

# THE ROLE OF THE HUMAN CAPITAL IN ATTRACTING THE FOREIGN INVESTORS. EMPIRICAL EVIDENCES FROM ROMANIA

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## Abstract

Knowing the importance of the foreign direct investments (FDI) for the economic development of a country, the present paper intends to analyse if the Romanian human capital represents one of the main factors that attracts the foreign investors. In order to reach this goal, several research methods were used. To have an overview regarding the role played by human capital in attracting the foreign investors at the beginning of the XXI<sup>st</sup> century, we have *investigated the specialized literature and analysed several case studies*, conducted on various countries. Moreover, to see the trend of the FDI inflows in Romania, we have *analysed the secondary data offered by various statistical yearbooks and reports*. The major part of this paper is based on an *in-depth interview*, conducted on the managers and experts from 12 multinational companies that are present in Romania. The purpose of this interview was to identify the role played by the Romanian human capital in attracting the foreign investors. The importance of the present paper results from the fact that the research's conclusions may offer valuable information for the Romanian policy makers to create a favourable environment for the FDI inflows, on long term.

**Key words:** foreign direct investments' inflows, human capital, Romania

**JEL Code:** F21, F23, E24

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## Introduction

One of the main issues taken into account by the national strategies of the Central and Eastern European countries was focused on attracting the foreign direct investments (FDI), as they were considered able to enhance the economic growth. Even if the way in which the FDI influence the economic growth was largely debated in the specialized literature – the neoclassical models underlying the capital accumulation effect of the FDI on growth while the recent endogenous growth models attributing the growth-contributing effect of FDI exclusively to technology spillovers from foreign firms to the domestic sector –, it is widely

accepted that, as the foreign companies invest in a country, they introduce capital and advanced technologies to the recipient economy. However, in order to register growth through technological change, it is considered that a country must have high levels of human capital. Moreover, in the beginning of the XXI<sup>st</sup> century, the empirical evidences show that achieving a certain level of human capital became one of the main preconditions for a country to attract and maintain the foreign investors.

After the EU adhesion, Romania has experienced a significant increase in the FDI inflows, reaching the historical maximum level in 2008. However, the consequences of the global economic and financial downturn started to be felt in Romania in 2009, when the number of these inflows has almost halved. Since then, despite some occasional increases, Romania could not regain a sustainable positive trend of the FDI inflows.

Considering all these aspects, the main objective of the present paper is to analyse whether the Romanian human capital represents a major determinant for the foreign investors. The results of this paper might be useful for the policy makers in order to create the proper environment for the human capital accumulation.

## 1 Research methodology

In order to reach the established objective, several research methods were used.

To have an overview regarding the role played by the human capital in attracting the foreign investors at the beginning of the XXI<sup>st</sup> century, we have *investigated the specialized literature* and *analysed several case studies*, conducted on various countries. This literature review offered a scientific support to our empirical results.

Another method we have used was the *analyses of the secondary data*. In order to see the trend of the FDI inflows in Romania after 2000, we have collected, tabulated and analysed the information offered by various statistical yearbooks and reports.

A third research method used in this paper was a qualitative one: *the in-depth interview*, conducted on the managers and experts from 12 multinational companies, partly/entirely financed with foreign capital, which are present in Romania. We have chosen this method because it best served our purpose: to identify the role played by the Romanian human capital in attracting the foreign investors. The in-depth interviews offered us the possibility of obtaining 'deep' information and understandings regarding this aspect.

The initial sample included 15 companies, but the managers/experts from 3 of them refused to take part to our interview. Most of the companies included in the sample are from

the services' sector and some others from industry. According to their size, 7 of the selected firms have between 10 and 49 employees, the rest of them having 50–149 people. The firms were selected from five out of the eight development regions of Romania, respectively from the regions: North-East, South-East, South, Bucharest-Ilfov and North-West.

The paper is structured on three main parts: in the first one we briefly present the evolution of the FDI inflows in Romania during the last 15 years, the second part investigates the general role played by the human capital in attracting the foreign investors in the beginning of the XXI<sup>st</sup> century, offering examples from various countries, and in the last part we underline the importance of the Romanian human capital in attracting the FDI, based on the results of the interviews.

## **2 The evolution of the FDI inflows in Romania after 2000**

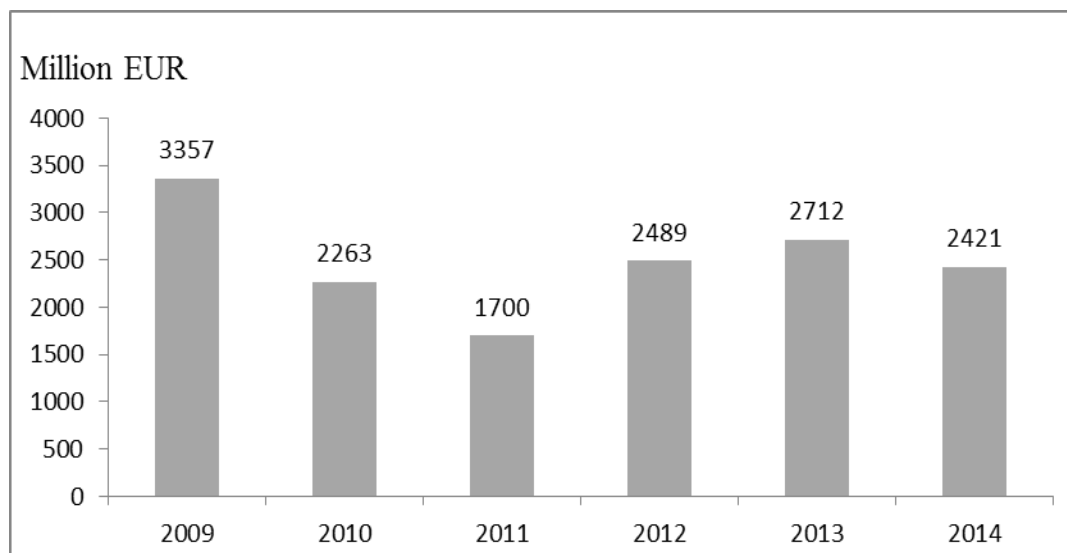
After the communist period, Romania has passed through a long and difficult transition process. This is one of the reasons why, until 2000, the number of the foreign investors attracted by this country was relatively low. At the beginning of the XXI<sup>st</sup> century, the number of the FDI inflows in Romania has increased, together with the value of their investments. This positive trend was more visible especially after 2004, when various EU pre-adhesion measures were implemented.

In the EU adhesion year – 2007, the FDI inflows totalled 7.25 million euros, amount which placed Romania on the first position among the South-Eastern European states and on the second one among the Central and Eastern European countries, after Poland (Diaconu Maxim, 2013). In 2008, the value of the FDI attracted by Romania reached the historical maximum level of 9.496 million euros (NBR, 2009). Due to this value, Romania maintained the second position in the Central and Eastern Europe region, in terms of the FDI inflows, after Poland. However, in the context of the economic and financial crisis that started to be felt in Romania in 2009, the FDI inflows considerable diminished. Therefore, in 2009 the number of FDI projects have almost halved while their value decreased with more than 70 percentage points (see Figure 1).

As we can see from Figure 1, during the last years, the FDI inflows in Romania had a sinuous evolution. The periods of increases in the value of these investments were significantly small and unstable. These evidences demonstrate that Romania could not regain a sustainable positive trend of the FDI inflows. Moreover, the fact that in 2014 the FDI

attracted by Romania were on a downward trend, their value being almost five times smaller than in 2008, should represent a worrying aspect for the policy makers.

**Fig. 1: The evolution of the FDI inflows in Romania between 2009 and 2014 (in million euros)**



Source: NBR, *Foreign direct investments in Romania*, National Bank of Romania, 2015, ISSN 2247-5095, <http://www.bnr.ro/PublicationDocuments.aspx?icid=9403>

### **3 Overview regarding the human capital's role in attracting the foreign investors**

The idea according to which both human capital and the foreign direct investments are among the main determinants of the economic growth is not new. The impact of the FDI on the host country's level of human capital has also been largely debated, most of the analysts considering that the multinational corporations, as active providers of education and training, bring new skills, information and technology to that economy. However, only in the beginning of the XXI<sup>st</sup> century, the economists became more focused on underlining the importance of human capital in attracting the foreign investors. In this context, it was agreed that apart from the traditional factors, such as the market potential or the low relative unit labour costs, a higher stock of human capital could also increase the FDI inflows by making the investment climate more attractive for the multinational companies. This takes place through the direct effects of the highly skilled workforce and through their indirect effects, such as improved socio-political stability and health (World Bank, 2015). Moreover, as Chung and Yeaple (2008) noticed, more and more multinational companies invest abroad,

using a knowledge sourcing strategy, in order to catch up with competitors and to obtain technical diversity.

In the case of the developing countries, there are quite a large number of studies underlining the importance of the human capital in attracting the foreign investors. For example, after an empirical study, Noorbakhsh, Paloni and Youssef (2001) have concluded that the human capital is not only a statistically significant determinant of the FDI inflows, but also one of the most important determinants of these investments. Reisen and Soto (2001), noticing the increasing importance of the human capital, argued that achieving a certain level of education became one of the main preconditions for a developing country to attract and maintain the foreign investors, particularly the efficiency-seeking multinational companies.

According to the results obtained by Dutta and Osei-Yeboah (2013), who examined the relationship between the human capital and the FDI level for 76 developing countries, the literacy rate has a positive and significant effect on FDI inflows. Majeed and Ahmad (2008) have focused on the other qualitative side of human capital – health, in order to investigate its importance in attracting the FDI. Taking into consideration 23 developing countries, they showed that the health expenditure, as measure of human capital, has a positive and significant effect on the FDI inflows, because the productivity and the learning abilities of the workers depend on their health.

Analysing the case of the South Asian countries, Khan (2007) concluded that these states need to develop corporate knowledge and market driven skills to benefit from the increased FDI inflows. To sustain this idea, he brought the example of the Singapore's experience, which indicates that countries without vast natural resources can still attract large inflows of FDI by offering high quality human capital to the foreign investors.

The importance of increasing the stock of human capital to attract a larger amount of FDI in the ASEAN states has been statistically demonstrated by Thangavelu and Narjoko (2014). Using data from 2000 to 2009, they concluded that it is imperative for these countries to improve the level of human capital and also the infrastructure if they want to augment their attractiveness for the foreign investors.

To explain the differences in the regional growth in China, Fleisher, Li and Zhao (2010) analysed the endowment with physical and human capital and the level of FDI inflows. Their results present the importance of the investments in education in the less developed regions, arguing that a higher level of human capital will increase the number of the foreign investors, which will stimulate the economic growth.

Bengoa and Sanchez-Robles (2003) have conducted a research on a sample of 18 developing countries from Latin America. Their findings show that the host country needs an adequate level of human capital in order to benefit from long term FDI inflows. Moreover, they argue that the human capital by itself may not be sufficient to attract the foreign investors. A country also needs economic stability, which can be achieved through efficient institutions. These institutions are also crucial for the proper investments in the human capital (Busse and Hefeker, 2007).

#### **4 The importance of the Romanian human capital in attracting the foreign investors**

The assessment of the role played by the Romanian human capital in attracting the foreign investors is based on the results of an interview conducted on the managers and experts from 12 multinational firms, partly/entirely financed with foreign capital, which are present in Romania.

A first aspect discussed with the managers/experts of these firms regarded the reasons of investing in Romania. Six aspects were mentioned by all of them, referring to the low costs of production (including wages), the availability of the labour force with adequate qualifications and skills and good knowledge of a foreign language, Romania's EU membership, the fiscal facilities, little competition and the availability of the subcontractors and suppliers. Other few aspects were mentioned only by some of the managers/experts, depending on the location of their company in Romania or on their previous experiences in other markets. Some of these reasons included the macroeconomic stability, the geographical proximity to the Central European states (aspect indicated by the companies located in the North-West part of the country), relatively big domestic market, good institutional environment and relatively good infrastructure (aspect mentioned only by some of the companies located in the North-West region).

After indicating the reasons of investing in Romania, the companies' representatives were asked to give grades from 1 to 5 to all these aspects, where 5 represented 'very important reason' and 1 'least important reason'. Based on the obtained results, an average score for each indicated reason was calculated. The hierarchy of the six aspects mentioned by all the companies' representatives can be seen in Table 1.

**Tab. 1: The importance of the reasons of investing in Romania**

Factor	Average score
Low costs of production (including wages)	4.83
Availability of the labour force with adequate qualifications and skills	4.58
Romania's EU membership	4.5
Fiscal facilities	3.91
Availability of the subcontractors and suppliers	3.83
Little competition	2.83

Source: own research

As it results from Table 1, for the companies included in the interview, the availability of professionals and workforce with adequate qualifications and skills is one of the most important factors which encourage them to invest in Romania. This aspect has the second highest average score, after the low costs of production, but the difference between them is quite small. Considering this fact, we may assume that the companies which decide to invest in Romania are especially attracted by the low cost of the qualified labour force.

The following questions of the interview were particularly focused on aspects related to the human capital. Most of the interviewed persons considered that the large number of the university graduates in Romania represents an important factor in attracting the foreign investors because they have the possibility of choosing the best potential employees. However, a negative aspect of the Romanian educational system mentioned by all of the respondents is that most of the young graduates have only theoretical knowledge and lack the practical issues.

The multinationals which preferred Romania were also attracted by the fact that most of the young people can fluently speak at least one foreign language. Actually, this was an important aspect indicated especially by the respondents from the service sector. While some of them are looking for the employees with good knowledge of English, others want young people that are good in German. However, for the companies from the industrial sector, the ability of speaking a foreign language is not such an important requirement.

Based on the responses of most of the interviewed persons regarding the qualities they are looking for at the potential employees, the profile of a suitable person for a non-managerial position includes: tertiary education, a minimum 2 years of work experience in the field, fluent in at least one foreign language and age between 25 and 35 years old. From this

profile we can deduce, once again, the fact that the level of education and the skills of the potential employees are very important for the foreign investors.

Being asked about the specializations they are looking for at the candidates for a job in their company, while the respondents from the service sector indicated that they usually select graduates of the economic and IT faculties, the technical education is particularly important for the companies from the industrial sector.

An essential aspect considered by the foreign investors when hiring people is the period of previous employment. Actually, most of the companies' representatives from the service sector said that even if they require minimum 2 years of previous experience, they prefer people who have already worked in that field more than 3 years, because it is more likely that these persons have the proper abilities and skills. Moreover, they will require less training programs after being hired in their company.

The findings regarding the previous experience are very interesting in the context in which the managers/experts from the multinational companies also want young employees, preferable around 25-27 years old. This aspect should raise the problem of the partnerships between the universities and the private sector, in order to offer the students the possibility of working in different companies during their studies. Actually, most of the respondents agreed that if such partnerships would be implemented, the benefits would be both for the companies and for the students, because after finishing the university they would also have practical knowledge and abilities and the job searching period would be much shorter. Moreover, some of the students might be recruited by the companies during their university studies.

From the point of view of the trainings offered by the interviewed companies, all the respondents mentioned that their firms offer the employees the opportunity of enhancing and improving the skills through various programs. While the companies from industry organize trainings especially in Romania, some of the services' sector companies also give the chance to the employees of improving their knowledge abroad. The subjects of the training courses generally concern aspects related to management, marketing, production, IT, finance or banking. Once again, most of the respondents mentioned that if the students would have the possibility of working in their companies during the university studies, after hiring them, the training period would be much shorter. Moreover, after finishing their studies, some of them would be able to accede to the managerial positions.



## Conclusion and future research directions

The results of our interview are in complete accordance with the theoretical approaches regarding the importance of the stock of human capital in attracting the foreign investors. Therefore, the main conclusion of our study refers to the fact that the availability of the labour force with adequate qualifications and skills is one of the most important factors which encourage the multinational companies invest in Romania. Actually, the foreign investors are looking for young potential employees, preferable up to 30 years old, with tertiary education, good knowledge of a foreign language and with previous work experience in the field. This profile of the potential employee raises the problem of the partnerships between the universities and the private sector, in order to offer the students the possibility of working in a company during their studies.

The importance of the present paper results from the fact that the research's findings may offer valuable information for the Romanian policy makers to create a favourable environment for the FDI inflows, on long term.

Based on the results of the interview illustrated in this paper, we intend to develop a questionnaire that will be applied on a much larger number of foreign companies present in Romania, in order to obtain more elaborated results.

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