

CHAPTER I

INTRODUCTION

1.1. Research background

Globalization make changes in every life aspect. These changes include the economic sector that provides a significant development effects on the management and treatment of business in the world. Businessmen are starting to realize to not depend on tangible assets, but also further develop the knowledge assets, which is one form of intangible assets. Asset knowledge is considered as one of the assets that can be used to obtain and maintain a competitive advantage for a company.

In today's knowledge based on economy, intellectual capital and more important value than physical assets are considered for organizations and businesses and the sense of intellectual capital as a strategic component of real capital and the capital of contemporary organizations, especially organizations, research centers and foundations of knowledge. Intellectual capital is born in the realm of science (Sanchez, 2010).

In the knowledge-based economy, the intellectual capital of the organization is to create value in today's world; the success of any organization depends upon the ability to manage these assets. The growing importance of intellectual capital as an effective tool is for enhancing the competitiveness of the companies. Measuring intellectual capital in order to compare different companies is necessary to determine their true value and improve their controls. Knowledge

of today's top tools of economics is, where heroic acts economics, science and technology, there is increasing use of information. Knowledge-based companies have a large proportion of their investments in intangible assets and for finance and accounting management for companies that traditionally have Unobtrusive performance in different financial situations did not reflect a real challenge of remains (Seetharaman, 2002).

Along with the economic changes that occur in companies that have the characteristics of science-based, the prosperity of a company depends on a creation of transformation and capitalization of knowledge itself (Sawarjuwono and Kadir, 2003). In science-based management systems, conventional capital such as natural resources, financial resources, and other physical assets become less important than capital based on science and technology. Rupert (in Sawarjuwono and Kadir, 2003) explained that by using science and technology, it can be obtained how to use other resources efficiently and economically, which will lead to excellence in competition. Stewart (2013) described that intellectual resources such as knowledge, information and experience, are a tool for creating wealth and defining Intellectual Capital as the new wealth of the organization.

According to the Organization for Economics Cooperation and Development (OECD, 1999) in Ulum, 2007, described Intellectual Capital as the economic value of two categories of intangible assets, namely organizational (structural) capital which refers to software systems, distribution networks and supply chains. While human capital includes human resources within the

organization and external resources related to the organization, such as consumers and suppliers.

So far, the distinction between intangible assets and Intellectual capital has been disguised in the intangible sense, both of which are referred to in terms of goodwill (APB, 1970; ASB, 1997; IASB, 2004). This can be followed to the early 1980s when the notes and general understanding of intangible values, usually given the name of goodwill, began to appear in business and accounting practices (IFA, 1998).

In tracking the practice of intangible records, Guthrie et al. (1999) and IFA (1998) found that traditional accounting cannot present information about the identification and measurement of intangibles in organizations, particularly knowledge-based organizations. New intangible types such as employee competence, customer relationships, simulation models, administration systems and computers are not recognized in traditional financial and management reporting models. Even in practice, some traditional intangibles, such as brand ownership, patents and goodwill, are still rarely reported in financial statements (IFA, 1998; IASB, 2004). In fact, International Accounting Standards (IAS) 38 on Intangibles assets prohibits the internally created brand recognition, logo (mastheads), publication title, and customer list (IASB, 2004).

Some developed countries in the world since the first intellectual capital (IC) has become the main focus of corporate management in achieving the mission and goals of the company. For example we can see Switzerland, Switzerland is a country famous for the best chocolate producers in the world,

unique in this country there is no cocoa trees, but they bring it from other countries such as Ghana and others. This proves that in addition to physical resources / assets, intangible resources in this sense intellectual capital (IC) is one of the determinants of a company's success. According to the website www.portalhr.com (2007), we can see from the big companies such as Toyota Motor Company, Samsung Group, Yahoo, Unilever, and Nokia, it seems that everyone does not doubt the success of their strategy. Believe it or not, these companies begin their success by focusing strategy not only on matters of target and revenue, but building a knowledge-based enterprise. For companies that have run the concept of knowledge based enterprise, knowledge becomes the most important and strategic resources for the company. The organization of the company should always look for ways to manage the knowledge contained in each individual member to produce quality, competing products, services and solutions, so that the company can achieve competitive advantage.

While in mainland China, several of the big companies began to realize the importance to managed the intellectual capital of the company. An Yi and Howard Davey (2010) research about intellectual capital disclosure in Chinese (mainland) companies. Finding research that, the current level of IC disclosure by mainland Chinese companies are still not high. Most of the reported IC attributes are expressed in discursive rather than numerical or monetary terms. However, the average number of items disclosed is high enough to suggest that there is a clear awareness of the significance of IC disclosure. While the disclosure quality is not considered strong, it does suggest that the companies have a

modest commitment in communicating their IC information to an external audience.

The company's awareness of the importance of Intellectual Capital is the foundation for the company to be superior and competitive. The benefits of the company by itself will provide value added for the company. Appuhami (2007) described that, the greater the value of intellectual capital (VAIC) of the company, the more efficient use of the company's capital in creating value added for the company. Physical Capital as part of intellectual capital becomes the resource that determines the performance of the company. In addition, if intellectual capital is a measurable resource for increasing competitive advantages, then intellectual capital will contribute to the company's performance. Intellectual capital is believed to play an important role in improving corporate value and corporate financial performance. That companies are able to utilize intellectual capital efficiently, then the market value and company performance will increase.

According to Pulic (1998), the main goal in a knowledge-based economy is to create value added. In order to create value added, we need the right size of physical capital (financial funds) and intellectual potential (represented by employees with all the potential and capabilities attached to them). Furthermore, Pulic (1998) described that intellectual abilities (then called VAIC™) show how both these resources (physical capital and intellectual potential) have been efficiently utilized by the company.

Pulic (1998: 1999, 2000) does not directly measure company IC's, but proposes a measure to assess the efficiency of value added as a result of the

company's Value Added Intellectual Coefficient (VAIC). The main components of VAIC TM can be seen from the company's resources, such as physical capital (VACA - value added capital employed), human capital (VAHU), and structural capital value (STVA).

Meanwhile, the corporate financial performance of the company is one of the fundamental aspects of the company's financial condition that can be done based on the analysis of the company's financial ratios in a period. Robert Ang (1997), some of the usual financial ratios Used in conducting fundamental analysis are Price Earning Ratio (PER), Return On Investment (ROI), Current Ratio (CR), Debt to Equity Ratio (DER), and Total Assets Turnover.

The relationship between VAIC TM and corporate financial performance has been evidenced empirically by Firer and Williams (2003) in South Africa. The results indicate that the relationship between the efficiency of value added IC (VAIC TM) and the three basic measures of firm performance (such as ROA profitability, ATO productivity, and MB - market to book value) are generally limited and inconsistent. Overall, the results of this study indicate that physical capital is the most significant factor affecting the performance of companies in South Africa.

Chén et al. (2005) used the Pulic (VAIC TM) model to examine the relationship between IC and market value and company corporate financial performance using a sample of public companies in Taiwan. The results show that Intellectual Capital (VAIC TM) positively affects the market value and corporate financial performance of the company. In fact, Chen et al. (2005) also evidences

that Intellectual Capital (VAIC™) that can be one of the indicators to predict the company's performance in the future. In addition, the study also proves that investors may provide different assessments of the three components of VAIC™ (such as physical capital, human capital, and structural capital).

Tan et al. (2007) used 150 companies listed on the Singapore stock exchange as a research sample. The results are consistent with the research of Chen et al. (2005) that IC (VAIC™) is positively related to company performance; IC (VAIC™) is also positively related to the company's performance in the future. This study also proves that the average growth of IC (VAIC™) of a company is positively related to the performance of the company in the future. In addition, this study indicates that the contribution of IC (VAIC™) to company performance is different based on the type of industry.

Maditinos et al. (2011) used 96 samples from the company population listing on the ASE (Athens Stock Exchange) in Greece, examined the impact of VAIC on firm performance and market value. In the research indicates that IC has no effect on market value, other than that only human capital efficiency (VAHU) that influence on market value. In this study IC also has no effect on company performance and only capital employed efficiency (VACA) which affect to company performance (ROE).

In china, research about Intellectual Capital observed by Zhang Xinyu (2014) used public pharmaceutical companies in mainland china period of 2010 to 2012, conclude the relationship between intellectual capital and firm performance, through Value Added to Invested Capital (VAIC) method of evaluating

intellectual capital and factor analysis of firm's overall performance score. The research finds out that both financial capital and human capital are positively correlated with firm performance while structure capital has no impacts on China's medicine/ manufacturing. Human capital of Western medicine manufacturing has a more positive correlation with firm performance than that of Chinese medicine manufacturing, but structure capital has no correlation with performance.

At the same time, Mina Kharal et al. (2014) also research intellectual capital and firm performance, an empirical study on the oil and gas sector of Pakistan. Using the VAIC model of intellectual capital measurement ROA, ROE, EPS, Sales growth and M/B ratio as proxies of internal and external performance of the company. This research finds out that has positive impact of intellectual capital on the organizational performance and value in the Oil & Gas sector of Pakistan. Thus, intellectual capital could be considered an intangible asset and spending with regard to the development and establishment of intellectual capital should be considered asset with long term value.

Furthermore Zarei et al. (2015) conducted a study on Iranian Banks listed in Tehran stock Exchange over the period 2004-2013. The result of regression analysis shows that structural capital and human capital efficiency have positive and significant effects on banks' corporate financial performance. Also, the first lag of physical capital efficiency has positive and significant effect on ROA, ROE, and ATO, but, its effect on MB is not significant. Finally, estimations show that

the effect of IC on the corporate financial performance of banks is positive and significant

Based on the results of previous studies, the researchers tried to re-examine the influence of Intellectual Capital on the performance of existing companies in Mainland China. Researchers took samples from manufacturing companies listed on the Hong Kong Stock Exchange for the period 2013-2015.

This research using the indicators, that are Return On Assets (ROA), Return On Equity (ROE), and Asset Turnover (ATO) with method proposed by Pulic that is Value Added Intellectual Coefficient (VAIC). Using the VAIC variables as proxy intellectual capital refers to the research of Chen et al. (2005), Tan et al. (2007) and Ulum (2007). Based on the explanation above, this study is entitled **“The Impact of Intellectual Capital on Corporate Financial Performance: Analysis of Manufacturing Companies Listed in Hong Kong Stock Exchange for Period of 2013-2015”**.

1.2. Problem Identification and Limitation

1.2.1 Problem Identification

Based on the research background above, the identification problem of this research are follow:

- a. In the knowledge-based business era, the increase in corporate performance is not depend on tangible assets, but also uses intangible assets. Intangible assets are intellectual capital. Intellectual capital is considered one of the most influential factors in improving company's

performance. Because the success of any organization depends on the ability to manage these assets.

- b. The current level of Intellectual Capital (IC) disclosure by mainland Chinese companies are still not high and the disclosure quality is not considered strong. Even though, the Chinese companies started to realized the important of the intellectual capital for the company still going concern.

1.2.2 Problem Limitation

The problem limitation, it's necessary to make a clear the hedging of problem analyzing. The aim is to prevent the deviation problem. This research is only for H-shares companies which is manufacturing companies in Mainland China and have been listed their share on Hong Kong Stock Exchange at least for period 2013-2015. The company's financial statements have closing date of December 31 and declare monetary information in Chinese Yuan currency. The net profit, equity book value, and asset Turnover of the companies must positive. The dependent variable studied are profitability ratios such as Return On asset (ROA) and Return on Equity (ROE) and activity ratio is Asset Turn Over (ATO)

1.3. Problem Formulation

Based on the phenomenon above, the problem formulations are:

- a. Does Intellectual Capital (IC) has positive significant impact on Return On Asset (ROA)?
- b. Does Intellectual Capital (IC) has positive significant impact on Return On Equity (ROE)?
- c. Does Intellectual Capital (IC) has positive significant impact on Asset Turnover (ATO)?

1.4. Purpose of Research

Based on the problem formulation above, this study aims to determine that the impact of intellectual capital (IC) on the corporate financial performance of manufacturing companies listed in Hong Kong stock exchange for the period 2013-2015.

1.5. Benefit of Research

This study is expected to provide the following benefits are:

- a. For writer

The writer can understand the impact of Intellectual Capital (IC) which is an intangible asset on corporate financial performance of the company.

- b. For companies

As basic consideration for the company to developing their Intellectual Capital (IC) to improve company performance.

c. For investor

This study can give information to investor that intellectual capital has impact on corporate financial performance of the company, the investor to know the real situation, so it can be used as basic for decision making.

d. For next researcher

This study can give information for the next researcher.