Is human capital a major determinant for foreign investors? Comparative study between India and Romania

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Abstract

The economic literature of the twenty-first century stresses the idea according to which achieving a certain level of human capital is one of the main preconditions for a country to attract and maintain foreign investors, particularly the ones seeking to improve the efficiency of their activities. Therefore, the main aim of the paper is to analyse if human capital represents a major determinant in attracting the foreign investors in two emerging economies – Romania and India. In order to reach this objective, two qualitative methods were used: the documentary research and the in-depth interview, conducted on the managers/experts from eleven multinational companies, which are present in both countries. The results of the study underline that the level of education and the skills of the potential employees have become increasingly important drivers of foreign investments in both India and in Romania, even if the leading determinant still remains the low cost of production.

Keywords: human capital, foreign direct investment, multinational companies, India, Romania

Introduction

The boom of the foreign direct investment (FDI) inflows into the emerging economies from the end of the twentieth century suggests that the multinational companies regarded these host countries as investment locations which could bring them competitive advantages. While this aspect has largely been emphasized in the literature, various experts argue that the factors which attract the foreign investors have changed during the process of globalization. In this context, it is important to correlate the evolution of those determinants, during time, with the changes that took place in the investments' sectoral composition. Therefore, it can be noticed that during the 1970s, the foreign investments were concentrated mainly in the primary sector, the availability of natural resources in the host country being the most important determinant. During the 1980s, when the investors reoriented towards the manufacturing sector from the developing states, the size of the domestic market and the production costs became the main factors of attraction. In the end of the twentieth century and beginning of the

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twenty-first century, a significant shift took place into the sectoral distribution of the foreign investments: a large part was redirected towards the service sector and to the technology-intensive industries. In this context, the investors looked for stable economic, financial and political countries, with efficient and transparent institutional environments and also with high levels of human capital. Therefore, as noticed by Bengoa and Sanchez-Robles (2003), the host countries need human capital, economic stability and liberalized markets in order to benefit from foreign investments, on long term.

Various studies have empirically tested the role of the human capital in attracting foreign investors in the emerging economies. Their results underline the idea according to which the availability of the skilled labour force in the host country significantly influences the geographical distribution of the foreign investments (Zhang and Markusen, 1999; Noorbakhsh *et al.*., 2001; Dutta and Osei-Yeboah, 2013). These conclusions can be explained through the fact that more and more multinational companies invest abroad, using a knowledge sourcing strategy, in order to catch up with the competitors and to obtain technical diversity (Chung and Yeaple, 2008). Therefore, achieving a certain level of education became one of the main preconditions for an emerging country to attract and maintain the foreign investors, particularly the efficiency-seeking multinational companies (Reisen and Soto, 2001). Most of the examples that support this idea come from East, South-East or South Asia: Dasgupta *et al.*. Sinha (1999) argued on the case of China, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam, Kumar (1990) on India and Khan (2007) on the South Asian region. However, there are also some studies conducted on the Central and Eastern European states, including Romania, which emphasize that the human capital stock heavily influences the foreign investments' flows and the associated technology transfer (Botric and Škuflic, 2016; Disdier and Meyer, 2004).

Considering all these aspects, the main objective of the paper is to analyse if the human capital represents a major determinant for the foreign investors that are attracted by Romania and India. We have chosen these two states because they have some important economic similarities which can positively influence the FDI inflows. Both of them are emerging countries that registered the highest economic growth in their region, in 2015: Romania – 3.7 per cent, the highest in the Eastern Europe, and India – 7.6 per cent, the highest in the South Asia (World Bank, 2016). Moreover, both of them started to attract FDI flows since the beginning of the 1990s, in the context of the economic reforms that opened up the markets to the foreign investors. Also, in Romania, as well as in India, the level of the wages (an important determinant for the investors) is much lower compared to other countries. Finally, in both economies, the service sector, especially the Information Technology (IT) field, became increasingly important for the foreign investors during the last 10 years.

The novelty of the study results from the fact that it aims at emphasizing the role played by human capital in attracting the foreign investors in the two emerging states.

1. Research methodology

In order to reach the established objective, several research methods were used. A first method was the *documentary research*, based on the *analysis of the secondary data* and on the *investigation of the specialized literature,* in order to have an overview regarding the evolution and the sectoral distribution of the FDI inflows in India and in Romania.

Another qualitative research method used in this paper was *the in-depth interview,* conducted on the managers/experts from eleven multinational companies, partly/entirely financed with foreign capital, present both in Romania and in India. Only one manager/expect from each company responded at our interview. The initial sample included fifteen companies but four managers/experts refused to take part in our interview. The chosen companies are both from industry (pharmaceuticals, automobile) and from service sector (IT and consultancy).

The interviews were conducted in Romania, during the period September 2017 – February 2018, but the questions were focused on the investments' environment of both analysed countries. All the interviews were performed face-to-face.

This research method was chosen because the in-depth interviews offered us the possibility to obtain 'deep' information and understandings regarding the role played by human capital in attracting the foreign investors in India and in Romania.

The main issues discussed with the respondents referred to the most important factors that determined their company to enter the two markets. The companies' representatives were asked not only to mention these determinants, but also to give grades, from 1 to 5, to all the aspects they have identified, both for Romania and India, where 5 represented 'very important reason' and 1 - 'least important reason'. The last part of the interview was focused on aspects related to the human capital stock of the two analysed countries, such as: the importance of having a university degree when hiring, the presence / absence of the practical abilities and the experience of the young graduates, the ability of innovating and the creativeness of the potential employees, as well as their risk-taking propensity. The results of the interviews are presented in the third part of the paper.

2. Literature review regarding the investments' environment from India and Romania

Since 1991, after the adoption of a liberal investment policy under the economic reforms implemented in **India**, the attracted FDI inflows have steadily increased. According to the statistics, these investments have surged from 129 million USD in 1991-1992 (Dutta and Sarma, 2008) to 40 billion USD in the financial year 2015-2016 (UNCTAD, 2016), fact that placed India in the top FDI destinations in 2015, before China and US. However, despite the general positive trend of the FDI inflows in India during the last twenty-five years, some fluctuations have also been noticed. The declines occurred in the context of the regional downturns (such as the Asian crisis, which negatively influenced the FDI inflows in India between 1998 and 2000, or the USA terrorist attacks, which had negative consequences on these investments between 2002 and 2004) or of the global crisis (between 2009 and 2010, due to the falling share of the investments made by the key source countries, such as USA, Japan, Mauritius, Germany or UK). Yet, although the global crisis has slowed the rate of the FDI growth in India in 2009, it has reinforced India's position in the global investors' perceptions. An UNCTAD report considered India the second most important FDI destination, after China, between 2010 and 2015 (UNCTAD, 2015).

During the analysed period (1991-2015), some significant shifts occurred in the sectorial distribution of the FDI. If until the beginning of the twenty-first century most of the FDI inflows went into the manufacturing sector (Satyanand and Raghavendran, 2010), during the last ten years the Indian service sector, which has a tremendous growth potential, has significantly increased its attractiveness for the foreign investors, contributing with more than 50 per cent to the GDP (Vyas, 2015). IT and telecommunications are among the fastest growing branches. Actually, the rapid development of the telecommunication sector was largely due to the multinational companies that entered this market and transferred the advanced technologies. With a growth rate of 45 per cent, the Indian telecommunications' branch has the highest growth rate in the world (Sagar and Lalitha, 2013). The IT field is also one of the booming sectors in India, with an increasing contribution to the GDP – more than 8 per cent in 2014 (India Brand Equity Foundation - IBEF, 2015) – and to the exports – around 45 per cent in the service exports of the country, in 2015 (National Democratic Alliance Government, 2016). The IT spectacular evolution in India was mainly due to the reforms implemented by the government in order to facilitate the IT industry's growth and expansion.

In the context in which the service sector requires a developed human capital and foreseeing the importance of the IT for the economic growth, the Indian government has continuously invested in building a supply base for qualified manpower and an institutional infrastructure for capability development (Arora *et al.*., 2000). Moreover, in the context of the economic reforms that took place in the early 1990s, the Ministry of Finance indicated that India’s comparative advantage was in software and not in hardware. Therefore, the demand for software’s trained personnel, especially engineering graduates, has grown rapidly during the last two decades. In this context, the capacity of the higher education system in engineering has been expanded, new institutions being set up (Kumar, 2000). All these efforts to increase the stock of human capital in India were also favoured by the usage of English in schools and universities. This last aspect represented another important factor in attracting the multinational companies.

To all these advantages, it adds the fact that the South Asian region has the world´s largest working-age population and a quarter of the world’s middle-class consumers (World Bank, 2015). Given all these aspects, it can be argued that India, the second most populous country in the world after China, offers not only a huge consumer market to the foreign investors, but also an ample supply of qualified manpower for the service sector, at a much lower cost compared to other countries. A survey conducted by Ernst and Young revealed that India was considered the most attractive market in 2015 by a leading 32 per cent of the investigated investors; meanwhile, 60 per cent of the respondents placed the country among the top three investments’ destinations (Ernst and Young, 2015).

Romania faced a long and difficult transition period after 1989, when the communist regime collapsed. Due to the slow privatization process, unstable economic environment and weak legislative system, many foreign investors avoided the country until 2000s. In the beginning of the twenty-first century, due to macroeconomic stabilization, strong GDP growth and large-scale privatizations, amplified by the perspective of the European Union (EU) adhesion, Romania benefited from record FDI inflows. The historical maximum level (13.849 billion USD) of the attracted foreign investments was reached one year after the EU adhesion, in 2008 (World Bank, 2017). However, the negative consequences of the global economic and financial crisis led to a considerable decrease of the FDI inflows in Romania, since 2009. According to the statistics, these investments started to regain a positive trend only after 2012, but their level still remains very low compared to pre-crisis period.

From the point of view of the sectoral distribution of the FDI inflows in Romania, significant changes can be noticed during the analysed period (1991-2015). If until 2006, the secondary sector, especially the manufacturing industry, received the highest share of the FDI, the situation reversed between 2007 and 2008. During these years, the share of the investments in the service sector has surpassed the share in industry (National Bank of Romania, 2008; National Bank of Romania, 2009), fact which indicates that the investors became more interested in higher added-value production and capital-intensive sectors than in exploiting the low-cost advantages. This change has also been encouraged by the government, who implemented several measures aimed at offering fiscal facilities to the investors in the capital-intensive sectors, especially in IT.

During the recession period, when the level of the foreign investments' inflows in Romania significantly decreased, the secondary sector regained its leading position, in 2014 attracting almost half of the total FDI (National Bank of Romania, 2015). Yet, looking at the statistics, we can see that the industry's contribution to the GDP started to diminish since 2012, in favour of the IT and telecommunication field. In 2014, compared to previous year, this field registered an increase of 11 per cent and reached a share of 6 per cent of GDP, which was double than in 2011 (National Institute of Statistics of Romania, 2015). Due to this positive evolution, the IT and telecommunication field had the second highest contribution to the Romanian economic growth, in 2014. The shift of the economic structure from the low value-added sectors towards higher value added fields may suggest that, in future, the importance of the Romanian IT and telecommunications will increase for the foreign investors. This may also be encouraged by the attractive legislative and fiscal environments and by the large number of the Romanian potential employees, highly qualified in IT and telecommunications.

3. Results and discussions

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

One of the first aspects discussed with the experts was about the main factors that determined their company to enter the two markets. In the case of India, all the respondents mentioned the low cost of production's factors, including wages, the skilled labour force which has a very good knowledge of English, the stable economic and social policies and the support offered by the government. When mentioning this last aspect, they referred both to the fiscal facilities the investors may receive, such as loans, tax breaks, grants, subsidies or the removal of restrictions and limitation, and to the investments made by the government for the development of the infrastructure in certain areas. Other factors, mentioned only by some of the respondents, are the abundant labour force, the efficient distribution system, the large consumer market with unexplored fields and with huge growth potential and also the proximity to other large Asian/European markets.

When referring to Romania, all the interviewed companies' representatives mentioned four important factors that encouraged the investments in this country. The major determinant was represented by the low production costs, especially labour, compared to other Eastern European states. This reason was accompanied by other aspects such as the fact that the potential employees had adequate qualifications and skills and they were able to fluently speak at least one foreign language, the large domestic market and the fiscal facilities offered by the government. Other few aspects were mentioned only by some of the managers/experts, depending on the moment they entered the Romanian market or on their previous experiences in other countries. Some of these reasons included the macroeconomic stability of the country, the reduced competition (aspect indicated only by some of the investors that entered the market in the beginning of 2000s), the geographical proximity to the Central and Eastern European states, Romania's European Union membership (aspect mentioned only by the companies that entered after Romania's European Union adhesion, in 2007) and the availability of the subcontractors and suppliers.

After indicating the investments' reasons, the companies' representatives were asked to give grades, from 1 to 5, to all the aspects they have mentioned, both for Romania and India, where 5 represented 'very important reason' and 1 - 'least important reason'. Based on the obtained results, an average score was calculated for each indicated reason. Table 1 and 2 show the hierarchy of the aspects mentioned by the companies' representatives, for India and Romania. For each country, there were taken into consideration only the aspects mentioned by all the respondents.

As we can see from Table 1, India was considered attractive by all the respondents especially because it has a production cost advantage. This result is not surprising, considering the fact that, in 2012, the average hourly wage for an adult worker in India was 0.53 USD, compared to 1.15 USD in China or 21.34 USD in USA (World Bank, 2013). However, our results suggest that these investors were also attracted by the fact that the potential employees had adequate qualifications and skills and most of them were able to fluently speak English. Actually, this aspect received the second highest average score, being very close to the first indicated reason – the low costs of production. Considering this fact, we may assume that the companies which decide to invest in India are especially attracted by the low cost of the qualified labour force.

Table 1. The importance of the investing reasons in India

Factor	Average score
Low costs of production (including wages)	4.9
Availability of the labor force with adequate qualifications and skills	4.63
Government's support:	
- Fiscal facilities	4.36
- Investments in infrastructure	4.27
Stable economic and social policies	3.81

Note: The average score was calculated as an average of the grades given by the eleven respondents for each factor.
Source: Author's results

According to the average scores indicated in Table 1, on the next positions can be found the support offered by the government to the foreign investors and also the stable economic and social policies. A survey conducted by Ernst and Young (2015) confirms the fact that India's macroeconomic and political stability as well as the implication of the government in creating a favourable business climate are among the major attractiveness' factors for the foreign investors.

Table 2 shows some similarities between Romania and India, from the point of view of the attractiveness of the investment's environment. According to the average scores, in Romania, as well as in India, on the first three positions are the low-cost of production, the availability of the labour force with adequate qualifications and skills and the fiscal facilities offered by the government. Moreover, comparing the average scores of the first two factors obtained in the two countries, we can see that they have similar values. These results suggest that, as in the case of India, the human capital was one of the most important factors which encouraged the foreign companies to invest in Romania. This aspect was doubled by the fact that the average hourly wage for an adult worker in Romania is lower than other Easter European countries. For example, in 2012, in Romania the average hourly wage was 3.89 USD, while in Hungary it was 5.28 USD (World Bank, 2013).

Table 2. The importance of the investing reasons in Romania

Factor	Average score
Low costs of production (including wages)	4.9
Availability of the labor force with adequate qualifications and skills	4.54
Fiscal facilities	3.81
Large domestic market	3.45

Note: The average score was calculated as an average of the grades given by the eleven respondents for each factor.
Source: Author's results

The following questions of the interview were particularly focused on aspects related to the human capital stock of the two analysed countries. Most of the interviewed persons considered that the increase of the tertiary education enrolment rate, which took place both in India and in Romania (World Economic Forum, 2017, pp. 203, 305), represents an advantage in attracting the foreign investors, because they will have a larger pool from where to choose the best potential employees. However, they argued that, unfortunately, in Romania most of the young graduates have only theoretical knowledge and lack the practical abilities. To this minus it adds the fact that, according to the statistics, the quality of the Romanian educational system it has slightly decreased during the last years (World Economic Forum, 2017, p. 305). Meanwhile, in India the quality has increased. This explains why the properly trained work force represents one of the most problematic factors for doing business in Romania, while in India it is the least problematic aspect, according to a survey conducted by World Economic Forum (Ernst and Young, 2015).

The multinationals' representatives argued that another determinant for entering Romanian and Indian markets was the fact that most of the young people can fluently speak at least one foreign language, especially English. Actually, this was an important aspect mainly indicated by the respondents from the service sector. However, for the companies from the industrial sector, the ability of speaking a foreign language is not such an important requirement.

An essential aspect considered by the foreign investors when hiring people is the period of previous employment. Most of the companies' representatives from the service sector mentioned that they ask for minimum two years of previous experience in the field, because they prefer persons that already have proper abilities and skills, which will need less training programs.

Regarding the ability of innovating and the creativeness of the employees, the information obtained from the respondents was quite similar for Romania and for India. The results suggest that, especially in the service sector, most of the multinationals' employees from the two countries respond very well to the companies' initiatives of generating new business solutions. Moreover, they cooperate and share the ideas with their co-workers, fact which leads to positive spill-over effects. Despite these similarities between the two countries, the respondents mentioned that, in Romania, the employees have a higher risk-taking propensity than in India. The explanation for this difference may be found in the religious and cultural background of the two states. As mentioned in different empirical studies, the impact of religion on corporate risk-taking propensity might be negative in the case of Catholic, Islamic, Buddhist and Hindu – based societies (Liu, 2010; Díez-Esteban *et al.*., 2019) and positive in the Orthodox and Protestant nations (Díez-Esteban *et al.*., 2019). Moreover, in Romania, the risk-taking propensity may be encouraged, in a wrong manner, by the 'shortcuts' offered as models by the society – those businesses based on high risks speculations, with high yields, as well as substantial incomes obtained with little effort (Popescu *et al.*., 2014).

Conclusions

The aim of the paper was to analyse if the human capital represents a major determinant for the foreign investors that are attracted by Romania and India. To achieve this objective, we have used both a *documentary research*, based on the *analysis of the secondary data* and on the *investigation of the specialized literature*, and *the in-depth interview*, conducted on managers/experts from eleven multinational companies, partly/entirely financed with foreign capital, present both in Romania and in India.

Our research has found that the level of education and the skills of the potential employees are very important aspects for attracting foreign investors both in India and in Romania, even if the leading determinant remains the low cost of the factors of production. These results, obtained through the in-depth interviews, are in line with the shift that took place in the sectoral distribution of the foreign investments, when a large part of them redirected towards the service sector and to the technology-intensive industries. Our results are also supported by the literature, which underlines that the availability of the skilled labour force in the host country significantly influences the geographical distribution of the FDI.

In the case of India, the support offered by the government in building a supply base for qualified manpower and an institutional infrastructure for capability development had a significant influence in attracting the foreign investors. The results of our interview highlight that the increase in the tertiary education enrolment rate together with the improvements in the quality of the educational system encourage the multinational companies to invest in India. Moreover, some particular skills and abilities of the potential employees, such as a good knowledge of English or the innovation capability, were also very important factors that attracted the foreign investors in this country.

The shift that took place during the last years in the Romanian economic structure, doubled by the attractive legislative and fiscal environments, determined the foreign investors to look for higher value added fields. They have also been encouraged by the large number of the Romanian potential employees with tertiary education, fluently speaking at least one foreign language, with innovation capabilities and high risk taking propensity. However, the major complain of the foreign employers is that most of the young Romanian graduates lack the practical abilities. This aspect raises the problem of enhancing the partnerships between the universities and the private sector, in order to offer students the possibility of working in a company during their studies.

The novelty of this study results from the fact that, by using theoretical and empirical arguments, it particularizes the importance of the human capital in attracting the foreign investors on the case of India and Romania. Therefore, the findings may offer valuable information for the policy makers of the two countries in order to create a favourable environment for the FDI inflows, on long term.

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