

CHAPTER I

INTRODUCTION

A. Research Background

Nowadays, the development of business activities is starting to develop rapidly and complex. Technological innovation and competing competition to change the way they do business so that it refers to change that are continuously competitive and have a going concern concept (Widarsono, n.d). The performance of business organizations is influenced by their strategies and operations in market and non-market environments (Baron, 2000). In financial reports it is necessary to create intellectual capital, this is because the source of economic value is not the production of material goods, which is proven that financial statements have limitations in explaining the value of the company. The creation of intellectual capital in the form of human capital and structural capital consists of databases, brands, processes, and systems (Edvinsson and Malone, 1997).

The intangible asset that becomes a new source of financial performance and competitive advantage is knowledge. This is because the success of a business depends on the company's ability to use its knowledge resources (Pulic, 2004). Knowledge has become a new engine in a business development (Starovic et al., 2003), so that in the end business people are starting to realize that the competitive ability of a company lies not only in how many tangible assets it has, but also in the ability to innovate, information systems, organizational management, and its human resources (Agnes, 2008). If

knowledge is the engine of development, a successful organization is one that leverages the knowledge and skills of its employees to achieve a competitive advantage. Currently the market value of leading organizations is much higher than their book value, this difference is interpreted as intellectual capital and includes intangible assets which are not like physical assets and although they are more important and their value is not seen in traditional balance sheets (Stanfield, 2005). The measurement of intangible assets, intellectual capital, is a challenge for scholars to find new ways of measuring it. This is due to the shift from a physical-based economy to a knowledge-based economy (Pulic, 2004). The development of a science-based economy today will encourage companies to increase the importance of intellectual capital (Sawarjuwono and Kadir, 2003).

The above statement is in accordance with what is stated in the Qur'an Surah Al-Mujadalah verse 11:

يَا أَيُّهَا الَّذِينَ آمَنُوا إِذَا قِيلَ لَكُمْ تَفَسَّحُوا فِي الْمَجْلِسِ فَافْسَحُوا يَفْسَحِ
 اللَّهُ لَكُمْ وَإِذَا قِيلَ انشُرُوا فَانشُرُوا يَرْفَعِ اللَّهُ الَّذِينَ آمَنُوا مِنْكُمْ
 وَالَّذِينَ أُوتُوا الْعِلْمَ دَرَجَاتٍ وَاللَّهُ بِمَا تَعْمَلُونَ خَبِيرٌ ﴿١١﴾

Meaning: "O you who believe, when it is said to you: "Be spacious in the assembly", then be spacious, Allah will certainly provide spaciousness for you. And when it is said: "Stand up, then stand up, surely Allah will exalt those who

believe among you and those who are given knowledge by several degrees. And Allah is Knowing of what you do”.

This verse explains that standing in an assembly includes knowledge and faith, and Allah SWT will exalt those who are knowledgeable and have faith to some degree according to what Allah has given them in the form of knowledge and faith. One of the sciences in question is intellectual capital which can be beneficial for the company and of course therefore, He will reward everyone who does good deeds with his deeds, if it is good it will be rewarded with good and if it is bad, it will be repaid with evil.

The importance of knowledge assets as a form of intangible assets is increasingly emphasized by business organizations (Petty and Guthrie, 2000). Intellectual Capital (IC) is knowledge that can benefit the company. The benefits mentioned are that knowledge plays an important role in providing added value and company functions. The added value and function of one company to another will be different and make each company have a different identity (Santoso and Setiawan, n.d). Intellectual capital is defined as an intangible asset which includes technology, customer information, brand name, reputation and corporate culture that are very valuable for the competitiveness of the company (Low and Kalafut, 2002). According to Huang (2007), Intellectual Capital is the total of all competencies and skills possessed by employees in creating wealth for a company.

IC is now playing a role as a key to profit growth and a source of innovation, not only as a resource and driver in creating value and growing the company

(Schiavone et al., 2014). The existence of surplus value owned by each company is a phenomenon of the interest of researchers in measuring this surplus value (Basyar, n.d). The measurement of intellectual capital is still being researched and developed along with the increasing recognition of intellectual capital as a driver of corporate value and competitive advantage keunggulan (Chen et al., 2005). One of the findings in the measurement of intellectual capital was developed by Pulic (1998) as a basis for assessing the efficiency of intellectual capital in various industries. In this model, intellectual capital is measured through the value added efficiency of human capital (VAHU), value added efficiency of capital employed (VACA), and value added efficiency of structural capital (STVA). However there are inconsistent results in the intellectual capital studies, this was responded by Nadeem et al., (2018) by reconstructing Pulic's (1998) model into an Adjusted Value-Added Intellectual Coefficient (A-VAIC) model. What distinguishes this model from the previous model is that the structural capital component is replaced by an innovation capital component, measured through R&D. Good intellectual capital in the company can improve the company's performance in financial statements.

Financial statements according to PSAK No 1 (2004) are part of a complete financial reporting process from income statements, balance sheets, cash flow statements, statements of changes in financial position, notes and reports as well as explanatory materials that are an integral part of the financial statements. Financial performance can be seen from the financial statement of a company. The

company's financial performance describes the level of implementation carried out by the company in accordance with the applicable financial implementation regulations (Fahmi, 2012). The company's financial performance shows the level of efficiency and effectiveness of the company in achieving its goals. Performance measurement is useful for decision making and company performance evaluation. Financial ratios are used by users of information to measure the company's financial performance such as profitability ratios. An indicator of financial performance that is often used to make a decision is the profitability ratio. This is because the profitability ratio is very suitable for evaluating and measuring the effectiveness of management performance in carrying out its business productivity to manage all company assets.

Based on the background described above, the researcher is interested to conduct the research with the title "**The Influence of Intellectual Capital on Financial Performance**".

This study is a replication of previous research, namely the research of Chowdhury (2018) with the title "Impact of Intellectual Capital on Financial Performance: Evidence from the Bangladeshi Textile Sector". In previous studies, Intellectual Capital testing used VAIC measurements and financial performance measurements used ROA, ROE, and ATO measurements. While in this study, researcher tested Intellectual Capital using A-VAIC measurements and financial performance using ROA and ATO measurements. The researcher uses the A-VAIC measurement model reconstructed by Nadeem et al., (2018) due to the

criticism of the insignificant results of the VAIC model by Pulic (1998). Many of these criticisms are directed at the measurement of SCE which uses HC (Human Capital) subtracted from VA (Value Added) to get SC (Structural Capital). This causes the superimposition of VA and HC. While the measurement of IC (Intellectual Capital) using A-VAIC with the cost of R&D investment as a measure of SC. Such measurement has at least two advantages. First, R&D investment represents SC so this model includes SC. Second, R&D investment overcomes the superimposition of VA and HC. In the research of Nadeem et al., (2018) the new component in the A-VAIC model (INVCE) has a positive and significant effect on ROA and ROE in developed and developing markets. This shows that INVCE is a more accurate SC measurement when compared to the VAIC model by Pulic (1998). Moreover, the researcher chose ROA as a representative for profitability measurement because this study aims to examine the effect of intangible assets, namely intellectual capital, on financial performance. Based on the research on the various sources, ROA is more effective to measure how efficient the management uses assets to generate earnings. In addition, there are also differences in the object of research, the company studied by the author is a company registered on the Indonesia Stock Exchange that are included in the manufacture companies with the years 2018-2020.

B. Research Questions

From the background that has been outlined above, the problem of research are:

1. Does Capital Employed Efficiency (CEE) have a positive association with financial performance (ROA)?
2. Does Capital Employed Efficiency (CEE) have a positive association with financial performance (ATO)?
3. Does Human Capital Efficiency (HCE) have a positive association with financial performance (ROA)?
4. Does Human Capital Efficiency (HCE) have a positive association with financial performance (ATO)?
5. Does Innovation Capital Efficiency (INVCE) have a positive association with financial performance (ROA)?
6. Does Innovation Capital Efficiency (INVCE) have a positive association with financial performance (ATO)?

C. Research Purposes

In connection with the formulation of the problem above, the purpose of this study is to obtain empirical evidence:

1. Capital Employed Efficiency (CEE) has a positive association with financial performance (ROA).
2. Capital Employed Efficiency (CEE) has a positive association with financial performance (ATO).
3. Human Capital Efficiency (HCE) has a positive association with financial performance (ROA).

4. Human Capital Efficiency (HCE) has a positive association with financial performance (ATO).
5. Innovation Capital Efficiency (INVCE) has a positive association with financial performance (ROA).
6. Innovation Capital Efficiency (INVCE) has a positive association with financial performance (ATO).

D. Research Benefit

The following are the expected benefits of the research carried out:

1. Theoretical Benefits

This research is expected to be used as a learning resource for academics and business people on intellectual capital and financial performance.

2. Practical Benefits

This research is expected to pave the way for further research on the influence of intellectual capital on the company's financial performance. This research is expected to provide many contributions to the literature on intellectual capital through the A-VAIC model.

3. Decision Making

This research is expected to help company policy makers to have a clear understanding of how intellectual capital affects the company's financial performance. So that company policy makers can appropriately maximize intellectual capital to improve the company's financial performance.