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Research Article

Literature Analysis on the Role of FDI (Foreign Direct Investment) in Improving Economic Stability of Malaysia

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Abstract:

The purpose of this research is to analyse yearly data from 1971 to 2010 in order to determine the impact of foreign direct investment on genuine GDP in Malaysia. A VAR model using an integration approach is used to assess the influence of foreign direct investment (FDI) on Malaysia's real GDP by the researchers. In Malaysia, the short-term impacts of the two variables are explored using the Vector Error Correction model (VECM). The relationship between future FDI and real GDP may also be examined using Granger causality. The primary results show that the expansion of the Malaysian economy has been positively affected by the rise of FDI. To be more precise, a permanent 1% rise in FDI levels results in a 49.135 percent increase in Malaysia's GDP. Mutually reinforcing relationships exist between GDP and FDI. From 2014 to 2024, the publications were chosen using a purposive selection method that relies on credible sources from the Scopus, Web of Science, and Google Scholar databases. The findings show that competition to attract FDI is heating up throughout the world. The host country's economy stands to gain a lot from FDI, which is why there is so much rivalry in this space. FDI has the ability to alter market structures, create jobs, and transfer technical know-how. Further, FDI may boost investor returns by giving companies a leg up in the market. Since academics and policymakers have long acknowledged the advantages of FDI, the role of this investment in economic development has piqued their attention. The article lays forth the fundamentals of FDI for building an inclusive investigation in the future. A more thorough comprehension of FDI may be had by using this method. Nevertheless, future research should make use of qualitative methods, such as surveys and interviews.

1. Introduction

Firms often acquire productive assets in other countries as part of their FDI strategy to create a physical presence overseas. Investing in a foreign country with the intention of increasing returns, broadening product availability, and taking advantage of economies of scale is known as FDI. FDI is defined as "Investment in a company by a person or group outside of the country with the intention of acquiring a financial interest in the company and/or a voting interest in its management" in the Balance of Payments Manual. As a mechanism to produce economic growth (GDP), FDI has remained vital in most nations, even though its

pattern has varied little over time. A 2002 OECD survey found that nations with less developed economies saw FDI as their only hope for economic modernisation and progress. As a result, governments, particularly those in developing nations, are looking to international investors for funding. In 31 developing countries, there was a strong correlation between foreign direct investment and economic progress, both in the short and long term[3].

Ever since gaining independence from Britain in 1975, Malaysia has made a concerted effort to draw in foreign direct investment (FDI). The country has been touting its numerous appealing qualities, such as its abundant and affordable labour, huge local markets, intangible goods, macroeconomic stability, trade liberalization, productive legal facilities, and special trade status under the Generalized System of Preferences (GSP). The annual rate of growth for real gross domestic product was 6.5% between 1957 and 2005. The Government of Malaysia (GOM) sought to restrict FDI in order to achieve its economic growth objectives, which included acquiring foreign technology, cash, and expertise. In the 1960s, an economy focused on import substitution began to give way to an export-oriented economy that was both expansive and dynamic. After that, FDI in the manufacturing sector helped propel the economy to an all-time high real GDP growth rate, which averaged 8.9 percent per year from 1988 to 1996. Competition to attract FDI is heating up throughout the world. The host country's economy stands to gain a lot from FDI, which might lead to changes in market structures, more job possibilities, and the transfer of technical know-how, all of which exacerbate the competition. FDI may also boost investor profits by giving companies a leg up in the market. Academics and policymakers have long acknowledged the favourable impacts of inbound FDI on economic development, which has piqued the critical attention of researchers in this area[1].

2. Background of the Study

Malaysia is a prime example of a developing nation in Southeast Asia that has benefited greatly from FDI, which has helped fuel economic development, social change, and general stability. Foreign direct investment (FDI) is a critical factor in a country's economic development, which is why Malaysia liberalized and modernized its economy to attract FDI in the 1980s. By streamlining regulatory processes, improving infrastructure, establishing free trade zones, and granting tax benefits, the Malaysian government has made the country an appealing investment destination, according to authorities such as the Malaysian Investment Development Authority (MIDA). As a result of these initiatives, Malaysia has emerged as a major centre for MNCs, especially in the industrial, electrical, oil and gas, and service industries. FDI has been crucial in bolstering the macroeconomic stability of Malaysia[4].

It facilitates the integration of the local economy into global value chains, assists in industrial upgrading, brings in necessary financial inflows that lessen reliance on unstable short-term financing, and encourages the transfer of technological know-how and management skills. Moreover, it helps to increase productivity, which in turn helps to create jobs, and it encourages innovation and competitiveness within local markets. FDI has helped economies weather storms by sustaining investment and output levels during periods of economic uncertainty or external shocks like the COVID-19 pandemic and the Asian Financial Crisis in the late 1990s[2].

3. Purpose of the Study

The growth of Malaysia's economy in terms of international trade and investment is greatly influenced by foreign direct investment (FDI). The author of this article asserts that Malaysia now has a leg up in the competition thanks to FDI. Gaining a long-term stake in a foreign country's assets or company is the primary goal of FDI. This usually entails purchasing existing businesses or starting new ones in order to create a presence or have a dominant interest in a firm. Gaining a competitive edge, expanding into new areas, and cutting expenses are common objectives.

4. Literature Review

FDI impact on GDP growth has been the subject of much scholarly discussion. Lucas (1988), Rebelo (1991), and Romer (1986) created the endogenous growth model. Human capital accumulation and research and development are the forms of capital introduced by this growth model, which also highlights the externalities that arise from these forms of capital. FDI motivates host nations to upgrade their industrial systems by incorporating new inputs and technology. Furthermore, if FDI produces productivity, positive externalities, and spill over effects, it may also promote economic development internally. FDI has the potential to enhance long-term economic growth by facilitating technical advancement, capital accumulation, and the enhancement of human capital. According to a widely-cited study on the topic, FDI is more important than domestic investment in driving

economic development since it facilitates the introduction of new technology. It was Schumpeter (1911–1934) who first investigated the impact of the expansion of the financial industry on GDP growth. According to Patrick and Charles (1966), development of the financial sector can stimulate economic growth through two main avenues: first, shifting resources from stagnant to dynamic areas and second, encouraging innovation and entrepreneurship in these areas[10].

According to Romer (1986) and Lucas (1988; 1993), a developed financial system leads to better resource allocation since it encourages saving and decreases asymmetry of information. Using the Johansen multivariate cointegration approach and the Granger causality test, recent research have examined the complementing impact for six East Asian nations and three developed countries (the US, UK, and Japan). Subsequent research confirmed that development of the banking sector is critical for FDI to have a favourable influence on long-term economic growth in seven out of nine nations surveyed. The opposite is true for the banking industry; testing of short-run causation found that it is significantly different in six out of nine nations. Researchers analyse Malaysia by use of a limits test and an unconstrained error correction model (UECM). Findings show that in the short run, FDI, FSD, and the complementing effect all have greater elasticities than in the long run[5].

However, the degree to which FDI boosts host nations' economies via backward linkages is affected by the development of their banking sectors. Indeed, several nations have shown the substantial correlation between FDI and GDP. Included nineteen emerging nations in South and Southeast Asia and Latin America, as well as a correlation between FDI and GDP development. Latin America's GDP and FDI have a long-term link, according to his findings. Sri Lanka in East and South East Asia and five Latin American countries—Argentina, Brazil, Chile, Guatemala, and El Salvador—also showed signs of this kind of interaction. In addition, the five countries in South and East Asia—Pakistan, Indonesia, India, and Thailand—had a symmetrical connection between GDP and FDI. Finally, in Latin America, a short-run link was seen between FDI and GDP, which was not integrated in Bolivia, Ecuador, Honduras, and Mexico. On top of that, Borensztein, Gregoria, and Lee (1998) used data from 69 developing nations to demonstrate that FDI contributes to GDP growth. They employed a regression approach that seemed unrelated for their research, known as SUR. The same obvious conclusion holds true: FDI boosted economic development in the target nations. Nevertheless, the human capital of the nation was a determining factor. When a nation had a certain level of human capital, FDI had a significant impact on economic development via increased productivity. With the help of productive human capital, it was clear that FDI might boost economic development[6].

5. Research Question

What is the impact of FDI (Foreign Direct Investment) in improving economic stability of Malaysia?

6. Methodology

Analysing numerical data related to variables using one or more statistical models is a fundamental aspect of quantitative research. A potential advantage of quantitative research is an enhanced comprehension of the social milieu. Researchers often use quantitative methods while investigating problems that impact particular individuals. Outcomes of a quantitative study shown visually as objective data. In quantitative research, the collecting and analysis of numerical data is crucial. With their assistance, researchers may more readily compute averages, generate projections, identify relationships, and extrapolate findings to larger populations.

6.1 Research design:

Using SPSS version 25, the quantitative data analysis was carried out. To determine the strength and direction of the statistical association, the odds ratio and 95% confidence interval were used. A statistically significant threshold was established by the researchers with a p-value less than 0.05. Using descriptive analysis, researchers were able to gather crucial data points. Information analysed using statistical computing tools or data collected by polls, questionnaires, or surveys is often subject to quantitative methods of evaluation.

6.2 Sampling:

Research participants completed questionnaires to provide information for the study. Utilising the Rao-soft software, researchers ascertained a study population of 754 individuals, prompting the distribution of 852 questionnaires. The researchers received 980 responses, removed 22 for incompleteness, resulting in a final sample size of 958.

6.3 Data and Measurement:

The research mostly used a questionnaire survey as its source of information, conducted by either direct conversation or a Google Form survey. The questionnaire had two separate sections: (A) demographic information gathered from both online and offline sources, and (B) responses to traits evaluated using a 5-point Likert scale. Secondary data was obtained from many sources, mostly online.

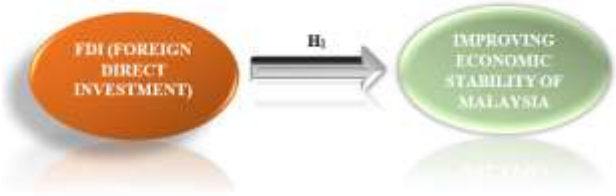
6.4 Statistical Software:

The statistical analysis was conducted using SPSS 25 and MS-Excel.

6.5 Statistical Tools:

To understand the key features of the data, descriptive analysis was used. Analysing the data using ANOVA is a researcher's responsibility.

7 Conceptual Framework



8. Result

Factor Analysis

A common use of Factor Analysis (FA) is to identify the presence of latent variables within observable data. In the absence of definitive visual or diagnostic indicators, it is customary to use regression coefficients for assessments. In FA, models are crucial for success. The objectives of modelling are to identify errors, intrusions, and discernible connections. The Kaiser-Meyer-Olkin (KMO) Test is a method for evaluating datasets generated by multiple regression analyses. The model and sample variables are confirmed to be representative. The data exhibits redundancy, as shown by the figures. Reducing the proportions enhances the clarity of the data.

The KMO output is a numerical value ranging from zero to one. A KMO value ranging from 0.8 to 1 indicates a sufficient sample size. The following are the acceptable levels, as per Kaiser: The subsequent approval standards established by Kaiser are as follows:

A regrettable 0.050 to 0.059, inadequate 0.60 to 0.69 Middle grades often span from 0.70 to 0.79. The quality point score varies from 0.80 to 0.89.

They are amazed by the spectrum of 0.90 to 1.00.

Table 1: KMO and Bartlett's Test for Sampling Adequacy Kaiser-Meyer-Olkin statistic: 0.836 the outcomes of Bartlett's test of sphericity are as follows:

The chi-square statistic is about 190, having 190 degrees of freedom and a significance threshold of 0.000. This confirms the veracity of claims made just for sampling reasons. Researchers used Bartlett's Test of Sphericity to assess the significance of the correlation matrices. The Kaiser-Meyer-Olkin measure reveals that a value of 0.836 signifies the sample's adequacy. Bartlett's sphericity test produces a p-value of 0.00. A positive outcome from Bartlett's sphericity test indicates that the correlation matrix is not an identity matrix.

Table: KMO and Bartlett's

KMO and Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.836
Bartlett's Test of Sphericity	Approx. Chi-Square	3252.968
	df	190
	Sig.	.000

Furthermore, Bartlett's Test of Sphericity validated the overall significance of the correlation matrices. The Kaiser-Meyer-Olkin measure of sample adequacy was 0.836. A p-value of 0.00 was found by researchers using Bartlett's sphericity test. Notably, the correlation matrix was found to be invalid according to Bartlett's sphericity test.

Independent Variable

FDI (Foreign Direct Investment)

When a person or group from one nation puts money into a company in another country with the plan to remain for a long time, it's called foreign direct investment (FDI). The long-term commitment of investors is what distinguishes FDI from foreign portfolio investments, when investors only own foreign assets. A FDI may take the form of a long-term stake or the expansion of an existing company into a new foreign market. An example of an FDI

would be the acquisition of property and buildings in another nation, which would give the buyer complete ownership over such assets. What this means in layman's terms is that a foreign corporation may invest in a company, piece of real estate, or productive asset (like a factory) in one nation and then control it. Thus, the idea of direct control distinguishes it from foreign indirect investments or foreign portfolio investments. An example of an international factor movement is FDI, which occurs when a company from outside of the target country purchases a majority stake in a domestic company. FDI differs from foreign institutional investment (FII), which is the passive purchase of foreign assets such as public stocks and bonds, due to the "control" component. The Financial Times states that in closely owned companies, the idea of control is not always clear. They state that although the internationally acknowledged threshold of 10% of voting shares is often used, this percentage may be misleading since even a smaller block of shares can result in control[7].

Dependent Variable

Improving Economic Stability of Malaysia

Enhancing Malaysia's economic stability involves persistent endeavours to fortify the nation's capacity to sustain stable development in the face of both internal and foreign economic shocks. Minimising and stabilising inflation, maintaining fiscal discipline, establishing a stable currency rate, reaching sustainable levels of public debt, and fostering healthy employment are all essential macroeconomic goals. Building robust financial and institutional structures that can sustain growth over the long term, keeping investor confidence high, and achieving a balanced trade and current account performance are all components of economic stability for Malaysia. Through bolstering economic stability, Malaysia strives to establish a robust economic climate that encourages inclusive development, entices investment from inside and beyond the country, and improves the general welfare of its citizens. An increase in exports and sustained growth in domestic demand contributed to a 5.1% annual growth rate for Malaysia's GDP in 2024 (compared to 3.6% in 2023). Domestically, improvements in family finances, legislative initiatives aimed at bolstering households, and a more favourable job environment were the primary drivers of increased expenditure. More investment growth was spurred by strong investment approvals and the continued advancement of public and private sector multi-year projects. The New Industrial Master Plan, the National Energy Transition Roadmap, and the National Semiconductor Strategy are examples of national master plans that include these programs. In terms of the outside world, exports bounced back on the back of rising consumer spending, more tourism, and a persistent tech upcycle[8].

Relationship between FDI (Foreign Direct Investment) and Improving Economic Stability of Malaysia

FDI has a substantial and complex association with the enhancement of Malaysia's economic stability. The infusion of cash, the creation of jobs, and the enhancement of productivity via the transfer of technology and knowledge are the three main ways in which FDI directly contributes to economic development. In order to diversify its economic base and lessen its dependence on unstable commodities markets, these investments fortify important sectors including infrastructure, services, and manufacturing in Malaysia. Additionally, by growing foreign currency reserves and supporting export-oriented companies, FDI aids in stabilising the balance of payments. More investments and steadier financial markets might result from increased investor confidence. Consistent FDI inflows help cushion the blow of economic uncertainty or global downturns by keeping the wheels of industry turning, government income rolling, and jobs hanging on. Consequently, FDI is crucial for bolstering Malaysia's economy and ensuring stability in the long run[9].

Consequent to the above debate, the researcher posited the following hypothesis, which intends to examine the relationship between FDI and the enhancement of Malaysia's economic stability.

"H_{01}: There is no significant relationship between FDI (Foreign Direct Investment) and Improving Economic Stability of Malaysia"

"H_1: There is a significant relationship between FDI (Foreign Direct Investment) and Improving Economic Stability of Malaysia"

Table 2: H_1 ANOVA Test

ANOVA					
Sum					
	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	39588.620	385	5655.517	1055.921	.000
Within Groups	492.770	572	5.356		
Total	40081.390	957			

The result of this inquiry is significant. The F statistic is 1055.921, achieving significance with a p-value of .000, which is below the .05 alpha level. The hypothesis "H_1: There is a significant relationship between FDI (Foreign Direct Investment) and The

Enhancement of Malaysia's Economic Stability" is accepted, whereas the null hypothesis is rejected.

9. Discussion

The diagnostic findings show that the series follows a normal distribution, and the model is devoid of autocorrelation and heteroscedasticity. The estimated t-statistics from both equations are more than the t-critical value at the 5% level, thus it's safe to state that the results hold water and that there's sufficient evidence to support the claim that FDI significantly impacts Malaysia's economic growth. Both of these factors are positively correlated in Malaysia, as shown by the positive sign. FDI positively affects real gross domestic product (RGDP) because a 1% rise in FDI rates results in a 0.046072% increase in GDP growth rates. A one percent rise in the FDI rate will result in a growth boost of 0.044877%, thus demonstrating that FDI has a direct beneficial effect on RGNI. As a consequence, the findings corroborate researcher's expectations, as stated before, that FDI would boost Malaysia's economy. With the help of this research, policymakers may be able to better focus their assistance in order to achieve the intended aims. From an institutional perspective, the government must provide political and economic stability as well as administrative consistency in order to retain investors' trust. Furthermore, it has to push for laws that encourage free commerce and foreign direct investment. Also highly prized by investors are institutions that are exemplary and devoid of corruption, as well as a well-functioning bureaucracy.

10. Conclusion

Utilising a deduced endogenous growth model, this study investigated how FDI affected economic development in Malaysia. All statistical analyses followed a predetermined protocol that included the following tools: Hierarchical Multiple Regressions, the U-root test, and the Johansen Co-integration test. From 1975 until 2010, the duration was extended. FDI inflows and human capital accumulation were determined to have the greatest impact on the economic development of the host nation. FDI technology spill overs have not yet been adequately linked to human capital for them to contribute to economic development. Accordingly, it recommends that the government invest more politically and financially in raising the level of human capital in the nation so that it can entice and better accommodate FDI which would boost the economy overall. In addition, the transparency of the Malaysia's economy is well-positioned to continue growing because to a favourable foreign exchange environment. FDI factors that could influence a company's competitive advantage include local factor circumstances, relevant supporting industries, laws, and regulations. The review item in question offers a building blocks for developing a more comprehensive plan for future studies, recommending a mixed-methods neo-positivist strategy that integrates qualitative and. To have a better grasp of the topic at hand, quantitative research could be something to look into. The significance of a strong institutional framework in attracting high-quality FDI and, ultimately, restarting economic development, has been better understood thanks to this research. An industrialised, developing country like Malaysia attracts FDI because it is a sign of stability and trust for investors, which helps the economy succeed in the long run. Investment in the domestic economy, especially in the service and industrial industries, is heavily influenced by the rules and regulations put in place by the government. Governments need well-defined goals and strategies in order to make the most of available funds, provide a steady macroeconomic environment, and promote efficiency at all levels of operation.

Author Statements:

- **Ethical approval:** The conducted research is not related to either human or animal use.
- **Conflict of interest:** The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper
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