CHAPTER I

INTRODUCTION

1.1 Background

The goals of companies are to meet the stockholders' interest, to increase company value, to satisfy the needs of society, and to create a good company profile. The achievements of these goals are determined by the company's performance as a composite assessment of how well a company executes on its important parameters. There are several parameters to assess the company's performance, such as financial aspect and market valuation aspect.

A company's overall financial health can be assessed by examining its profitability. Profitability refers to the company's ability in using its resources to generate profits (earnings). It is very important for investors to be aware of profitability information to estimate the return on investment. Without a good rate of profitability, it will be difficult for a company to attract the external parties especially investors as the source of financing. It shows the importance of the profit for company's sustainability.

The market valuation is given by investors for the company value itself. Company value is an image of the public's trust based on the company's accomplishments. The company value is associated with its stock price. But, it is generally known that the stock's market value of a company could exceed or less than its book value. Therefore, it is important for investors to know whether the company is overvalued or undervalued.

The performance of the company has reported on its financial statement. The statement contains information which is useful for stakeholders in order to make the decisions. However, financial statement information has a limitation in explaining the company's value because it does not provide the hidden value. It makes the financial reports became lose their relevance and it cannot use to make decisions for investing and credit. Hence, the concept of intellectual capital is required because of its ability to explain and to provide the company's hidden value.

The understanding of the importance of intellectual capital (hereinafter referred to as IC) in Indonesia is increase since there is a high level of competition as the coming of the globalization and free trade regime. To maintain its market, according to Kuryanto in Dewi et al. (2014) the companies have to change their business strategy from labor-based business to knowledge-based business. In a knowledge-based company, they apply the concept of knowledge management in charge of looking for information on how to select, manage, and utilize resources efficiently. Therefore the conventional capital resources, financial resources, and other physical assets become less important than capital based on knowledge and technology.

IC is important for companies because of this following reasons: first, IC information provides an indication of the future potential of a company (Berzkalne and Zelgalve 2014), it commonly happens that the market value of a firm exceed its book value, or there is large differences exist between company market and book value, and it can be explained by intellectual capital. Second, IC

contributes a very important role in creating and sustaining competitive advantage and value to a company.

The strategic role of intellectual capital is a company's potential to increase the competitive advantage that is might be not owned by other companies or difficult to be imitated by other competing companies. Intellectual capital with all of their knowledge and technology will be able to anticipate and adapt all forms of uncertainties that could threat the company's existence. Such conditions are benefiting in order to enhance firm's value through profit creation, strategic positioning (market share, leadership, and reputation), technological innovation, customer loyalty, costs reduction, and the increasing of productivity (Dewi et al., 2014).This statement is congruence with the Resource-based view (RBV) theory.

RBV theory explains that the company has resources which can make the company have a competitive quality and be able to direct the company to own a good long-term performance. The valuable and scarce resources can be directed to create competitive quality; hence the resources owned are durable and not easily copied, transferred, or replaced (Ulum et al., 2016). Hence, the company must aware with its intellectual capital as an important resource, because every company has unique intangible resources that able to create value in the market. It is should be managed well in order to increase company's competitive advantages.

The issue of whether IC affects the company's performance has attracted the attention of several researchers. The research by Aziz et al. (2010) has aimed to measure the effect of IC elements on the business performance of Jordanian Pharmaceutical firms. Based on their journal, most organizations do not understand the IC nature and value. Where IC in Jordanian pharmaceutical firms is consider as a newly emerging concept. This research's result finds that IC and its elements have a substantive and significant relationship with business performance.

Mehri et al. (2013) tries to examine the effect of the aggregate measure of IC and its components on firm performance. They take the firm performance of high intangible-intensive industries in Malaysia as its sample. The result is IC as aggregate measure has a positive significant effect, while the individual components of IC give different findings. It is important to point the individual components to analyze which component are more highly significant effect and which one is lower.

Fathi et al. at the same year examine the relationship between IC and financial performance. They find that there is a significant and positive relationship between IC and value added efficiency with the financial performance measure. The result of this research is similar with Mehri et al. (2013) that show the different degree of significant on IC components.

In the next year, Berkzalne and Zelgalve make an empirical investigation of the impact of IC on company value. It rising issue about large difference between company market and book value as an indication of the company's future potential. They find that increase in IC should increase the value of the company.

The further research is in 2016 by Zicheng et al. It empirically gauges the impact of IC as measured by VAIC and its components on business performance in the context of selected listed Most Admired Knowledge Enterprises (MAKE) - award winners and their comparable non-MAKE recipient counterparts. It compares the MAKE winners and non-MAKE winners in order to measure the impact of IC and business performance which has a result that non-MAKE winners company is highly influenced by IC rather than MAKE winners because of the theory of utility.

Based on the research above, it can conclude that Aggregate intellectual capital (VAIC) has a positive significant effect to company's performance while the individual components of IC will give the different finding. But the research above commonly involve the companies as a general or use only companies inhigh IC intensive industries as its sample. There only a few numbers of research that use the companies or industry based on its intellectual capital intensity such as the research by Zhiceng et al. (2016). They use companies which join in MAKE award. But, the research by Zicheng et al. themselves takes the comparison between the companies that already have to apply the knowledge basis. Hence, it is rarely to find research that makes a comparison about the effect of IC on company's performance between high IC intensive industries and low IC intensive industries.

Therefore this research is intended to give a contribution to examine and to compare the effect of IC on company's performance that has different intellectual capital intensity. This research involves manufacturing companies as its population with two purposes, to limit the research scope in order to obtain specific results and also due to competition in this type of industry is done by large companies which are competing to achieve the competitive advantage. It is expected that this research will provide more specific results.

This research is expected to be benefiting for several parties. This research is expected to gives contribution for academicians and practitioners in understanding the effect of IC on the performance of manufacturing companies that has different levels of IC intensity especially in Indonesia. It is expected to encourage the company to utilize its IC in order to become its competitive advantage. The last, it is also expected to use as a reference, comparison, and development for further research in doing the similar research.

1.2 Problem Statement

Based on the background explained before, the problems that will be discussed in this research as follows:

1. How is the effect of Intellectual Capital (VAIC) on the performance of manufacturing companies that has different intellectual capital intensity?
2. How is the effect of intellectual capital components (VACA, VAHU, and STVA) on the performance of manufacturing companies that has different intellectual capital intensity?

1.3 Research Objectives

Based on the problems formulated above, the purposes of this research are:

1. To examine and to compare the effect of Intellectual Capital (VAIC) on the performance of manufacturing companies that has different intellectual capital intensity.
2. To examine and to compare the effect of intellectual capital components (VACA, VAHU, and STVA) on the performance of manufacturing companies that has different intellectual capital intensity.

1.4 The Writing Systematic

This research consists of five part or chapters as follows:

Chapter I: Introduction

This chapter outlines the research conducted, which consists of the background; problem formulation; research purposes and benefits; writing systematically.

Chapter II: Literature Review

This chapter explains about basic theories underlying this research which are gathered from different sources (such as opinions from the experts, books, journals, and the internet – based information) and review of previous research to develop hypothesis.

Chapter III: Research Methodology

This chapter explains about the research design; population, sampling, technique and samples; types and sources of data; data collection method; research variables; and analysis techniques used to analyze the data in the research and test the hypotheses.

Chapter IV: Result and Discussion

This chapter explains the analysis of the results from the research based on the data and the information gathered answers of hypotheses developed, and discussion.

Chapter V: Conclusion

This chapter describes the conclusions from the analysis of data, the implication of research, the limitations of this research, and the research suggestions as a feedback.