

# Is it possible that intellectual Capital Affects Performance?

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Received: January 19, 2021

Revised: March 01, 2021

Accepted: March 22, 2021

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## Abstract

The impact of capital structure, good corporate governance, and intellectual capital on financial performance and firm value is examined in this study. The impact of financial performance on the value of a company. Examine the impact of capital structure, corporate governance, and intellectual capital on a company's financial performance. There were 193 financial reports in this study, with a sample size of 62 financial reports. Purposive sampling was used as a sampling technique. SEM-PLS is the analysis method used. The findings show that capital structure, good corporate governance, and intellectual capital have a positive and significant impact on financial performance and firm value. Firm value is influenced by financial performance in a positive and significant way. Good corporate governance and intellectual capital have a small but significant impact on firm value through financial performance. Through financial performance, capital structure has a negative and insignificant effect on firm value.

**Keywords:** Capital Structure; Good Corporate Governance; Intellectual Capital; Financial Performance; Firm Value

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## 1. Introduction<sup>a</sup>

Management's ability to improve shareholder welfare is an indicator of the company's management success (Ahmad et al., 2018). Investors believe that a company's value reflects its success in general (Sujoko & Soebiantoro, 2007). A company's value is reflected in the share price, which is determined by the capital market's demand and supply. It reflects how the general public views financial performance (Naufal, 2014). Stock performance, as measured by stock price, is highly correlated with firm value. According to (Munawir, 2010), financial performance in a company is a description of the company's financial condition to provide accurate information for stakeholders in making financial decisions (Putri & Lutfillah, 2020). Financial performance can be measured on two levels: on the inside, by looking at the ratios in the financial statements, and on the outside, by evaluating the company's value as expressed in share prices (Sarafina & Saifi, 2017). As measured by stock prices, companies with strong financial performance can increase their value and avoid financial difficulties (Rumini et al., 2019).

Good financial performance will send a positive message to investors and shareholders about a company's long-term viability and survival (Siro, 2013). The capital structure of a company has a direct impact on its financial performance (quote). The capital structure combines the company's sources of long-term funds used for operations to maximize its value (Husnan & Pudjiastuti, 2004). A company's capital structure refers to how it finances its operations with a combination of debt and equity capital (Martis, 2013). When the capital structure is above the target of its optimal capital structure, increasing debt lowers the company's value (Brigham & Houston, 2006). Previous research findings have not yielded consistent results when it comes to determining the optimal capital structure. It's due to differences in industry types and characteristics, which lead to differences in business risk and, in turn, affect the optimal capital structure's composition. Meanwhile, the findings of Wheeler et al., (2000) show that if a company is not profitable, it is necessary to reduce debt. It is due to the fixed costs of debt repayment and interest payments. According to the trade-off theory (Myers, 1984), debt can be used if the benefits of tax savings outweigh the company's obligation to pay interest and nominal installments. However, if debt usage exceeds the optimal capital structure's limit or the cost of capital is too high, the company's value will suffer. Empirical research on capital structure's impact on financial performance and firm value continues to yield mixed results.

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The findings (Pratiwi, 2016; Adnyani et al., 2020; Jessica, 2018; Rahman, 2015) shows that the capital structure has a partial impact on a firm's financial performance. However, Rahman's (2015)'s findings show that not all capital structure ratios have a significant impact on firm value.

If the company has good corporate governance (GCG), it can achieve its long-term goals for its shareholders' benefit. However, a strong commitment from stakeholders is required to ensure the effective implementation of GCG (Hamdani, 2016). GCG is defined by the Organization for Economic Cooperation and Development (OECD) as a system for controlling and directing a company's business activities, including regulating the separation of duties, rights, and obligations of those with a stake in the company's long-term viability, such as shareholders, board of directors, managers, and all members, as well as other stakeholders (Widhianningrum & Amah, 2012). The ineffectiveness of the GCG mechanism, which consists of the board of commissioners, board of directors, and audit committee, which serves as a supervisor on the development of company performance, can lead to stakeholder distrust, which leads to distrust of financial performance disclosed through financial statements. The effective functioning of the GCG mechanism, on the other hand, can increase trust and provide value to stakeholders, ultimately affecting company value (Widhianningrum & Amah, 2012). The effects of the GCG mechanism on financial performance and company value are still being studied, with mixed results. GCG has a positive and significant effect on firm value, according to (Putra & Wirawati, 2020; Nurhidayah, 2020). However, results from (Sulastri & Nurdiansyah, 2017; Adnyani et al., 2020) show that not all GCG mechanism elements have a significant impact on financial performance and firm value.

One of his employees, Malinda Dee, embezzled funds from Citibank's private banking customers, as an example of Indonesia's case. It occurred as a result of Citibank's ineffective monitoring system, which resulted in the loss of approximately 500 customers (source: detik.com, 06/04/2011). The implementation of GCG, on the other hand, has an impact on the company's performance and reputation. For example, in 2015, PT. CIMB Niaga Tbk in Indonesia won the ASEAN Corporate Governance Award in two categories: top 50 ASEAN Public Listed Companies and top 3 Public Listed Companies from Indonesia based on the ASEAN CG Scorecard (source: tempo.co, 19/11/2015). Conflicts of interest are preventing the GCG mechanism from working properly in a number of companies. According to agency theory, GCG is a concept (Myers, 1984). The existence of a contractual relationship between managers and owners is explained by this theory. It is due to the fact that human nature is inherently selfish (Dalton et al., 2007). The contractual relationship frequently does not meet the expectations of the principal (Chen et al., 2012). It has the potential to increase agency costs and cause financial distress, affecting financial performance and firm value.

The dominant factor also impacts the company's financial performance, which is linked to its intellectual capital (IC). IC has been identified as an intangible asset (resources, capabilities, and competencies). Knowledge, information, human experience, resources, and company organizations are examples of intangible corporate assets (Pulic, 2008). The resource-based theory (Penrose, 1959) emphasizes how stakeholders can improve financial performance through its IC influences firm value. Superior IC can only be achieved if the company can effectively improve and manage the IC components (human capital, structural capital, and relational capital/capital employed) effectively (Sydler et al., 2014).

Because it is a source of strategic renewal, creativity, innovation, and competitive advantage, human capital is the company's most valuable asset (O'Sullivan & Schulte Jr, 2007). Meanwhile, even though employees have stopped working and left the company, structural capital remains (St-Pierre & Audet, 2011). Finally, relational capital refers to a company's ability to derive value from complex relationships with outside stakeholders (Meles et al., 2016). Effective IC component management can have a big impact on financial performance and firm value. Findings on the impact of IC on financial performance and firm value are still mixed. According to the findings of (Wijayani, 2017; Brigita & Farida, 2017), intellectual capital has a positive and significant impact on financial performance and firm value. However, research by (Nanik, 2016; Susanti, 2016) shows that IC does not affect firm value.

This research aims to look into the impact of financial performance variables on the relationship between capital structure, GCG, and intellectual capital, and firm value. In previous studies, financial performance was only used as an antecedent variable that influenced firm value. Several previous research findings continue to yield conflicting results. As a result, more research is needed to explain the causal relationship between capital structure, GCG, intellectual capital, and firm value in manufacturing companies listed on the Indonesia Stock Exchange through financial performance.

Fixed short-term debt, long-term debt, preferred stock, and common stock are balanced in the capital structure (Naufal, 2014). The capital structure is a component of a company's financial structure, reflecting how its assets are financed. It is displayed on the liabilities side of the balance sheet. Meanwhile, the capital structure refers to the company's long-term debt, preferred/priority shares, and ordinary share capital financing. Capital structure management aims to integrate the company's sources of permanent funds for operations to maximize its value. Factors such as company size, asset structure, leverage, company growth rate, profitability, taxes, lender attitudes, market conditions, internal company conditions, and financial flexibility influence capital structure selection (Brigham & Houston, 2006).

Corporate governance refers to a set of rules that govern the rights and obligations of shareholders, company executives, government creditors, employees, and other internal and external stakeholders, or a system that governs and controls a company's strategy and performance (Munawir, 2010). There are two types of mechanisms for monitoring GCG: internal and external mechanisms. Internal mechanisms such as the General Meeting of Shareholders, the composition of the board of commissioners, the board of directors' composition, and meetings with the board of directors are used to control the bank.

In the meantime, external mechanisms, such as company control and the market, influence the company and internal mechanisms.

Intellectual capital is an intangible asset that can be used to increase a company's value and competitiveness (Chen et al., 2004; Stephani & Yuyetta, 2011). The VAIC method measures the efficiency of three types of company inputs: human capital, structural capital, and physical and financial capital. The financial performance is a description of the company's financial condition over time, both in terms of raising funds and channeling funds, and is typically measured by capital adequacy, liquidity, and profitability indicators (Naufal, 2014). Knowing the level of liquidity, knowing the level of solvency, knowing the profitability level, and knowing the level of stability are the goals of measuring a company's financial performance. Dewa's (2016)'s findings show that financial performance has a significant impact on firm value. Reni (2016), on the other hand, found that not all financial performance indicators have a significant impact on firm value. A public appreciation of a company's performance and achievements in serving the community or stakeholders are called company value (Brigham & Houston, 2006). Avoiding the high risk, paying dividends, and maintaining its height are all aspects of company guidelines for maximizing company value.

## 2. Research Design and Method

This study includes causality research when viewed from variable relationships, based on the objectives to be achieved. Documentation, which is research that takes or accesses data to be sampled from a population already available through the Indonesian Capital Market Directory through the IDX website, is the data collection approach.

**Table 1. Variable Definition and Measurement**

Variable	Definition	Construct	References
Capital Structure (X1)	The company's funding structure consists of a combination of debt and equity, which can affect firm value through the cost of capital	<ul style="list-style-type: none"> <li>• Long term debt to equity ratio (LtDER)</li> <li>• Long term debt to assets ratio (LtDAR)</li> <li>• Debt to equity ratio (DER)</li> <li>• Debt to Asset Ratio (DAR)</li> </ul>	(Sartono, 2014)
Good Corporate governance (X2)	a series of systems used to control the company through supervisory mechanisms that are following the rules to create value added for all stakeholders	<ul style="list-style-type: none"> <li>• Board of commissioners size</li> <li>• Board of directors size</li> <li>• Audit committee size</li> </ul>	Faizal (2005)
Intellectual Capital (X3)	It is an intangible asset that can be used to increase the value and competitiveness of the company	<ul style="list-style-type: none"> <li>• Value Added Capital Employed (VACA)</li> <li>• Value Added Human Capital (VAHU)</li> <li>• Structural Capital Value Added (STVA)</li> </ul>	Pulic, (2008)
Financial Performance (Y)	One of the factors that show the effectiveness and efficiency of an organization in achieving its goals	<ul style="list-style-type: none"> <li>• Return on assets (ROA)</li> <li>• Return on equity (ROE)</li> <li>• Gross profit margin (GPM)</li> <li>• Operating profit margin (OPM)</li> <li>• Net profit margin (NPM)</li> </ul>	Atmaja, (2008)
Firm Value (Z)	Is the price that investors are willing to pay based on the market price the company is going to sell	<ul style="list-style-type: none"> <li>• Price Earning Ratio (PER)</li> <li>• Price Book Value (PBV)</li> <li>• Return Saham (RS)</li> <li>• Earning Per Share (EPS)</li> </ul>	Irham, (2013)

The population is a complete element that is usually a person, a transactional object, or an event that we want to study or become a research object (Suliyanto, 2018). This study's population is financial statements from 193 manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2020. (primary and chemical industry sectors, various industrial sectors, consumer goods industry sectors). The sample is a subset of the population unit or a portion of the population

(Suliyanto, 2018). The minimum sample size is 62 companies, which were chosen using purposeful sampling. The following criteria were used to sample: (a) Manufacturing companies listed on the Indonesia Stock Exchange for 2016-2020. (b) Businesses that present and publish comprehensive financial reports for the years 2016 to 2020.

SEM-PLS was used as the analytical method in this study to answer the hypothesis. The SEM-PLS testing model is divided into two parts: measurement model testing and structural model testing. All the variables in the hypothesis as written are referred to as operational research variables. Here we illustrate this research model, which is arranged in Figure 1.

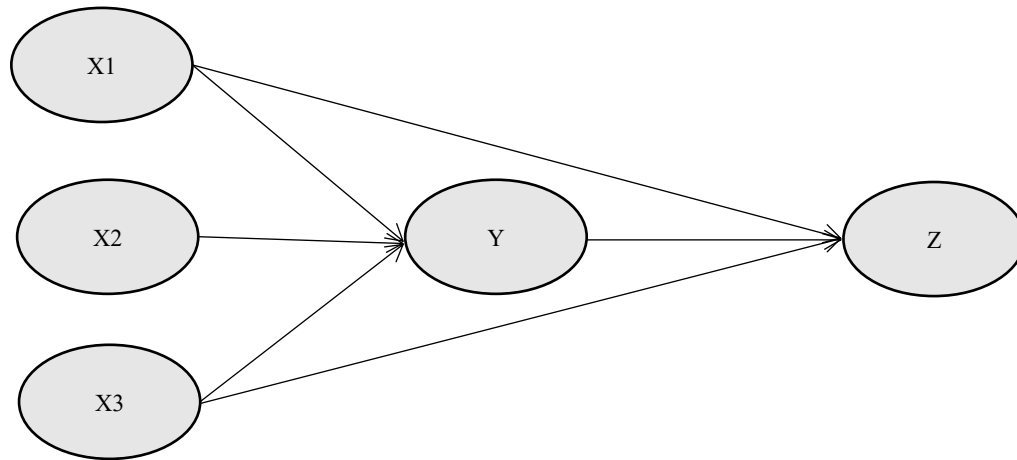


Figure 1. Research Model

### 3. Results and Discussion

#### Result Analysis

The measurement model is a component of a structural equation model that describes the relationship between latent variables and their indicators. There are three criteria for evaluating the outer model using data analysis techniques and Smart PLS software: The goal of convergent validity is to determine whether any relationship between indicators and constructs or latent variables is valid. Average Variance Extracted is used to assess Convergent Validity, a construct with reflective indicators (AVE). If the AVE value is less than 0.5, the construct can explain more than half of the items. Similarly, if the AVE value is less than 0.5 and the loading factor is less than 0.5, the instrument is considered valid (Sarstedt et al., 2017).

Table 1. Convergent Validity

Description	Loading Factor ( $\lambda$ )	AVE	Info
X1.1 ←----- Capital Structure	0,887	0,647	Valid
X1.2 ←----- Capital Structure	0,845		
X1.3 ←----- Capital Structure	0,894		
X2.1 ←----- GCG	0,835	0,810	Valid
X2.2 ←----- GCG	0,827		
X2.3 ←----- GCG	0,881		
X3.1 ←----- Intellectual Capital	0,753	0,690	Valid
X3.2 ←----- Intellectual Capital	0,743		
X3.3 ←----- Intellectual Capital	0,717		
Y1.1 ←----- Financial Performance	0,897	0,683	Valid
Y1.2 ←----- Financial Performance	0,721		
Y1.3 ←----- Financial Performance	0,714		
Y1.4 ←----- Financial Performance	0,743		
Y1.5 ←----- Financial Performance	0,765		
Z1.1 ←----- Firm Value	0,729	0,702	Valid
Z1.2 ←----- Firm Value	0,742		
Z1.3 ←----- Firm Value	0,832		
Z1.4 ←----- Firm Value	0,791		

**Table 2. Composite Reliability and Cronbach Alpha**

Variable	Composite Reliability	Info	Cronbach Alpha	Info
Capital Structure	0,809	Reliability is excellent	0,822	High Reliability
Good Corporate Governance	0,881	Reliability is excellent	0,787	High Reliability
Intellectual Capital	0,813	Reliability is excellent	0,753	High Reliability
Financial Performance	0,873	Reliability is excellent	0,851	High Reliability
Firm Value	0,821	Reliability is excellent	0,770	High Reliability

**Table 3. Latent Variable Correlations**

Variable	Capital Structure	Good Corporate Governance	Intellectual Capital	Financial Performance	Firm Value
Capital Structure	1,000	0	0	0	0
Good Corporate Governance	0,736	1	0	0	0
Intellectual Capital	0,718	0,6203	1	0	0
Financial Performance	0,740	0,723	0,549	1	0
Firm Value	0,749	0,739	0,755	0,621	1

**Table 4. AVE Roots and Discriminant Validity**

Variable	AVE Roots	Discriminant Validity
Capital Structure	0,8643	Fulfill
Good Corporate Governance	0,8426	Fulfill
Intellectual Capital	0,7681	Fulfill
Financial Performance	0,7635	Fulfill
Firm Value	0,7758	Fulfill

**Table 5. Hypothesis Testing Results**

HIP	Variable			P-Value	Direct Effect	Indirect Effect	Total Effect	Info
	Eksogen	Intervening	Endogen					
1	CapitalStructure	-	Financial Performance	0.000	-0.403	0.000	-0.403	Negative and Significant
2	Good Corporate Governance	-	Financial Performance	0.000	0.349	0.000	0.349	Positive and Significant
3	Intellectual Capital	-	Financial Performance	0.003	0.273	0.000	0.273	Positive and Significant
4	Capital Structure	-	Financial Performance	0,002	-0,248	0,000	-0,248	Negative and Significant
5	Good Corporate Governance	-	Financial Performance	0,000	0,483	0,000	0,483	Positive and Significant
6	Intellectual Capital	-	Financial Performance	0,029	0,244	0,000	0,244	Positive and Significant
7	Financial Performance	-	Financial Performance	0.000	0.424	0.000	0.424	Positive and Significant
8	Capital Structure	Financial Performance	Financial Performance	0.062	-0,248	-0,171	-0,077	Negative and Significant
9	Good Corporate Governance	Financial Performance	Financial Performance	0.058	0,483.	0.148	0.631	Positive and Significant
10	Intellectual Capital	Financial Performance	Financial Performance	0.061	0,244	0.116	0.260	Positive and Significant

Internal consistency reliability aims to determine whether any indicators can detect the latent construct (Sarstedt et al., 2017). Based on the principle that each indicator must be highly correlated with its construct, discriminant validity aims to determine whether a reflective indicator is a good measure of its construct. The correlation between constructs and the AVE root can be used to determine discriminant validity. If the AVE root value for each construct is greater than the correlation value between constructs and other constructs in the model, discriminant validity is good. Structural Model Testing (Inner Model). Inner model testing is to see the relationship between endogenous variables and exogenous variables by looking at the path coefficient results and the level of significance (Ghozali & Latan, 2015).

## **Discussion**

### ***The Influence of Capital Structure on Financial Performance and Firm Value***

The hypothesis testing findings show that capital structure has a negative and significant impact on financial performance and firm value. To improve financial performance, static trade off theory explains the balance between debt benefit and the cost of financial distress (Myers, 1984; Atmaja, 2003). Nonprofitable organizations, on the whole, rely on a significant amount of debt. Because the company has a small profit reserve, this is the case. The company uses long-term debt as an alternative source of funding. Companies with large debts pay a lot of interest and save a lot of money in taxes. Profitability is affected by companies that save a lot of money on taxes. Investors consider profitability when evaluating financial performance. The traditional theory explains why companies that use debt and companies that do not use debt have different values (Chowdhury & Chowdhury, 2010). Companies that can increase firm value through increased leverage are prudent, according to this theory. Increasing the proportion of debt in the capital structure will boost the company's value. However, increasing leverage beyond this point will raise the company's overall capital cost and reduce its total market value. Companies with strong financial performance will see their value rise.

According to the findings, financial leverage is an alternative that can be used to increase profits, according to the findings (Brigham & Houston, 2006). Financial difficulties will cause the performance to decline if the interest expense is significant and the operating profit is insufficient. On the other hand, debt interest expense is a tax deduction that can help you improve your financial situation. Debt can, in this case, be said to improve financial performance. According to signaling theory, managers must provide positive information to increase stakeholders' trust (Myres, 1984; Atmaja, 2003). This data is used to calculate the company's financial performance. A company's share price and value will rise as its financial performance improves. This study's findings back up (Pratiwi, 2016; Adnyani et al., 2020; Jessica, 2018; Rahman, 2015), demonstrating that capital structure has a significant impact on firm value. However, Rahman's (2015)'s findings show that not all capital structure ratios have a significant impact on firm value.

### ***The Effect of Corporate Governance on Financial Performance and Company Value.***

The hypothesis testing results prove that GCG has a positive and significant effect on financial performance and firm value. Stewardship theory explains that the board of directors can be trusted to act in the best possible way for shareholders' interests (quote). However, this will be different if the board of directors has behavior that tends to be self-interested because it can be detrimental to the company's interests in the long run. For example, a board of directors that prioritizes better performance is more likely to report better company profitability. Fraud committed by the board of directors to obtain personal benefits can influence shareholders' decisions. Therefore, the board of commissioners and the audit committee can help mediate between the board of directors and shareholders' interests.

According to agency theory, shareholders who are unable to manage their own company can delegate operational responsibilities to managers. However, if the manager has a conflict of interest, it may be difficult to improve shareholder welfare. As a result, a supervisory mechanism is required to manage the company effectively. GCG will promote a transparent, clean, and professional management/board of directors' work pattern. Members of the board of commissioners, the board of directors, and the audit committee will all be part of the GCG mechanism, which will help to minimize conflicts of interest between shareholders and managers. The board of directors carries out the company's operational activities. Meanwhile, the board of commissioners and the audit committee monitor the company's operations to ensure that it is well-run. Profitability, which is a measure of financial performance, is expected to rise due to good company management via the GCG mechanism. Stock prices can rise as a result of good financial performance, which impacts the company's value. GCG has a positive and significant effect on financial performance and firm value, according to (Putra & Wirawati, 2020; Nurhidayah, 2020; Sulastri & Nurdiansyah, 2017; Adnyani et al., 2020).

### ***The Influence of Intellectual Capital on Financial Performance and Firm Value.***

The hypothesis testing results show that intellectual capital has a positive and significant impact on financial performance and firm value. According to the Knowledge Based Theory, companies with good intellectual capital will improve their performance (Sveiby, 2001). When intellectual capital, which includes human capital, physical capital, and structural capital, is managed effectively, financial performance can be improved. Financial performance, as seen in financial reports, is an important source of information for company stakeholders. Stakeholders expect company management to provide information about company activities, which can be accomplished by developing good relationships, according to stakeholder theory (Gray, 1988). The presence of positive stakeholder relationships fosters trust and makes it easier for businesses to obtain funds to improve their performance. According to the Theory of the Firm, the goal of a company is to



maximize shareholder welfare (Jensen & Meckling, 1976). Financial performance, which provides an overview of a company's financial condition, reflects firm value. This study's findings corroborate those of Diaming (2017), demonstrating that intellectual capital has a positive and significant impact on financial performance. According to research, the value added intellectual coefficient does not affect firm value (Nanik, 2016; Susanti, 2016).

### ***The Influence of Capital Structure, Good Corporate Governance, and Intellectual Capital on Firm Value through Financial Performance***

According to the hypothesis test results, the capital structure has a negative and insignificant effect on firm value through financial performance. The rising use of debt raises the risk that the cost of financial distress will lower the company's profitability. Because a company's profitability reflects its financial performance, poor financial performance will impact its value. According to this study, financial performance is a variable that has no bearing on the capital structure of a firm's value. Through financial performance, GCG has a positive and insignificant effect on company value. The GCG mechanism is not well-implemented, and it has the potential to raise agency costs. It occurs because the manager's supervisory function as a board of directors is not carried out to its full potential. The company's profitability may be harmed as a result of agency costs. Profitability reflects a company's financial performance, and poor financial performance negatively impacts the company's value. As a result, financial performance is a variable that has no bearing on GCG's impact on firm value. The hypothesis test results show that intellectual capital has a positive but insignificant impact on firm value via financial performance. Profitability can be harmed by ineffective intellectual capital management. If not properly optimized, expenditures for human capital development create inefficiencies and have a negative impact on financial performance. Poor financial performance impacts relational capital, which in turn has an impact on firm value. Can have a negative impact on the company's profitability. As a result, financial performance is a factor that has no bearing on the capital structure of a company's value.

## **4. Conclusions**

Financial performance has no bearing on the value of a company's capital structure, corporate governance, or intellectual capital. The presence of agency costs and financial costs of distress results in poor financial performance and has no firm value. The right capital structure can boost financial performance and increase the value of a company. Tax savings and profitability can be achieved by using debt that does not exceed the optimal capital structure. Profitability is a measure of a company's financial success. As a result, determining the best capital structure has a big impact on financial performance and its value. The GCG mechanism can help a company's financial performance and value. The board of commissioners, board of directors, and audit committee's effective implementation of GCG mechanisms has a significant impact on financial performance and firm value. Financial performance and company value can both benefit from intellectual capital. Financial performance and firm value are significantly influenced by companies with strong human capital, structural capital, and relational capital. Financial performance can be improved by effectively and efficiently managing human capital to reduce training and development costs. Similarly, good relational capital management can improve the relationship between businesses and their customers.

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