies the nature of the link between the investor and the investment required to qualify for IIA protection and ISDS access (the investor is typically required to own or control the investment). IIAs take different approaches to this question:

- One approach defines investment as assets “owned or controlled, *directly* or *indirectly*, by an investor” of the other contracting party. It expressly permits indirect ownership or control of the investment through multiple or various ownership layers.
- Another approach is silent on the type of link required. Prevailing arbitral interpretation under this approach allows both direct and indirect ownership or control. This is the case in the majority of older IIAs.

Figure IV.28. SBA requirements: treaty practice over time (Per cent)



Source: ©UNCTAD analysis. Data derived from UNCTAD’s IIA Mapping Project.

(iv) Definition of ownership and control

Some IIAs define ownership and control, again following different approaches:

- *Ownership*. Some treaties refer to the share of legal ownership rights and define ownership of an enterprise as requiring “more than 50 per cent of the equity interest”.
- *Control*. Some treaties leave open or are ambiguous as to whether control can be *legal* (e.g. legal capacity to exercise control over the company) or must be *effective*, resulting in diverging arbitral interpretations. Other treaties provide clear guidance, noting that control must be effective.

c. Key policy challenges and responses

IIAs increasingly circumscribe their coverage in response to three specific challenges: claims brought (i) by entities controlled by a third-country or host-State entity (round-tripping), (ii) by mailbox companies, or (iii) by entities with ownership links to the investment that were purposely created in anticipation of a claim (time-sensitive restructuring). They can do so through more restrictive definitions and through denial of benefits (DoB) clauses. In addition, IIAs can clarify the meaning of effective control, if necessary urging tribunals to ascertain the ultimate owner controlling the relevant investment. To rule out claims by mailbox companies, IIAs can require that claimants have substantial business activities (SBA) and provide indicators for what might constitute SBA. Finally, IIAs can deny ISDS access to entities that have restructured at a time when a dispute had already arisen or was foreseeable. However, only half of the new IIAs (those concluded since 2012) and hardly any of the older IIAs include DoB clauses.

The broad definition of investor typically contained in IIAs, combined with the complexity of ownership and control in corporate structures and the ease of incorporation in many jurisdictions, results in a situation in which the actual coverage of a particular IIA may be far larger than initially anticipated. Table IV.7 summarizes the challenges and indicates the policy responses developed in IIAs. Some of these challenges resemble issues that have also been dealt with in the international tax community; the OECD Base Erosion and Profit Shifting (BEPS) outcome can provide useful background (box IV.10).

Table IV.7. Complex ownership structures: IIA challenges and policy responses

Challenges	Policy responses
	Excluding treaty coverage/denying access to treaty benefits for...
Indirect ownership (e.g. round-tripping)	Corporate entities effectively controlled by a host-State or third-country entity
Mailbox companies	Corporate entities without SBA (“mailbox” companies)
Time-sensitive restructuring	Corporate entities with ownership links to the investment that have resulted from restructuring in anticipation of potential disputes with the host States (“time-sensitive restructuring”)

Source: ©UNCTAD.

(i) Corporate entities effectively controlled by a host-State or third-country entity

As illustrated above, about one third of ISDS claims are filed by entities that are ultimately owned by parent companies in countries that are not party to the treaty on which the claim is based. Some recent IIAs have narrowed the scope of IIA protection by explicitly excluding investors that are owned or controlled by third- or host-State nationals. IIA negotiators have a number of policy options to this end (figure IV.29).

First, IIAs can limit protection to investments and investors owned or *effectively* controlled by nationals of a contracting party, either through the definition of investment and investor clauses (e.g. Macao, Special Administrative Region (SAR)–Netherlands BIT (2008)), or by way of reserving the right to deny benefits.

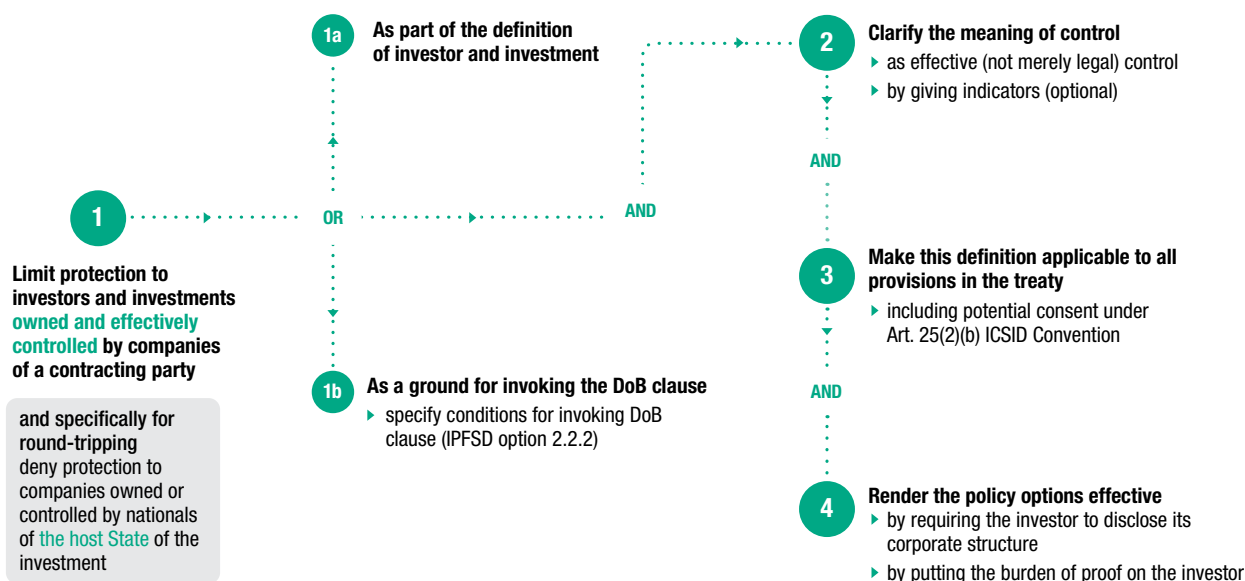
Tax policies are a major determinant of complexity in MNE ownership structures. As a result, recent efforts to improve international taxation and tackle tax avoidance by international investors, in particular the OECD Base Erosion and Profit Shifting (BEPS) project (and the BEPS Action Plan promoted by the G20) have grappled with many of the issues facing international investment policymakers today. Key elements in the final BEPS recommendations published in 2015 that are relevant for IIAs in the context of complex ownership issues fall under two actions:

- **Action 3: CFC Rules.** Controlled foreign company (CFC) rules apply to foreign companies that are controlled by shareholders in the parent jurisdiction. The BEPS recommendations set out how to determine when shareholders have sufficient influence over a foreign company for that company to be a CFC. Regarding the definition of control, the BEPS recommendations focus on two elements: (i) the type of control that is required and (ii) the level of that control. They recommend a control test that includes at least legal and economic control, and note that countries could supplement this with a de facto control test or a test based on consolidation for accounting purposes. Regarding level of control, the BEPS project recommends treating a CFC as controlled when residents (including corporate entities, individuals or others) hold more than 50 per cent of shares. The recommendations note, however, that countries may set their control threshold at a lower level. The BEPS project recommends using one of three approaches to aggregate shareholders for purposes of the control test: an “acting-in-concert” test, aggregation of related parties or a concentrated ownership test. The recommendations state that CFC rules should apply when there is either direct or indirect control.
- **Action 6: Preventing treaty abuse.** To prevent the use of mailbox companies, the BEPS project recommends including in treaties (i) a statement on the intention to avoid opportunities for non-taxation, (ii) limitations-on-benefits (LOB) rules limiting the availability of treaty benefits to entities that meet certain criteria and (iii) a general anti-abuse rule based on the principal purpose test. Regarding LOB to avoid treaty abuse, the BEPS project proposes a series of tests to determine whether an entity is eligible for treaty benefits. The tests are based on characteristics such as legal structure, ownership or activities, ensuring a link between the entity and the residence state. The LOB rules are to be included in the OECD model tax treaty. A simplified version of the LOB rule is also proposed, combined with a general “principal purpose test” to capture cases not caught by the simplified rule. The latter test states that treaty benefits can be denied when it is reasonable to conclude that obtaining treaty benefits was one of the principal purposes of any arrangement that resulted directly or indirectly in that benefit (e.g. when the principal purpose of an intermediate entity is to obtain coverage under a treaty).

Importantly, the LOB rule contains provisions dealing specifically with indirect ownership; the indirect ownership rule would require that each intermediate owner of the entity being tested be a resident of either contracting State (i.e. all intermediate entities in an ownership chain would need to be eligible for treaty benefits). The indirect ownership rules are bracketed: countries may consider this indirect ownership requirement to be unduly restrictive and prefer to omit such a rule in the treaties or treaty models.

Source: OECD (2015b and 2015c).

Figure IV.29. | Indirect investments and round-tripping: IIA options



Source: ©UNCTAD analysis.

However, as indicated above, in stipulating the criteria of effective control by nationals of a contracting party, IIAs generally do not intend to limit qualifying investors to ultimate owners or parent companies only. The purpose of provisions requiring effective control is usually merely to avoid investors gaining access to treaty benefits through artificial corporate structures and entities without substance. Whereas there are specific policy options for dealing with mailbox companies (discussed separately below) a particular challenge resulting from indirect ownership structures is the case of investment round-tripping (i.e. investment effectively or ultimately owned or controlled by a *host* State beneficiary). Some ISDS claims have been filed by entities controlled by a host State national. This raises questions related to the customary international law (CIL) principle that a national cannot bring international action against its own State. Arbitral opinions diverge in their approaches to these situations.

In order to avoid coverage for round-tripping investment in particular, IIAs can require effective *foreign* ownership and/or control (i.e. by the contracting parties other than the host state) or deny benefits to entities owned or effectively controlled by *host*-State nationals.

A second step, which brings additional predictability, is to clarify the meaning of effective control (box IV.11). When choosing indicators or criteria for effective control, policymakers need to strike a balance between objectivity and sensitivity to different circumstances.

Box IV.11. Clarifying the meaning of effective control

Policymakers seeking to clarify the meaning of “effective control” can find guidance in certain IIAs and decisions by arbitral tribunals. They may also be inspired by the controlled foreign companies (CFCs) rules proposed in Action 3 of the BEPS recommendations.

Some IIAs have clarified what is meant by effective control by providing a non-exhaustive list of factors to be considered by tribunals. They include factors such as owning more than 50 per cent of the entity’s capital or equity participation, voting rights that allow for a decisive position in the entity’s managing bodies and the right to select or exercise substantial influence over the selection of the entity’s managing bodies. In the context of the definition of effective control, legal factors (voting rights, right to select members of the entity’s managing bodies) are relevant, but not necessarily sufficient for the tribunal to find the existence of control (which will depend on the circumstances of the case).

Arbitral interpretations also provide guidance on the meaning of effective control. Tribunals have considered that majority shareholdings would normally imply the existence of control (see e.g. *Aucoven v. Venezuela* (2001)).^a Tribunals have also inquired into effective control in cases where ownership did not lead to a straightforward answer (in *Pac Rim v. El Salvador* (2012)).

When deciding on the existence of effective control, tribunals have considered a variety of factors, including:

- The ability to effectively decide and implement the key decisions of the business activity of an enterprise (e.g. initiate the investment operation, authorize expenditures, approve budget and dividend payment, decide on branding and marketing strategy, receive reports on the controlled entity’s activities)
- Participation in the day-to-day management of the entity (e.g. conduct of meetings on behalf of the company; being the effective addressee of relevant correspondence – such as legal advice – regarding the company’s operations); appearance of being the effective decision maker in minutes from management body meetings
- Access to know-how (e.g. access to technology, supplies and machines, selection of the suppliers, expertise regarding the expected return on the investment); access to capital (such as initial expenditures)
- Authoritative reputation

(See e.g. *Philip Morris v. Australia* (2015), *Vacuum Salt v. Ghana* (1994) (contract-based case, but relevant for the definition of foreign control under Art 25(2)(b) ICSID Convention), *Thunderbird v. Mexico* (2006), *Caratube v. Kazakhstan (I)* (2012), *CECFT v. Gabon* (2005) (contract-based case).

On occasion, tribunals have also pierced through corporate layers to ascertain the ultimate corporation or national entity controlling the relevant investor or investment (e.g. *TSA Spectrum v. Argentina* (2008), *National Gas v. Egypt* (2014)).

Source: ©UNCTAD.

^a However, this presumption can be rebutted (as in *Caratube v. Kazakhstan (I)* (2012)).

Given the cross-cutting relevance of the concept of control in IIAs, any definition of control that is adopted in an IIA – whether in the scope and definition, or DoB or any other provision – should be applicable to *all* clauses contained in that IIA. This would also extend to the meaning of “foreign control” under Article 25(2)(b) of the ICSID Convention, if the IIA contains such a jurisdictional clause.

Finally, policymakers can decide to render these options more effective by requiring investors to disclose their corporate structure and/or by allocating the burden of proof of effective control to the investor. Both can help remedy the information asymmetry between the investor and the respondent State.

With respect to disclosure, no IIA has such requirements related to corporate structures. Disclosure mechanisms used in the context of BEPS (Action 12) could provide useful guidance to investment policymakers.²⁸ As far as the DoB clause is concerned, the general rules on burden of proof would require the party invoking the clause – i.e. the respondent (host) State – to prove the facts. However, tribunals have asked the investor to provide evidence that it is entitled to benefits (Lee, 2015). Consideration could be given to build on such practice and to include a specific reference in the DoB clauses of IIAs for claims allegedly involving mailbox companies and round-tripping investment.

(ii) Corporate entities without SBA (mailbox companies)

Of the ISDS claims filed by claimants whose ultimate owners have a different nationality, more than a quarter do not engage in SBA in the country whose nationality they claim (for cases initiated between 2010 and 2015). In other words, they are mailbox companies (figure IV.27). Arbitral tribunals mostly concur in their approach to mailbox companies acting as claimants: unless the treaty contains a SBA or similar requirement, mailbox companies incorporated in the other contracting party have been recognized as protected investors, even if they are owned or controlled by host-State or third-State nationals (unless they were inserted into the ownership chain after the dispute arose or in anticipation of such a dispute, as discussed in the next subsection).

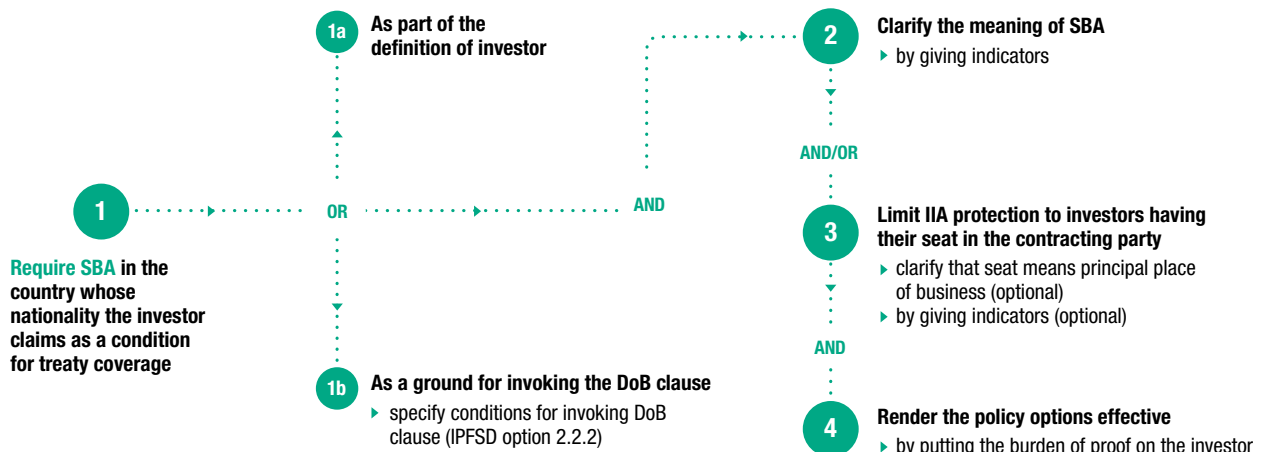
Some recent IIAs that require SBA in order to benefit from treaty protections reflect an emerging policy response. Comparing treaties over time shows that this approach is becoming more frequent: whereas earlier BITs required SBA in their definition of investor clause in only 16 per cent of analyzed treaties, the share rises to 30 per cent in the sample of recent BITs (those concluded since the launch of UNCTAD’s Policy Framework, which includes this policy option; see figure IV.28). In addition, 55 per cent of recent BITs contain DoB clauses with a SBA requirement, as compared with a mere 5 per cent of earlier BITs.

In order to preclude mailbox companies from using ISDS, IIA negotiators have a number of options. Figure IV.30 summarizes the policy options, some of which can be found in recent treaty practice.

The first option, which has already made its way solidly into treaty practice, requires a company to engage in SBA in order to qualify for protection under an IIA (Feldman, 2012). If included in the “definition of investor” clause (e.g. in the Canada–EU CETA (negotiations concluded) and the Iran–Japan BIT (2016)), the SBA requirement is a necessary condition for an investor to benefit from IIA protection. If included in the DoB clause (e.g. as in the ECT (1994) and the Canada–Republic of Korea FTA (2014)), the SBA requirement becomes relevant only if the defending State invokes the DoB clause.²⁹

A second step, bringing additional predictability, is to clarify the content of SBA (box IV.12). When choosing indicators or criteria for SBA, policymakers need to strike a balance between objectivity and sensitivity to different circumstances. Purely objective criteria, e.g. minimum years of establishment, bring predictability and clarity but also risk being perceived as unduly rigid.

Figure IV.30. | Mailbox companies: IIA options



Source: ©UNCTAD analysis.

Another set of options builds on the fact that such mailbox companies typically would not qualify as the seat of corporate structures (a company’s seat implies the location of real operations, e.g. of administrative or managerial nature). In the absence of other options, taking the “seat approach” – i.e. conditioning IIA coverage on an investor having its seat in a contracting party (as in the Afghanistan–Germany BIT (2005) and the Albania–France BIT (1995)) can help preclude coverage of mailbox companies. Defining the seat as or referring directly to the “place of management”, as done in the BLEU–United Arab Emirates BIT (2004) or the ASEAN Agreement for the Promotion and Protection of Investments (1987), can help make this option effective.

Finally, policymakers may decide to render both of the above options more effective by allocating the burden of proof to the investor (i.e. in case of doubt, the investor is required to prove that it has SBA or an effective seat).

(iii) Corporate restructuring in anticipation of potential disputes (“time-sensitive restructuring”)

Some investors engage in restructuring specifically for the purpose of bringing an ISDS case (sometimes in anticipation of a disadvantageous government action). Host States regularly contest the permissibility of such corporate transactions as a means to gain access to IIA rights. Arbitral tribunals have considered this issue as early as in 2005 (*Aguas del Tunari SA v. Bolivia* (2005)). Since then this issue has become increasingly common in ISDS cases. Of the 78 cases in which jurisdiction was denied (between 2000 and 2015), time-sensitive restructuring was an issue in at least 8.

The most recent and prominent example is the jurisdictional decision in *Philip Morris v. Australia* (2015). In that case, the Hong Kong–based claimant, Philip Morris Asia Ltd, had acquired all the shares in an Australian company that wholly owned another Australian company, Philip Morris Ltd (PML). PML was the holder of the allegedly expropriated rights, acquired from a Swiss-incorporated company that is part of the Philip Morris group (Switzerland does not currently have an IIA with Australia). The tribunal considered that the commencement of the arbitration shortly after the claimant’s restructuring in Hong Kong (China) constituted an abuse of rights and declined jurisdiction.

Arbitral interpretations on these issues have evolved – with time – into an increasingly consolidated approach: structuring an investment in order to take advantage of IIAs concluded by the host State is generally acceptable. However, restructuring leads to a denial of jurisdiction if at that time the dispute already existed or to an abuse of rights if it was sufficiently foreseeable by the investor (Baumgartner, forthcoming).³⁰

IJA negotiators have two main options to deny treaty protection in case of time-sensitive restructuring (figure IV.31). Recent IIAs and negotiating documents offer initial responses to build on.

First, IIAs can deny ISDS access to entities that have restructured themselves to gain such access at a time when a dispute had already arisen or was foreseeable (e.g. as in the EU–Viet Nam FTA (negotiations concluded) and the EU’s November 2015 TTIP proposal). In distinguishing between good faith restructuring and abusive practices, focusing on the objective criterion of time is preferable to focusing on the main goal or purpose of the restructuring (as included in the EU–Viet Nam FTA (negotiations concluded), the EU’s November 2015 TTIP proposal and India’s December 2015 model BIT). This helps overcome the problem of establishing the purpose or goal of structuring a corporation, which is an inherently subjective enquiry (and which can be rendered moot by invoking additional, e.g. tax, reasons for the restructuring). This policy option can be pursued through a specific provision or through the DoB clause (then also specifying conditions for invoking the DoB clause; see earlier discussion).

Box IV.12. Clarifying the meaning of substantial business activities (SBA)

Policymakers seeking to clarify the meaning of SBA can find guidance in existing IIAs, model treaties and decisions by arbitral tribunals. They may also be inspired by initiatives in other policy areas grappling with similar concerns stemming from complex ownership structures, notably the OECD’s BEPS plan, which in Action 6 of its recommendations suggests options for limitations on benefits.

Thus far, only a few IIAs clarify the meaning of SBA. These IIAs are typically negotiated in a specific context (e.g. the China–Hong Kong, SAR CEPA (2003), the China–Macao, SAR CEPA (2004)) and include clarifying indicators in the “rules of origin” for trade in services (covering such trade through commercial presence (Fink and Nikomborirak, 2007)). General indicators include factors related to:

- The entity’s business itself (the nature and scope of business, number and type of clients and contracts, amount of sales, turnover from tax returns, payment of profit tax under local law, years of establishment or the requirement to exercise a similar activity in the home as in the host country)
- The entity’s employees (the number of employees, share of employees having permanent residence in or nationality of the home country)
- The physical presence of the entity (ownership or rental of premises, costs for maintenance of physical location, phone and fax numbers offered to clients and other third parties for contact with the company)

These IIAs also include sector-specific criteria (e.g. for legal, construction, banking, insurance and other financial services: three or five years of operations; for transportation services: share of ships, calculated in tonnage, registered in the home country). A memorandum from the German Federal Ministry for Economic Affairs and Energy on a model BIT for developed countries with a functioning legal system (BMW, 2015) provides an indicative list of factors for ascertaining the existence of SBA. They include (i) a recognizable physical presence, (ii) actual economic activities and (iii) a considerable number of employees. This model, as well as the Indian draft model BIT (July 2015 version), also expressly exclude certain activities, such as the passive holding of stock, from the definition of SBA.

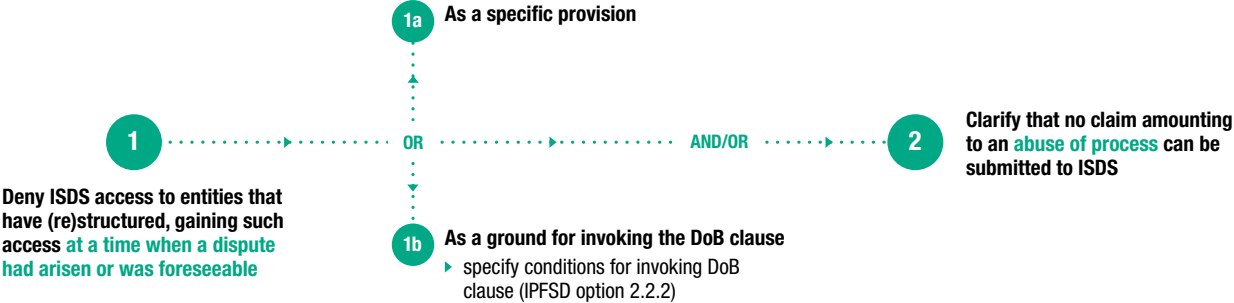
Arbitral tribunals have used indicators for ascertaining the existence of SBA. In the absence of specific treaty language, tribunals have considered:

- The place where the board of directors meets and whether the board’s minutes were available (in *Pac Rim v. El Salvador* (2012))
- The existence of a continuous physical presence (in *Amto v. Ukraine* (2008) and *Pac Rim v. El Salvador*)
- The existence of permanent staff (in *Amto v. Ukraine*)
- The active holding of shares in the entity’s subsidiaries (in *Pac Rim v. El Salvador*)

Source: ©UNCTAD.

Second, IIAs can explicitly refer to the legal doctrine of abuse of process (derived from the abuse of rights) (e.g. as in the CETA), which tribunals have typically used to deny ISDS access to entities that obtained protection as a result of last-minute corporate restructuring.

Figure IV.31. | Time-sensitive restructuring: IIA options



Source: ©UNCTAD analysis.

E. RETHINKING OWNERSHIP-BASED INVESTMENT POLICIES

1. National investment policy: the effectiveness of ownership rules

a. Evaluate where rules and regulations on foreign ownership are fit for purpose

The increasing complexity of MNE ownership networks is largely a natural consequence of globalization. The practical difficulty of determining ultimate ownership of and control over foreign affiliates call into question the effectiveness of some ownership-based investment policies. Policymakers should evaluate the rationale for rules and regulations on foreign ownership and assess their relative effectiveness and “fit-for-purpose” compared with alternative policies (such as competition or industrial development policies), where this is feasible and appropriate. Some countries may require assistance, including by international organizations, to build the necessary regulatory and institutional capacity.

Ownership complexity challenges policy effectiveness

Ownership and control are fundamental concepts in investment policy and investment-related policy areas. They have become basic ingredients for policies aimed at building domestic productive capacity and harnessing the economic benefits of foreign investment; for policies aimed at keeping strategic resources in national hands; for policies protecting sectors with a public service responsibility and basic infrastructure industries; and for national security policies, among others.

The new data presented in this chapter on ownership structures of MNEs and their foreign affiliates, and the review of ownership and control in existing investment rules, lead to new perspectives on ownership-based investment policies. For more than 40 per cent of foreign affiliates worldwide, investor nationality is not what it seems. Affiliates are sometimes directly owned by a foreign company but actually controlled (ultimately owned) by a domestic company; they are often directly owned by a domestic company but actually controlled by a foreign company; they are frequently directly owned by a company in foreign country A but ultimately controlled by a company in foreign country B (see figure IV.11). Moreover, ownership and control are sometimes extremely dispersed – affiliates are owned by direct and indirect shareholders within the same MNE spread across on average three jurisdictions – and investor nationality has become more difficult to ascertain, affecting the practical application of nationality-based policy measures.

Furthermore, ownership is just one means to exercise control, and the relationship between nominal ownership and control is not always linear. As demonstrated in this chapter, even minority ownership stakes can be sufficient to exercise control, through the use of cross-shareholdings, preferential shares or voting blocs. And there are non-equity forms of control (such as contracts and licensing agreements, or control over key inputs, distribution channels, brands, patents, trademarks, etc.) that cannot be deduced from company shareholder registers and often remain invisible to investment authorities and regulators (see *WIR11*).

Yet, the design of many national investment policies is still largely based on a world of predominantly straightforward direct ownership relationships. Since foreign ownership limitations are not a guarantee against foreign control, policymakers have to prevent the circumvention of ownership restrictions and put in place administrative procedures to verify direct and indirect ownership links of foreign invested companies. Such procedures can be costly for States to implement and cumbersome for investors to comply with, to the point of negatively affecting a country's investment climate.

Alternative and complementary policies

The effectiveness of ownership-based investment policies is called into question not only because of the complexity and dispersion of ownership links, and the availability of alternative levers of control for MNEs, but also because ownership-based policies may not be sufficient by themselves to achieve their stated objectives.

In some policy areas, e.g. national security, there is no credible alternative to ownership restrictions (chapter III). However, in other policy areas, alternative or complementary approaches may exist. For example, if the ultimate objective of ownership restrictions is to avoid excessive market power of a foreign investor, competition policy may provide a more suitable solution. If the objective is industrial development and productive capacity building, government procurement, requirements and/or incentives to achieve economic outcomes (to the degree that they are permitted under a country's international commitments), or business linkages programmes may be an alternative. If the ultimate objective of ownership restrictions is to safeguard access to and affordability of public services, then mandatory supply rules, price caps or subsidies for the poor may be alternate solutions. If the goal is to protect domestic cultural heritage, there may be a case for rules on local media content.

Naturally, pursuing alternative policy solutions requires having the necessary regulatory and institutional capacity in place. For example, effective competition policy requires strong laws and sufficient capacity to enforce them; e.g. in order to address crowding-out concerns and prevent large MNEs from capturing a dominant position in a fragmented market. In addition, antitrust authorities must be able to prove that an investment is anti-competitive and prepared to defend their decision before the court. Foreign ownership rules, in contrast, can simply be imposed, do not require justification and must be accepted by investors. Similarly, ownership restrictions may be considered an easier way of dealing with administratively burdensome regulation of private investors providing otherwise public services. Shifting from foreign ownership restrictions to alternative policy options may require developing the necessary administrative and regulatory capacity. Some countries, in particular the least developed countries, may need assistance, including by international organizations, to build the required regulatory and institutional capacity (such as, for example, the capacity building provided by UNCTAD in the area of competition law and policy).

However, using foreign ownership restrictions as an enforcement mechanism for other public policy concerns comes at a cost, especially where foreign investors are needed to supply capital or technology or to provide access to overseas markets, and where domestic owners may lack the capacity to effectively serve or develop the market. The pros and cons of replacing ownership restrictions with alternative policy solutions should hence be evaluated on a sector-specific basis, in light of the existing regulatory framework and the available enforcement capacity.

Fit-for-purpose test

For assessing the viability of alternative policy solutions, policymakers should conduct a "fit-for-purpose test" on ownership-based national investment policy measures, asking two sets of questions:

(1) How functional are ownership-based policies for the ultimate policy objective?

- Is the prevention of foreign control per se the ultimate policy objective, or is it a tool to achieve broader policy objectives?
- To what extent are existing ownership restrictions achieving their stated objectives?
- Are there alternative, more direct policy tools available to achieve the objective? What are the relative costs and benefits of such alternatives as compared with ownership-based policies?

(2) What is my country's implementation capacity?

- What capabilities are there for the analysis of ownership chains, shareholding structures and complex control transfer arrangements or non-equity modes of control of existing investors?
- What are the capacities for administering and enforcing alternative policy approaches, such as competition laws or sector-specific regulations?
- What is my country's capacity to synergize competition, tax and other authorities?

b. Improve disclosure requirements and approval procedures

Where ownership-based policies are considered necessary, investment authorities can improve disclosure requirements to assess ownership chains and ultimate ownership. They should be aware of the administrative burden this can impose on public institutions and on investors. Synergies with other agencies in policy areas that investigate ownership chains, such as competition authorities and tax authorities, should be exploited.

Rules and regulations on foreign ownership will continue to play a significant role in national investment policies. As shown in section D, policymakers have a range of options to safeguard the effectiveness of ownership rules – to avoid circumvention of restrictions, to prevent de facto foreign control and to preclude unwarranted access to benefits exceptionally reserved for foreign investors by nationals. The examples of mechanisms that have been put in place by countries illustrate the key elements of the policy response to complex ownership:

- Clarify the objectives of ownership rules. Where the objective is the prevention of foreign control, broaden the scope of screening and approval procedures or ownership reviews beyond direct shareholdings to include complex shareholding structures and non-equity relationships.
- Strengthen procedures for discovery of ownership chains and ultimate ownership and introduce more stringent disclosure requirements, including (where relevant for round-tripping) of ultimate beneficial owners.
- Strengthen measures aimed at preventing circumvention of ownership rules, including anti-dummy laws and general anti-abuse measures.

The mechanisms described in section D also make clear that the application of rules and regulations on foreign ownership can make approval procedures increasingly onerous. Policymakers should aim to apply these procedures more selectively to minimize the administrative burden and costs for the State and the investors. They should consider, e.g.

- Rationalizing approval procedures where there are no ownership limitations. The costs and benefits of such additional procedures over and above normal business registration processes should be evaluated.
- Introducing thresholds (e.g. minimum foreign equity stake and/or investment value) for approval procedures.

It should be noted that, for MNEs, strengthened disclosure requirements on full ownership structures up to ultimate owners may constitute a relatively limited additional administrative burden. For them, the trend towards greater transparency is already a reality in some policy areas and in many jurisdictions, and is becoming part of the cost of doing business in a “new

normal”. The impact of increased transparency on ultimate beneficial ownership will be more strongly felt among individual owners and corporations acting as a vehicle for private wealth.

Finally, governments investigate ultimate ownership and control also in other investment-related policy areas. These include fiscal policy, competition policy and policies dealing with illicit financial flows. Tax policy looks at ownership structures to evaluate international transfers and to assess withholding taxes. Competition policy is concerned with ownership links (potentially leading to collusion) between different players in the market; and illicit financial flows need to be traced to ultimate beneficial owners to be tackled or sanctioned effectively. These policy areas have in common that, by their nature, they often examine the extended ownership structure of legal entities with foreign participation, often up to ultimate and beneficial owners. Investment authorities are not alone in dealing with the challenges associated with complex ownership of affiliates. There are potential synergies from information sharing and in the imposition of disclosure requirements. Realizing such synergies, using a single-window approach, is important in the context of global efforts to facilitate international investment in productive assets (UNCTAD’s Investment Facilitation Package, chapter III).

2. International investment policy: the systemic implications of complex ownership

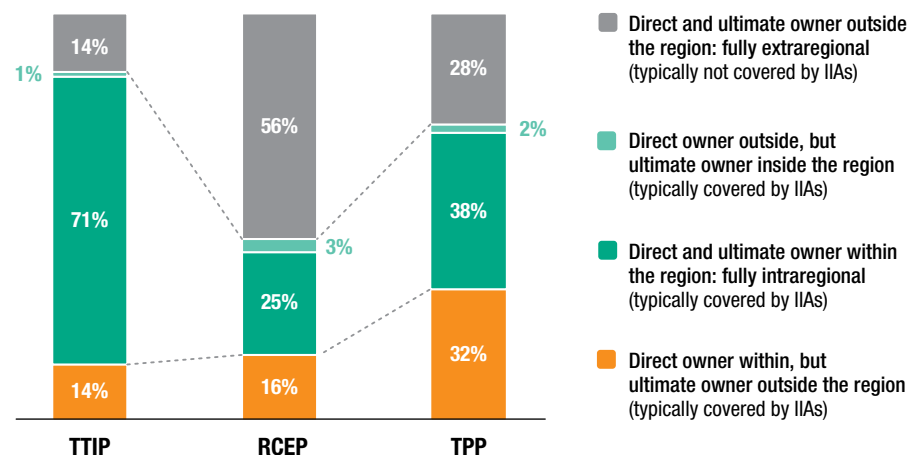
a. Anticipate the multilateralizing effect arising from ownership complexity

At the international level, policymakers should be aware of the de facto multilateralizing effect of ownership complexity. The broad definition of investors/investments in investment treaties, combined with the extensive networks of affiliates of large MNEs and the ease of establishing legal entities in many jurisdictions, significantly extend the protective coverage of IIAs. This is highly relevant also for regional treaties and treaty negotiations: between one seventh (TTIP) and one third (TPP) of apparently intraregional foreign affiliates in major megaregional treaty areas are ultimately owned by parents outside the region, raising questions as to the ultimate beneficiaries of these treaties.

The notions of ownership and control have systemic relevance for the IIA universe and its coverage of FDI. The broad investor definition typically contained in IIAs, combined with the complexity of corporate structures, the ease of incorporation in many jurisdictions and the relative ease with which ownership structures can be changed, reveal that the actual coverage of a particular IIA could be far larger than initially anticipated. Essentially, as long as a country has one (broadly worded) IIA, an investor from any country could potentially benefit from that IIA by structuring its investment into the country concerned through an entity established in the other contracting party.

Investors can engage in “treaty shopping” based on existing treaties. In addition, new treaties provide protection to existing corporate structures, thus covering existing investments that may be ultimately owned by investors in third countries. For many countries this is not a cause of concern because they consider that, independent from their ultimate ownership, these investments provide economic benefits (e.g. paying taxes, creating employment, generating exports) like any other domestic or contracting-party owned investment. However, third-party ultimate ownership may give rise to “free-riding” or strategic concerns; and such free-riding can be significant. For example, a substantial share of foreign affiliates in major megaregional treaty areas that at the direct ownership level appear to be intraregional are ultimately owned by parents outside the region, i.e. the benefits of the treaty in question accrue (or would accrue) also to third parties (figure IV.32).

Figure IV.32. Ownership of foreign affiliates in TTIP, RCEP and TPP
Origin of direct and ultimate owners of foreign affiliates



Source: ©UNCTAD analysis based on Orbis data (November 2015).

When negotiating new treaties, negotiators generally do not evaluate the ownership patterns of MNEs in the territories of the contracting partners. They also tend not to take explicitly into consideration the ease with which companies can be incorporated in treaty-partner jurisdictions. As a result, protection may be offered to a much larger pool of companies than anticipated. This issue becomes even more important when negotiating treaties with pre-establishment provisions.

b. Engage in international collaboration to reduce uncertainty about IIA coverage

Policymakers should aim to avoid uncertainty for both States and investors about the coverage of the international investment regime and its multitude of bilateral, regional and megaregional treaties. International collaboration could aim to build a common understanding of “effective control” and a common set of criteria for substantial business activity and for identifying the origin of investors, as a basis for a more consistent interpretation of investment rules and treaty coverage, and as an integral part of global efforts to facilitate international investment.

In the absence of a multilateral approach to investment rulemaking, the challenges arising from ownership complexity will persist. Section D described a number of options that IIA negotiators have adopted in recent treaties to address the most pressing issues stemming from complex ownership structures: round-tripping, mailbox companies and time-sensitive corporate restructuring. These options

- Limit protection to investors and investments effectively controlled by companies of a contracting party.
- Require SBA in the country whose nationality the investor claims as a condition for treaty coverage.
- Strengthen DoB clauses to deny protection to investors without SBA, investors ultimately owned by host-State nationals and investors that engaged in restructuring for the purpose of obtaining treaty coverage.

With the multitude of options available to IIA negotiators to use alone or in combination, treaties will continue to incorporate diverging practices. Adding the varying interpretations by arbitral tribunals, there is a risk of persistent uncertainty as to the coverage of treaties.

A first step towards more consistent interpretation of investment rules could be collaborative efforts at the international level, with the support of international organizations, to find a common understanding of “effective control” and a common set of criteria for SBA and for identifying the origin of investors. Such efforts would resemble recent progress made in the area of international taxation, where similar issues resulting from complex ownership structures have been addressed (see box IV.10 in section D) in work on preventing the granting of treaty benefits in inappropriate circumstances.

Such an understanding could be reflected in new treaties or form the basis of an interpretative statement for existing treaties. Both could help reduce uncertainty for States and investors as to the coverage of the IIA regime and complement efforts to improve the global investment policy environment.

* * *

In conclusion, the overarching objective of investment policy is to make investment work for sustainable development, maximizing its benefits and minimizing its negative effects. Complex ownership structures call into question the effectiveness of ownership-based policy tools widely used for this purpose, both nationally and internationally. This requires a re-evaluation of these tools for the pursuit of the common goal.

One approach is to improve the application of ownership-based regulations by enhancing disclosure requirements and procedures to identify the ultimate owner of an investment. Another approach is to replace, where feasible and appropriate, ownership-based regulations with other policies such as competition, taxation, industrial development, public services or cultural policies. It is important to find the right policy mix, effective and proportionate. Whichever approach is chosen, a balance between liberalization and regulation must be found in pursuing the ultimate objective of promoting investment for sustainable development.

To help policymakers chart a way forward, WIR16 provides insights on the global map of ownership links in MNEs, and on how national and international policymakers around the world can respond to the challenges posed by complex ownership structures. The new data, empirical analysis, and policy responses presented here can inspire further research to support better informed policy decisions. They also make a strong case for targeted technical assistance and capacity building, and for more international consensus-building. UNCTAD will continue to support these efforts.

NOTES

- ¹ Ownership links looking upward from corporate parents, i.e. including beneficial ownership, have been examined in other studies with different research objectives, e.g. aiming to establish the level of concentration of corporate control (La Porta et al., 1999; Glattfelder, 2010), or aiming to show relationships between business groups such as in Japanese keiretsu or in Korean chaebol groups (Prowse, 1992; Gedajlovic and Shapiro, 2002; Chang, 2003).
- ² Other common constructions used to separate legal and economic rights include foundations, which may exercise legal control and issue certificates embodying economic rights. Foundations are, again, rare in the internal ownership structure of MNEs, and more commonly used by individual/family owners.
- ³ Empirical studies indicate that in most countries corporations tend not to skew voting rights, maintaining the one-share-one-vote principle which states that ownership percentages yield identical percentages of voting rights (La Porta et al., 1999; Deminor Group, 2005; Goergen et al., 2005; Glattfelder, 2010).
- ⁴ Based on a screening of over 80,000 examples of complex MNE ownership structures, less than 1 per cent display instances of cross-shareholdings. Where cross-shareholdings exist in the internal ownership structures of MNEs they are generally not considered desirable by the MNE itself; they can be the result of unforeseen commercial or legal circumstances and past M&A transactions. There have also been instances of affiliates purchasing shares in listed parents to support the stock price or in share buy-back schemes, resulting in cross-shareholdings.
- ⁵ There is a significant body of literature on cross-ownership relations: La Porta et al. (1999); O'Brien and Salop (1999); Claessens and Djankov (2000); Dore (2002); Chapelle (2005); Gilo et al. (2006); Almeida et al. (2007); Trivieri (2007).
- ⁶ The first set of affiliates can be identified directly in Orbis by setting ownership thresholds at 50 per cent. The second set of affiliates cannot be derived directly in Orbis but has been generated here following the aggregation methodology developed in Rungi et al. (2016).
- ⁷ The number of this group varies depending on an exogenously determined "probability threshold". A level of probability that an alternative voting bloc could emerge, however unlikely, has to be accepted. For the set of companies identified here the probability of control of Top 100 parents is higher than 50 per cent. This set has been excluded from the analyses in this section. The control-probabilities method for the calculation of corporate boundaries is developed in Rungi et al. (2016).
- ⁸ Lewellen and Robinson (2013) find that historical coincidence is a statistically significant determinant of ownership complexity. With the database used for the analysis in this chapter it is not possible to fully test this hypothesis (although some observed, overly complex and chaotic ownership structures seem to support it). Unlike Lewellen and Robinson, who use data at the group level, this chapter uses data at the individual affiliate level, where the information available is the date of incorporation of each affiliate and not the date on which the affiliate was actually annexed to the group. In the context of the largest MNEs, which actively acquire affiliates through M&As, this is a critical limitation.
- ⁹ See Bartlett and Ghoshal (1990); Bartlett and Beamish (2011).
- ¹⁰ Several studies analyze the relationship between MNEs effective tax rate and presence of affiliates in OFCs (e.g. Desai et al., 2006a; Desai et al., 2006b; Maffini, 2009); for an extensive literature review, see Fuest and Riedel (2009). *WIR15* focuses on the impact of FDI through OFCs for host countries' domestic revenues.
- ¹¹ Huizinga and Voget (2009) show evidence on tax as a determining factor behind the choice of parent entity in cross-border mergers. Other studies confirm the importance of tax as a driver for corporate structures. Lewellen and Robinson (2013) find that tax motives feature prominently as determinants of ownership structures.
- ¹² The relevance of international investment treaties, specifically BITs, is also confirmed by Lewellen and Robinson (2013) showing that affiliates located in countries with more extensive investment treaty networks are more likely to be owners.
- ¹³ The evidence of the increasing complexity of MNE ownership structures is confirmed by other studies. Based on a large sample of United States MNEs, Lewellen and Robinson (2013) document that the average complexity of complex MNEs has been increasing since 1994, although the share of complex MNEs has decreased (the distribution curve has become steeper). This work is particularly relevant to the discussion in this chapter as it explores complexity in the ownership structure of firms' operations abroad. "Complex" MNEs in this study are measured by cross-border links between their foreign affiliates. The analysis shows that the number of complex MNEs has declined from 52 per cent of the sample in 1994 to 45 per cent in 2009; at the same time, the share of assets organized in chains for complex MNEs has increased from 40 per cent to 60 per cent over the same period; similarly the average chain length increased, from 2 to 2.5.
- ¹⁴ See http://ec.europa.eu/taxation_customs/taxation/company_tax/anti_tax_avoidance/index_en.htm for the proposed anti-avoidance package.

- ¹⁵ The top-down approach is followed in many major studies of corporate groups, including some using firm-level data, e.g. La Porta et al. (1999); Altomonte and Rungi (2013); Lewellen and Robinson (2013); Altomonte et al. (2014). For a literature review, see also Khanna and Yafeh (2007).
- ¹⁶ GUOs are reported by Orbis as part of the ownership information provided at the firm level. Above the corporate GUO there may be non-corporate owners, fragmented ownership or unknown shareholders due to a break in the ownership information. (The latter case is common when GUOs are in tax havens, where information on shareholders is typically not available.) In cases where no shareholder reaches a majority stake, the GUO is not defined and the company is excluded from the perimeter of analysis. A strict majority condition for ownership reflects a conservative approach: it restricts the analysis to companies with unique direct and ultimate owners. Some ownership complexities may therefore be lost. However, in the vast majority of cases (about 90 per cent) corporate ownership follows a strict majority ownership path, so the impact is limited.
- ¹⁷ This approach differs conceptually from the definition of foreign affiliates normally used in FDI and foreign affiliates statistics (FATS), which is based on foreign ownership of 10 per cent or more. The standard definition, due to its low threshold, is likely to be slightly more expansive. However, given the predominance of relatively simple direct shareholding structures in practice, the results coincide almost completely.
- ¹⁸ Because the objective of the analysis is different, the relevant perimeter of foreign affiliates for the analysis of the direct shareholder level differs from the one used to compute the mismatch index. In this subsection, the set of foreign affiliates is not based on the nationality of the ultimate owner but only on the characteristics of the direct shareholders; a foreign affiliate is defined as any entity with an aggregate direct foreign share above 10 per cent. This definition of foreign affiliates includes all cases 2 and 3 in the ownership matrix and does not fully exclude cases 1 and 4. The choice to depart from the 50 per cent plus threshold allows the inclusion of a larger number of relevant cases, characterized by fragmented direct shareholder structures. For the same reason, this analysis also relaxes the condition of fully corporate direct shareholders, allowing also for mixed ownership between corporate shareholders and other types of shareholders, e.g. individuals and/or families (the share of mixed cases is limited, at about 15 per cent).
- ¹⁹ The 20 per cent threshold is in line with International Accounting Standard provisions related to Investments in Associates and Joint Ventures, which establish that an entity exerts significant influence on the investee if it holds directly or indirectly 20 per cent or more of the voting power. The notion of “significant influence” defines the scope of investment in associates and joint ventures: “Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies”. The same 20 per cent threshold is also generally used in other studies on JVs; e.g. Dhanaraj and Beamish (2004).
- ²⁰ This picture differs notably from other studies in the field that assign a far more prominent role to banks and financial institutions in the ownership and control of international production. That is because this chapter describes the ownership relationships within MNEs, where industrial companies play a leading role, whereas others target ultimate beneficial ownership, where institutional investors and financial institutions necessarily end up with the lion’s share. See Glattfelder (2010).
- ²¹ The bottom-up approach yields a distribution of GUOs by number of foreign affiliates that is highly skewed toward the simplest one-company-one-GUO ownership structure, corresponding to almost 70 per cent of GUOs. A small share of very large GUOs (0.5 per cent with more than 100 foreign affiliates) control a significant share of foreign affiliates (30 per cent of the total). These findings are consistent with the results discussed in section B, derived through the top-down approach.
- ²² See the World Bank’s Investing Across Borders database.
- ²³ Ownership-related policies refer to all measures under “Entry and establishment” in the UNCTAD Investment Policy Monitor database. “Entry and establishment” includes the sub-categories “Ownership and control”, “Access to land”, “Approval and admission”, and “Other”. The sources can be found on UNCTAD’s Investment Policy Hub (see <http://investmentpolicyhub.unctad.org>).
- ²⁴ In practice, however, such rules have not stopped partnerships such as those between Alitalia and Etihad, in which Etihad owns 49 per cent of the venture; without its backing the Italian venture may not have survived.
- ²⁵ See also UNCTAD (2015d).
- ²⁶ Also the World Trade Organization (WTO) General Agreement on Trade in Services (GATS), covering trade in services through commercial presence, focuses on direct ownership and does not consider ultimate ownership.
- ²⁷ The “control” approach is typical in Dutch IIAs and used in some Austrian, French, Swedish and Swiss IIAs.
- ²⁸ Certain IIAs contain transparency provisions for investors, with varying degrees of robustness or stringency. Some IIAs (e.g. NAFTA (1994), Republic of Korea–Viet Nam (2015), TPP (2016)) reserve the host State’s right to request information concerning an investment, after its establishment, for informational or statistical purposes. Other IIAs (e.g. Azerbaijan–San Marino (2015); Azerbaijan–Croatia (2008)) contain more demanding provisions that reserve the host State’s right to seek information from potential investors (or their home State) regarding their corporate governance history and practices.
- ²⁹ It is important to specify the time frame within which the host State can invoke the DoB clause (see option 2.2.2, UNCTAD Policy Framework, 2015).
- ³⁰ *Phoenix Action v. Czech Republic* (2009), *Mobil v. Venezuela* (2010), *Pac Rim v. El Salvador* (2012), *Philip Morris v. Australia* (2015).

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