CHAPTER I

INTRODUCTION

1.1 Background of the Problem

The era of globalization, technological innovation and increasingly fierce business competition, forces companies to change the strategies used in running their business. The growing business world makes business people realize that ownership of their resources is not only an ability that must be owned in competition, but the ability to innovate, information and knowledge of human resources is also an ability that a company must have. Since the enactment of the ASEAN Economic Community in 2015 which has the aim of improving the economy of each country with the concept of creating ASEAN as a single market and production business unit where there is free flow of goods, services, production factors, investment and capital and the elimination of trade tariffs for trade among ASEAN countries, resulting in considerable pressure on the industry nationally, especially in the market domestic.

To maintain the market, companies must change their business based on labor into a business based on knowledge with the main characteristics of science (Kartikasari & Hadiprajitno, 2014). With the existence of economic changes that are characterized by a knowledge-based economy with knowledge management, the prosperity of a company depends on a transformation and capitalization creation from that knowledge (Sawarjuwono, 2003). The success of a company in facing a competition is very dependent on a knowledge management strategy rather than a strategy of allocating physical and financial assets (Bontis et al., 1999). This reality causes executives to pay more attention to the intangible assets owned by their companies.

Intangible Asset has several advantages over Tangible Asset, one of which is that intangible assets have a longer and renewable economic life. This is in accordance with Barney (1991) who states that intangible assets can be treated as strategic assets that can provide a sustainable competitive advantage for the company because of their valuable, difficult to imitate, rare and difficult to substitute for other things. An example of the many intangible assets is the competence of people or employees who are in a company. If one day the employee dies, the company can recruit new people with similar skills and knowledge. So that knowledge can be said to be an essential and vital component of business and a more sustainable strategic resource to gain and maintain the company's own competitive advantage. One of the approaches used in the assessment and measurement of knowledge assets is Intellectual Capital (IC), which has become the focus of attention in various fields, including management, information technology, sociology, and accounting.

The company's awareness of the importance of IC is the foundation for a company to be superior and competitive. The superiority of the company itself will provide added value for the company (Solikhah et al., 2010). According to Mondal and Gosh (2012), the definition of Intellectual Capital or IC differs from one researcher to another. There is no mutual agreement regarding the definition of IC. In general, IC can be defined as an intangible asset, or an important intangible factor of a company, that has a significant impact on the overall performance and success of the company, even though IC is not explicitly presented in the balance sheet (Ghosh & Mondal, 2009; Joshi et al., 2013). IC is a combination of staff competency, internal structure, and external structure (Chowdhury et al., 2018). Although there are various definitions of IC, mainly due to the fact that there are two approaches, namely knowledge-based and economic, a large number of scientists and practitioners identify three components of IC, namely human capital, structural capital and customer (relational capital) (Chowdhury et al., 2018; Maditinos et al., 2011).

Human capital (HC) is a core component of IC which is indicated by the company's wealth as seen from employee competencies consisting of knowledge, skills, education, relationship skills and values (Chowdhury et al., 2018). Bontis et al., (1999) stated that HC simply represents the individual knowledge stock of an organization which is represented by its employees. If the human resources owned by the company are good, the management of the company's assets will be good, with good asset management, the company will gain an advantage in competing with other companies so that it can survive from everything that threatens the company's survival and will improve performance corporate finance.

Structural capital (SC) is also very important for an organization to create added value for the products produced and to gain competitive advantage and advantage through the use of IC in creating value through the development of simultaneous work processes (Collins & Smith , 2006). SC is the supporting infrastructure that supports the functioning of HC. Bontis et al., (1999) argue that if an organization has a very bad SC, it will be very difficult to achieve the full benefits of IC as a whole.

Customer (relational) capital (RC) includes consumer loyalty, service to all consumers, and good relations with suppliers (Chowdhury et al., 2018), the important concept of RS is knowledge formed in marketing channels. A developing organization that has a good RC can create a good dynamic between suppliers and customers. This is because the supplier or customer has high loyalty, this condition can increase the profit earned by the company. This is because RC is an IC component that provides real value to the company.

Chen et al., 2005 suggested an indirect measurement of IC, namely by measuring the efficiency of the added value generated by the company's intellectual ability, called the Value Added Intellectual Coefficient (VAIC). The model concept used in VAIC is the concept of tangible capital and financial capital and IC (Bayraktaroglu et al., 2019; Chowdhury et al., 2018). VAIC is a method for measuring the IC performance of a company which is a value added coefficient consisting of Capital Employed Efficiency (CEE), Human Capital Efficiency (HCE) and Structural Capital Efficiency (SCE).

This approach is relatively easy and possible because it uses existing data in the company's financial statements. VAIC describes how much intellectual capital adds value to a company from the use of these assets. Use of the VAIC measurement method provides opportunities for companies and stakeholders to find out how much tangible assets and intangible assets provide value and how efficient they are in providing benefits to the company (Kujansivu & Lönnqvist, 2007).

Resource based theory is used as the basis of research theory. According to Barney (1991) this theory explains the resources needed for the company and whether it can manage or use it. Resource based theory states that IC is a company resource that plays an important role, as well as physical capital and financial capital (Solikhah et al., 2010). Intellectual capital is used as a knowledge-based company asset, consisting of the company's experience, expertise, and abilities. Intellectual capital is usually used to help the company's business continuity in order to achieve long-term competitiveness (Pike et al., 2005). Based on this context, companies need to develop strategies to be able to compete in the market. In principle, sustainability and the capabilities of a company are based on IC, so that all available resources can create value added (Puntilo, 2009). IC as an organizational capability to create, transfer, and implement knowledge.

The company's financial performance is a result that makes use of resources. Profit is a parameter in measuring financial performance. Therefore, profit is needed by a company for the survival of the company. Profits will be obtained if the company continues to carry out its operational activities. The company's operational activities will be achieved if it has resources who are knowledgeable and competent in their fields. Profits will provide a positive signal for the company's future prospects regarding the company's financial performance so that with the increasing profit growth, it will provide a positive signal for the company's financial performance. Better profit growth will indicate that the company's financial performance is getting better, because profit is a measure of a company's performance. The financial report contains a summary of the company's financial data and performance results for one year. The financial statements are prepared based on the interests of company management and other parties who have an interest in the company's financial data. The financial report produced by the company is an information used in assessing the company's financial performance. Profit is an indicator of the performance of a company, because the presentation of the information presented is an important focus of financial performance. Investors will see the company's performance from the annual financial reports issued by the company based on the company's financial performance and operational performance.

Measuring the company's financial performance is a reference that can be profitable or not profitable for a business. Measurable company performance to find out all information is needed by stakeholders and other interested parties. Companies that have achieved their goals can be seen from the results of their work so that various efforts will be made to achieve good performance. One of the things done by the company in order to achieve good performance and be able to continue to innovate is that the company effectively develops quality human resources, reliable technology, and good relationships with customers where these are elements of IC.

With the management of IC performance as an added value in the company, it can also be seen as an effect on performance. The measure of business performance in this study is seen from the company's financial performance in terms of company profitability and company efficiency. Profitability is also related to efforts to maintain the survival of a company in the future. High profitability will reflect better financial performance. IC used by a company to maintain and increase its profitability. Efficiency is also related to efforts to maintain the life of a company, this can be seen how efficiently a company manages company assets so that it can be said that the efficiency of the company in managing assets is related to IC. High efficiency will reflect better financial performance as seen from the management of company assets.

Currently, intellectual capital is one of the important issues that is very interesting to study, various research results show inconsistent results (Chowdhury et al., 2018), especially about IC with company performance. The greater the intellectual capital, the more efficient the use of capital in the company. The results of research by Firer et al., (2003) found that intellectual capital has a positive effect on company performance. Likewise, research conducted by Chen et al., (2005), Chu et al., (2011) proved that intellectual capital has a positive effect on firm performance and market value. Komnenic & Pokrajčić, (2012) who examined the performance of MNCs in Serbia found that there was a positive relationship between human capital and all financial performance indicators used but structural capital was only positively related to ROE, whereas based on (Chowdhury et al., 2018) it shows that IC affects The productivity outcome of a company and IC shows little influence on the company's financial profitability based on ROE and does not show a significant effect on ROA.

Contrary to this study, the research of Solikhah et al. (2010) failed to prove that IC had a positive effect on the market value of the company. In the research of Chu et al., (2011) which examined the effect of IC on MBTV, ROA, ROE, and ATO, it shows that there is a negative relationship between Human Capital indicators and all financial performance indicators. Research conducted by Achmad Solechan, (2017) on the financial performance of companies in Indonesia found that Human Capital has no effect on EPS and has a negative effect on ROA and Tobins'q and structural capital also has a negative effect on EPS, ROA, and Tobins'Q.

The inconsistent research results make the authors interested in examining IC matters and proving empirically whether IC has a significant effect on the financial performance of textile and garment industry companies listed on IDX in the 2016-2019 period. The reason the author chose the textile and garment industry is referring to previous research, namely research by Chowdhury et al., (2018) which examined textile companies in Bangladesh and in Indonesia the textile and garment industry is a national priority that is still prospective to be developed. The Textile and Garment Industry itself is one of the contributors in the non-oil and gas processing industry to the contribution of Indonesia's Gross Domestic Product. Based on data obtained from the Central Statistics Agency, the development of the Textile and Garment Industry has increased from 2016 to 2019.

Table 1.1

Development of Textile and Garment Industry to GDP (In %)

Type of industry	**2016**	**2017**	**2018**	**2019**
Non-oil and gas industry	4.43	4.85	4.77	4.34
Textile & Garment Industry	-0.09	3.83	8.73	15.35

Source: secondary data, processed

In table 1.1 it can be seen the development of the textile industry and Garments from 2016-2019. With the appointment of the Textile and Garment industry as a pilot for industry 4.0 and since the establishment of the Free Flow agreement between ASEAN countries, which is a formidable challenge, it requires the textile and garment industry to improve human resource competence which is in line with IC so that the textile and garment industry can survive in the market. Because basically, IC affects the performance level of a company. According to (Ulum et al., 2008) the creation of intangible value should receive sufficient attention because it has a very large impact on the company's financial performance. If the company aims to increase profit revenue, then good service and relationships with customers are needed. IC is a unique resource that makes IC as the key for companies to create value-added companies and achieve the company's competitive advantage. Companies that have a competitive advantage can survive and compete with companies in a business environment. The indicator used in this assessment is the profitability of the company using the ratio of Return on Assets (ROA) and Return on Equity (ROE) and the efficiency of the company using the Asset Turnover (ATO) ratio in accordance with previous research conducted by Chowdhury et al., (2018).

1.2 Problem Formulation

Based on the background of the problems described above, the problem formulations to be examined does intellectual capital and its indicators affect the financial performance of textile and garment companies listed on the Indonesia Stock Exchange?

1.3 Research Objectives

The objectives of the research is to determine the effect of intellectual capital and its indicator on financial performance.

1.4 Research Benefits

The results of this study are expected to provide benefits to the author himself and various parties. First, the results of this study are expected to be material for consideration and input for textile and garment companies that are in an effort to improve financial performance and increase corporate value in the face of today's competitive era. With the research on the role of intellectual capital, it is hoped that companies in Indonesia will increasingly realize the importance of a good managerial role in managing every asset they have, including intangible assets. Second,this research can be used as material for further research in order to increase insight and knowledge about the influence of intellectual capital on financial performance and corporate market value.

1.5 Writing Systematics

This research consists of five chapters. First, Chapter 1 as Introduction that will describes background, problem formulation, research objectives, research utility and writing systematics. Second, Chapter 2 Literature Reviews, this chapter contains the theory used to approach the problem to be studied. Then also completed with studies that have been done previously by other researchers. In addition, theoretical studies also contain theoretical frameworks and hypotheses formulated to conduct research.

Third, Chapter 3: Research Methodology,This section describes the methods used in research by providing an explanation of the variables in the study, population and sample, data collection sources and methods, and data analysis techniques. Fourth, Chapter 4: Research Results and Discussion This chapter will discuss the description of the research object, data analysis, interpretation of the results and arguments for the results obtained in accordance with the techniques used. And the last, Chapter 5: Closing that contains an explanation of the conclusions, limitations of the study, and suggestions from this study for interested parties.