

CHAPTER I

INTRODUCTION

A. Research Background

The development of the business / trade in the world is currently very fast. This shows the ability of every human being to compete with each other for goodness. Today, the development of world economy shows the tight competition among management in developing each company. Management of the company is required to make strategies and innovations in improving the company, so that it is able to compete with the other companies. In world economy development, companies must be able to create the great future company with collective learning that is also integrated with core capabilities such as unique company resources or assets. The combination of these capabilities can create a good future for the company. The intensity of business development has made management of companies aware of the competitive ability, not only of capital ownership of the company, but also of increasing innovation, information and knowledge possessed by company resources.

Management has the responsibility to improve the financial performance and maintenance existence of the company. The company has the responsibility also in increasing the knowledge of the resources owned by the company. The current business environment requires companies to be able to manage each hard capital (physical and human capital) and soft capital. Companies must be able to develop capabilities, competencies and excellence in a sustainable manner that relies on knowledge. Companies that are able to develop their own resources can

improve firm and financial performance. Good financial performance will boost the existence and value of the company. If the value of the company increases, it will attract investors to invest in the company. High company value indicates management's ability to manage the company, such as managing company assets.

According to Chu et al., (2014), companies must have the ability to maintain and utilize knowledge as a strategic step in knowledge-based business development. Every company competes to maintain the existence of each company by creating a new innovation and increasing its resources. Various strategies are carried out by management in improving and maintaining the quality of the company, one of the strategy is by changing the business strategy from a *labor-based business* to a *knowledge-based business* (Sawarjuwono & Kadir, 2003). Currently, the company does not only focuses on physical and financial capital based on labor-based business, but also focuses on asset management / intellectual capital which makes the characteristics of the company based on knowledge.

Intellectual capital is a component that creates competitiveness and improves the financial performance of a company. Financial performance is created through the use of company-owned resources. Financial performance can be assessed by looking at the profits obtained from the company through its operational activities. The higher profits will be obtained if management has superior resources and has good knowledge and competence in their fields. Good profit growth will also have a good impact on the company and shows the company's prospects in the future.

According to QS. Al-Baqarah Verse 148:

وَلِكُلِّ وِجْهَةٌ هُوَ مُوَلِّيهَا فَاسْتَبِقُوا الْخَيْرَاتِ أَيْنَ مَا تَكُونُوا يَأْتِ بِكُمْ اللَّهُ جَمِيعًا إِنَّ اللَّهَ عَلَىٰ كُلِّ شَيْءٍ قَدِيرٌ ١٤٨

The Meaning: "For every one there is a direction to which they face (in their prayers). So hasten towards all that is good. Wheresoever you may be, Allah will bring you together (on the Day of Resurrection). Truly, Allah is Able to do all things." (QS. Al Baqarah: 148).

This verse explains how human beings are allowed to compete with each other at the concept of *Lahiriah* and *Bathiniah* in the world. The concept of competing can be interpreted with various activities that are useful and able to increase the welfare. One of these activities is competing in the business world. Competition in the business world must be carried out in a way that is *halal* and *thoyib* so that it is able to get blessings from Allah SWT. By doing a *halal* and *thoyib* business, the blessings of business and the value of the company are not only beneficial in this world but also useful in the hereafter.

The increasing firm value shows the potential good market value for the company. The high corporate value creates investor trust to management in managing the company. Management takes various ways in increasing the profit of the company which has a positive impact on the value and financial performance of the company. One way that a company can maintain its existence and improve good performance for the company is by continuing to innovate to develop better quality human resources, advanced technology, and create good relationships between the company and customers, where these three things are components of Intellectual Capital.

Intellectual capital is an intangible asset that is managed by management by utilizing science and technology. In intellectual capital, there are components (hidden value) that can increase the company's growth and competitiveness. Intellectual capital began to develop after issuance Statement of Financial Accounting Standards (PSAK) No. 19 regarding intangible assets (Revised 2010). PSAK No. 19 which describes intangible assets, where intangible assets are identifiable non-monetary assets without any physical form.

The competition between all of the companies can be implemented by utilizing all the resources, with result that it can produce high company value. The two verses, Al Baqarah: 70 and 148, have relevance to this research. This research is intended to convey the relationship between Intellectual Capital and the competition of each company in increasing the value of the company.

According to QS. Al Isra Verse 70:

وَلَقَدْ كَرَّمْنَا بَنِي آدَمَ وَحَمَلْنَاهُمْ فِي الْبَرِّ وَالْبَحْرِ وَرَزَقْنَاهُمْ مِنَ الطَّيِّبَاتِ وَفَضَّلْنَاهُمْ عَلَى
كَثِيرٍ مِمَّنْ خَلَقْنَا تَفْضِيلًا (70)

The meaning: "We have honored the sons of Adam; provided them with transport on land and sea; given them for sustenance things good and pure; and conferred on them special favours, above a great part of our creation." (QS. Al-Baqarah: 70).

The verse explains how perfection and honor are possessed by mankind. In this verse, there is the word تَفْضِيلٌ which has the same meaning as *Al-Takrim*, namely how the wealth and perfection possessed by mankind is given by Allah SWT. Al-Takrim in the verse is interpreted as a difference and wealth in the form

of intellect that only mankind has and is not shared to the other God's creatures. Intellectual has a function so that humans can understand everything, including in providing an understanding of business development. Intellectual and understanding in the world of business is one of the important points that humans must have, because these two things are the capital to develop better business management. If a company is managed by human resources who are poor in knowledge, intellectual and understanding of the company's development, the company cannot develop better.

Intellectual Capital is the center of attention in creating value added in gaining a competitive advantage in business, especially for companies that are knowledge-based in industries (Nimtrakoon, 2015). Intellectual capital is one of the intangible assets that cannot be measured accurately. In the research of Frykman and Tolleryd in Hamdan (2018), intellectual capital is all non-financial assets that are not appearing on the balance sheet at various companies. The component of intellectual capital according to Bontis (2000) are Human Capital, Relational Capital and Structural Capital.

According to Pulic (2000), there is a methodology that is often used in measuring the efficiency of intellectual capital and financial capital, by supporting the value added of the company. Pulic has developed the methodology for calculating intellectual capital and is used by all researchers. The methodology for calculating Value Added Intellectual Capital (VAIC) developed by Pulic consists of several main components consisting of physical capital value added, human capital value added, and structural capital value added.

The components of intellectual capital are related to each other. The components of intellectual capital formed by three main elements, namely Human Capital, Structural Capital and Customer Capital are interrelated and have an effect on business performance. Human capital, which is the capital owned by the company, which includes the knowledge and skills of employees. Human capital shows how each employee is able to create a product with their abilities. The availability of information and technology within the company is part of Structural capital. Relational Capital is capital that manages good relationships between companies and consumers. Each component is interconnected in the creation of value and productivity from business performance.

The company uses intellectual capital to generate higher profits. Intellectual capital is an important capital for the development of company performance (Serenko & Bontis, 2013). The company's performance can be seen by external parties (investors) through the company's financial reports. Financial report is a tool to provide information for users in understanding current company performance and providing an assessment of future company performance (Ebaid, 2012).

The company's financial performance is the company's ability to utilize its resources. One of the parameters in measuring firm performance is how the company gets a profit. Profit is an important thing that is needed by a company in fulfilling the company's operations. Profit also shows a positive projection for the company in the future, as high as the company's profit, it will show the company's ability to manage the company and give a positive sign to the company's financial performance.

Achievement of optimal company performance can be achieved if every sector in the company has a competitive advantage. In measuring firm performance, investors (external parties) can use several methods, namely measurement of performance based on results (accounting-based method) and measurement through risk and return to the market (market-based method). These two measurements will show how management maximizes the use of assets and capital in obtaining profits and increasing the value of the company.

Accounting-based performance measurement is the measurement most often used by investors in evaluating the ability and efforts of managers in managing the company. Accounting-based performance measurement, can be measured by looking at ROA, ROE, and EPS in financial statements. In addition, investors can take measurements by measuring market-based performance. This measurement is done by assessing and measuring the price of the company's shares circulating in the market. This assessment can be done using the Tobins'q. Tobins'q can be used in measuring company performance by looking at the company's ability to manage company assets and maximize the potential market value of a company.

Companies need capital to carry out their operational activities. One of the ways to get capital in its business activities is by attracting investors to invest in the company. Management uses various methods in creating value added to increase performance and value to the company. By providing value added to the company, the company can attract more investors to invest in the company. The higher capital obtained, the higher management must be able to manage every capital and assets owned. Management of capital and assets that are owned must increase the profit

that will be obtained by the company which will increase the value of the company as well.

In achieving and improving good performance, companies must have innovation, so that they can work effectively by maximizing existing resources, including quality human resources, reliable technology, and good relationships with customers. LQ45 Company is a reputable company which is listed on the Indonesia Stock Exchange. The LQ45 Company is a company that has good liquidity and is easy to cash in the capital market. The LQ45 Company implies that the company has good fundamental performance and management is able to produce innovation or value added for the company. The one innovations is a component of intellectual capital. The company has a goal of increasing firm performance, therefore intellectual capital can be one of the elements that must be maximized by the company so that the company is able to generate higher profits and good firm performance.

This research was conducted to determine the effect of disclosure of intellectual capital on firm performance, which is formed on two bases, namely the accounting-based method (financial performance) and the market-based method. In the research return by Sunarsih and Mendra (2012), it is mentioned that the more the intellectual capital of a company increases, the more the utilization of the company's capital. If the company is able to maximize its capital and resources, including the company's intellectual capital, the company's market share will be increased as well.

The research on intellectual capital has been carried out in various countries. The study of Tan et al., (2007), describes the relationship between intellectual capital and financial performance. The study used 150 public company data available on the Singapore Exchange. Value Added Intellectual Capital is a method of calculating Intellectual Capital on financial performance which is proxied by ROE, EPS and ASR. The results of this study indicate that intellectual capital has a positive influence on financial performance (Tan et al., 2007).

The Research on disclosure of intellectual capital was also carried out in Indonesia. Research conducted by Devi et al., (2017) examines the effect of intellectual capital on financial performance as proxies by ROA. This research shows that there is a positive influence on financial performance. The same research was conducted by Faradina and Gayatri (2016), showing that there is an influence of intellectual capital on financial performance. The better company is in managing its intellectual capital, and the better company's performance will be increasing to.

The other studies have shown different results. The results of research conducted by Santoso (2011), the research show that there is no effect of intellectual capital on company performance either based on the accounting-based method or the market-based method. The results of the same study conducted by Zakaria and Djoko (2016), show that intellectual capital does not fully affect financial performance. There is only one component which can affect financial performance, namely the Company's Capital Employee (CCE). On the contrary, the research conducted by Berzkalne and Zelgalve (2014) shows that Intellectual Capital has a positive influence on the firm value with the Tobins'Q proxy.

Several studies on intellectual capital have proven that intellectual capital has a significant effect on the company's financial performance. Several other studies have proven otherwise, meaning that there are inconsistencies in the results of the research. The inconsistency of this research is due to differences in research objects, proxies of company performance variables and analysis tools used.

Based on the background described above, the researchers are interested to conduct the research with the title "**The Relationship between Intellectual Capital and Firm Performance: Differentiating between Accounting-Based and Market-Based Performance in LQ45 Company Indonesia 2018-2019**". This research is a replication of previous research, namely the research of Allam Hamdan (2018) with the title Intellectual Capital and Firm Performance: Differentiating between Accounting-Based and Market-Based Performance. This study tested Intellectual Capital on Firm Performance by using ROA and Tobins' Q proxies' measurement.

This research was conducted due to inconsistencies in the research results, so the researchers retested by changing the research proxy. The difference in the research conducted by the author is the change of the measurement of ROA to ROE. In addition, there are also differences in the object and the year of the data which were taken in the research. The company studied by the author is a company registered on the Indonesia Stock Exchange with the criteria for companies that are included in the LQ45 IDX Company with the years 2018-2019.

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 and significant effect on Firm Performance?
2. Does Human Capital Efficiency (HCE) have a positive and significant effect on Firm Performance?
3. Does Structural Capital Efficiency (SCE) have a positive and significant effect on Firm Performance?

C. Research Purposes

The objectives from this study are as follow:

1. To examine whether Capital Employed Efficiency (CEE) has a positive and significant effect on Firm Performance.
2. To examine whether Human Capital Efficiency (HCE) has a positive and significant effect on Firm Performance.
3. To examine whether Structural Capital Efficiency (SCE) has a positive and significant effect on Firm Performance.

D. Research Benefits

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

1. Theoretical Benefits

This research is expected to provide a fairly broad and significant empirical study as a source of knowledge and scientific literature for

academics and business people who examine the effects of intellectual capital affecting companies based on accounting-based methods and market-based methods.

2. Practical Benefits

This research is expected to add experience and insight for future researchers in knowing how to reveal the effect of intellectual capital on the company. This study is expected to be an input for every company management in maximizing the use of the company's capital, including intellectual capital.

3. Decision Making

This research is expected to help management in determining policies in the utilization of intellectual capital so that increase firm performance.