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Foreign Direct Investment and New Business Start-Up in Southeast Asian Countries: Does Education Matter?

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ABSTRACT

This paper investigates the impacts of foreign direct investment (FDI) and education on the number of business start-up in Southeast Asian Countries. Several studies have shown that people who attend college or university have a higher possibility of becoming entrepreneurs because they have access to entrepreneurship instructional programs and more assistance for practical activities. On the other hand, increasing education might change people's tendency to start new firms. Higher educated people may have better options for sources of income and less desire to start their own business as a result. Using the panel data of nine Asian countries, it is found that net inflows of FDI promote domestic entrepreneurship. Interesting evidence emerges when education is taken into account, the relationship between FDI and new business start-ups is negatively moderated by the level of education. This research uses two levels of education measurements, namely secondary and tertiary education. It is found that secondary education and tertiary education have different impacts on start-up business. The presence of foreign firms in countries with tertiary education level provides better salary options and therefore triggers workers to choose multinational firms rather than become entrepreneurs. This finding implies that net inflows of FDI in Southeast Asian countries with highly educated workers can influence the determination to start new businesses. These results support evidence that educational level is an essential mediating factor in the linkage between FDI and new business start-ups in Southeast Asian Countries.

INTRODUCTION

Many countries show an effort to attract foreign direct investment (FDI) believing that it could bring enormous benefits such as job opportunities, capital accumulation, technology transfer, managerial know-how, international production network, and productivity gains (Arif and Khan, 2019). The benefit of FDI is not only limited to the firm performance and profitability, but it also helps to develop the host country

productivity. On the other hand, the presence of FDI may bring detrimental effects on development by competing in local products or financial markets. The increased competitive tension might lead to difficulty for new entrants and the failure of local businesses (Amoroso & Müller, 2018). While spillover effects of FDI have been intensely debated, there is a growing concern on the importance of entrepreneur contributions on host economies. Innovations from entrepreneurs generate new products or services, which allow the creation of a new market, stimulating a new business, absorbing existing employees, and helping economic development. Entrepreneurs has emerged as a focal point of economic policy in increasing economic growth (Audretsch, 2018). The number of start-up business can also indicate competitive tension in the market. Additionally, capital from foreign investors can clearly increase the pressure on domestic markets and prevent some domestic firms to compete fully. Therefore, new business creation can be an interesting medium to evaluate the spillover effect of FDI.

Besides the relationship between foreign and domestic firms, another aspect that influences the spillover effect is the condition of the host country's absorptive capacity (Munemo, 2017).The variation in human capital among host countries leads to a variation in the FDI effects. Each year, The World Economic Forum conducts surveys on Southeast Asian youth to understand their view, concerns, and priorities in life. The survey in 2019 found an interesting result, specifically for Indonesia, that the trend for becoming an entrepreneur is increasing. The strong start-up culture and the successful history of start-up businesses are the two main reasons for Indonesian youth to choose to be entrepreneurs. In relation to this increasing interest, the number of start-up businesses in Indonesia grew to an estimated 30 percent. In contrast, the case of Singapore is quite different. Despite the advancement in technology and education, only 16.9% of young Singaporeans were interested in becoming an entrepreneurs (Tan, 2019). Education can help individuals increase their quality and productivity and therefore, it is an important factor in increasing the level of absorption of the host country. Highly skilled labor is one of the crucial preconditions for FDI to promote economic growth (Balasubramanyam*et al*., 1999) and attract more FDI, especially the efficient-seeking type (Cleeve *et al.*, 2015). Moreover, the experience and knowledge of working in MNC can motivate highly skilled labors to create their businesses.

The low interest of Singaporean youth in becoming entrepreneurs shows that education can interfere with the relationship between FDI and business start-up. According to a study by Hossain *et al*. (2015), higher education can increase the salary by 13.2%. An employee with high pay satisfaction tends to have a lower intention to leave job or search for a new vacancy. In addition, dissatisfaction with salary triggers negative emotions and affects the decision to stay in the firm. The relationship between FDI and domestic firms can determine the direction of the spillover effect, but education may have a critical mediating effect on this relationship. Is FDI more effective at promoting entrepreneurship in countries with high levels of education? Or could it be the case that high education levels help people to get promoted at work and hinder their desire to start their own business? This current study is in an effort to answer these two crucial questions.

Turning the focus of this work, some researchers have considered FDI-new business start-up nexus such as Nxazonke and van Wyk (2020) who examined the role of FDI on domestic entrepreneurship on Africa, Kim (2019) investigated the mediating effect of strategic alliances between FDI and the start-up rate in Korean, Arif and Khan (2019) studied the impact of FDI on new business start-up with the presence of financial development. While none of these articles focused on the quality of human capital, especially in the Southeast Asian. Looking at the Association of Southeast Asian Nations (ASEAN) data publication, the productive-working-age population has reached 59.6%, potentially contributing to the regional GDP (ASEAN Secretariat, 2019). However, the large number of productive populations is challenging to provide sufficient employment opportunities. In response to the large numbers of the productive population, Southeast Asian countries promote entrepreneurship and human capital development through Strategic Action Plan on Small and Medium Enterprises (SMEs) Development (SAPSMED 2025). Whether foreign direct investment inflows to Southeast Asian countries promote new employment or new business start-up? This current research contributes to this debatable question by providing evidence in the Southeast Asian region. It examines the impact of FDI on new business start-up and the importance of education in mediating the relationship. The remainder of this paper is structured as follows. The second section discusses different theories between FDI, education, and new business start-up. The third section describes the data and variables employed in the empirical study. It also contains the explanation related to variables and models.

The fourth section discusses the result of our studies. Last, the fifth presents the conclusion and limitations of this research.

1. LITERATURE REVIEW

1.1 FDI and new business start-up

According to Danakol *et al.* (2017); Girma *et al.* (2019); Pathak *et al.* (2015), the spillover effect of FDI on local firms may be either positive or negative. Positive spillovers can occur through at least three channels. Firstly, local firms adopt similar organizational practice, technology, and know-how introduced by foreign firms (technology transfer effect). Since the products are already in the market, domestic entrepreneurs can benefit as late-entrants. They may recognize the strength and weaknesses of the products or strategies, thereby reducing failure risk. Secondly, new products and services from foreign firms may generate new business opportunities for local firms. The presence of foreign firms may give new opportunities that have never been explored through subcontracting activity, collaboration, or creating input to fulfill the needs of the foreign firms (Kim, 2019). Thirdly, labor mobility is another channel through which the diffusion of technology, skill and idea occur. Employees who work in foreign firms can learn about operations, strategies, and corporate culture. Experience from working in foreign firms helps them take a better job in the local firms or open their businesses (Danakol et al., 2017; Arif & Khan, 2019).

On the other hand, FDI can discourage the creation of new businesses. Traditionally, before starting a new business, individuals might compare the salary for working as an employee and the income as an entrepreneur. As foreign firms have capital-intensive production and advanced technology, they support their employees in developing their skills and becoming more productive workers than those in domestic firms. In this case, entrepreneurs might have high opportunity costs due to the high salary offers in foreign firms (Pathak *et al.*, 2015). This situation leaves domestic firms with limited workers' choices due to their inability to compete with foreign firms in terms of salary. Additionally, the entry of foreign firms can raise the competitive tension in the local market and push the less efficient local firms out of market. This condition causes foreign firms to capture a larger market share (catch up effect). The competition, then, in turn, raises the barrier to entry. According to Nxazonke & van Wyk (2020), barrier to entry can occur due to several reasons such as raising product standards, lower production cost, a very advanced technology requirement and a high establishment cost when first entering a market. FDI can have positive spillover through technology and knowledge diffusion, demand creation, and labor mobility. On the contrary, FDI can also have negative spillover through occupational choice, increased competitive tension, and entry barriers. We thus test the following hypothesis:

H1a: *FDI has a positive impact on the number of new business start-up.*

H1b: *FDI has a negative impact on the number of new business start-up.*

1.2 FDI, education, and new business start-up

The extent to which host countries can grasp FDI spillover benefits depends on their specific condition. Mere access to foreign knowledge and technology is insufficient to lead host countries' long-term development. It is equally essential for the host country to consider alternative ways to fully absorb and diffuse the spillover benefits in the economy. A sufficient absorptive capability is a requirement for FDI to contribute host country's economic growth. In particular, human capital is regarded as an important element that influences absorptive capacity (Thompson and Zang, 2015). Possessing a minimum human capital threshold could help FDI increase their productivity (Borensztein et al., 1998). Human capital can be defined as education, experience, and skill obtained through school, training and work experience. Foreign firms may consider human capital a crucial factor since it can enhance a firm's competitive advantage (Van Trang et al. (2019)). The condition of human capital can hinder the potency of individuals in creating their businesses.

Higher education in the labor force may translate into a higher individual's absorption level, potentially maximizing their innovation capabilities. Hayduk (2019) argued that sports organizations should consider the importance of education when selecting a host site for their event. They emphasized the ease of doing business in a country where the labor force is educated. Further, education tends to increase creativity, self-confidence, and efficacy, and consequently, it can help perceive and pursue opportunities (Fuentelsaz *et al.*, 2018). Individuals who enroll in university or college have a greater likelihood for being entrepreneurs as they get entrepreneurship educational programs and more support in terms of practical activities. Highly educated workers gain more benefits with their ability to recognize a variety of business opportunities and their skill to grasp them. Singh (2017) conducted research related to the relationship between FDI and a firm's productivity. In the cases where unskilled labors are employed, the productivity of labors remains the same.

In contrast, improving education might influence the tendency to create new businesses. Individuals with high education levels might have better options for sources of income and, therefore, have less entrepreneurial intention. As they accumulate more advanced knowledge and skills, this group of youngsters might have higher salaries and better working conditions than their counterparts with a lower educational level (Wu and Wu, 2008). Moreover, the occupational choice is broadened for a high education youngster in accordance with the entry of foreign firms. A research conducted by Danakol et al. (2017) found that foreign firms tend to offer a more attractive salary for skilled and trained workers in a specific managerial position, preventing them from starting their businesses.
Given this discussion, we thus test the following hypothesis:

H2a: *Education will positively moderate the relationship between FDI and the number of new business start-up.*

H2b: *Education will negatively moderate the relationship between FDI and the number of new business start-up.*

2. DATA AND METHODOLOGY

To analyze the relationship among the variables, this research employed unbalanced panel data by using E-views 10. The data are collected from World Development Indicator (WDI) with 9 Southeast Asian countries from 2006 to 2018. The period of this research is based on the availability of business-start-up data. Due to the unavailability of data, we exclude Vietnam from our dataset.

2.1 Variables

The dependent variable is new business start-up. It is measured by the number of new business registrations with limited liability per 1000 working-age population. This new business density data only covers the formal sector as the data for the informal sector is not available due to the difficulty of quantifying the number of firms that compose it. In addition, the data for partnership and sole proprietorships are also excluded due to the difference in regulation and definition across the countries.

The key explanatory variables are FDI and education. FDI is defined by net inflows from foreign investors and is divided by GDP. The data is in percentage (% of GDP). For education, as the level of education is varied from one country to another, this research uses the perception of the World Bank. There are two proxies for education. The first measurement is using secondary education. It is the ratio of total enrollment to the total population related to that education level. Secondary education completes the basic education offered at the primary level and focuses on the foundation of human development and lifelong learning. Another measurement uses tertiary education. This level of education requires people to complete secondary education, regardless of whether or not it is intended to provide an advanced qualification in research.

Besides these two variables, several control variables are included accounting for an alternative explanation. According to Arif & Khan (2019), business regulation and GDP growth can, directly and indirectly influence business start-up creation. In order to stimulate new business creation, policymakers are

required to create a good business environment. The number of procedures to register a new business and the time (in days) required to start a business are the measurements for business regulation, whereas higher economic growth can be used to signal good market opportunities for entrepreneurs. GDP growth is defined by the annual percentage growth rate of GDP.

2.2 Model Specification

This paper aims to examine the effect of FDI and education on new business start-up. Panel data models were used for the sample of Southeast Asian countries from 2006 to 2018. We also include the interacting variable between FDI and education to capture the mediating effect of education in affecting the linkage of FDI and new business start-ups. Hereby is our research model:

$$NewBuss_{i.t} = a_0 + a_1 FDI_{i,t} + a_2 Edu_{i,t} + a_3 FDI_{i,t} \times EduSec_{i,t} + a_4 BussPro_{i,t} + a_5 GDP_{i,t} \quad (1)$$

$$NewBuss_{i.t} = \beta_0 + \beta_1 FDI_{i,t} + \beta_2 Edu_{i,t} + \beta_3 FDI_{i,t} \times EduSec_{i,t} + \beta_4 TimeReq_{i,t} + \beta_5 GDP_{i,t} \quad (2)$$

Where *i* and *t* denotes country and time (years), respectively. $NewBuss_{i.t}$ is the number of new business start-up; $a_s$and β_s are the regression coefficients; $FDI_{i,t}$ stands for foreign direct investment; and $Edu_{i,t}$ stands for education. The interaction term $FDI_{i,t} \times EduSec_{i,t}$ test the role of secondary education in explaining the impact of FDI on new business start-up. Models 3 and 4 are, thus, obtained by replacing $EduSec_{i,t}$ in equation 1 and 2 with $EduTer_{i,t}$, respectively.Moreover, new business procedures ($BussPro_{i,t}$), time required to start a business ($TimeReq_{i,t}$) and GDP per capita growth ($GDP_{i,t}$) are used as the control variables.

3. RESEARCH RESULTS

3.1 Summary Statistics

Table 1 presents summary statistics of the observed variables. New Business has a mean value of 1.2717, indicating that around one new business start-up per 1000 working-age population on average. The average percentage of people enrolled in secondary education is more than two times higher than in tertiary education. About 78% of Southeast Asian people have already enrolled in the secondary level. While for tertiary education, it is only 31.9863% of people have enrolled on this level of education. It shows that not everyone who completes their secondary education directly continues tertiary education. It is possible that after they complete their secondary education, they start to enter the workforce due to their preferences or personal reasons.

Table 1. Summary Statistics

	Mean	*Std. Dev.*	*Min.*	*Median*	*Max.*
NewBuss	1.2717	1.8694	0.0068	0.5322	10.0108
FDI	5.1221	5.2411	-1.3205	3.7309	28.0170
EduSec	78.4339	20.4267	39.7384	81.4755	120.6512
EduTer	31.9863	17.2137	5.6786	31.2065	88.8865
TimeReq	54.7754	45.5396	1.5000	34.0000	187.0000
BussPro	10.4783	4.1466	2.0000	10.0000	18.0000
GDP	4.8444	3.0427	-2.4655	5.4735	10.7711

Note: The results are obtained from the raw data

Source: World Development Indicator (2021)

As mentioned in the previous section, business start-up regulations have two measurements: time requirement and the number of procedures. On average, people need to spend 54 days to start a new business in Southeast Asian region, with a minimum of 1 day and a maximum of 187 days. The average number of procedures to start a new business is 10 procedures, with a minimum of 2 procedures and a maximum of 18 procedures.

3.2 Correlation Analysis

Table 2 reports the correlation coefficient of the transformed variables used in this research. As a rule of thumb, a model can be exempted from highly correlated or multicollinearity if the correlation between independent variables is less than 0.7 (Hill *et al.*, 2018). The results show that none of these variables is larger than the suggested number, indicating an absence of multicollinearity. As FDI has a positive correlation with new business, it may indicate that having greater FDI can stimulate the creation of business start-up.

Table 2. Correlation Matrix

	NewBuss	*FDI*	*EduSec*	*EduTer*	*TimeReq*	*BussPro*	*GDP*
New-Buss	1						
FDI	0.1510	1					
EduSec	0.7270***	0.0707	1				
EduTer	0.6396***	0.2628**	0.6640***	1			
TimeReq	-0.6669***	0.1769	-0.4413***	-0.6669***	1		
BussPro	-0.3259**	-0.4212***	-0.0818	-0.4375***	0.2738**	1	
GDP	-0.5109***	0.1601	-0.6998	-0.3685***	0.2842**	0.0322	1

Note: ***, ** indicates the significant level of 1%, and 5%.

3.3 Fixed Effect Regression

The results from panel data regression analysis are presented in Table 3. FDI is found to positively impact the number of new businesses start-up at the 1% significance level, so H1a is accepted. This finding suggests that when a country receives a high net FDI inflow, it could encourage the number of new business start-up. Based on models 1-4, secondary and tertiary education demonstrated a positive relationship with the number of new businesses. However, the interaction between FDI and education provided interesting results. Specifically, the significant and negative impact is only found in the interaction between FDI and tertiary education. This finding implied that high levels of education could interfere the relationship between FDI and number of new businesses. Thus, H2b is supported.

Table 3. Fixed-effect regressions

	(1)	*(2)*	*(3)*	*(4)*
C	-1.4304***	-2.0977***	-1.2043***	-1.9694
	(-4.0254)	(-6.3005)	(-2.8014)	(-5.3258)
FDI	0.0604	0.1201	0.1245***	0.1336***
	(0.6962)	(1.2923)	(3.3423)	(2.9326)
EduSec	0.0130***	0.0169***		

	(3.6477)	(4.5087)		
FDI*EduSec	-0.0004	-0.0010		
	(-0.4150)	(0.9860)		
EduTer			0.0215**	0.0331***
			(2.1426)	(3.3069)
FDI*EduTer			-0.0022**	-0.0025**
			(-2.2016)	(-2.2404)
BussPro	-0.0412***		-0.0438***	
	(-3.7808)		(-3.0511)	
TimeReq		-0.0023*		-0.0014
		(-1.8140)		(-0.8643)
GDP	-0.0063	-0.0059	-0.0027	0.0013
	(-0.3871)	(0.3247)	(-0.1644)	0.0731
R-squared	0.9876	0.9852	0.9824	0.9796
Adjusted R-squared	0.9846	0.9817	0.9782	0.9748
F-stat	331.41	277.34	235.52	203.6

Note: ***, **, * indicates the significant level of 1%, 5%, and 10%.

4. RESULTS DISCUSSION

A positive relationship between FDI and new business start-up suggests that employee who works in foreign firms can develop their skills and experience, which help them to start their own business. Besides, new products and services from foreign firms could generate new demand or business opportunities, such as supplying input for their productions (Kim, 2019). The inflows of capital sustain countries' economic development, which can lead to a better opportunity and environment for becoming entrepreneurs.

The education coefficients in both secondary and tertiary levels are positive and significant implying that human capital is needed to increase the number of entrepreneurs. This result is different from Berrill et al. (2020) who found that countries with highly educated labor tend to have a smaller number of new business start-up. However, this could be because the salary offered in Southeast Asian countries is not as high as in the other region. Hence, the opportunity cost for switching from work in the company and opening their own business is smaller.

The interaction between FDI and level of education provides interesting results. Models 1 and 2 show that there is no significant impact of FDI in the countries with the number of people enrolled in secondary education. This result is in line with the result from Singh (2017), who found that in the case that foreign firms hire unskilled labor, the productivity was seen to be unchanged. On the other hand, tertiary education negatively impacts and is significant at a 5% level. This result could be due to students in tertiary education studying a more varied curriculum related to both technical and managerial nature (Jiménez *et al.*, 2015). Completing a tertiary level of education helps them better understand the knowledge and skill needed to get promoted at work.

Further, it shows that although FDI can encourage new business start-up, when these inflows are targeted in the countries with highly educated laborers it could lower the potency for entrepreneurs. Individuals with high education level have broaden occupational choice in accordance with the entry of foreign firms. The presence of foreign firms in the host countries could provide better salary options (Danakol *et al.*, 2017). The employee might consider that working in foreign firms provides stable income, and they do not need to worry about the high-risk failure of being entrepreneurs. Further, as foreign firms usually have more advanced knowledge and technology, it might trigger them to work in these firms. In another word, the high net FDI inflow in highly educated laborers could influence the determination of people to start their own businesses. Regarding the control variable, business procedure is found to have a negative and

significant impact on new business start-up. The lengthy and complex business procedure could increase business costs and discourage people from new business creation (Munemo, 2017).

CONCLUSIONS

This research employs fixed-effect panel data of Southeast Asian countries to analyze the relationship between FDI, education, and new business start-up. The main findings of our research are as follows. There is a positive spillover effect of FDI on new business start-ups, indicating that higher net inflows could increase the number of business start-up. Foreign firms could generate new demand and business opportunities in the host countries, such as upgrading the employee's skill, collaborating on their products, etc. However, the linkage between FDI and domestic firms varies on the level of nation's education. This research confirms that secondary and tertiary education have different impacts on business start-up. Tertiary education, with a more profound learning process related to managerial expertise, helps people to have high performance and get promoted in the workplace. As the presence of foreign firms can provide broad occupational choice, it could cause high opportunity costs for entrepreneurship. Our results suggest that in countries with high net inflows and highly educated workers, more workers will prefer to work in foreign firms with stable income than start their own business.

The policy implication relates to our research is first, the selection of FDI might carefully be observed. Government can try to select FDI with some criteria if they want to increase the entrepreneurship rate. Second, the government might consider providing incentives for foreign firms to collaborate with local businesses or universities. During the collaboration process, local businesses or universities can enhance their knowledge and skill. As a result, it might generate new ideas for business opportunities. Moreover, the desire to be entrepreneurs is hinder in the nations with tertiary education. Education negatively moderates this relationship because school or university has not been focused on preparing for entrepreneurships. Developing an entrepreneurship curriculum can help students to involve in business practices and build a sense of initiative and entrepreneurship. Finally, the result of secondary education can signal that this education is still not sufficient to either preparing students to start their own business or help them be promoted in foreign companies. Hence, it is suggested to improve the relevance of secondary education not only for preparing their higher level of education but also the readiness for entering workplace.

In summary, this research contributes to a better understanding of the impact of education on the relationship between FDI and business start-up. It is subject to limitation, nonetheless. For instance, this research only uses the data for the formal sector due to data unavailability. Besides, it is suggested to not only use enrollment rates to measure education, but it also can use for instance survival rate or education success.

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