

## **CHAPTER I INTRODUCTION**

### **A. Background**

Along with the times and increasing competition in the business world, it encourages companies to compete for competitive advantage. One way that is taken by the company is to manage asset or corporate wealth maximally. One of the most important sources of assets in a company is intangible assets. According to Pablos (2002), with the rise of the knowledge-based economy, the traditional bases sources of competitive advantage that depends on tangible assets in creating firm value and sustaining competitive advantage began to erode. The management of intangible assets has increased over the past few years.

Guthrie et al. (2012) have shown Intellectual capital (IC) and intangible assets (IA) performance increase the overall performance of the enterprise. Organization starts to invest in intangible assets such as intellectual capital. Intellectual capital is one of the approaches used in the assessment and measurement of intangible assets that are now being the focus of attention in various fields, such as management, information technology, sociology, and accounting (Petty and Guthrie, 2000).

Nowadays, an era of information of economics it is far more dynamic and the economic development of the country depends on how the country applies the knowledge. Many parties such as the researchers, academicians, practitioners, and entrepreneurs pay more attention to

intellectual capital as the core of the knowledge-based economy. Intellectual capital performs a crucial role to enhance the innovation and creativities in organizations.

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. The company that applies the knowledge-based business will experience changes in its firm value. The increase of firm value depends on the company's resource management because its function is to make sure that the company has undertaken the business strategy efficiently and effectively.

The performance of a company can be known from the analysis of financial statements. One of the analytical methods used in analyzing financial statements is ratio analysis. Ratio analysis is a frequently used analysis in analyzing financial statements. Rahmawati (2015) explains that the analysis of financial ratios gives an overview of good financial performance. The model often used in the analysis is in the form of financial ratios. The results of the analysis of financial statements published by the company are one source of information on the position, performance, and changes in the company's financial condition.

The environment changes and technology advancements have provided the economy with increased momentum and increasingly growing

competitions has limited profit and affect the risk of financial distress. Technical Committee of Audit Corporation year 2002 state that the owners, managers, investors, business parties and creditors are relying on corporate financial statements for evaluating the financial success of a company and its tendency toward financial distress. Financial statements play an essential role in the financial decisions of investors and creditors about a particular institute (Accounting and Auditing Research Centre).

In the year 2008 – 2014, global economic conditions experienced instability. This is marked by the American and European crisis and the value of the dollar continues to strengthen. Indonesia's macroeconomy, which is included in the emerging market category, also gains influence on that condition. Meanwhile, during the period from 2008 to 2014, the inflation rate was unstable and tended to increase from year to year. These conditions will certainly affect the dynamism of the company. From the external conditions as described earlier, it is very important to assess the risk of bankruptcy if viewed from the internal side. A company is said to be good if the company is able to withstand external uncertainty by strengthening its internal management.

Financial distress is a condition in which the company has financial difficulties to fulfill its obligations. The occurrence of negativity or negative earnings is one of the signs of the company experiencing Financial Distress. If Financial Distress happens continuously then it can bring a company to bankruptcy. Information on Financial Distress can be used by management

in taking merger or takeover actions to improve the company's ability to pay debts and manage the company better.

The performance of a company can be known from the analysis of financial statements. Ratio analysis is a very common analysis used in analyzing financial statements. In addition, financial ratios can be used to predict Financial Distress in a company (Luciana and Emanuel, 2003). The results of the analysis of financial statements published by the company contain information on how the position, performance, and changes in the financial condition of a company. The results of financial statement information sources can be used by various parties, both internal parties and external parties in determining the basis of policy and decision.

Financial distress occurs prior to bankruptcy in a company. Therefore, every company should make predictions of financial distress because the condition of financial distress will show the condition of company health especially about the company bankruptcy in the future. One of the factors that can cause the company to go bankrupt is the economic condition of a country.

Around the year 2015, the Association of Southeast Asian Nations (ASEAN) brought into being the ASEAN Economic Community (AEC). The competition between firms in the ASEAN region becomes increasingly competitive. The resources management of firms has to utilize more

effectively and efficiently because is needed to add the value of firms so they can face and compete in the ASEAN Economic Community.

ASEAN Economic Community (AEC) is being spaced for each region to develop a quality to compete in a free market that started in around the year 2015. The financial and banking sector react to the ASEAN Economic Community by establishing the ASEAN Banking Integration Framework (ABIF) which is an inter-bank integration in the ASEAN region. The main objective of ABIF is to provide market access and operational flexibility in ASEAN member countries for Qualified ASEAN Banks (QAB) which are ASEAN banks that meet certain requirements agreed upon by ASEAN. The requirements of banks to become candidates for QAB are, among others, ASEAN's strong capital banks, highly resilient and well managed, and compliance with prudential regulations in accordance with prevailing international standards. These banks are expected to be a driver of trade and investment in ASEAN. However, ABIF remains concerned with the fulfillment of prudential requirements for QAB candidates who will enter and operate within an ASEAN country. The participation of a country in the implementation of ABIF also concerns the readiness of the financial sector of each ASEAN member country. In this regard, the main ASEAN countries will help each other for readiness in the process of accelerating the integration of banking in the ASEAN region through the support of education, training, and experts. ([www. bi.go.id](http://www.bi.go.id)).

In developing countries like Indonesia, the existence of a bank becomes very important in the process of economic development. The banking sector is considered as the knowledge-intensive sector (intellectual capital intensive industry sector) and this sector mostly offers services orientated products to their customers. In addition, the banking sector is included in the service sector where customer service is highly dependent on intellectual/human capital intelligence. Banking is an industry that falls into the category of knowledge-based industries that utilize the innovations it creates to provide value for the products and services produced for consumers (Ambar, 2004).

The existence of the industrial revolution 4.0 also indirectly affected the banking sector in anticipation of a change in digitalization. The financial services sector such as banking companies must adjust to not be left behind from developing countries that continue to grow. Initiatives prepare a reliable workforce and special skills for mastering technology and modernizing information systems that can expand the reach of services for the community (financial inclusion). So that risk mitigation that will emerge from the impact of the entry of the revolutionary era 4.0 can be measured and controlled. Therefore, in this situation, Intellectual Capital which consists of three components, namely human capital, structural capital, and employed capital certainly also has an important role in the company in this situation, so that the company is able to compete globally.

## Figure 1.1 Human Capital Index 2015

**Figure 1: Human Capital Index 2015—ranking of ASEAN countries**

ASEAN		
Global Rank	Country	Score
24	Singapore	78
46	Philippines	71
52	Malaysia	70
57	Thailand	69
59	Vietnam	68
69	Indonesia	67
97	Cambodia	59
105	Lao PDR	56
112	Myanmar	53

Note: Insufficient data to cover In 2015 edition: Brunei Darussalam.

*Source: Human Capital Outlook 2015, World Economic Forum*

From Figure 1.1 above table is known the rank of Human Capital Index in 2015 in ASEAN countries. Singapore occupies the first position of countries incorporated in the ASEAN Countries. A small country with virtually no natural resources, Singapore has become one of the most developed countries in Asia primarily due to its strong emphasis on developing human resources and for continuously making a significant investment in its human capital. Whereas the Indonesian human capital occupies a position below other developing countries such as the Philippines, Malaysia, and Thailand.

It is important to measure the intellectual capital of the company actually after the ASEAN Economic Community which began in 2015 until now. Therefore, the companies know how the level of intellectual capital affects the firm performance. There is some well-known measurement method that commonly to is used to measure intellectual capital such as

Market Value to Book Value (MV/BV), Value Added Intellectual Coefficient (VAIC) model, Economic value added pattern (EVA), Balanced scorecard pattern (EVA), Tobin's Q pattern. All these methods, creating and using knowledge, are constructed to measure non-financial and qualitative items of intellectual capital (Petty and Guthrie, 2000).

Based on the explanation above, the writer conducted research with the title: **“THE EVIDENCE OF INTELLECTUAL CAPITAL: A Study in Indonesian Banking Sector Dealing with ASEAN Economic Community in the Year 2015 - 2017.”**

## **B. Research Scopes**

The scope of this research are as follows:

1. Independent Variable tested empirically in this research is Intellectual Capital (VAIC). Dependent variables tested empirically in this research are Firm Value (M/B) and Risk of Financial Distress (using Altman Z Score Index Model)
2. Samples used in this research are banking sector companies that listed in Bursa Efek Indonesia (BEI or IDX), Bursa Malaysia (BM), Philippines Stock Exchange (PSE), and Stock Exchange of Thailand (SET) on the year 2015-2017.



### **C. Research Questions**

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

1. Does the Intellectual Capital (VAIC) positively influence the firm value of banking companies in Indonesia, Malaysia, Philippines, and Thailand?
2. Does the Intellectual Capital (VAIC) negatively influence the risk of financial distress of banking companies in Indonesia, Malaysia, Philippines, and Thailand?

### **D. Research Objectives**

Based on the research questions above, this research has a purpose as follows:

1. To analyze the positive influence of Intellectual Capital (VAIC) towards the firm value of banking companies in Indonesia, Malaysia, Philippines, and Thailand.
2. To analyze the negative influence of Intellectual Capital (VAIC) on the risk of financial distress of banking companies in Indonesia, Malaysia, Philippines, and Thailand.

### **E. Research Contributions**

1. Theoretical Contribution

This research will not only contribute to relating countries but also help the manager of the company to measure and evaluate how far the level

of intellectual capital in the firm. Not only that, this research will give understanding for the next researcher about Intellectual Capital.

## 2. Practical Contribution

This research estimates the Intellectual Capital owned by the banking companies in four countries in ASEAN. The measurement of intellectual capital that using VAIC method can show firm value and financial performance that may arise the risk of financial distress. It also can be used to develop the quality of the assets as the investment especially in the intellectual capital of each country.

## F. Previous Research

The research about Intellectual Capital has been done before. Chen *et al.* (2005) conducted research with Taiwanese listed companies as the sample. The independent variable used in their research is VAIC (VACA< VAHU< and STVA) while 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) are the dependent variables.

On the other hand, Sunarsih and Mendra (2012) conducted the research with Indonesia listed Companies from the Indonesia Stock Exchange (IDX) as the sample. They use financial performance (ROE) and firm value (price to book value) as the dependent variable, while the independent variable is VAIC (with the three components: VACA, VAHU,

and STVA). Resources-based theory, stakeholder theory, and intellectual capital were the theory that used in their research.

Khasanah (2016) uses Indonesian listed banking companies. The dependent variable of the research is financial performance (return on assets) and firm value. The independent variable used is VAIC (VACA, VAHU, and STVA) and ownership as moderating variable. The stakeholder theory, resource-based theory, agency theory, and intellectual capital were used in the research.

Yalaman's research in 2013 did research in the Turkish banking sector both in short and long period between 1995-2006. The aim of the study was to analyze the empirically the relationship between investment in intellectual capital and the bank's performance. The measurement of intellectual capital in this research used Value Added Intellectual Coefficient (VAIC). The findings showed that intellectual capital was increasing the bank's profitability, market value and productivity, especially in the long run (Yalaman, 2013).

Nikmah and Irsyana (2016) conducted research and used Indonesia listed banking companies as the sample. They used firm value (price to book value) as the dependent variable. The financial performance (return on assets) was used as an intervening variable while the independent variable used was VAIC (VACA, VAHU, STVA).

Ardalan and Askarian (2014) did research about the application of Intellectual Capital on the Financial Distress Model Using Neural Network. The independent variable is Intellectual Capital (VAIC) and risk of financial distress as the dependent variable. The analysis used a multiple regression data panel. The results of the research are Intellectual capital has a positive effect on risk if financial distress.

Pour *et al.* (2014) used companies listed in Tehran Stock Exchange in Iran to analyze the impact of Intellectual Capital (VAIC) on the risk of financial distress. The result about Intellectual Capital was related with return on equity, return on assets, employee productivity, and market to book value ratio.

The similarity of this research with the previous researches is on the measurement using Value Added Intellectual Capital (VAIC) model with three components of intellectual capital that consist of Human Capital (VAHU), Structure Capital (STVA), and Customer Capital (VACA). Theories used in this research are Stakeholder Theory, Resource-Based Theory (RBT), and Intellectual Capital. The differences of this research with some of the previous researches are in the sample used. This research uses Indonesia, Malaysia, Phillipines, and Thailand banking companies. The measurement of the dependent variables in this research is also different. For the measurement risk of financial distress, this research uses Z-Score Index, while for the firm value is utilizes Market Value to Book Value Ratios to Equity (M/B).