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**THE ITALIAN BUSINESS REGISTER ON ENTERPRISE GROUPS
AS A SURVEY FRAME FOR STATISTICS ON FOREIGN AFFILIATES***

Supporting paper submitted by the Italian National Statistical Institute**

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1. Introduction

During the last decade the acceleration in the liberalisation process gave a new impulse to international activities of enterprises – external trade flows as well as foreign direct investment – located in different countries but belonging to Transnational Enterprise Groups (TEG). Such a process increased the need of measuring – both at National and European level – the effects of globalisation on the structure of the domestic economies and the Internal Market, in terms of numerosness and dimension of autonomous enterprises, in order to define effective competition and regulation policies.

More specifically the European Commission, involved in the negotiations for the liberalisation process – especially in the service sector as defined under the General Agreement on Trade in Services (GATS) – asks for statistics on the activity of foreign affiliates (FATS). To support this activity Eurostat is preparing a Regulation of the European Parliament and the Council on the "Structure, Activity and Performance of Foreign Affiliates", that will provide a harmonised framework for the production of such statistics by all European Statistical Institutions (both Central Banks and National Statistical Institute).

These new requirements on one hand pointed out the insufficiency of traditional Balance of Payments statistics, that being based on the concept of territoriality, reflect only the financial aspect of Foreign Direct Investment flows, and on the other pushed Statistical Institutions of Member States towards a more decisive adoption of statistics based on enterprises. On the practical side this requires the set up of information on Enterprise Groups (EG) into the National Business Registers (BR), as the basic frame for surveys, in order to identify the population for Inward and Outward statistics.

In the following paragraph the paper discusses the concepts, definitions, field of observation and sources adopted by the Italian BR on EG, in accordance with the guidelines of the new Eurostat Recommendation Manual on Business Registers, and compares them with the requirements of the future EU Regulation on Statistics on Foreign Affiliates. The third paragraph describes the frame of the Pilot Survey on the Activities of Foreign Affiliates launched by Istat to check, integrate and validate the information contained in the BR on EG for years 2000 and 2001. The last paragraph draws some final conclusions and remarks.

2 The Italian Business Register on Enterprise Groups

The Business Register is a statistical frame for surveys and classifications built up according to internationally accepted concepts and definitions, in order to improve the comparability of the resulting statistics among MS. The inclusion of information on EG into the BR reflects one of the strategies promoted by Eurostat for the implementation of statistics on enterprises and their control links. In this perspective the EG is considered the co-ordination unit at international level, that serves to links enterprises and legal units located in different countries and recorded in National BR according to residency criteria. The BR, integrated with information on control, constitute the basic statistical tool to delineate the universe of reference for Statistics on Foreign Affiliates.

Concepts and definitions

Council Regulation (EEC) N° 696/93 on Statistical Units defines the Enterprises Group as “*an association of enterprises bound together by legal and/or financial links (...). A group of enterprises can have more than one decision-making centre, especially for policy on production, sales and profits. It may centralise certain aspects of financial management and taxation. It*

constitutes an economic entity which is empowered to make choices, particularly concerning the unit it comprises”.

With respect to this definition two clarifications are necessary: first of all the EG can be observed only through links between legal units¹ (and not between enterprises), since the enterprise is only a statistical construct and may itself consist of one or more legal units; secondly the relevant links are those based on the concept of control (and not ownership as in the Balance of Payment Foreign Direct Investment framework)².

Control can be direct or indirect³ and consists in the dominant influence of a Group Head (GH) over the medium and long-term strategies of one or a set of other legal units (subsidiaries), such that the GH is able to influence the decision in the ordinary or extraordinary meetings of all the subsidiaries. The dominant influence can be exercised in different ways. The acquisition of the absolute majority of shareholdings with voting rights (50 per cent, plus one vote) is the main instrument used to take control over a legal unit⁴.

Control (and not ownership) is the only criterion that allows to track a one-to-one relationship between the enterprises and the Group Head in a mutually and exclusive way (Figure 1). This solution avoids the risk of duplications from a theoretical point of view, but on the practical side its implementation is very problematic. In particular it depends on the fact that Member States cannot use a single comprehensive source containing information on transnational links among enterprises in order to correctly derive control links from the whole transnational ownership structure and to identifying "real" Group Head of TEGs. Generally only truncated parts of TEGs are visible by the National perspective and therefore duplications are very likely to occur.

Field of observation

The concept of control applies to any legal unit, regardless of the juridical form, but given the difficulties to statistically observe and measure control, the field of observation is limited to only those resident legal units with juridical form that implies capital divided in shares or quotas.

This limitation of the field of observation may affect the potential Inward Foreign Affiliates population, since local or central government body, non-limited partnership, sole proprietorship, association, charities, foundations and other non-profit units are excluded by definition. On the other hand any legal unit, regardless of its juridical form, can be Group Head and therefore candidate for the Outward population.

Chapter 21 of the Recommendation Manual on BR excludes all natural persons that are not legal units from being GH. This limitation is necessary to make consistency with the definition of the EG and the BR themselves, but will cause inconsistencies with the field of observation of Foreign Affiliates as defined by the future UE Regulation, where it is stated that the Inward and Outward populations can consist of any institutional unit⁵. This is the reason why the EU Regulation names Ultimate Controlling Unit any institutional unit at the apex of the EG and do

¹The Annex of the Council Regulation on Statistical Units in Section II (Part A point 3) says that a legal unit includes: a) legal persons whose existence is recognised by law independently of the individuals or institutions which may own them or are members of them; b) natural persons who are engaged in an economic activity in their own right.

²Council Regulation (EEC) N° 696/93 in Annex III C, Explanatory notes 4, defines the Group Head as “a parent legal unit which is not controlled either directly or indirectly by any other legal unit”.

³According to Council Regulation n° 696, (Section III, C4 of the Annex) on the statistical units for the observation and analysis of the production system in the community “The subsidiary enterprise of a subsidiary enterprise are considered to be subsidiaries of the parent enterprise (...). This means that a parent unit may have indirect control over a legal unit (sub-subsidiary) through other subsidiaries. Indirect control does not require the parent unit to own a majority of integrated shareholding in the capital share of the sub-subsidiaries.

⁴The absolute majority of ownership of the capital share is neither a necessary nor a sufficient condition to have control. Finally, control can be a de facto situation, generated by strategies of outsourcing, that generate dependency of one legal unit from another without any participation into the capital.

⁵“Foreign affiliate shall mean an enterprise resident in the compiling country on which an institutional unit not resident in the compiling country has control, or an enterprise not resident in the compiling country on which an institutional unit resident in the compiling country has control”.

not use the term Group Head which includes legal units only (see note 2). The Ultimate Controlling Unit corresponds with the Group Head when it is a legal unit and include all other institutional units otherwise.

The exclusion from BR of natural persons not legal unit was adopted into the Recommendation Manual, not only for consistency with the definition of legal unit, but also on request of those Member States that cannot collect this information. Nevertheless it is clear that such limitation in the field of observation of the units at the apex of an EG may introduce a bias in the number of EG: they can be overestimated if a natural person in fact controls more than one group and can be underestimated if a natural person controls more than one legal units that are not linked to any other legal unit (Figure 2).

The Italian Business Register on EG, built up from the integration of three administrative sources already takes into account also natural persons. The Administrative Sources used for the set up and maintenance of the Italian BR on EG are the following:

- 1) the Archive containing - for each non listed legal unit with capital divided into shares or quotas - all the shareholders (managed by the Chamber of Commerce);
- 2) the Archive of all relevant shareholders of listed companies (managed by the National Committee on Listed Companies);
- 3) the list of Foreign Affiliates and of resident controlled units of companies obliged to the Consolidation of Accounts according to the VII Council Directive.

Moreover, as far as the field of observation is concerned, specific consideration are due for branches of foreign enterprises located in the compiling economy that, according to the future Regulation, should belong to the Inward FATS population. The SNA93 includes the branches in the category of "*quasi-corporations*" that are "*unincorporated enterprises that function as if they were corporations*"⁶, and the ESA95 considers them as institutional units since they are included in the group of "*notional resident units*"⁷. Therefore they should be included into the BR on EG, even though they are not autonomous legal units but only local units of foreign enterprises. There are practical problems to identify them as foreign owned into the BR, because being resident units have an Italian fiscal code. They can only be recognised, within a certain degree of confidence, by applying methods of textual analysis to the denomination.

Identification of non resident Group Head in the Italian BR on EG

Finally, distinguishing by resident and non-resident Group Head (or Ultimate Controlling Units) is fundamental for identifying both Inward and Outward populations as well as the overlapping area between them.

The identification of non resident Group Head in the Italian BR is currently constrained by the content of the administrative sources used to build up and maintain the BR. In fact, source under point 1) allows to get only the first foreign controlling unit, while from source under point 2) it is possible to correctly identify the Group Head or the Ultimate Controlling Unit, but regards very few TEGs. From the Consolidated Accounts only information on resident Group Head are available.

Starting from this basic information, the procedure used to reconstruct the chain of control from all ownership structures leads in the majority of TEGs to the identification of the first foreign controlling unit, and makes it impossible to attribute the correct nationality to the TEG, that is the geographical breakdown required by the EU Regulation.

⁶ SNA 1993: IV. Institutional Units and Sectors, §4.49, 4.50(c).

⁷ ESA 1995Ch. 2 Units and grouping of units, §2.13(f), 2.15.

The identification of non resident Group Head is the major difficulty encountered by the BR on EG, built up on administrative sources. Such difficulty exists not only for the statistician, but also for the competent regulatory authorities that manage the administrative sources and sometimes for the enterprises of TEGs themselves, that know only their immediate parent unit - usually the one that consolidates their accounts - but not necessarily the whole transnational chain of the group.

From the side of administrative sources some lights for future developments are shaded by different kind of initiatives that are taking place: the realisation of a European Business Register by the Chambers of Commerce of some European Countries, that are voluntarily integrating their information; the progresses of the European legislation towards the improvement of transparency and exchange of data among Member States. Although the exchange of such data for statistical purposes is still impossible and would require a substantial modification of the statistical confidentiality legislation, this is already possible for other administrative and fiscal purposes⁸.

Alternatively, information on Group Heads (or on Ultimate Controlling Units) can be obtained, as in the United States, through direct reporting on enterprises – either in the direct investment survey or in the structural business surveys, with possible increase of burden on respondent and - given the delicate matter - rate of non-response.

3 The Pilot Survey on Economic Activities of Foreign Affiliates in Italy

According to the recommendations included in the Manual on Statistics of International Trade in Services, jointly published by the UN, EC, IMF, OECD, UNCTAD and WTO in 2002, there are two basic approaches for the production of Foreign Affiliates statistics: direct reporting and, with respect to Inward Foreign Affiliates statistics, the combination of information from enterprise surveys (especially SBS surveys) with those contained in BR as far as resident enterprises under foreign control are concerned. In addition, the manual stresses the fact that these two approaches “*are not necessarily mutually exclusive*”⁹. Eurostat follows a similar approach, although more register oriented. In effect, while the provisional version of the EU Regulation on Statistics on Foreign Affiliates does not impose any specific methodological procedures to produce Foreign Affiliates statistics, the provisional draft of the EU Recommendations Manual for the compilation of Inward statistics clearly stresses the relevance of a Business Register containing information on foreign owned enterprises as a fundamental statistical tool.

From a technical point of view, the advantages and drawbacks of these two different approaches, direct reporting *versus* Business Register, must be considered with respect to the peculiar characters of the target population and to the requirements of the EU Regulation in terms of sectoral and geographical breakdowns.

The population of enterprises under foreign control represents an unobserved subset of the general population of active enterprises resident in the compiling economy. In particular, the magnitude of this population is very likely to be limited, while the possibility to identify and

⁸ See Article 26 of Oecd Model Tax Convention on Income and Capital, (January 2003); Directive 77/779/Cee and Regulation 218/92/Cee.

⁹ In particular, the manual states that “In many cases, a mix of the two approaches may work best, with the “FDI context” being used for the compilation of outward Foreign Affiliates statistics and for the identification of foreign-owned companies, and the “enterprise statistics” context being used for the compilation of inward Foreign Affiliates statistics, with a more detailed activity breakdown and a more comprehensive set of variables. A Business Register including information on EG is a suitable mean of maintaining such information. That approach has already been adopted in some countries that use them to maintain data on foreign ownership.

track the set of enterprises under foreign control over time is a rather complicated issue. In addition, the EU Regulation requires, with respect to this specific population, a high level of sectoral and geographical details for the estimation of a large range of variables. As a consequence, a censorial rather than a sampling approach is implicitly required. Given that, the high costs of a censorial approach with respect to direct reporting on the whole population of resident enterprises make this alternative quite ineffective, while the inclusion and updating such information into the Business Register, in order to focus on the target population, appears the best solution.

The methodological solution adopted by Italy relies on a mix approach, including both the use of the Business Register, to identify potentially foreign owned enterprises, and direct reporting to a focused population - in order to check data quality of the register on one hand and to acquire new information on the Ultimate Controlling Unit (which is usually not available in the BR) on the other. This solution aims at maximising the potential benefits of the two different approaches and to reduce, by a combined strategy, their specific drawbacks. In particular, the adoption of the Business Register on EG as a basic frame guarantees a high level of coverage with respect to the potential population of foreign owned enterprises, while direct reporting with respect to a focused population minimise the trade-off between the acquisition of relevant information on the Ultimate Controlling Unit and the statistical burden on respondents.

The sampling procedure considers the list of enterprises under potential foreign control, according to the BR definitions and field of observation. This list includes different typologies of enterprises under foreign control. Each typology is characterised by a different probability of being under foreign control. Although the estimation of *a-priori* probabilities is not feasible, some reasonable hypotheses can be made in order to reduce the dimension of the population of enterprises to be surveyed. The selection of the sample is made on the basis of a two steps procedure, according to the typology of enterprises under potential foreign control: for all the enterprises above a given threshold – defined in terms of coverage on turnover between 85 and 95 per cent by three digits NACE – a censorial approach is adopted. Below the thresholds, a sampling approach is adopted.

The questionnaire is based on harmonised concepts and definitions at European level (such as Enterprise Group, Ultimate Controlling Unit, etc.) and requires basic information such as:

- enterprise self-classification among different typologies (independent enterprise, enterprise belonging to an Enterprise Group with domestic control, enterprise belonging to Enterprise Group with foreign control, branch of a foreign resident enterprise);
- name and country of residence of Ultimate Controlling Unit.

Additional information are also included in order to exploit different modes of foreign control and the capacity of the respondent to built up the chain of control up to the Ultimate Control. While the first kind of information is relevant to improve the methodology for the identification of the list of enterprises under potential foreign control, the latter is important in order to assess the quality of information given by the respondent, by crossing different information within the questionnaire and making comparison with those contained in the Business Register. For instance, the quality of information given by an enterprise, self classified as “related to an Enterprise Group with a domestic Ultimate Control is judged according to the answer given in the section dedicated to the capability of the enterprise to reconstruct the chain of control. If the answer to this question is unconditional (“Yes, until the Ultimate Control”) then the quality of information can be considered good, on the other hand if the answer is negative or conditional (“Yes, but only until the National borders”) the quality can be considered poor and the signal of foreign control given by the register not rejected. The information collected through the survey is

systematically compared with those provided by the register and the quality of the data assessed. Specific statistical procedures are adopted to cope with non-response.

As a result, a validated version of the BR on EG will be obtained, including new information on the country of residence of the Ultimate Control. The link between this Business Register and the SBS surveys at the level of enterprise provides the basic framework to produce consistent and reliable estimates by sectoral breakdown.

4. Final remarks

The set up and maintenance of a statistical survey on the Activities of Foreign Affiliates, according to EU harmonised concepts, requires a great efforts to produce estimates on a large set of economic variables, with very detailed sectoral and geographical breakdowns, with respect to a very limited and rather slippery population of enterprises.

In particular, the population of enterprises resident in the reporting economy and under control of foreign institutional units is very difficult to target and track over time. As a consequence, the availability of a BR including information on foreign affiliates in the compiling economy is a crucial tool to produce reliable statistics.

Italy has adopted a more complex approach which combines the information potential of the BR on EG with a very limited and focused direct reporting on enterprises. In particular, the information included in the EG Register is exploited in order to identify, with different levels of probability, the population of enterprises under potential foreign control. A survey on potential foreign controlled enterprises is performed in order to check the data quality of the Business Register on foreign affiliates and to acquire new information on the country of origin of the Ultimate benefice owner.

The main advantages of this approach are the high coverage of the target population and the consistency with EU definitions. However, this approach may present some limits, especially in terms of timeliness with respect to EU Regulation time schedule for the production of Inwards Foreign Affiliates statistics (20 months lag with respect to the reference period). The inclusion of some questions directly in the SBS survey is very helpful to cope with this problem, as long as it updates the information of the registers according to the reference period.

The general framework for the production of statistics on the Activities of Foreign Affiliates in the compiling economy requires a large set of statistical sources, which contribute in different ways to the final output. Within this framework, the BR on EG represents the basic frame of the surveying system, as it provides the basic information to detect and track the relevant population of enterprises.

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