UNIVERSITI TEKNOLOGI MARA

# THE FACTORS AFFECTING FOREIGN DIRECT INVESTMENT FOR SERVICES INDUSTRY IN MALAYSIA

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# ABSTRACT

More private investment is needed in the services sector in Malaysia's effort to become a high-income economy. Research on the factors that influence foreign direct investment (FDI), particularly in the services industry, is scarce at the national and even at the industry level. The location theory asserts that inflows of FDI into a host country are influenced by the factors such as resources, infrastructure, market conditions, cost, and the business environment. A panel dataset of a few services industries from 1989 to 2019 is used in this study to examine the location theory's validity in Malaysia. The data was analysed using Correlation Analysis, Descriptive Analysis, Normality Test, and Regression Test. inflows of FDI into the services sector have been influenced by market size, inflation rate, communication infrastructure and skilled workers at the industry level. Progress in liberalizing FDI appears to have a minimal effect on the dynamic changes of other variables.

Keywords: Foreign Direct Investment (FDI), market conditions, human capital, inflation rate

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# INTRODUCTION

## 1.1 INTRODUCTION

An openness to foreign direct investment (FDI) and market liberalization have long been recognized as essential factors in the growth of manufacturing in emerging countries. As one of the first Southeast Asian countries to open its economy to FDI in the early 1970s, Malaysia was one of the innovators. FDI and export-led manufacturing were reinstated in the mid-1980s (Jomo, 2007). The fast growth of manufacturing in the 1990s has resulted in manufacturing having the greatest share of the economy's workforce. The World Bank's recognition of Malaysia as one of the "East Asian Miracle" economies sparked a period of rapid economic expansion. However, the popularity of this appellation was short- lived after the Asian Financial Crisis (AFC) of 1997 interrupted the country's economic expansion. The dot-com bubble and China's entrance to the World Trade Organization (WTO) in the early 2000s contributed to slower growth in the manufacturing sector following the AFC.

Low-cost manufacturing FDI inflows were also impacted by the rise of China, which put significant competitive pressures on low-cost manufacturing, while Malaysia's manufacturing sector struggled to upgrade as the rapid development in this sector undermined its low labor cost advantages. The Second Industrial Master Plan (1996-2005) acknowledged the constraints of labour-intensive production and intended to modernize industrial development by including the expansion of the service sector. As the industrial sector's growth continued to decline, the government pushed for more services development to promote the services sector as a new engine of growth. To this day, the country's Third Industrial Master Plan (2006– 2020), Economic Transformation Plan, and five-year development plans continue to foster the growth of the services sector. In 2015, Malaysia announced its first Services Sector Blueprint Economic Planning Unit (EPU), detailing the development of the services sector as the next source of growth for the country. Aiming to counteract a decline in FDI inflows in manufacturing by encouraging more, the government has been gradually liberalizing its services sector to attract more of the foreign investment sought for.

For economic growth, the services sector is critical since it is linked to the optimal