

THE GEOPOLITICS OF ASEAN COOPERATION AND FIRM VALUE: EVIDENCE FROM MULTINATIONAL CORPORATION IN MALAYSIA

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Abstract

This study examines the influence of ASEAN cooperation on firm value by using data from multinational firms in Malaysia that actively trade in ASEAN countries from 2009 to 2013. The study analyzes geopolitical influences with regard to the influence of military power, material power and social power of ASEAN cooperation. The study findings showed that geopolitics of ASEAN cooperation are negatively associated with the value of multinational firms. Overall the evidence suggests that corporate strategies should consider the risk of military, material and social power of the ASEAN cooperation in designing market penetration in ASEAN countries.

Keywords: *geopolitical influences, ASEAN Cooperation, Multinational Firm*

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Introduction

International business has long been the domain of multinational corporations (Ramasamy 1999; Eckert, Dittfeld et al. 2010; Gammeltoft, Filatotchev et al. 2012; Yan 2013). Compared to firms from well-established developed countries and newly industrialised countries, Malaysian multinational firms are still small, relatively new in some industries, and young in the international market competitions (Ramasamy 1999). However, according to the UNCTAD 2015 World Investment Report, Malaysia is among the 9 largest outward

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investing economies in developing countries and stood out as the second largest ASEAN investor because of recent and significant increase in the outward investment flows made by its multinational corporations (UNCTAD 2015). Besides that, Malaysia's largest multinational companies have also provided unique investment opportunities for global investors to take advantage of ASEAN's growth and plays a key role in steering ASEAN into an economic community (Ahmad 2013; Yan 2013).

Despite a growing number of Malaysian corporation investing abroad, very little empirical research has looked deeply into the dynamic aspects of the internationalisation and emergence of Malaysian-based firms (Ahmad 2008). Indeed, the lack of research is particularly apparent in examining the risk and performance of Malaysia's MNC (Mustapha 2014). Moving towards the ASEAN Economic Community (EAC) at the end of 2015, many investors have questioned about the risk and performance of Malaysia's MNC (BERNAMA 2015). The main reason is, any political decision among EAC and Asian major powers' are calculated to advance national strategic interests as well as the fortunes of multinational businesses. Many scholars who have studied this have said that, besides economic uncertainty, geopolitical uncertainty is importance mechanism in corporate decision making that corporate strategies could not be ignore (Behrendt and Khanna 2003; Reynaud and Vauday 2009; Teixeira and Dias 2013). The geopolitical event of Brexit for examples, have shown a job cut and lower profit from MNC operating in European countries after the Brexit vote (Frontier Strategy Group 2016). The effect of this event demonstrates that geopolitical uncertainty, wherever and however they may take place, can have on business. Thus, our study presents new evidence on the effect of geopolitical stakes on the firm value of MNCs in the developing counties, with special attention to the hard power and soft power of ASEAN cooperation. The rest of the paper is organized as follows. First, we review the theoretical background and existing empirical literature as a basis for research hypothesis. Second, we elaborate the data source and research method. Third, we discuss the results and finally Conclusions follow.

Geopolitics of ASEAN cooperation and Businesses in Malaysia

Geopolitics is a multidisciplinary approach that studies the geographical, political, historical, strategic and economic of state in terms of boundaries and international structures (Flint 2006). In the classical work of geopolitics, Kjellen defines geopolitics as the 'geographical organism or phenomenon of space' and relates the power of heartland / state territories as a subject of studies. After the post world war II, with the emergence of world-economic system, modern geopolitics pioneered by Taylor (1994) has introduced hegemonic states as the subject of studies (Taylor 1994). Today, when the market competition becomes more complex, most of the geopolitical intellectual discusses the issues that related to the hegemonic power of multilateral institutions (e.g. ASEAN corporation) and its impact on regional economic, finance and businesses (Cohen 2008).

In the process of understanding the hegemonic power of ASEAN, we first relate geopolitical phenomena with world system theory proposed by sociologist Immanuel Wallerstein in the 1970s. According to the world systems theory, the world is divided into three areas: core, semi-periphery and periphery countries (Chirot and Hall 1982). Core states are dominant

capitalist countries that have a strong and independent military power, high technologies of skill and strong capital intensive. United States, Japan and Europe are examples of a core states. Periphery countries, on the other hand, are commonly referred as third-world countries and less developed industry. They have a low-skill, low labor-intensive and dependent on core countries for capital aid. Within ASEAN states, Cambodia is an example of periphery countries.

Next, semi periphery countries fall into the middle of economic spectrum. They play a major role in mediating economic, political, and social activities that link core and peripheral areas. They are generally industrialized countries and allow for the possibility of innovative technology, reforms in social and organizational structure. These changes can lead to a semi periphery countries being promoted to a core nation. Some of ASEAN countries that fall into this category are Singapore, Indonesia and Malaysia (Babones and Alvarez-Rivadulla 2007).

To achieve the highest level in the world system hierarchy, Malaysia affirms their commitment with ASEAN cooperation. In the process of globalization, living as a small state makes Malaysia difficult to compete with giant countries in the global marketplace. Thus, a unity of ASEAN is the best opportunity for Malaysia in getting hegemonic power or in other words the ultimate power in the world system. As a multilateral institution, ASEAN members will adjust their own bargaining positions and invest some of their power resources in the building of ASEAN organization. This organization, in turn, contributes to the smooth functioning of the global market system (Eichengreen 1989). At the same time, provide benefits to foreign companies who invest in ASEAN states.

While involving directly with ASEAN market, we suggest that corporate strategies should calculate the capabilities of ASEAN smart powers and how it's affect firm value. Smart power is a geopolitical mechanism that combined the hard and soft power of states/institution (Wilson 2008). Hard power is refer to traditional power strategies that focus on military intervention, coercive diplomacy, and economic sanctions to enforce national interests. Meanwhile soft power describes the intangible ways of obtaining hegemonic powers (Nye 1990). Nye defines it as 'the capability to persuade, attract, and co-opt people to do what they do not want to do', and these strategies are usually associated with natural resources, cultural attraction, ideology, and bilateral relations. Understanding the smart power of ASEAN is considered as an important geopolitical mechanism to corporate strategies because it can provide a basic understanding on how ASEAN undergo with their geopolitical uncertainty. Furthermore, the growth of public listed firm in Malaysia is the main engine of Malaysia's economic growth (Ramasamy 1999). Any changes in political decision between ASEAN members may affect the value of a firm especially firm that have their segmentation in ASEAN countries.

Theory and Hypothesis Development

This study uses hegemonic stability theory initiated by Charles P. Kindleberger as a basic theory for hypothesis development. Hegemonic stability theory explains the origin conflicts and ways to minimize the conflicts that can occur between states in grabbing hegemonic power, or a single dominant power in the world economic system (Snidal 1985; Webb and

Krasner 1989). The highest priority for the hegemonic state is the maximization of its economic gain. To achieve these objectives, most states cultivated ties with its major competitors and develop multilateral institutions. Through this institutional cooperation, the states have the opportunity to dominance both, economic and military power (Schubert 2003). It's not only the nation, but businesses will get benefits from this alliance. For example, they can transaction costs, reduce policy uncertainty, and builds consistent expectations for economic interactions. Hegemonic stability, however, is not easy to sustain because of the conflict of autonomy interest between institutional members, which will negatively impact business performance (Salehi, Ranjbari et al. 2014). Thus, base on this underlying theory, we develop three hypotheses as follows:

- H1 The geopolitical of ASEAN cooperation influence firm value of MNC in Malaysia.
- H1a The geopolitical of ASEAN cooperation positively influences firm value of MNC in Malaysia.
- H1b The geopolitical of ASEAN cooperation negatively influences firm value of MNC in Malaysia.

It is expected that this study can provide an overview to corporate strategies on how geopolitical risk/opportunity in ASEAN may impact the firm value of MNC in Malaysia.

Data Collection and Methodology

This study undertook a quantitative research approach using content analysis as a mode of data collection. We gathered financial information from the annual report of publicly listed firms in Bursa Malaysia that are active from 2009 to 2013. We also use the data from the World Development Indicators database and image data from multimedia photo gallery, access from Prime Minister's Office links within 2009 – 2013; to measure the smart power of ASEAN cooperation.

Data sampling

We began the sampling procedure by identifying companies that fit the definition of MNC. Based on previous literature, we defined MNCs as follows:

Table 1: MNC Classification

No	Classification procedure	References from previous literature
1	International segmentation: Companies that operate in at least two countries	Martinez and Ricks (1989), Ramasamy (1999).
2	Control of equity: Holding company holds at least 20% equity in its international subsidiaries	Ramasamy (1999);Mustapha (2014).
3	Control of assets/sales activities: At least 10 percent of holding assets/sales come from its international subsidiaries	Michel and Shaked (1986), Hashim and Mohd Saleh (2007), Ramasamy (1999)

Base on table 1, we excluded companies from the financial, insurance, banking, trust, securities and closed-end funds sectors because these companies are subject to different regulations unlike those in other industries. MNCs from the IPC, mining, and hotel industries were also excluded because these companies are not fairly distributed across industries. The procedure generated 176 companies with total pooled observations of 880 company years over a period of 5 years with complete data.

Measures of Dependence Variables

Following the valuation methodology developed by Fauver et al. (2004), we estimate the excess value as a proxy for firm value of each MNC. The excess value is calculated by using Equation (1)

$$\text{Excess Value} = \frac{\ln(\text{the actual capital to sales ratio})}{\ln(\text{the imputed capital to sales ratio})} \quad (1)$$

Even though the actual value of a firm can be measured by using capital-earnings ratio, capital-assets ratio and/or capital-sales ratio (Berger and Ofek 1995; Denis, Denis et al. 2002; Fauver, Houston et al. 2004), but we solely employ capital-sales ratio because of lack of information on international segmentation earnings and assets. Thus, capital-sales ratio is calculated by using Equation (2)

$$\text{The actual capital to sale} = \frac{MVE + PS + DEBT}{\text{holdings total sales}} \quad (2)$$

Where;

MVE is the market value of equity computed as price per share multiplied by the number of outstanding common shares; PS is the liquidating value of preferred stock; DEBT is the value of short-term liabilities net of short-term assets plus the book value of long-term debt; and TA is the book value of total assets.

Next, imputed value is calculated as the median capital-sales ratio. By considering the geopolitical effect on firm value, we propose a geopolitical benchmark. This approach is very similar to the technique proposed by Fauver et al. (2004) but with some modifications. Imputed value is calculated as the median capital-sales ratio. The median value is obtained from the weighted average of all imputed values computed for each of the firm's segments. The imputed values of the firms that operate in the same industry(s) are computed. To calculate the imputed value, we group the firm's international segmentation based on ASEAN countries to represent the geopolitical influence on the firm's in ASEAN countries. Hence, for example, if an oil and gas MNC has 30% of its sales in the Singapore, 10% in Indonesia and 20% in Vietnam, then the imputed value using the geopolitical benchmark would be:

$$\text{Imputed value} = (0.6) \text{ (the value of the median pure-play ASEAN oil \& gas MNCs)}$$

Given that, we are forced to assume that the MNC has the same product mix throughout its various international segments (Fauver, Houston et al. 2004).

Measures of Independent Variables – The Smart Power ASEAN Cooperation

To measure the smart power of ASEAN cooperation, we based on most acceptable scholar such as Salehi et al. (2014), Cohen (2003) and Taylor (1994). We use military power as a proxy for hard power strategies and both, material resources and social power as proxies for soft power strategies.

Military power

Military power is a traditional geopolitical power. According to Venier (2004), any state that has a dominance maritime power would be able to dominance the whole empire. Followed by the past researchers (Venier 2004; Virmani 2006; Reynaud and Vauday 2009; Armijo, Mühlich et al. 2014), this study will use a number of military personnel and military expenditures as a proxy to military power owned by ASEAN (mpASEAN). Data will be obtained from the WDI for 2009-2013 and based on the weighted average basis by countries listed under the members of ASEAN.

Material resources

We follow Nye’s (1990) soft power approach in explaining the power of material resources of ASEAN. We define five sub dimensions of material resources as shown in Table 2. This table provides the detail proxies of material resources of ASEAN cooperation that based on geopolitical capabilities index. These proxies are the most acceptable mechanism among geopolitical scholars such as Armijo et al. (2014), Teixeira and Dias (2013), and Reynaud & Vauday (2009).

Table 2: Material Resources of ASEAN Cooperation

Geopolitical factor	Indicator	Previous research
Material power of ASEAN countries (mrASEAN)	1. [OIL] - ln[Oil: total proved reserves (thousand million barrels)]	Reynaud and Vauday (2009); Teixeira & Dias (2013); Armijo et al. (2014)
	2. [GAS] - ln[Natural gas: total proved reserves (trillion cubic metres)]	Sources: <i>Oil & Gas Journal</i> and BP, Nuclear Energetic Agency and The World Bank: World Development Indicator Database
	3. [NCLR] - ln[Nuclear energy: operable reactors (Mwe)]	
	4. [P] - ln[Population density (people per sq. km of land area)]	
	5. [S&T] - Science and technology capability: research and development expenditure (% of GDP)	

Thus, material resources are calculated as follows:

$$MR_{it} = OIL_{it} + GAS_{it} + NCLR_{it} + P_{it} + S\&T_{it} \quad (3)$$

Social Power

Social power is the power of state that related to social groups, social relations, social safety, ideology and cultural (Flint 2006). In this study, we limit our study only on social relation among political elites as a proxy for social power. This is because we would like to measure the uniqueness of business culture in Malaysia which is relationship-based between politician and businesses. Political elite is measure as bilateral activities between Malaysian Prime Minister, Dato ' Sri Najib Bin Tun Haji Abdul Razak and heads of State in all ASEAN countries.

We obtained the data from visiting report of Prime Minister of Malaysia, which can be access via multimedia photo gallery, Prime Minister's Office, Putrajaya Malaysia. We characterized the Prime Minister bilateral activities in four difference agenda:

- i. A personal visit of the heads of state of all ASEAN countries to Malaysia
- ii. A personal visit of Malaysian Prime Minister to ASEAN countries.
- iii. Conferences or seminars in Malaysia that attended by the head of state in all ASEAN members
- iv. Conferences or seminars conducting in other ASEAN countries, that was attended by Prime Minister of Malaysia

The value one (1) is calculated if the above criteria are match and zero (0) for otherwise.

To analyze the influence of geopolitical power on MNCs, we multiply institutional geopolitical scores with firm's segmentation sales. We assume that holding firms that have their segmentation on ASEAN countries will obtain a stronger geopolitical effect compared with firms that have no segmentation on ASEAN countries. Thus, the formula of geopolitical power on MNCs is as follows:

$$gp_{it} = \sum ss_{it} * gf_{it} \quad (4)$$

where gp_{it} is the effect of geopolitical power on MNCs i in year t , gf_{it} is the geopolitical factor score, and ss_{it} is the percentage of segment sales in ASEAN countries.

Control variables

To control firm characteristics, we follow several variables that have been widely used by earlier studies (Berger and Ofek 1995; Brick and Chidambaran 2010). The control variables are as follows:

$$f(\text{CONTROL}) = \beta_0 + \beta_1 TOA + \beta_2 ROA + \beta_3 LOA + \varepsilon \quad (5)$$

Where;

Firm size (TOA) = logarithm of total assets

Profitability (ROA) = EBIT/total assets
 Leverage (LOA) = total debt/total assets

Data Analysis

Descriptive and regression analyses were performed on the data gathered. The equation for the regression analysis is as follows:

$$\text{Excess Value}_{it} = \text{mpASEAN}_{it} + \text{mrASEAN}_{it} + \text{spASEAN}_{it} + f(\text{CONTROL}) + \varepsilon \quad (6)$$

Where;

Excess Value_{it} = firm value
 mpASEAN_{it} = military power
 mrASEAN_{it} = Material power
 spASEAN_{it} = social power
 f(CONTROL) = control variables
 ε = error term

Results and Discussion

Descriptive analysis

The descriptive statistics of the smart power of ASEAN cooperation and firm value are shown in Table 3. Based on the results, excess value has a positive mean score of 0.671. Meanwhile, the mean score of military power, material resources and social power are positively at 1.15E-08, 4.82E-10 and 1.37E-09 respectively. This initial result raises the following question: Does the smart power of ASEAN cooperation has a positive impact on the firm value of Malaysian public listed firm? This visual evidence has an interesting implication, which requires further regression analysis.

Table 3: Descriptive statistics

Variable	Mean	Min	Max
Excess Value	0.671	-0.840	3.300
Military power	1.15E-08	-1.474	1.016
Material power	4.82E-10	-7.482	1.623
Social power	1.37E-09	-0.803	4.645
TOA	0.040	-1.199	0.420
ROA	5.695	3.920	7.850
LOA	0.371	0.010	1.460

Regression analysis

This section shows how the smart power of ASEAN cooperation affects firm value. Excess value is used as a proxy for firm value. We developed a panel regression model and the statistics are adjusted for heteroskedasticity analysis. The analysis begins with the pooled OLS regression and fixed-effects model. We conducted a poolability test to ensure good and reliable estimates of the parameters of the model. The result of the fixed-effects model shows that all α_i are zero, which means that the OLS estimator is biased and inconsistent. Thus, the null hypothesis is rejected, and the presence of individual effects is accepted. The Hausman test (see figure 1) is then conducted to verify the presence of correlations between the unobservable heterogeneity and explanatory variables.

Based on the test on figure 1, the probability is less than 0.05. The null hypothesis is therefore rejected, and the fixed-effects regression model is continued.

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. hausman fe re
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	—— Coefficients ——			
	(b) fe	(B) re	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
mpASEAN	-.0760512	-.0366684	-.0393828	.0158178
mrASEAN	-.1441595	-.1522906	.0081311	.0069623
spASEAN	-.0217087	-.030259	.0085503	.0065848
TOA	-.3668866	-.2847832	-.0821033	.0381071
ROA	.1273912	.1415242	-.014133	.1109199
LOA	.0366535	-.0598379	.0964914	.0598914

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b = consistent under Ho and Ha; obtained from xtreg
B = inconsistent under Ha, efficient under Ho; obtained from xtreg

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Test: Ho: difference in coefficients not systematic
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chi2(6) = (b-B)' [(V_b-V_B)^(-1)] (b-B)
          = 14.33
Prob>chi2 = 0.0262

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Figure 1: Hausman test

Figure 2 shows the results of the fixed-effects (within) regression model.

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. xtreg EV mpASEAN mrASEAN spASEAN TOA ROA LOA, fe

Fixed-effects (within) regression      Number of obs      =      880
Group variable: no                    Number of groups   =      176

R-sq:  within = 0.1097                Obs per group: min =      5
      between = 0.0455                avg =              5.0
      overall = 0.0550                max =              5

corr(u_i, Xb) = -0.0606                F(6, 698)          =      14.33
                                          Prob > F           =      0.0000
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EV	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
mpASEAN	-.0760512	.0344699	-2.21	0.028	-.1437282 - .0083741
mrASEAN	-.1441595	.0231881	-6.22	0.000	-.1896864 - .0986326
spASEAN	-.0217087	.0263652	-0.82	0.411	-.0734732 .0300558
TOA	-.3668866	.1711056	-2.14	0.032	-.70283 - .0309432
ROA	.1273912	.1274293	1.00	0.318	-.1227995 .377582
LOA	.0366535	.1358532	0.27	0.787	-.2300765 .3033834
_cons	-.0539551	.7143581	-0.08	0.940	-1.456503 1.348593
sigma_u	.67208608				
sigma_e	.3170666				
rho	.81795437	(fraction of variance due to u_i)			

F test that all u_i=0: F(175, 698) = 20.87 Prob > F = 0.0000

Figure 2: Fixed-effects (within) regression model

Based on Figure 2, the estimated standard deviation of α_i (sigma_u) is 0.672. The value is much larger than the standard deviation of ϵ_{it} (sigma_e) which is 0.317. This finding suggests that the individual-specific component of the error is much more important than the idiosyncratic error. The standard error component model assumes that the regression disturbances are homoskedastic.

To ensure the validity of the statistical results, a modified Wald test is conducted for the group-wise heteroskedasticity in the fixed effects model. The serial correlation is also tested using the xtserial command implemented by David Drukker. The results ($p < 0.05$) indicate that the null hypothesis of homoskedasticity is rejected. The probability of serial correlation obtained for our model is $F = 0.0000$. This indicates that the errors are autocorrelated.

For the two problems of heteroskedasticity and serial correlation, the xtsc command implemented by Daniel Hoehle is used to adjust the standard errors of the coefficient estimates for possible dependence in the residuals because the xtsc, fe performs fixed-effects (within) regression with Driscoll and Kraay standard errors. The error structure is assumed to be heteroskedastic, autocorrelated up to some lag, and possibly correlated between groups.

This study made several noteworthy contributions to geopolitics and finance literature. Firstly, this study introduced the combination of two disciplines of studies; which is geopolitics and finance discipline into one study. This new study method should be used widely in future research. Secondly, the empirical findings in this study provide a new understanding of the impact of ASEAN cooperation and firm value of Malaysian MNC. Lastly, we provide panel data analysis of 5 years, which able to analyze the geopolitical condition and firm performance during Dato ' Sri Najib Bin Tun Haji Abdul Razak services as Malaysia Prime Minister. We also believe that geopolitical power may also play a strong role in other international organizational decisions, which is a concept that requires further analysis.

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