

## **CHAPTER II LITERATURE REVIEW**

### **A. Theoretical Framework**

#### **1. Stakeholder Theory**

Stakeholder theories are more focused on the position of stakeholders considered necessary to the company. The management of a company is expected to perform activities deemed crucial by their stakeholders and then report back the activities to stakeholders. This stakeholder group is the main consideration for the company in disclosing and/or not disclosing any information in the financial statements (Ulum, 2008). To meet the actually recognized expectations by stakeholders, the organization will voluntarily disclose information related to the organization's environmental, social and intellectual performance, beyond and above its mandatory demand. Shareholders, creditors, government, employee, customers, suppliers, and the public are part of the stakeholder group of the company (Suhendah, 2002)

The theory of stakeholder has the main objective to assist corporate management in improving value creation as a result of their activities and minimizing possible losses to stakeholders. In the context of explaining the relationship of intellectual capital with the financial performance of the company, as well as firm value, stakeholder theory is seen in both fields of ethics (moral) and managerial fields. The ethics field argues that the company has to treat all the stakeholders fairly or

equally and the management have to manage the company for the benefit of all stakeholders (Deegan, 2004, in Ulum 2008).

According to Watt and Zimmerman (1986) in Ulum (2008), the power of stakeholders to influence company management has to be seen as a function of the rate of stakeholder control over the resources that firms needed. In an effort to create value for the company, the company's management has to be able to carry out all resources owned by the company, both human capital, physical capital and structural capital. If all resources owned by the company can be carried out and utilized properly, it will create value added for the company so as to enhance the company's financial performance.

## 2. **Resources-Based Theory**

According to Barney *et al* (2011), Resources-Based Theory (RBT) being an essentials framework to explain and foresee what is underlying for competitive advantage and firms' financial performance. The firm's ability to maintain valuable, rare and irreplaceable resources, also to allocate and deploy resources effectively is part of an effort to create a sustainable competitive advantage (Barney, 1991).

Kozlenkova *et al.* (2014) explain that there are two fundamental assumptions regarding the firm's resources that are being essential logic of this theory, also explains how these resources can generate sustainable competitive advantage and the reason some firms

consistently outperform the others. First, even though the firm is in the same industry, each firm has a different set of resources. The assumptions regarding the heterogeneity of these resources reveal that some firms have better expertise for completing certain activities because they have unique resources (Peteraf and Barney, 2003). Second, the differences in resources will remain there due to difficulties in exchanging resources between firms (the resource immobility assumption), which will lead to the advantage of the heterogeneity of these resources continuing to occur from time to time (Kozlenkova et al., 2014).

### 3. **Intellectual Capital**

The definition of intellectual capital is often interpreted differently, the concept of intellectual capital refers to the resources of knowledge, experience, and technology available to companies that produce high-value assets and future economic benefits for the company. Intellectual capital is a knowledge-backed process of information to establish relationships with outsiders. Roos et al (1997) in Suhendah (2012) states that intellectual capital covers all processes and becomes intangible assets in the balance sheet including trademarks, patents, and brands. Brooking (1996) in Suhendah (2012) defines intellectual capital as a combination of intangible assets including markets, intellectual property, human resources, and infrastructure that performs its function within the enterprise.

Meanwhile, Stewart (1997) in Suhendah (2012) defines intellectual capital as all intellectual knowledge, all information, and experience used by companies to create prosperity. Of all these definitions, intellectual capital can be considered an intangible asset owned and used by the company to generate benefits and improve the welfare of the companies.

Bontis et al. (2000) stated that in general, the researchers identified three main constructs of IC, namely: human capital (HC), structural capital (SC), and customer capital (CC). According to Bontis et al. (2000), HC simply represents the individual knowledge stock of an organization represented by its employees. HC is a combination of genetic inheritance; education; experience, and attitude about life and business. Furthermore, Bontis et al. (2000) state that SC covers all non-human storehouses of knowledge within the organization. These include databases, organizational charts, process manuals, strategies, routines and everything that makes the value of a company greater than its material value. While the main theme of CC is the inherent knowledge in marketing channels and customer relationship that an organization develops through the business (Bontis et al., 2000).

Human capital is a source of innovation and improvement in an organization but becomes an element that is difficult to measure. Human capital includes the knowledge of each individual in an organization that exists on its employees that can be unique to each individual and generic

generated through a competence, attitude and intellectual intelligence (Bontis et al., 2000). Human capital is a source of very useful knowledge, skills, and competencies in a company. Human capital reflects the collective ability to produce the best solution based on the knowledge that the people in the company have to add value to the company. Human capital is a combination of knowledge, skills (skill), the ability to innovate in the completion of tasks include company value, culture, and philosophy (Bontis et al., 2000).

Structural capital is the knowledge that remains within the company that gives the company the ability to meet the company's routine processes and structures that support the employee's efforts to produce optimal intellectual performance and overall business performance. Structural capital arises from processes and organizational values that reflect the internal and external focus of the company along with the development and renewal of value for the future. Structural capital is a means and infrastructure that supports employees to create optimum performance, including the organizational capability to reach the market, hardware, software, database, organizational structure, patent, trademark, and all organizational capability to support employee productivity (Bontis et al., 2000). The concept of structural capital allows the creation of intellectual capital and becomes the liaison/processing of human resources into intellectual capital.

Customer capital is the knowledge of a range of markets, customers, suppliers, governments and industry associations. Capital relations with customers can be created through the knowledge of employees processed with structural capital that results in good relations with outsiders. The interaction of the three components of intellectual capital will create an overall corporate value. Customer capital is a component of intellectual capital that provides real value to the company by creating a harmonious relationship or relationship with its partners or parts outside the company's environment. Customer capital consists of corporate relationships with stakeholders covering the relationship between the company with consumers, suppliers, creditors, and investors (Suhendah, 2012).

In Indonesia itself, IC phenomenon has grown especially after the emergence of PSAK no. 19 revisions (IAI, 2008) on intangible assets. Although intangible assets are not explicitly stated as intellectual capital (IC), more intellectual capital gets high attention. In PSAK no. 19, it is stated that intangible assets are grouped into two categories: intangible assets whose existence is limited by certain provisions, such as patents, copyrights, leases, limited franchises and unconfirmed periods such as trademarks, secret processes, and formulas, perpetual franchise and goodwill. The definition contains an explanation that the intangible resources are mentioned such as science and technology,

design and implementation of new systems or processes, licenses, intellectual property rights, market knowledge and trademarks.

#### 4. **Value Added Intellectual Capital (VAIC)**

Pulic (2000; 2004) built a model to measure how components of IC can create value and competitive advantage for a firm, the model is called the VAIC. The VAIC offers a relatively simple quantitative approach based on the firm's accounting information to measure the IC and its components (Pulic, 2000). One of the important concepts of VAIC is the corporate intellectual ability that refers to the efficiency of the total value creation produced by two types of resource, namely IC resources and physical resources, which work simultaneously in the business environment (Pulic, 2004). The basic assumption of VAIC is that the IC itself cannot operate independently without the support of financial and physical capital (Pulic, 2004). VAIC is a combination of several components or elements, namely human capital efficiency, structural capital efficiency, and physical capital efficiency.

#### 5. **Market to Book Value (M/B)**

Market to Book Value (M/B) is a comparison between market value and book value of a company. M/B is an indicator used to assess market stock price. If the M/B have high value means that the stock value is also high. Market value is a value of the company's total shares. Market value can be used to appraise a company from investor's point of view. The level of profit, speculation, book value, and confidence

level of the investor determine the level of market value whether it decrease or increase. Book value is a value of the company's net affluence between the total assets and total liabilities of a company. The Market to Book Value shows the difference between market and book value of a company.

## 6. **Financial Distress**

Financial Distress is a condition where companies are experiencing financial difficulties and are threatened with bankruptcy (Dermawan, 2008). In other words, 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.

By knowing the level of risk from Financial Distress can be used as an identification tool to improve the condition before it comes to crisis or bankruptcy conditions. 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 and can provide early warning signs of future bankruptcy (Platt and Platt, 2002).

According to Syaifudin (2001), financial difficulties caused by poor financial performance or low level of corporate financial health caused by several factors, such as the global financial crisis. Prediction



of financial difficulties is done by using financial indicators or performance indicators such as turnover / total assets, revenues/turnover, ROA, ROE, and profit margin.

#### 7. **Analysis of the Z-Score Bankruptcy Model**

According to Munawir (2002), financial failure is the inability of the company to pay its financial obligations at maturity, leading to a special agreement with the debtor to reduce or eliminate its debt. Bankruptcy is a financial difficulty so severely that the company is not capable of running its operations. While financial difficulties are liquidity difficulties that can lead to bankruptcy. Analysis of financial difficulties will greatly help make the decision to define attitudes toward companies that are experiencing financial difficulties.

#### 8. **Z-Score Model**

Z Score (Altman) is a multiple discriminant analysis (MDA) used to predict the probability of failure or bankruptcy of a company caused by financial problems. Z-Score was developed by Edward I Altman, a professor, and financial economist from New York University's Stern School of Business in 1968. In its development, the Altman Z-Score model has undergone several changes. Initially, the Altman Z-Score model was only used for public and manufacturing companies but now Z-Score has been modified and made for companies that run in services such as banking.

The Z-Score Index developed by Boyd, Graham, and Hewitt in 1993 is a measurement tool used to measure risk by showing the probability of distress in which equity and profitability do not adequately offset losses. The greater the value of Z-Score Index obtained, indicating that the bank is far from the risk or the bank is more stable. Previous research by Fitri (2014) states that the Z Score method is used as a determinant of bank distance against bankruptcy risk.

Z-Score model used in this research is the Z-Score model Index modifications are indeed devoted to service companies. Model Z Score can be used to measure distances from the symptoms of Financial Distress where the loss is above the equity ( $Eq < -\pi$ ) (where Eq is equity and  $\pi$  is profit), TA as total assets, ROA as return on assets,  $\sigma$  (ROA) as the standard deviation of ROA, and CAR as the capital ratio to total assets (Capital-Asset Ratio).

The chance of occurrence of a Financial Distress can be illustrated by probability ( $-ROA < CAR$ ). If the profit is normally distributed then Z can be calculated =  $ROA + CAR/SDROA$ . Banks are declared far from risk if  $ROA + CAR/SDROA > 0$ . Higher Z-Score Index results indicate banks are more stable.

## **B. Developing Hypotheses**

### **1. Intellectual Capital and Firm Value**

Utilization of the resource effectively and efficiently will influence intellectual capital value. Moreover, the management and the development of good resources also rise the growth of the company and market value. With those advantages, the company can increase its market value that is marked by the advanced company's share price.

According to Nikmah and Irsyahma (2016), the great utilization of intellectual, the increase of firm value and company's ability to give motivation towards its employee leads to the increase of productivity can enhance the market value. This research is in line with Resources-Based Theory which explain that the company has the advantage to implement the strategy in value creation in order to the company maintain its productivity.

Chen et al (2005) state that intellectual capital positively influenced future market value and performance of the company. To be competitive in business competition, the company needs intellectual capital as an important basis for the company.

Value-added created by company's capability in utilizing resources (intellectual capital). The action will improve the intellectual capital and it instantly increases the company's market value. From the description above, the hypotheses are:

**H<sub>1a</sub>: Intellectual Capital positively influences Firm Value in Indonesia.**

**H<sub>1b</sub>: Intellectual Capital positively influences Firm Value in Malaysia.**

**H<sub>1c</sub>: Intellectual Capital positively influences Firm Value in Phillippines.**

**H<sub>1d</sub>: Intellectual Capital positively influences Firm Value in Thailand.**

## **2. Intellectual Capital and Risk of Financial Distress**

According to the research conducted by Solikhah (2010) about the relation of intellectual capital the company's growth states that intellectual capital has a significant effect on the company's growth. Intellectual Capital value that consists of three components: VACA, VAHU, STVA based on the previous research already prove to give the significant effect to the company performance because intellectual capital being the competitive advantage of the company.

Financial Distress is the condition of financial difficulties that start from the liquidity difficulty (short term) as the indicator financial difficulty in the low level, until the bankruptcy as the indicator financial difficulty in high level (Emrinaldi, 2007). Whitaker (1999) state that financial distress happens when company cash flow below the account payable that already happen. It means that the company cannot fulfill the account payable that should be payable at the time.

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. According to Rahmawati (2015) explains that the analysis of financial ratios gives an overview of the analyzer about the 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.

According to the research conducted by Ardalan and Askarian (2014) states that Intellectual Capital negatively influences the risk of financial distress of the company. The higher the value of Intellectual Capital, the risk of financial distress will be lower. The company is further away from the risk of bankruptcy. This statement also proved by the research conducted by Pour et. al. (2014). From the description above, the hypotheses are:

**H<sub>2a</sub>: Intellectual Capital negatively influences the risk of financial distress in Indonesia.**

**H<sub>2b</sub>: Intellectual Capital negatively influences the risk of financial distress in Malaysia.**

**H<sub>2c</sub>: Intellectual Capital negatively influences the risk of financial distress in Philippines.**

**H<sub>2d</sub>: Intellectual Capital negatively influences the risk of financial distress in Thailand.**

### C. Research Model

**Figure 2.1**

**Model Indonesia, Malaysia, Philippines, and Thailand**

