

# The Nexus between Levels of Foreign Direct Investment (FDI) and Doing Business Index (DBI) in Malaysia: How Regulations Affect Business Environment and the Malaysian Economy

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**Abstract:** A competent government and fair rules of governance can facilitate entrepreneurship, encourage investment and sustain business economy. As the government regulations potentially increase equity and efficiency in administrative procedures, the business sector as a whole grows. Similarly, as the government interventions conceivably ensure safety and soundness of the market, the economy as a whole develops. And so why there is a need for an economy like Malaysia to be pursuing to improve regulatory quality and create a competitive business environment were foreign direct investments are attracted? However, most business and other economic regulations are viewed to have been imposing obligations or constraints on business and investment environments as opposed to its intention to provide incentives for mutually beneficial cooperation and opportunities for fairly acceptable competition. As Malaysian Government strike a balance between sustaining a stellar performance of the domestic market while supporting a favorable investment climate given its existing incentive and regulatory regimes, more regulatory reforms are still needed to increase quality of regulations and support the ease-of-doing business initiatives in Malaysia. Although the study did not imply causation, it is enough to establish that higher Doing Business rankings are associated with more foreign investment which in turn generate business, create employment, exchange of technologies, and emergence of innovation, among other, that provide beneficial collateral effects on the economy.

**Keywords:** foreign direct investment, doing business index, FDI, business regulations, ease of doing business.

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## 1. INTRODUCTION

Creating an efficient and effective business environment is in the interest of all sectors of a society. An efficacious government and sound governance can facilitate business. As the government regulations potentially increase equity and efficiency in administrative procedures, the business sector as a whole grows. Similarly, as the government interventions conceivably ensure safety and soundness of the market, the economy as a whole develops (Stiglitz, 2009).

And so why there is a need for Malaysia to be pursuing to improve regulatory quality and create a competitive business environment were foreign direct investments are attracted? The importance of regulatory reform in Malaysia is persuasive enough for the Malaysian government not to recognize. Better regulations and deep reforms are obligatory. Since the regulations happen at the Executive and Legislative branches as well as in the local government levels of the government, conduct of intensive review of all multiple layers of laws, regulations, issuances and policies on business procedures and requirements must be done with a view towards rationalizing them. Further easing of red tape, relaxing of regulations, streamlining of business procedures and enabling a favorable business environment are among the effective ways to encourage a sound investment climate in the Malaysia.

Among the fundamental regulations critical to a well-functioning economy are those regulations that have direct link to the workings of the business sector. However, most business and other economic regulations are viewed to have been imposing obligations or constraints on business and investment environments as opposed to its intention to provide incentives for mutually beneficial cooperation and opportunities for fairly acceptable competition (Allen+Clarke, 2010; Asian Development Bank 2015; OECD, 2015; World Bank, 2016). Consequently, if these impositions are not removed and revisited could result in higher transactional costs for consumers and businesses (BSP, 2016), higher administrative costs for the government (NEDA, 2015), lower market productivities (OECD, 2015) and lesser opportunities for growth in the economy (Ellig & Broughtel, 2012).

Government regulations, or the range of legal instruments such as constitutional provisions, statutory laws, government policies, administrative orders and regulatory regimes (OECD, 2010), shape the way how consumers, businesses and economies behave. Undoubtedly, these regulations have numerous effects on a given economy, both positive and negative. When properly designed and implemented, such regulations can be in the best interest of the public. Conversely, unnecessary or poor regulations can inflict substantial burdens on society and economy as a whole.

Over the years, Malaysia has metamorphosed into an economy whose growth and development are found to be unprecedented (World Bank, 2016). Amidst the pressing internal challenges and the volatile external environment, the Malaysia has continuously outperformed its regional neighbors with a resilient, sound and sustainable economy (ADB, 2016). But as the Malaysia journey towards having more competitive market and business environments, regulations are viewed differently and unfavorably. A number of these regulations have failed to “provide a significant beneficial impact on the problems it was intended to address”.

## **2. RESEARCH PROBLEM**

While the unprecedented growth of the Malaysian economy is attributed with the past economic reforms which paved the way for the inflow of foreign direct investments and remittances, influx of foreign direct investments, and increase in business process outsourcing (BPO) industry players, there is a compelling need to sustain it. And as Malaysia strive to boost global competitiveness, it must not forget that other economies are pursuing the same objective.

As long as the consumers and businesses are saddled by too much regulation and to large extent, unnecessary administrative procedures making them operate in a restrictive and cumbersome regulatory environment, Malaysia will continue to grapple in the bottom half of the competitive ladder and endure the consequences of lagging behind its neighbors.

In the business and economic world, market failure serves as a logical rationale for government action and a standard justification for public intervention (Stigler, 1975). Stiglitz (2009) then observed that over the past 200 years, economic phenomena and historical episodes have shown that markets often fail to perform its fundamental function of allocating capital thereby causing devastating social and economic costs.

It is further argued that market alone could not achieve desired policy outcomes without certain degree of governmental intervention. It is in this situation where government regulation is greatly justified. And in most cases, when societies and economies become more complex, diverse and open, regulations become more essential.

Co-equal with fiscal policy and monetary policy, regulation serve as the third key lever of the fundamental powers of the state (OECD, 2010). It is best viewed as a policy for public interest when it works efficiently. Through this regulatory lever, economic growth and economic development can be positively promoted with a dynamic business environment where innovation and entrepreneurship flourish.

For Ellig and Broughel (2012) and Rodrigo (2005), regulatory policy aims to provide clear, vigorous, constant and consistent “whole-of-government” measure to attain high-quality regulation. Following the same mindset as to why regulation is needed in business, one will look at the assumption that business regulatory policy is one of the major factors that influence an “economy’s attractiveness and competitiveness” (Rodrigo & Andres-Amo, 2008).

In terms of regulatory quality, the Malaysia trails behind many of its Asian neighbors such as Singapore, Japan, Korea, Malaysia and Thailand. In a World Bank (WB) Report in 2014, the Malaysia scored 51.7 out of 100. In another report by WB (2014), the Malaysia registered 62.1 out of 100 in terms of EDB as a result of poor regulatory quality.

There is gap in understanding how quality of regulation and doing of business in Malaysia affect the level of foreign direct investment over the years and in the long-run.

### **3. RESEARCH QUESTIONS**

This study looks into how the quality of regulations on various key business operations affect the development and growth of the business sector in general in the Malaysian context. This study explores to answer how ease of doing business in Malaysia affects the level of foreign direct investment in the areas where regulatory reforms have taken place and where initiatives and efforts are much needed.

Specifically, this study seeks to answer some compelling questions:

- (i) Why despite strong macroeconomic fundamentals which propel remarkable economic growth Malaysia remained to lag behind other developing economies in terms of global competitiveness and unstable level of foreign direct investment;
- (ii) How will the Malaysian Government strike a balance between sustaining a stellar performance of the domestic market while supporting a favorable investment climate given its existing incentive and regulatory regimes;
- (iii) What regulatory reforms are needed to increase quality of regulations and support the ease-of-doing business initiatives in Malaysia; and ultimately,
- (iv) Is the ease of doing business in Malaysia associated with more foreign direct investment in Malaysia?

### **4. RESEARCH OBJECTIVES AND SIGNIFICANCE OF THE STUDY**

In order to systematically classify government regulations, the OECD (1998) offered a three-fold typology of regulation both for advanced and developing economies. First, the economic regulation which focuses on how to improve market efficiency for goods and services through imposition of government restrictions on entries, prices and quantities. Second, the social regulation which intends to protect society's rights and well-being through the protection of the security and safety of the people and the environment. And lastly, the administrative regulation which relates to the over-all administration and management of public and private sectors by the government. As governments design a number of institutional arrangements in order to regulate the market and the economy, there are a number of other non-regulatory approaches that are viewed to be effective such as provisions of economic or market-based instruments and incentives, public ownerships, voluntary codes of standards and practices, among others (Larouche, 2010).

It is for these reasons that this research project aims to investigate the interplay of key regulations on business operations and processes in shaping investment landscape of a country or given economy. Specifically, the research project aims at looking at how economic regulations, social regulations and administrative regulations negatively or positively affect the ease of doing business in Malaysia. This research project has the objective to identify the levels of intervention and degree of regulations imposed to businessmen, investors and entrepreneurs as reflected by key business operations with in turn provides encourages or discourages FDI.

The major importance of the study is its impact to the evolving pool of knowledge and growing academic and empirical discussions that attempt to answer the old-age issue of business regulations and investment creation: how much level of FDI will a country attracts given the level of regulation on business and trade it holds. As the research project explores whether the ease of doing business is an empirically or statistically significant determinant of foreign direct investments, it will also examine driving factors associated with the improvements in the overall World Rankings. As it attempts to contribute to the literature, the author looks on how Malaysia as one of the emerging economies is making waves in improving business regulations and attracting foreign investments. It was presented that ease of doing business is favorable to any economy in the long-run (Djankov, McLiesh and Ramalho, 2006; Gillanders and Whelan, 2010; Djankov, Freund and Pham, 2010).

Building on groundbreaking studies and research work, the author highlights Malaysia's journey in the Doing Business ranking and Foreign Direct Investment ranking as a pilot country-specific research case. The Malaysia case will provide insights to both internal and external stakeholders. For the internal, domestic stakeholders, the policymakers working for and with the government, businessmen, academicians, and scholars like me will learn and appreciate the outputs and results of the study. For external stakeholders like investors and business leaders will be apprised of the driving forces that shape the business climate of Malaysia as an investment hub in Asia.

## **5. REVIEW OF RELATED LITERATURE AND STUDIES**

Since the launch of the Doing Business Ranking by WB, a number of studies and articles were published in the international journals and press that have drawn a seeming connection between Ease of Doing Business (EDS) and Foreign Direct Investment (FDI). These articles and publications often offer suggestions and correlation analysis that higher Doing Business rankings are associated with more foreign investment which in turn create employment, exchange of technologies, and emergence of innovation, among others, that provide beneficial collateral effects on the economy (WB, 2011). Relative to the above discussion, the research project centers on the two major concepts presented: Ease of Doing Business (EDS) and Foreign Direct Investment (FDI). It explores that key concepts and principles of EDS and FDI as well as draws the fundamental factors that shape them.

### **5.1. Business Regulations and Ease of Doing Business:**

The motivation of the study is the latest claim that “the factors driving investment decisions by multinational corporations are changing...with a focus on stable and predictable business environments” which are given substantial weight in the international realm of trade and business (Investing Across Borders, 2010).

The amount of freedom and level of ease in navigating in business environment is one of the FDI determinants that are found significant that later on affect the government policies and trade regulations according to the WB.

### **5.2. Foreign Direct Investment and Malaysia:**

Theoretically minded economists and empirically driven trade experts, have contributed a large literature on foreign directive Investment. FDI as a much studied phenomenon has been considered to be influenced by a set of factors that countries. This set of factors may or may not that attract high average FDI levels.

Being the ASEAN's 3rd largest economy, Malaysia is recognized to have maintained its competitive edge as a high income economy by continuously reforming its business regulations. With that, Malaysia is one of the top performing countries in the region. More than its effort in maintain a business friendly environment, Malaysia has been noted to be one of the most stable countries in Asia (BMI, 2017). The robust economy characterized by positive and aggressive infrastructural expenditure by the government and increased consumption by the middle class further spur growth trajectories.

The business regulation environment in Malaysia is characterized by reliability and simplicity. As a matter of fact, based on the WB Group report, Malaysia belongs top rank of countries in terms of ease of doing business. Malaysia's stable and efficient market institutions and business friendly regulations encourages more investment influx. In terms of investment, Malaysia is considered an FDI net recipient. FDI accounts as the major component of foreign inflows influenced by manufacturing and primary industries.

Indeed, it is worth indicating that Malaysia provides the necessary qualification to be a country of choice for the investigatory research exercise to see the level and depth of the relationship between ease of doing of business and level of foreign direct investment. The research uses the data and information of Malaysia's performance in various WB's Doing Business Reports from 2007-2016 to do a 10-year historical analysis. It shall use the Distance to Frontier (DTF) normalized percentage scores of Malaysia.

### **5.3. Business Regulations and Regulatory Reforms:**

Undeniably, regulations are at the very core of all business transactions. If properly designed and implemented, regulations can efficiently facilitate these transactions and allow businesses and investors to set up and operate effectively. However, if poorly designed, it can make life cycle of business very difficult.

According to the OECD (2010), regulatory policy, alongside fiscal and monetary policy, is one of the three core policy levers at the disposal of governments for managing the economy and society, implementing policy and influencing behavior. Therefore, the regulatory policy reform must be highlighted in the country's medium- and short-term agenda as it is the third policy handle of the government which is necessary to achieve sustainable business sector and inclusive economic growth.

It must be noted that heavier regulation has been associated with a great extent of informality and corruption (Schneider, 2002; Kaufmann, Kraay, and Mastruzzi, 2003). WB in a report identified countries that heavily regulate business the most are those countries which are poor and underdeveloped (Doing Business, 2010). Ironically, the more regulations, the

higher the costs and delays the government is incurring. Moreover, countries with the frailest regulatory and supervisory institutions, with the most complicated and the most exorbitant regulatory business procedures tend to create more regulations (Allen+Clarke, 2010).

Based on research, developing countries are expected to use OECD framework for regulatory reform which adopts the three stages that OECD countries undergo in implementing regulatory reform: (a) deregulation; (b) regulatory quality improvement; and (c) regulatory management.

For OECD (2015), regulatory reforms are necessary to improve efficiency and competitiveness caused by incompetence in governance, inadequacy of structural improvements, insufficiency of institutional arrangements and inadequacy of administrative capacity. While monetary and fiscal policies remain supportive of growth, regulation as one of the policy levers must be facilitative in the process.

As reported in the 2016 Doing Business, countries with efficient regulatory processes register to have better regulatory quality. In the same global report, the Malaysia was recognized as the “most-improved country” against all global competitiveness indicators since 2010. This is mainly attributed to the Malaysian government’s aggressive and bold actions in reforming a number of business regulations and policies that helped facilitate ease of doing business in the country.

Despite improvements in competitiveness rankings, the Philippine government for example, has been reviewing its business processes and embraces important reforms that help sustain the improved performance of the economy (DTI, 2016).

Reducing of domestic business regulations and slashing of needless business processes –rather than increasing– are seen to have played a very crucial role in any long-term economic plans of a country. By supporting businesses, creation of jobs and security of employment are mutually beneficial for the government and society (UK National Archive, 2016).

When regulatory quality and efficiency come hand-in-hand, business environment will not be constrained, obstructed or hindered by troublesome, burdensome, complicated, unreasonable, contradictory, and overlapping administrative procedures and government regulations (Schwarz, 2010). For investment opportunities not to be missed, an imperative step to be taken is to make it easier for businessmen to start up and comply with government procedures and requirements.

By minimizing unnecessary business regulation and costly regulatory barriers in all business transactions, private incentives are encouraged, market discipline is evident, level playing field across sectors are created, and healthy competition is fostered (Schou-Zibell and Madhur, 2010).

In just a span of four years, UK government’s 2010 Red Tape Challenge has saved business over £10 billion and expected to deliver close to £20 billion of savings by 2020. This war on red tape across 30,000 businesses together with the public paved the way to the scrapping of “pointless regulations” and overhauled regulations to ease administrative procedures (UK National Archive, 2016).

With the same objective, the Australian Government institutionalized a bolder stance on red tape war. The Cutting Red Tape Initiative strategically targets to cut \$1 billion in red tape every year. Regulatory repeal activities were done every other year to scrap unnecessary legislation and costly regulation to save over \$700 million of compliance costs.

The Regulatory Guillotine Project allowed South Korea to eliminate 48.8% of the 11,125 business regulations and simplify 21.7% or about 2,415 business regulations. The initiative posted 1,066,200 new jobs and \$36.5 billion extra foreign direct investment over five years.

In Vietnam, the Project 30 aimed at reducing compliance costs for businesses and the public by 30 percent by creating simpler, more efficient and more transparent business procedures. Before the concerted effort to unburden the business sector, it takes 94 days and 12 administrative procedures to set up a new business in Vietnam.

#### **5.4. Link Between FDI and Doing Business:**

After the Doing Business Report of WB was published, many policy-makers, investors and academicians have associated the performance of economies in the Doing Business Index (DBI) to the inflows of foreign direct investments (FDI).

According to the WB, there were nearly 2,000 articles that were published internationally that have drawn a seeming connection between FDI and DBI. It was speculated that higher FDI is the result of high DBI score. Others have seen that as the country better its ranking in the Doing Business, investment climate has become favorable to investors as evidenced by eased business regulations and laws, reduced of red tape, and increased business efficiency. This further raised the questions: Does overall ease of doing business actually reflect a favorable investment climate and therefore encourage more FDI inflows?

The distance to frontier measure is normalized to range between 0 to 100 represents the best performance (the frontier) of economies. Sample includes 157 economies with positive 2011 FDI inflows per capita of \$1,500 or less. This includes all economies covered by Doing Business 2012 for which data are available, excluding outliers with negative inflows or inflows greater than \$1,500 per capita. Dropping these outliers does not significantly affect the trend line.

### **5.5. Literatures on Ease of Doing Business (EDB):**

A number of seminar works and groundbreaking studies were devoted to seek clarification on the growing concern of eliminating barriers to starting a business across economies. The ease of doing business has been the battlecry among nations that see the importance of a highly competitive markets and embrace trade as mutually beneficial. When there is ease of doing business, entrepreneurs thrive and investors are encouraged. For the WB (2013), a good business climate encourages healthy competition and consequently, boosts entrepreneurship and innovation as well as firm creation and expansion.

A wealth of recent studies and contemporary literature emerged from the long-debated paradigms and principles and widely-discussed hypotheses and theories. This research project presents them as springboard for further discussion.

### **5.6. Business Climate of Malaysia:**

Once a British colony, Malaysia has outpaced its regional neighbors to become one of the growing and highly open economies in Asia. The Commission on Growth and Development 2008 Report cited Malaysia as one of 13 countries to have posted average growth of about seven (7) percent per year for 25 years (The World Bank, 2017).

Malaysia's economy posted the strongest growth in the fourth quarter of 2016 since the quarter ending December of 2015. Driven by rebound in exports and rapid increase in investment as well as robust private consumption, the economy grew from 4.3 percent in the previous three months to 4.5 percent year-on-year in the fourth quarter of 2016. Considering full 2016, the economy advanced 4.2 percent from 5.0 percent in 2015. From 2000 to 2016, annual GDP growth rate averaged 4.73 percent (Trading Economics, 2017).

Private consumption grew by 6.2 percent year-on-year in the fourth quarter of 2016 on the back of continued wage and employment growth. Public consumption, on the other hand, grew 4.2 percent in the last three months of 2016 from 2.2 percent in the third quarter (Trading Economics, 2017).

More than two (2) percent increase in Gross fixed capital formation outpaces the two (2) percent-growth posted in the previous quarter. The sustained capital spending in the services sector including manufacturing sector pushed private investment. In the interim, government investment remained slow-moving following almost four (4) percent drop in the third quarter of 2016 (Trading Economics, 2017).

Exports and imports both experienced growth in the quarter ending December of 2016. Exports recovered to more than one percent from a 1.3 percent decrease in the quarter ending September of 2016. Imports increased to 0.7 percent in the fourth quarter from a 2.3 percent dive in the previous quarter. The number of unemployed rose 1.7 percent from 2016 to 514,800. Meanwhile, those employed also increased in number to 14,401,800 or a surge of 1.4 percent. The labor force increased by 1.5 percent to 14,916,700. Further, the jobless rate soared by 3.4 percent from 3.3 percent in the previous period. (Trading Economics, 2017).

ASEAN is the cornerstone of Malaysian foreign policy, underlining the geo-political significance and economic relevance of association to the country. Under Malaysia's chairmanship of ASEAN, several declarations were signed by the ASEAN leaders – the 2015 Kuala Lumpur Declaration on the Establishment of the ASEAN Community and the Kuala Lumpur Declaration on ASEAN 2025: Forging Ahead Together during the 27th ASEAN Summit in Kuala Lumpur on 22 November 2015. The two declarations were results of ASEAN's collective resolve to further integrate the three community pillars, namely: ASEAN Political-Security Community (APSC), the ASEAN Economic Community (AEC) and the ASEAN Socio-Cultural Community (ASCC).

Malaysia is a highly developed country in the region. In terms of investment, Malaysia is seen as a profit center in Asia with its favorable investment climate. Policies of the government are investment friendly and supports liberalization. The investment incentives, tax holidays and credits, and intellectual property rights protection are just among the facilitating factors (ASEAN Advantage, n.d.)

### **5.7. Malaysia's Performance in World Rankings:**

Malaysia is considered to be one of the few economies that implemented reforms as part of efforts dedicated for local entrepreneurs by merely improving its business climate, according to the WB Group's latest Doing Business report. In the Doing Business 2017: Equal Opportunity for All report, Malaysia was recognized as an economy where market and public efficiency and quality of business regulations are evident. Continuous reform efforts by the government over the past decade led to the implementation of a reinforced credit recording system by providing consumer credit scores and a web-accessible system for placing and transacting goods and services tax.

With the reform in credit reporting, Malaysia has attained a perfect score on the depth of credit information index of the Doing Business indicator of Getting Credit. Meanwhile, the implementation of an online tax filing and payment system has made it easier to pay taxes (The World Bank, 2016).

According to the Doing Business 2017 report, Malaysia ranked 23rd in the Doing Business global ranking stakes and remained a top performer in several Doing Business areas. In Dealing with Construction Permits, the country is among the top 16 performers globally. Malaysia has managed to optimize completion of requirements for obtaining a construction permit to 79 days compared to the global average of 156 days.

As the third best economy in terms of protecting minor investors, Malaysia has benefited in terms of FDI. In terms of Getting Electricity, it would take an investor 31 days to get connected to the electrical grid compare to the global average of 76 days, which makes Malaysia to belong to the top 10 in OECD high-income regions in this Getting Electricity scoresheet. But despite these, Malaysia as compared to Indonesia, Philippines and its ASEAN neighbour still lag behind in terms of overall global competitiveness. The incentive and influence of a regulatory policy are attributed to the proportionality, efficiency, transparency, effectiveness, consistency, flexibility and predictability of the regulatory processes (Doing Business Report, 2016; Allen+Clarke, 2010; and, Rodrigo; 2005). According to Kaushik Basu, Chief Economist of the WB, "economies that have efficient regulatory processes are measured by Doing Business indices have high regulatory quality".

In a report by World Economic Forum (2016), economic development is redefined as a "new normal" of lower productivity growth, higher unemployment rate, subdued economic growth, and reduced investment. Rather than being in the new normal, economies are now expected to take the necessary strategies to step up and reaccelerate growth trajectories. Obviously, advanced economies are gaining more grounds on emerging markets as evidenced by geographical patterns of growth.

Economies that rank favorably on Doing Business indices inclined to perform well in other international surveys and studies, such as Global and World Competitiveness Index, Corruption Perceptions Index, and Economic Freedom Index, among others (World Bank, 2016).

Various global and international organizations, institutions and societies seek to assess drivers of productivity and competitiveness performance of selected economies. The Economic Freedom Index, for example, takes economic freedom as "a critical component of life that transcends the market, opening the gates of better well-being to ever more people worldwide". On one hand, Corruption Perceptions Index measures the perceived levels of corruption in the public sector around the world and how it affects more than six billion individuals in countries where corruption is a serious problem affecting private and business sectors.

The present and future growth and prosperity levels of a given economy as determined by key factors and interrelations are captured in the Global Competitiveness Report. It builds on a common understanding on how public and private stakeholders address challenges and embrace opportunities through economic regulations and policies.

On a given niche, Travel & Tourism Competitiveness Index examines how policies and regulations enable the development of the travel and tourism industries which in turn contribute to the over-all competitiveness of a given economy. The Enabling Trade index, on the other hand, looks at how nations maximize the potentials and benefits of trade. It examines how governments partner with businesses in facilitating exchange of goods and services to make everyone better-off. Complementarily, the efficiency of international and cross-border supply chains as a result of trade policies and regulations is examined through the Logistics Performance Index.

As innovation becomes inevitable, the Global Innovation Index (GII) captures the multi-dimensional facets of innovation that shape markets to be globally competitive.

In partnership with INSEAD and Cornell University, the World Economic Forum publishes Global Information Technology Report series that measures the drivers of the ICT revolution and how governments leverage on ICTs for market development. Complementary to this is the e-Government Index which looks into government effectiveness in the provision of economic and social services its people in five major sectors, namely education, employment, health, finance and social well-being (UNDESA, 2005).

Alongside with well-being, national and local security issues of selected economies are measured up against economic and market stability through Fragile States Index. The magnitude of disparities among genders and level of gender equality in education, employment, enforcement and economics are quantified in the Global Gender Gap Report.

## **6. RESEARCH HYPOTHESIS MODEL**

Generally, it can be assumed that despite strong macroeconomic fundamentals which propel remarkable economic growth Malaysia remained to lag behind other developing economies in terms of global competitiveness and unstable level of foreign direct investment.

Striking a balance between sustaining a stellar performance of the domestic market while supporting a favorable investment climate given its existing incentive and regulatory regimes has been a challenge to economies. The question what regulatory reforms are needed to increase quality of regulations and support the ease-of-doing business initiatives may not be readily

Relative to the discussion in the introduction and review of literature, doing business (DB) is associated with foreign direct investment (FDI). For this research, factors (taken independent and dependent variables) surrounding the DB and FDI will be presented and analyzed.

The importance of Doing Business Index indicators as determinant of FDI net inflows has glimmered attention in determining their relationships. The present study intended to explore the relationships between Doing Business indexes and FDI inflow. In this study, the main question to be answered is whether changes in Doing Business Indexes, which are indicating the quality of institutions and regulatory reforms leads to attract FDI inflows. Doing Business is an international report that describes the business environment in various countries, through quantitative and qualitative indicators. These indicators are representing the functioning of countries institutions and strengths. In the current study the econometrics analysis, random effect method has been used to identify the empirical relations and significant areas for attracting FDI net inflows.

In general theory, as the business climate of a given country is rated better, the more that country would likely to attract greater amount of FDI inflow. The regression estimation shows all indexes have inverse relationships, except registering properties, getting credits and trade across borders. Additionally, all the areas are most probably to influence FDI inflows excluding paying taxes and resolving insolvency or closing business in the region.

There were attempts to establish relationships between the Doing Business Index (DBI) variables and the Foreign Direct Investment Inflows in USD millions based on a number of reasons. The prominent reason is the theoretical idea that variables of DBI and net inflows FDI which are greatly based on two premises:

- (i) Multinational enterprises (MNEs) have the propensity to invest in abroad as incentivized by a number of trade liberalization efforts or not to invest; and
- (ii) Investment and business factors such as degree and costs of regulation, nature of institutions, and level of competition, among others, in host countries can either encourage or discourage MNEs to have investment decisions.

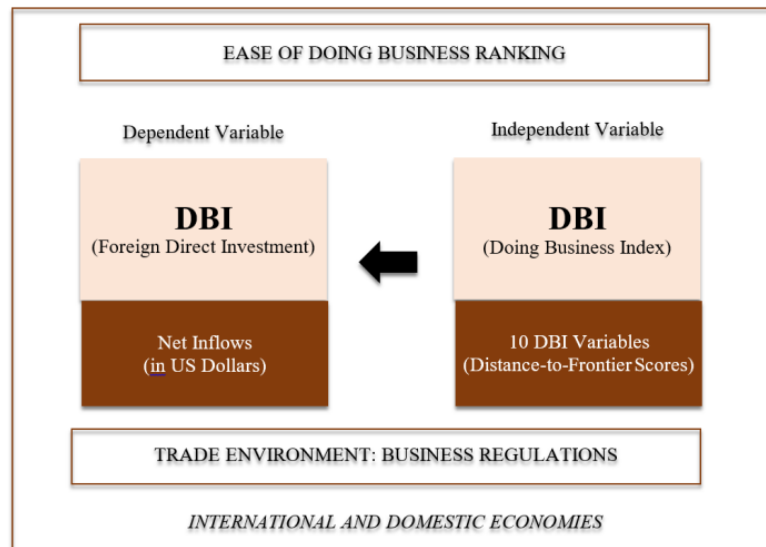
These two premises are widely considered when prominent theories of John Dunning and Douglass C. North were conceived and later on known as the “eclectic paradigm”. Accordingly, the “eclectic paradigm theory” or “OLI paradigm theory”, direct investments are depends upon OLI determinants: ownership, location and internationalization environments.

For this research project, these OLI determinants are further examined. In the case of Buckley, et al (2007) and Azam, et al (2010), it was expressed that there are no commonly and theoretically accepted FDI determinants. In an attempt to provide acceptable determinants, institutional qualities, macroeconomic fundamentals, and business regulations have been explored as important variables in FDI determination.



For the WB, there are ten (10) variables that are captured in the Doing Business Index (DBI). Each variable are best measured using the Distance-to-Frontier (DTF) methodology.

**CONCEPTUAL FRAMEWORK:**



For the purpose of studying empirical analysis to identify DBI relationships with FDI inflows in this chosen countries (region), due to the data availability we only determine nine doing business indicators with FDI inflows, the study will consider a model as follows:

**EQUATION:**

$$NFDI_t = (SB_t, P_t, RP_t, GC_t, PI_t, PT_t, TB_t, EC_t, CB_t)$$

Where:

*NFDI<sub>t</sub>* = Foreign Direct Investment Net Inflows

*SDTF* = Distance to Frontier Score

*SB<sub>t</sub>* = Starting a Business DTF Score for the *t<sup>th</sup>* year

*DP<sub>t</sub>* = Dealing With Construction permits DTF Score for the *t<sup>th</sup>* year

*RP<sub>t</sub>* = Registering Property DTF Score for the *t<sup>th</sup>* year

*GC<sub>t</sub>* = Getting Credits DTF Score for the *t<sup>th</sup>* year

*PI<sub>t</sub>* = Protecting Investors DTF Score for the *t<sup>th</sup>* year

*PT<sub>t</sub>* = Paying Taxes DTF Score for the *t<sup>th</sup>* year

*TB<sub>t</sub>* = Trade Across Borders DTF Score for the *t<sup>th</sup>* year

*EC<sub>t</sub>* = Enforcing Contracts DTF Score for the *t<sup>th</sup>* year

*CB<sub>t</sub>* = Closing Business DTF Score for the *t<sup>th</sup>* year

**Data Gathering Method and Technique of Data Analysis:**

This research paper looks at the impact, effect and/or relationship between ease of doing a country maintains and amount of FDI that country attracts. To do this, it will use the WB’s Doing of Business reports to get the various DTF scores of Malaysia over the years, starting from 2007 to 2016. Each variable is consist of sub-variables that are specifically calculated to arrive to the overall DTF score.

Net FDI inflows in US dollars will also be taken from the databases WB and World Trade Organizations. To ensure that data sets are complete, cross data analysis will also be conducted using the database of Bank of Negara, Malaysia's central bank.

### Model Specification:

Using the earlier Hypothesis Model Equation,

$$NFDI_t = f(SB_t, DP_t, RP_t, GC_t, PI_t, PT_t, TB_t, EC_t, CB_t)$$

To reduce econometric problems and omitted variables, estimation methodology for the identified panel data series is used.

The economic equation, transforming equation 1 to equation 2) the can be specified as follows:

$$y_t = \alpha_1 + \sum \beta_{j=2} X_{jt} + \varepsilon_{it}$$

Where:

= Dependent Variable (FDI net inflows of Malaysia)

$\alpha$  = Intercept (constant)

$\beta$  = Slope of Coefficient

$j$  = Captures explanatory or independent variables

$\varepsilon$  = Error term

This research examined the relationship between DBI (distance-to-frontier) and FDI (net inflows) through simple linear regression. Pooled ordinary least squared (OLS), fixed effect and random effect models estimations will be explored. The specific DTF scores over time, the error term, the independent variables, and the relationship inherent between them, will determine the appropriate estimation method. Using Eviews 8.0, the estimations and analysis will be carried out.

### Regression Modelling:

Following Asterieou and Hall (2007), in order not to have errors in econometric specifications, order of integration for each variable will be estimated before any regression runs. In general terms, the research project will undergo the following major regression modelling steps:

- (i) Deterministic component is being hypothesized;
- (ii) Unknown parameters are estimated;
- (iii) Probability distribution of random error term are specified;
- (iv) Standard deviation of error is estimated;
- (v) Fitted model is evaluated; and
- (vi) Model for prediction and estimation is used.

### Statistical Research Findings:

The reliability and adequacy of the model were tested using a battery of tests. The following tests are consistent with and strict adherence to the fundamental econometric methods and processes as suggested in the books of Gujarati (2003) and Danao (2002). Calculation of parameters, tests of significance, and other diagnostic tests on the adequacy of the model was facilitated thru the use of Econometric Views (EViews) Version 7.0.

- (i) The regression results revealed that all ten (10) explanatory variables were statistically significant in affecting FDI as their respective computed t-values exceeded the critical t-value at 5 percent level of significance;
- (ii) Hence, the null hypothesis that Doing Business Indicators (DBI) have no significant effects individually was rejected and the alternative hypothesis was accepted;

(iii) The coefficient of determination ( $R^2$ ) yielded a coefficient of 0.999840 which implies that approximately 99 percent of the variations in FDI were explained by the explanatory variables. The remaining 1 percent could be attributed to other factors that were not included in the model and the error term;

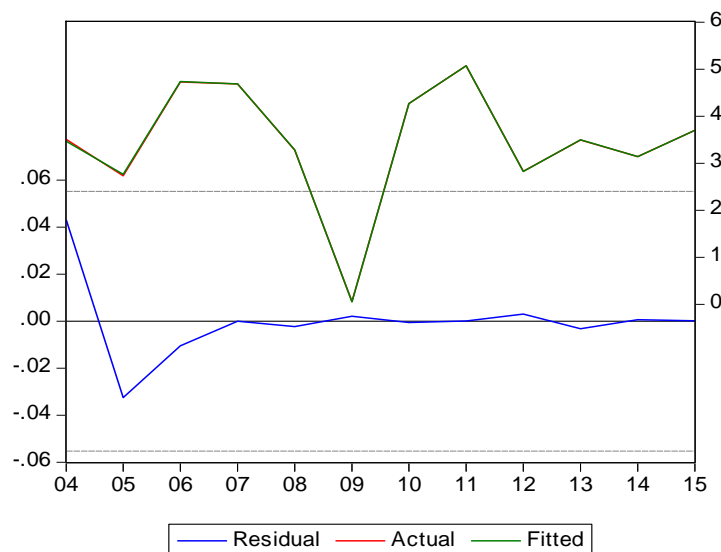
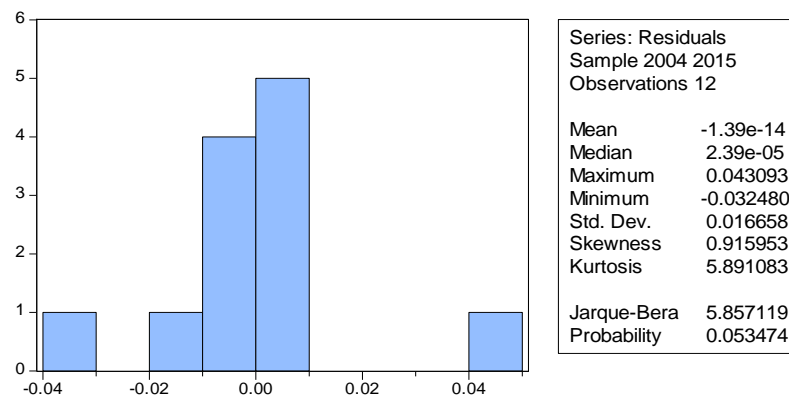
(iv) Also, the F-statistic exceeded the critical value at 5 percent level of significance, which means that the regression model was statistically significant and that the explanatory variables, when taken collectively, significantly affect FDI;

(v) The Durbin-Watson statistic was used to test the presence of autocorrelation. The DW statistic of 2.096212 was greater than dU of 1.65 and less than 4-dU or 2.35. Alternatively, this could be presented as  $1.65 < 2.096212 < 2.35$  which satisfies  $dU < d < 4-dU$ . This indicates that there is no positive or negative autocorrelation;

(vi) To present the correlation between variables or to show the degree of linear relationships between the variables included in the model, the displayed correlation matrix which conveys the relationship of all variables in a non-directional aspect;

(vii) The Jarque-Bera Normality Test was employed to ensure the validity of the parameter estimates and determine the normality of regression residuals. The computed statistic of 5.857119 with a probability value of 0.053474 which was higher than the 5 percent significance level affirmed the normality distribution of the regression residuals; and

(viii) In order to detect the problem of misspecification of the model, the Ramsey Regression Specification Error Test (RESET) was employed and the results showed that F-statistic of 7.664503 with probability value of 0.2207 indicated that the model was not misspecified at one (1) percent level of significance.



Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.482987	Prob. F(10,1)	0.8193
Obs*R-squared	9.941636	Prob. Chi-Square(10)	0.4456
Scaled explained SS	0.168838	Prob. Chi-Square(10)	1.0000

Test Equation:

Dependent Variable: RESID^2

Method: Least Squares

Date: 06/29/17 Time: 22:36

Sample: 2004 2015

Included observations: 12

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.532584	0.484665	-1.098869	0.4700
STARTBUS	0.002407	0.002300	1.046238	0.4856
CONST	-0.001453	0.001344	-1.081020	0.4752
ELEC	0.004177	0.003740	1.116672	0.4649
REGPROP	-0.000802	0.000749	-1.070335	0.4784
GETCREDIT	0.001392	0.001268	1.098102	0.4703
INVST	-0.002200	0.002212	-0.994592	0.5017
TAXES	-0.002442	0.002208	-1.105836	0.4680
TRADE	0.002077	0.002035	1.020747	0.4935
ENFCON	0.002427	0.002212	1.097184	0.4705
INSOLVENCY	-2.51E-05	4.22E-05	-0.593858	0.6588

R-squared	0.828470	Mean dependent var	0.000254
Adjusted R-squared	-0.886833	S.D. dependent var	0.000588
S.E. of regression	0.000807	Akaike info criterion	-12.05785
Sum squared resid	6.51E-07	Schwarz criterion	-11.61335
Log likelihood	83.34710	Hannan-Quinn criter.	-12.22242
F-statistic	0.482987	Durbin-Watson stat	2.096212
Prob(F-statistic)	0.819267		

Dependent Variable: FDIPERCENT

Method: Least Squares

Date: 06/29/17 Time: 18:12

Sample: 2004 2015

Included observations: 12

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1146.503	33.17721	34.55693	0.0184
STARTBUS	-5.569653	0.157457	-35.37250	0.0180
CONST	3.072677	0.091996	33.40015	0.0191
ELEC	-8.679076	0.256035	-33.89795	0.0188
REGPROP	1.797767	0.051294	35.04850	0.0182
GETCREDIT	-2.182792	0.086784	-25.15200	0.0253
INVST	4.504467	0.151420	29.74810	0.0214
TAXES	4.871511	0.151168	32.22576	0.0197
TRADE	-4.874356	0.139303	-34.99112	0.0182
ENFCON	-5.037817	0.151438	-33.26643	0.0191
INSOLVENCY	0.086407	0.002889	29.90400	0.0213

R-squared	0.999840	Mean dependent var	3.458459
Adjusted R-squared	0.998240	S.D. dependent var	1.316786
S.E. of regression	0.055248	Akaike info criterion	-3.605529
Sum squared resid	0.003052	Schwarz criterion	-3.161031
Log likelihood	32.63317	Hannan-Quinn criter.	-3.770098
F-statistic	624.7623	Durbin-Watson stat	2.096212
Prob(F-statistic)	0.031125		

Ramsey RESET Test:

F-statistic	7.664503	Prob. F(1,1)	0.2207
Log likelihood ratio	25.91081	Prob. Chi-Square(1)	0.0000

Test Equation:

Dependent Variable: FDIPERCENT

Method: Least Squares

Date: 06/29/17 Time: 18:16

Sample: 2004 2015

Included observations: 12

Variable	Coefficient	Std. Error	t-Statistic	Prob.
STARTBUS	-1.836791	0.712641	-2.577445	0.2356
CONST	-1.168139	0.428860	-2.723823	0.2240
ELEC	2.402881	0.867339	2.770406	0.2205
REGPROP	0.453025	0.179965	2.517304	0.2407
GETCREDIT	6.133044	1.947674	3.148907	0.1958
INVST	-5.521098	1.950069	-2.831233	0.2161
TAXES	-2.165342	0.703179	-3.079358	0.1999
TRADE	-0.667816	0.325273	-2.053092	0.2885
ENFCON	1.475302	0.508426	2.901705	0.2113
INSOLVENCY	0.326691	0.110394	2.959308	0.2075
FITTED^2	-1.318188	0.476141	-2.768484	0.2207

R-squared	0.977925	Mean dependent var	3.458459
Adjusted R-squared	0.757172	S.D. dependent var	1.316786
S.E. of regression	0.648880	Akaike info criterion	1.321290
Sum squared resid	0.421046	Schwarz criterion	1.765788
Log likelihood	3.072261	Hannan-Quinn criter.	1.156721
Durbin-Watson stat	2.629193		

## 7. CONCLUSIONS AND RECOMMENDATIONS

It undeniable that there is distinct and obvious correlation between the ease of doing business and the FDI inflows of a given economy. In fact many studies by WB and independent research bodies have substantially accounted that the levels of ease of doing business shape, determine and/or affect the levels of FDI inflows.

For this study, the contributions are seen to be manifesting on how well each of the 10 Doing of Business methodology indicators (DBI) behave from 2004 to 2015 and how it affected the level of FDI. Statistically speaking, FDI and DBI are positively correlated. As the DBI scores (represented by DTF) increases, the FDI level increases. This study then would further contribute to the growing studies and literature on the effects of DBI to FDI. As the study presents evidence that a positive and significant correlation between DBI and FDI flows, it confirms and reaffirms the WB. For businessmen, the

study allows them to see the role of ease of doing business to the level of foreign direct investment of a given economy. Additionally, the decision to invest and decision to where to locate business depends on how well the business environment is prepared in terms of regulations and transactions that needs to be followed and embraced. For policy makers, the study reiterates the vital role of having a strict or loose regulation in business and investment. The students provide analysis on the advantages and disadvantages of implementing business friendly regulatory and supervisory frameworks. Further, the study allows the policy makers to see the apparent threat posed by too much regulation and the gains of relaxing the regulations as well the overall benefits of allowing foreign investors to bring in their investments for domestic economy to grow. For academe and scholars, the study proves that there positive relationship between FDI and DBI and that components of DBI can be used in assessing the levels of FDI. Scholars can also benefit from the analysis and this could be used as a case study for those who are checking the impacts of DBI in other economies in Asia and other parts of the world. The students will also appreciate that linear regression, econometric methods and statistical tools have practical uses in answering social and economic phenomena and inquiries.

While the study presented a thorough correlation analysis, the study do not imply certain aspect of causation. While it supports the claim about the correlation between DBI and FDI, it only provides the definitive conclusion of the relationship. Thus, it only reflects overall climate of the investment landscape of Malaysia. Since the WB has only started the Doing of Business methodology in 2004, the data spread starts from 2004 to 2015 only. Obviously the limitation of the study is period covered Aside from this, the Doing of Business as a methodology only captures the investment climate of the small and medium-size domestic firms who were subjected to the World Business ranking. Since this study used statistical and econometric tools, the researcher made used of the complete set of data set provided by WB Report in the various reporting periods. The data, however, were assumed to be correct and the researcher did not counter check the details and computation of each indicator. The research study relies on the integrity of the data presented.

For future study, the researcher recommends that aside from foreign direct investment, other economic and investment factors could also be explored to see how Malaysia is able to take advantage of the ease of doing business. Foreign currency, inflation and overall economy performance could also be used is dependent variables. To see how Malaysia perform in the international trade and economy, the study can be extended to include other countries to see whether other countries level of FDI as correlated with the DBI-DTF scores are better or at par with Malaysia.

Malaysia, despite strong macroeconomic fundamentals which propel remarkable economic growth, has a lot to accomplish in terms of global competitiveness and level of foreign direct investment. As Malaysian Government strike a balance between sustaining a stellar performance of the domestic market while supporting a favorable investment climate given its existing incentive and regulatory regimes, more regulatory reforms are still needed to increase quality of regulations and support the ease-of-doing business initiatives in Malaysia. Undeniably, as reflected in the results of the study, initiatives over the period 2004-2015 in ensuring ease in doing business in Malaysia has helped in an increasing foreign direct investment.

Although the study did not imply causation, it is enough to establish that that higher Doing Business rankings are associated with more foreign investment which in turn generate business, create employment, exchange of technologies, and emergence of innovation, among other, that provide beneficial collateral effects on the economy.

Without doubt, World Bank in its publication "Investing Across Borders", is right to say that there are factors that drive investment decisions by foreign investors that have been changing through times as they focus on stable and predictable business environment. These factors are best explained by the Doing Business Indicators used as explanatory variables in this study, from "starting a business" to "managing solvency". The contribution of this study to the evolving pool of knowledge and growing academic and empirical discussions that attempt to answer the old-age issue of business regulations and investment creation: how much level of FDI will a country attracts given the level of regulation on business and trade it holds?

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