

# **CHAPTER I**

## **INTRODUCTION**

### **A. Background**

Intangible asset is one of the factors which has significant effect in developing the business sector nowadays. Radianto (2011) explains that a company and its competitive advantages are evaluated by the investors with intangible assets as the guidance. Another form of intangible asset that is human capital is playing a relevant lead in several countries.

Human capital is a substantial aspect since it affects the increase of Human Development Index in the countries all over the world. In measuring a country's average achievements, Human Development Index (HDI) is used. It is a commixture index which measures the country's achievement in the three essential aspects of human development especially life expectancy, education and income.

The objective of this index is to convince the public and government to evaluate the country development by improving the human well-being. Based on Human Development Report 2016, the level of human development in the world is refined. HDI value increased rapidly between 1990 and 2015. In that period, the hunger and poverty were reduced, mortality was decreased, technology was advanced, and the access to basic social service and environmental sustainability were improved.

HDI index of a country can be different; event though they have located in the same contingent. The example is Indonesia and Malaysia. Those countries are located in the same region of Asia, that is Southeast Asia. But, those countries has different human development index which means, the countries differs in life expectancy, education and Gross National Income (GNI) as shown in Table 1.1 below:

**Table 1.1**  
Human Development Index & Rank  
Indonesia and Malaysia

| Country   | HDI Value |       | HDI Rank |      | Classification<br>(2015) |
|-----------|-----------|-------|----------|------|--------------------------|
|           | 2014      | 2015  | 2014     | 2015 |                          |
| Malaysia  | 0.779     | 0.789 | 62       | 59   | High                     |
| Indonesia | 0.684     | 0.689 | 110      | 113  | Medium                   |

*Source: Human Development Report 2015 & 2016*

Malaysia is classified as high human development country. Malaysia reached 0.779 HDI value in 2014 and it increased in 2015 became 0.789 which was not far from the very high human development cutoffs point. The country ranked 62<sup>nd</sup> and then in 2015 the rank was on 59<sup>th</sup>.

On the other hand, Indonesia is classified as medium human development country. The HDI values for the countries are in a similar range. Indonesia had 0.684 HDI value in 2014 and it increased to 0.689. Its rank degraded from 110<sup>th</sup> to 113<sup>th</sup> in 2015. The table above shows that

Indonesia and Malaysia have different achievement in its people's life expectancy, education and income.

In brief, life expectancy, education and Gross National Income (GNI) are combined to obtain the value of Human Development Index. It shows that income is not the only key to achieve better human development, but also health and education. It underlines the importance of human capital which is a part of intangible assets.

Countries in range of medium to very high human development are showing the importance of human capital and increasing the index every year. It means the people in these countries have high life expectancy, higher education and higher GNI. The country starts to realize that human capital or intangible assets are very important to increase the country's development. In practical, the realization is done with investing in the human capital. Schultz (1961) in Kagan (2000) states that someone's knowledge and skill is a product of deliberate investment. The higher national input in human capital (life expectancy and education) will make a direct result on the increase of workers earnings (GNI). If the individuals are supported in acquiring education, it will increase the individuals' productivity as a result of the skill and knowledge obtained. Companies in the world start to compete in increasing their intangible assets.

After that, companies start to invest in intangible assets that play a very important role in determining the value of a company. These intangible assets include knowledge and innovations by their employees

(Ikapel, 2016). Even the current corporate performance measurement systems are heavily inclined towards financial and physical aspects of the company; there is only small amount of information regarding the performance of the intangible assets or intellectual capital efficiency.

One of the approaches used in assessing and measuring intangible assets is Intellectual Capital (IC). IC has a great role in determining company's value and performance level. Radianto (2011) explains that IC does not only surface in the developed countries but also in the developing ones. Intangible assets have very important lead in obtaining profit and turnover for organizations. The good management of IC is suggested as a strategy that make the company's future brighter. This convince the crucial role of IC.

Moreover, according to Khasanah (2016) company nowadays must change its business strategy to knowledge-based business. The knowledge-based company has ingenious and proficient employee to develop its product quality. Company that applies the knowledge-based business will experience changes in its firm value. The increase of firm value depends on company's resource management because its function is to make sure that company has undertaken the business strategy efficiently and effectively.

Besides, knowlegde-based business strategy increases the intangible assets. Higher intangible assets will make the company realize the importance of intellectual capital. High intellectual capital leads to

better performance. With the advantage, company is expected to increase its firm value and to increase the investment in the company.

Based on Chen, et al. (2005) the enlarging gap among firm market and book value attracts all attention to delve into the concealed value from financial statement. Its limitation in explaining the firm value can affect the financial reporting that is inadequate as a financial performance report. It makes accounting information can not be used for decision making in investing.

Bontis et. al. (1999) as quoted in Kucharcikova (2011) explains that Human Capital (HC) is an organizational human factor, combined intelligence, skills and expertise which make a unique character of an organization. The human element in organization shall be adequate enough to learn, to change, to innovate and to provide creative thrust that can ensure the long-term survival of the organization if motivated properly.

Khasanah (2016) states that Human Capital (HC) as one of IC components represents the individual knowledge stock of an organization delineated by its employees. HC is a combination amidst genetic inheritance, experience and attitude about business life. Another IC component, that is Structural Capital (SC) covers organization's all non-human storehouses of knowledge. Database, organizational charts, manuals, strategies and everything makes the firm value bigger than its book value are included as SC. Meanwhile, Customer Capital (CC) is knowledge about marketing channels and customer relationship where an

organization develops CC through business networking to keep the customer's loyalty towards the developing product.

IC is a key resource for an added value. The good IC utilization will lead the company to have competitive primacy that is used for competing with other companies in the business.

The increased understanding of IC disclosure shall be linear with its observation and its measurement. Puntillo (2009) states that intellectual capital (IC) itself clarifies the difference amidst accounting information, firm's market and book value that assembles the difference between businesses. IC is entitled as the firm's market value surpassing its book value. Firm's IC plays important part in modern value creation. IC is perceived as the main corporate asset which is able to generate the sustainable competitive and excellent financial performance. Currently, lots of empirical studies are accomplished with Ante Pulic's VAIC (Value Added Intellectual Coefficient). It can be appraised from the data in balance sheet as a proxy of IC.

Value Added Intellectual Coefficient (VAIC) is an indirect measure of efficiency of value added by corporate IC. Its method supports information about tangible and intangible's efficiency that can be used to achieve value to firm. Human Capital (HC), Structural Capital (SC) and Customer Capital (CC) are acknowledged as main elements of VAIC.

Banking sector is one of the most active companies which utilizes intellectual capital. Banking sector companies apply the knowledge-based

system in order to increase company's value. But, Nikmah and Irsyahma (2016), from the data that was obtained, found out that banking sector in Indonesia tend to report fewer intellectual capital attributes compared to companies in other sectors.

Based on the thoughts above, the writer conducted a research entitled: "THE INFLUENCE OF INTELLECTUAL CAPITAL TOWARDS FINANCIAL PERFORMANCE AND FIRM VALUE IN BANKING INDUSTRY".

## **B. Research's Scope**

The scope of this research:

1. Independent variable tested empirically in this research is Intellectual Capital. Dependent variable tested empirically in this research is Financial Performance and Firm Value (ROA and M/B).
2. Samples used in this research are banking sector companies listed in Indonesia Stock Exchange (IDX) and Bursa Malaysia (BM) on 2012-2015.

## **C. Research's Question**

Based on the research's scope above, the questions in this research are:

1. Does Intellectual Capital (VAIC) positively influence financial performance of banking companies in Indonesia and Malaysia?
2. Does Intellectual Capital (VAIC) positively influence firm value of banking companies in Indonesia and Malaysia?

3. Are there any differences of financial performance and firm value on banking companies in Indonesia and Malaysia?

#### **D. Research's Objective**

The objectives of this research are:

1. To analyze the positive influence of Intellectual Capital (VAIC) towards financial performance of banking companies in Indonesia and Malaysia.
2. To analyze the positive influence of Intellectual Capital (VAIC) towards firm value of banking companies in Indonesia and Malaysia.
3. To analyze the differences of financial performance and firm value on banking companies in Indonesia and Malaysia.

#### **E. Research's Contribution**

1. Theoretical Contribution

This research will not only contribute to Indonesia and Malaysia but also to developing nations. This research will also help the manager evaluate the usage in company's intellectual capital. Not only that, this research give understanding for the next researcher about Intellectual Capital.

2. Practical Contribution

This research estimates the Intellectual Capital owned by the banking companies in three countries. The amount of Intellectual Capital can be used to assess company's performance and firm value. The amount



also indicates how the companies help to increase the human development in every country.

## **F. Previous Research**

The research about IC has been done before. Chen et. al. (2005) conducted their research with Taiwanese listed companies as the sample. The dependent variable used in their research is firm value or market-to-book value ratios of equity (M/B) and financial performance (return on equity, return on total assets, growth in revenues, and employee productivity), while the independent variable is VAIC (VACA, VAHU, and STVA).

In the other hand, Sunarsih and Mendra (2012) use Indonesian listed companies. They use financial performance (return on equity) and firm value (price to book value) as dependent variable, while the independent variable is VAIC (VACA, VAHU, and STVA). The research uses resource based theory, stakeholder theory, and intellectual capital.

Khasanah (2016) uses Indonesian listed banking companies. She uses financial performance (return on assets) and firm value or market-to-book value ratios of equity (M/B) as dependent variable. The independent variable used is VAIC (VACA, VAHU, and STVA) and ownership as moderating variable. The research uses stakeholder theory, resource based theory, agency theory, and intellectual capital.

Nikmah and Irsyahma (2016) use Indonesian listed banking companies. They use firm value (price to book value) as dependent

variable. The financial performance (return on assets) is used as intervening variable while the independent variable used is VAIC (VACA, VAHU, and STVA). The research uses stakeholder theory and resource based theory.

The similarity of this research with the previous researches is on the measurement of intellectual capital, using VAIC with three components; Human Capital, Structural Capital, and Customer Capital. Theory used is Resource Based Theory (RBT) and Intellectual Capital Theory. The difference of this research with some of the previous researches is on the sample used. This research uses Indonesia and Malaysia banking companies. This research is also differs in the measurement of the dependent variables. For financial performance this research uses return on assets while for the firm value is using the market-to-book value ratios of equity (M/B).