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**The Impact of Inflow Foreign Direct Investment on the  
Local Human Capital Efficiency with the Role of  
Financial Deepening as Mediator: A Case of United Arab  
Emirates**

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**Mohamed Nabil Shamsan and Siti Aida Samikon**

Limkokwing Graduate School, Limkokwing University of Creative Technology, Malaysia,  
Kuala Lumpur

Emails: [dr.moshamsan@gmail.com](mailto:dr.moshamsan@gmail.com), [sitiaida.samikon@limkokwing.edu.my](mailto:sitiaida.samikon@limkokwing.edu.my)

### **Abstract**

**Purpose:** This research determines the impact of inflow foreign direct investment inflow foreign direct investment on the expanded concept of social and economic progress in the UAE, such as local human capital efficiency and financial deepening, which needs more clarification, while most of the studies focus on human capital in general.

**Methodology:** This study used a questionnaire based survey on a selected sample and used the SmartPLS 4 to analyze the data and conclude the results. With the help of quantitative techniques this data was collected from a sample of 8001 selected employees representing the DUBAI population. Only 376 were taken from those who had working experience in foreign companies in the UAE.

**Findings:** The results show that the inflow foreign direct investment has a significant positive relationship with the local human capital efficiency in the UAE. The role of the mediator in this study was significant and partial mediation with inflow foreign direct investment.

**Recommendation:** The most important question is about the availability of working in foreign companies. Also, the author mentioned that there is a gap in the human capital development study, and it has been recommended for future study.

**Keywords:** *Inflow foreign direct investment, local human capital efficiency, financial deepening.*

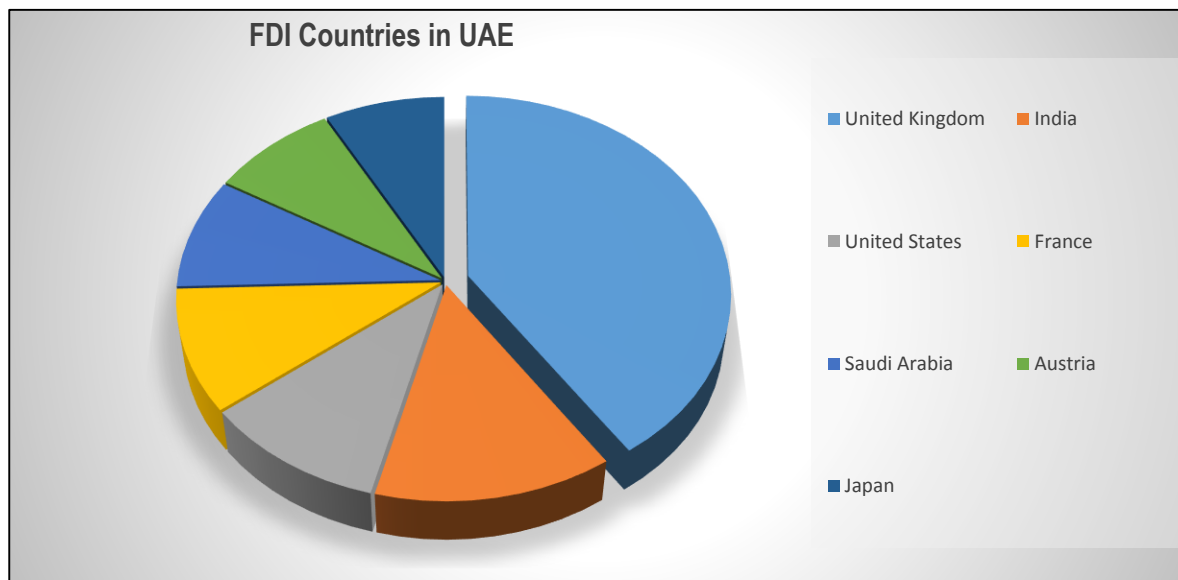
## INTRODUCTION

Global foreign direct investment (FDI) is the category of international investment that reflects the objective of obtaining a lasting interest by an investor in one economy in an enterprise resident in another economy. Global foreign direct investment (FDI) inflows for 2017 reached nearly two trillion dollars, indicating a rapid growth trend for FDI flows since the early 1990s. At least 10% equity ownership of an enterprise in another country constitutes foreign direct investment (FDI) (The World Bank, World Development Indicators, 2019). Business-friendly institutions, policies, and regulations worldwide have contributed to this remarkable trend (Globerman & Shapiro, 1999). Foreign direct investment is a source of external financing for a country with limited liquidity. They can receive funds across the world from rich countries (Barry, 2017). Foreign direct investment can represent establishing either a business operation activity or implementing a business asset in another country, even owning or investing in that particular company (Froot & Stein, 1991).

Foreign direct investment (FDI) is a fundamental factor for private and public sectors, especially in the United Arab Emirates (UAE CB, 2018). The Inflow Foreign Direct Investment (IFDI) industry in UAE has played a significant role in the economy's growth, based on the 2019 Global Investment Report (GIR) published by UNCTAD. The UAE consists of seven states controlled by a local federal government, following Abu Dhabi's capital.

## INFLOW FOREIGN DIRECT INVESTMENT (IFDI)

United Arab Emirates archived to be the ninth largest IFDI receiver in Asia. The UAE also topped Arab countries regarding new inflow foreign investment projects in Dubai, Ajman, Umm Al Qaiwain, Sharjah Ras Al Khaimah, and Fujairah. UK, India, France, Austria, and Saudi Arabia are the most foreign-invested countries.



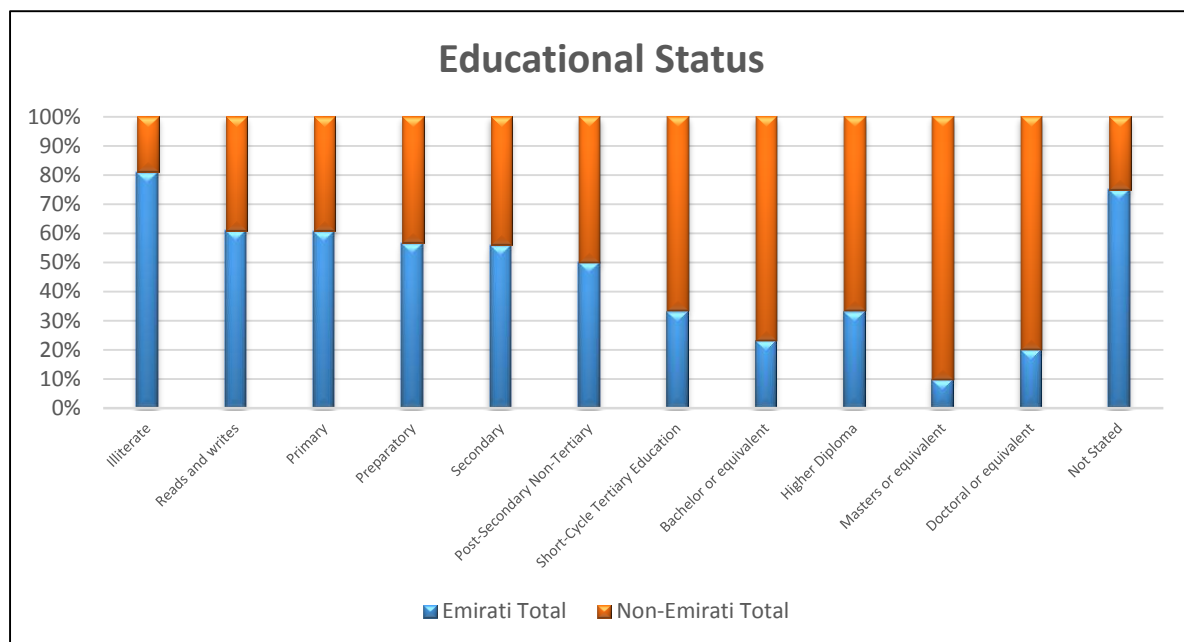
**Figure 1: IFDI countries in UAE (Santander, S.A-2019)**

The UAE government makes investment more attractive by providing foreign investors incentives, such as tax-free rates in some trading zones, and improving and adjusting investment regulations (UAE CB, 2019). However, investors focus on the most profitable sectors: aircraft parts and services, the construction industry, franchising, healthcare services, oil and gas field machinery and services, and renewable energy (Export Enterprises SA, 2018).

The UAE Investment is active in various industrial sectors. The top 10 industries are accommodation and food services, administrative and support services, agriculture, forestry and fishing, arts, entertainment and recreation, construction, education, electricity, gas, steam, air conditioning supply, financial, insurance, wholesale, and retail trade; repair of motor vehicles and motorcycles, professional, scientific and technical activities.

### LOCAL HUMAN CAPITAL (LHC)

Human capital is the skills of the labor that make the work more efficient, and it is considered a resource or asset for the company or the organization. It includes investing in people (e.g., health, education, and training). This kind of investment increases individual productivity of the individuals (Goldin, 2016). Human capital is one of the factors that determine the inflow of foreign direct investment in the UAE. However, the possibility of human capital will depend mainly on the country's institutional sector. Promising policy sectors prefer human capital to reap the benefits of more controversial FDI flows. The existence of freedom and confidence in the political and civil sectors and the strengthening foreign direct investment ties increased (Dutta, 2011). As explained by (Van Den Berg, 2006), the economic status of human capital is "the growth of any developing country depends on the quality of the labour force, the accumulated experience, the level of human capital, and the education system. These skills allow the country to generate new skills or adapt old ones". It must understand the technology adopted and obtain long-term growth based on the improvement in education and human capital.



**Figure 2: The level of education of the emirate population and its comparison with the non-emirate sector.**

Figure 2 shows that the percentage of the illiterate local population is higher than the non-Emirati even though the UAE is the largest IFDI in the Middle East. Secondary education results up to the doctoral level have been generated from employees in all UAE industries. However, the UAE does not benefit from foreign companies. The changes taking place in the education system failed to equip the entire younger generation with the skills and attitudes to play an important role in the rapidly growing private economy (UAE STAT.GOV, 2019).

Local human capital development depends on the quality of education and training, which in most developing countries is low. In addition, there is a knowledge and skills gap despite large investments in education, training, and human capital development in some developing countries such as Saudi Arabia (Alalshiekh, 2018). This study identifies the effectiveness of training and development (T&D) programmed by IFDI on increasing the level of education and productivity of local human capital relating to the Abulmohsen study, which UAE is at the same development level as Saudi Arabia. Identifying the increase in the level of satisfaction of local human capital towards existing training and development programs is very important.

### **FINANCIAL DEEPENING (FD)**

The strength of a well-initiated financial system can be a decision maker on investment project plans (Gómez, 2019). A host that has a good financial system can attract FDI inflows to help the country's development. Companies and organizations in the host country (local firms) benefit from knowledge and technology from IFDI spillovers. This also provides opportunities for new production and new process techniques. Host countries must take efficient actions to take advantage of spillover effects, upgrade process machinery, create processes and change the value of products, link to global markets, and invest in research and development. According to Habibi and Karimi (2017), profits from IFDI spillovers cannot be achieved without costs and affordability. This profit is represented by the amount of cash liquidity that the UAE can provide. To obtain the maximum benefit of this spillover, these requirements must be met, but it is rare that countries can cover the financial expenses of such processes and changes. The country faces a huge gap in technology, skills, and knowledge as the greater the amount of financial expenditure required (Habibi et al., 2017). However, in this study, the financial deepening is represented by the satisfaction and the services provided by the UAE banks to identify the overall effect of FD on the local human capital efficiency and the attraction of IFDI to the country.

### **INTERNATIONAL FOREIGN DIRECT INVESTMENT AND LOCAL HUMAN CAPITAL EFFICIENCY RELATIONSHIP**

IFDI is associated with direct and indirect impacts in developing countries (Girma, 2015; Hale & Xu, 2016). The immediate effects of IFDI are the provision of financial capital to the host countries (UNCTAD, 2017) and the increase in employment, wages, and productivity in the local labor market (Hale & Xu, 2016). Spillovers, also known as externalities, are the indirect effects of foreign direct investment (Newman, 2015; Hale et al., 2016), including technological spillovers (Cui, Chen, and Chang, 2017; Amoroso & Müller, 2018; Jude, 2016), increase in productivity (productivity spillovers) (Gachino, 2017; Sari, Khalifah, & Suyanto, 2016), transfer of skills and knowledge (skills and knowledge spillovers) (Kim & Park, 2017; Ali, Cantner & Roy, 2016; Foster-McGregor & Pöschl, 2016) also the labor spillover and increasing in wages rang among the local organization in the host developing country (Hale et al., 2016).

Studies have confirmed that foreign investors appreciate human resources' availability, whether in terms of the available capacity of local human capital (the gift) or the future (demographic) supply, as the most important factor in making their investment decisions. (Salike, 2016), another investigates the impact of human capital on attracting an FDI to a country and getting a high stock market development. The study found that the stock market's performance improves when human capital efficiency increases. However, that is leading to a high level of FDI inflow to developing countries (Tsaurai, 2018).

## RESEARCH GAP

Alalshiekh (2018) provides evidence that there are human skills and knowledge transfer related to IFDI spillovers to local organizations due to trained local managers' mobility from FDI subsidiaries to local organizations. However, this study needed to focus on the impact of the FDI subsidiaries on local human capital efficiency and how this experience, knowledge, and skill can improve local employees' productivity. Also, the author mentioned that there is a gap in the human capital development study, and it has been recommended for future study.

Haiyun Liu (2020) found that greater accessibility, reliability, and creditworthiness of bank- and equity-based financial services for foreign firms can bring prosperity to a region. However, this is not a straightforward process, and it is more challenging for developing economies under financial constraints and weak institutions. However, the author focuses on the relationship of the financial deepening with the institution's performance (FDI). However, this research does not focus on the role of local humans included in this study.

Mina (2019) examines the role of FDI in job creation as supported by many studies in different regions and countries, and the paper empirically examines the contribution of LMI shaped by labor policies to FDI flows in the GCC countries. Empirical evidence shows that cooperative labor-employer relations, flexible hiring and firing practices, linking wages to productivity, and reliance on professional management encourage FDI inflows. The author suggests that there is room for more research on FDI and its nexus with the local human capital.

## RESEARCH METHODS

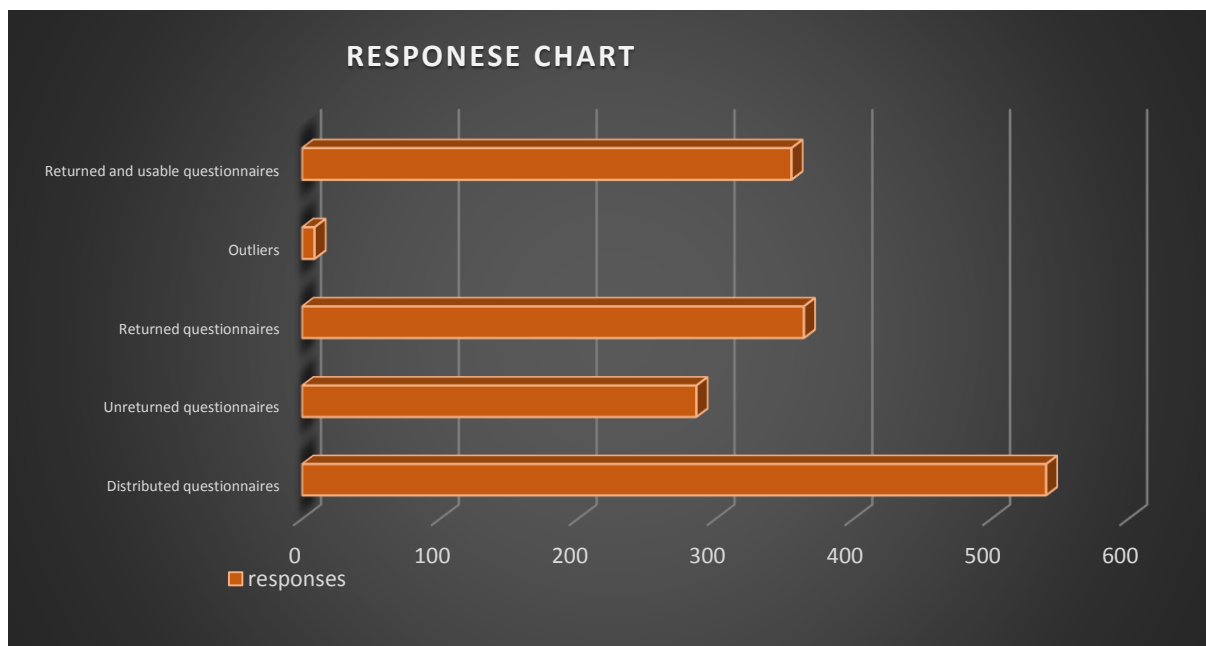
The quantitative research method of this tests the significance of the hypothesis, and it is called (a scientifically based method). This study used a survey questionnaire based on a selected sample and used the SmartPLS 4 to analyze the data and conclude the results. This research examines respondents' opinions on the impact and relationship between foreign IFDI enablers and the role of financial deepening in that relationship. The researcher used a research questionnaire that was distributed among the study sample, which is local workers. They have more than two years of experience working with foreign investment organizations in the UAE (Dubai).

The population of this research is 7000 companies registered in the UAE. This study has selected 35 foreign companies with more than 100 employees in UAE DUBAI that are registered with the government and are currently active and diverse between FDI and FMNE companies. The respondents are made up of local employees who work in this company. The sample was randomly distributed (Saunders, Lewis, and Thamhill, 2009). The most important question is about the availability of working in foreign companies.

## RESULTS

The findings of this study begin by describing the analysis related to the profile of the respondents, followed by the quality of the data's results, including the results of missing data tests, outlier tests, and normality tests which are important to prepare for further analysis. A descriptive analysis of demographic variables was conducted to determine the different characteristics of the respondents. In addition, this chapter provides hypothesis results with the effects of mediating variables to test the research framework developed and how the framework compares with the data. The procedure for estimating Structural Equation Modeling using PLS-SEM was conducted using SmartPLS- version 3. Cronbach's alpha, construct reliability, and average variance extracted (AVE) were used to assess construct reliability and validity as recommended by Hughes et al. (2010), with discriminant and convergent validity established.

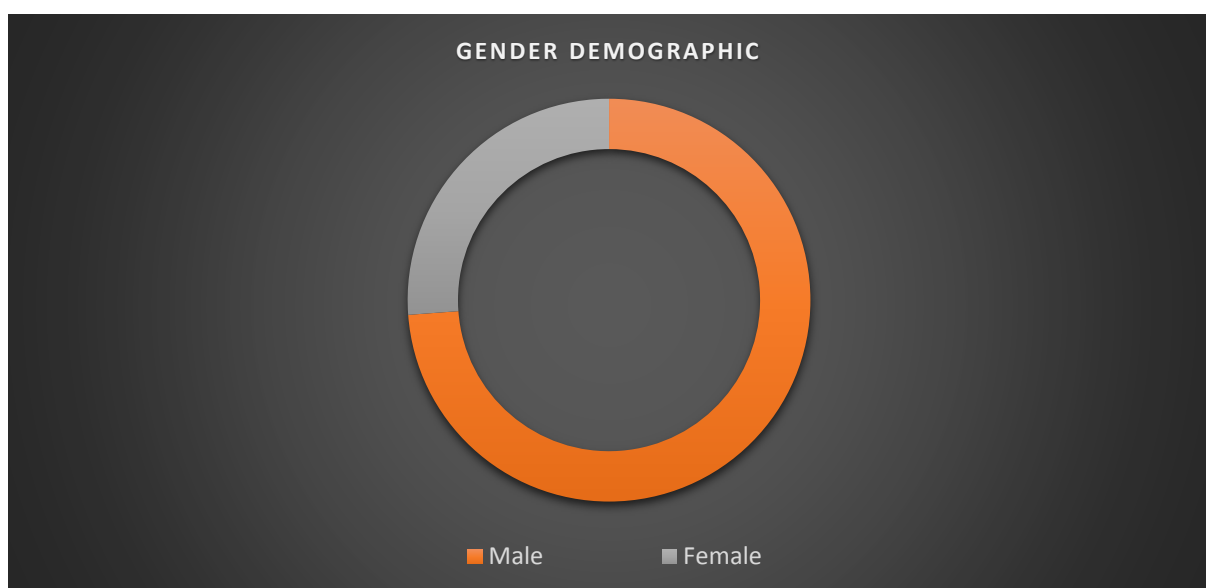


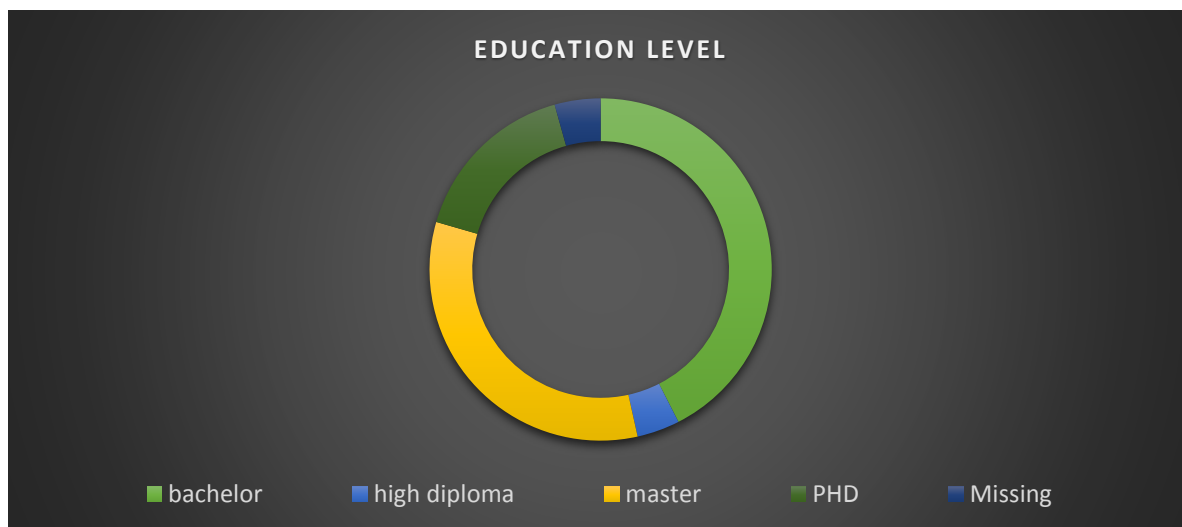
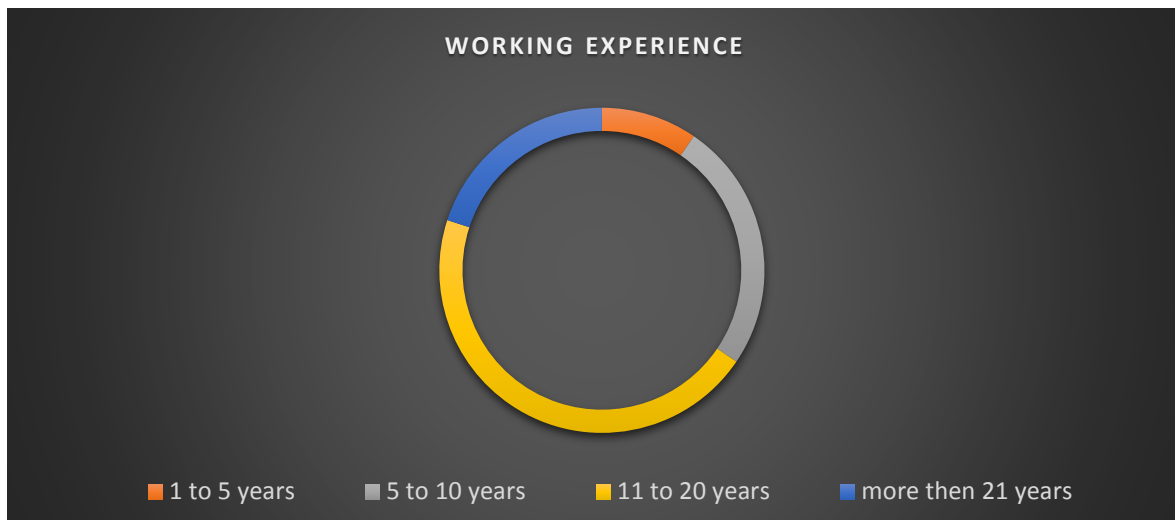
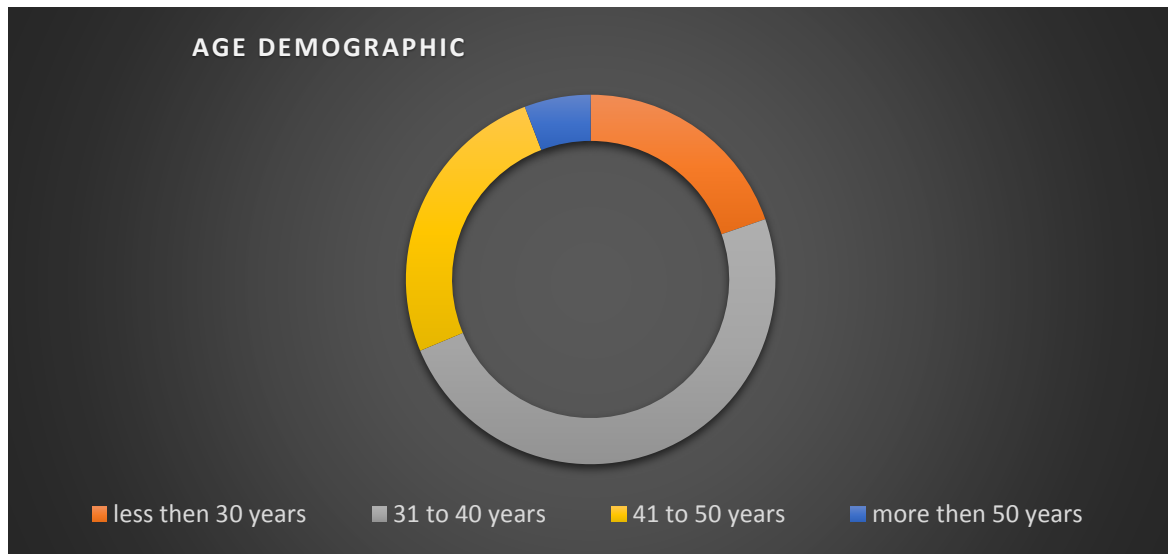


**Figure 3: The research questionnaire distribution report**

### DEMOGRAPHIC RESULTS

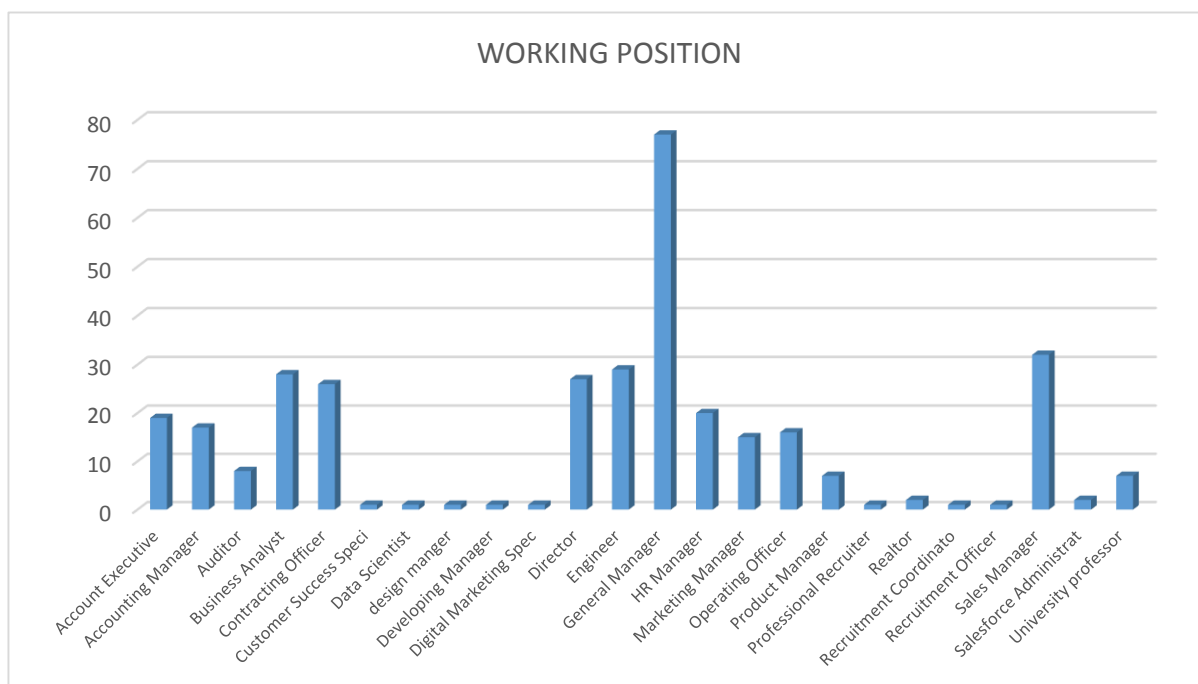
Findings in the results of gender, the majority of respondents were male, 73.6 and 26.1 were female. The age of the respondents of this study ranged from 30 years to over 50 years. The findings of this study showed that the respondents' work experience was as follows: 9.6 percent had 1 to 5 years of experience, 24.9 had 5 to 10 years of experience, 45.5 percent had 11 to 20 years of experience, and 20 percent had more than 21 years of work experience. In comparison, regarding the respondents' education level, 44.4 percent of respondents with a bachelor's degree, 4.2 percent with a higher diploma, 34.4 percent with a master's degree, and 16.9 percent with a Ph.D. degree. Referring to the findings of information the respondent's field of work, including engineering accounting, HR, design, and general manager were the most popular positions, with 22.3 percent.





**Figure 4: Describes the demographic outcome of the despondence**





**Figure 5: The population working position in the foreign company**

**AVE AND CROSS LOADING BETWEEN THE VARIABLES**

Convergent validity and AVE for the construct is at least 0.5, and the composite reliability measure (CR) of internal consistency reliability or more is 0.70. Chin (1980) advises that the AVE for each latent component is greater than 0.50 to obtain satisfactory convergent validity. Also, Table 1 shows that all constructs' test results (AVE) are greater than the required value of (0.5) and range from 0.502 to 0.515. Therefore, the findings show convergent validity. Cross-loading criterion (Chin, 1988) subjective independence can help reduce the presence of multicollinearity amongst the latent variables denoting that the average variance extracted (AVE) of a latent variable should be higher than the squared correlations between the latent variable and all other variables (Chin, 2010; Chin, 1998).

**Table 1: The research cross loading criterion and correlation**

	<b>FD</b>	<b>IFDI</b>	<b>LHCE</b>
IFDI 1	0.415	<b>0.737</b>	0.527
IFDI 2	0.285	<b>0.695</b>	0.471
IFDI 3	0.401	<b>0.761</b>	0.462
IFDI 4	0.512	<b>0.747</b>	0.400
IFDI 5	0.459	<b>0.678</b>	0.342
IFDI 6	0.477	<b>0.682</b>	0.363
FD 1	<b>0.733</b>	0.436	0.499
FD 1	<b>0.745</b>	0.327	0.456
FD 2	<b>0.687</b>	0.519	0.441

FD 3	<b>0.725</b>	0.440	0.400
FD 4	<b>0.594</b>	0.330	0.372
FD 5	<b>0.756</b>	0.471	0.363
LHCE 1	0.468	0.483	<b>0.790</b>
LHCE 2	0.495	0.585	<b>0.755</b>
LHCE 3	0.413	0.345	<b>0.709</b>
LHCE 4	0.428	0.274	<b>0.673</b>
LHCE 5	0.336	0.502	<b>0.670</b>
LHCE 6	0.409	0.240	<b>0.644</b>

The findings of the study show the t-statistics and the p-value of the impact of inward foreign direct investment IFDI on the local human capital efficiency LHCE with (2.75) t-statistics and (0.01), respectively. More specifically, the value of regression of the IFDI relationship with LHCE is positively significant. Thus, the hypothesis is accepted. And the relation of the variable regression was (0.23), which indicates a positive relationship. This means when the IFDI increases by one, the LHCE increases by 0.23.

In the stage of the mediator effect of the financial deepening between the IFDI and the LHCE, we looked at the t-statistic between the IFDI and FD it is significant (4.504) and the t-statistic between the FD and the LHCE is also significant (2.923). Moving to the next stage, we indicate the direct relationship between the IFDI and LHCE, which is significant by (3.161). Finally, testing the specific indirect effect between IFDI and LHCE through FD, which show in Table 4.10, a positive t-statistic value by (2.11) that we can determine the mediator effect between IFDI and LHCE in a complementary (partial mediation).

## DISCUSSION

This study aimed to explore and provide an understanding of the impact of inflow foreign direct investment (IFDI) on local human capital efficiency (LHCE) in the UAE. The findings of the study showed that there is a significant positive impact. The distributed questionnaire findings found that most LHCs have determined the impact of IFDI on LHC performance. The asset results show the IFDI as an excellent indicator that positively impacts LHCE in the UAE. Strong FDI countries have a two-way effect on the country's human skills and knowledge, and countries have been able to acquire skills through increased FDI inflows and sharing of skills and technology (Mohanty, 2019). In addition, local workers see the R&T provided by the company as an investment, not an expense for the company. Organizational ethics in the UAE show a positive correlation with distributing knowledge through employees in the organization.

## CONCLUSION

The study found that in the short and long term, local workers are less attracted to working in foreign companies because of the high academic requirements and lack of educational qualifications in the local work environment (Gong & Fan, 2006). The company's financial and stormy performance is met with or without the participation of local people and local employees in the UAE to meet the organization's expectations and meet the qualifications and skills required to carry out and archive the organization's goals. In conclusion, local workers in the UAE can work and handle a high level of skilled work environment (Zablah, Alex, Bellenger 2012).

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