

CHAPTER I

INTRODUCTION

A. Background

Globalization provides changes in all aspects of life such as, in the fields of science, technology, information, and economics. In the field of economics, globalization makes the companies more competitive. In 2015, Asean Economic Community (AEC) started making business people doing various ways to make their company survive. Business development causes competitive competition that will increase to be able to maintain their company's existence. Thus, each company should have strategy in order to compete and control the market share.

In June 2017, all 7-eleven outlets under the management of PT Modern Sevel Indonesia, has stopped their operations. The director of PT Modern International said that the 7-eleven outlets were closed because of the limited resources owned by the company to support operational activities. The other reasons are company cannot compete effectively and decide the marketing strategy incorrectly.

The competitive advantage of a company can be seen from intangible and tangible assets. Intangible assets are rated higher than the tangible assets of the company since the emergence of software companies like Microsoft in 1980, Yahoo! in 1990, etc (Saudagaran, 2004). Intangible assets are shown by

the intellectual capital which plays an important role as a success key and add the value for a company. The prior studies by Rodrigues, *et.al* (2015) and Taliyang and Jusob (2011) have shown the importance of reporting non-financial information such as information on Intellectual Capital (IC) rather than financial information. The intangibles play a greater role in a company's value creation process.

In Indonesia, the phenomenon of IC began to develop since the existence of *Pernyataan Standar Akuntansi Keuangan* (PSAK) No.19 (revised 2000) about intangible assets. According to PSAK No. 19 (revised 2009), intangible assets are assets that are not in cash that can be identified without physical form. The examples of intangible assets are science and technology, design and implementation of new systems or processes, licenses, intellectual rights, market knowledge and trademarks.

The same phenomenon happen in Malaysia, after a global trend and demand for more useful and comprehensive non-financial information about the company's operating activities, Malaysian companies must voluntarily disclose intellectual capital in their annual report. The disclosure is regulated in Malaysian Financial Reporting Standards (MFRSs) 138 about Intangible Assets. The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

In achieving the company's objectives, there are some major capitals that must be met, such as financial capital, physical capital, and intellectual capital. The absence of rules on the measurement and reporting, specifically on disclosing IC make IC difficult to measure accurately when compared with financial and physical capital. Conceptually, disclosure is an integral part of the financial reporting. Disclosure is divided into two; there are mandatory disclosure and voluntary disclosure. IC is categorized as voluntary disclosure in annual reports because it provides value for the company. Intellectual Capital Disclosure (ICD) has become a new form to control management and employee. It helps managers to make strategies to fulfill the expectations of stakeholders such as investors, and to convince the stakeholders on the advantages or benefits of the company's policy (Ulum, 2009).

One of strategies to fulfill the expectation from stakeholders is disclose the competitive advantage of the company. Increasing the relevance of annual reports by conducting ICD can be influenced by various factors; one of those factors is corporate governance (CG). Corporate governance affects the extent of intellectual capital disclosure (Haji and Ghazali, 2013). According to the Organization for Economic Cooperation and Development (OECD) corporate governance directs and controls system that operates the corporation. The corporate governance structure specifies the distribution of right and responsibilities among different participant in the corporation, such as the board, the managers, shareholders, and other stakeholder, and spells out the rule and procedure for making decision on corporate affairs. By doing this, it

also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance. This research will examine some of the characteristics of corporate governance that affect the extent of intellectual capital disclosure. The variables of corporate governance mechanism are board size, CEO duality, audit committee, and board gender.

Prior studies prove that the influence of CG mechanisms on ICD has been undertaken by Hidalgo *et al.* (2011), Taliyang *et al.*, (2011), Arifah (2012), and Rodrigues *et al.*, (2016). Rodrigues *et al.* (2016) found that ICDs increase with company size, dual corporate governance models, industry, listing on sustainability indexes and increases in board size up to a maximum point (beyond which disclosures decrease). Meanwhile, ICD are reduced by CEO duality and by a higher proportion of independent directors on boards.

The ICD phenomenon has been studied by comparing developed and developing countries (Velycia, 2014, Bhasin, 2014). However, there is still limited research that comparing ICD levels in developing countries. Therefore, this study aims to fill the lack of literature on intellectual capital disclosure in developing countries such as Indonesia and Malaysia.

One of the factors affecting voluntary disclosure is the territory of the country. According to Web *et.al* (2008), globalization and legal environment lead to improve the disclosure. The legal environment in home company's country affects the number of voluntary disclosure. Companies from weak

legal environment (civil law system) are less pressured to make good disclosure compared to companies from strong legal environment (common law system). Indonesia and Malaysia apply a different legal environment, although both Indonesia and Malaysia are developing countries. Indonesia applies civil law system, however Malaysia applies common law system.

Based on the explanation above, this research will examine the effect of corporate governance mechanism towards ICD. Mechanisms that use are CEO duality, board size, audit committee, and board gender. Sample that is used in prior study is listed Portuguese companies in 5 years period, while this study used high intellectual capital intensive companies listed in Indonesia Stock Exchange and Malaysia Stock Exchange 2015 and 2016. This research use that sample because the industry has the competitive advantage on technology and knowledge assets

The main focus of this study is to examine the influence of CG towards ICD in Indonesia and Malaysia IC intensive companies. Developing prior study by Rodrigues *et al.*, (2016), thus this study will compare the effect of independent variable in 2 different countries: Indonesia and Malaysia with the title “The Influence of Corporate Governance Mechanism towards Intellectual Capital Disclosure” (Empirical Study on Intellectual Capital Intensive Company listed in the Indonesia Stock Exchange and Malaysia Stock Exchange 2016).

B. Research Scope

This research focuses on the influence of corporate governance such as: CEO duality, board size, audit committee composition, and board gender towards Intellectual Capital Disclosure (ICD). This research is also comparing the ICD levels in Indonesia and Malaysia.

C. Research Question

1. Does the board size have positive significant effect towards intellectual capital disclosure level in Indonesia and Malaysia?
2. Does the CEO duality have negative significant effect towards intellectual capital disclosure level in Indonesia and Malaysia?
3. Does the audit committee have positive significant effect towards intellectual capital disclosure level in Indonesia and Malaysia?
4. Does the board gender have positive significant effect towards intellectual capital disclosure level in Indonesia and Malaysia?
5. Does have any difference between intellectual capital disclosures level in Indonesia and Malaysia?
6. Does have any differences in the influence of board size, CEO duality, audit committee, and board gender (the existence of women director) towards intellectual capital disclosures level in Indonesia and Malaysia?

D. Objectives of the Study

The objectives of the study, as follows:

1. to examine whether the board size have positive significant effect towards intellectual capital disclosure level in Indonesia and Malaysia
2. to examine whether the CEO duality have negative significant effect towards intellectual capital disclosure level in Indonesia and Malaysia
3. to examine whether the audit committee have positive significant effect towards intellectual capital disclosure level in Indonesia and Malaysia
4. to examine whether the board gender (the existence of women director) have positive significant effect towards intellectual capital disclosure level in Indonesia and Malaysia
5. to examine and compare the difference of intellectual capital disclosure level in Indonesia and Malaysia.

E. Significance of the Study

1. Theoretically
 - a. This research is expected to provide empirical evidence of factors affecting intellectual capital disclosure level.
 - b. This research is expected to add and develop concepts of intellectual capital disclosure level.
 - c. This research is expected to be the reference for future research about intellectual capital disclosure level.

2. Practically

- a. This research is expected to provide the importance of disclosing intellectual capital information in the annual report.
- b. This research is expected to encourage the company to be detail in disclosing the intellectual capital in order to provide the information for stakeholders and minimize asymmetry information.