

**EFFICIENCY OF COMMERCIAL BANKS IN MALAYSIA USING
VAIC METHOD**



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5. Report

5.1 Proposed Executive Summary

ICT has not been much considered as an important variable for intellectual capital measurement in previous studies. According to the Organization for Economic Co-operation and Development (1996), ICT is best regarded as the facilitator of knowledge creation in innovative societies. In the knowledge based economy, ICT is not only considered as a driver for change but as a tool for releasing the creative potential and knowledge embodied in people. A study of banks in UK found that Information Technology (IT) has a significant impact on intellectual capital performance (VAIC) (El-Bannany, 2008). Prior to the globalization and liberalization era, the commercial banks in Malaysia were facing stiff competition in terms of providing a variety of products and services, especially when Bank Negara opened up the financial sector to qualified foreign banks in its effort to drive domestic banks to better performance, efficiency, and innovation. Besides that, banks have been able to better serve their customers with the advance of ICT, by the usage of smart cards, ATMs, mobile banking, electronic banking, telephone banking, twenty four hour service, the overall quality of services, expanded portfolios of products and services, and better customer relationship management with the use of advanced tools and variety of products. Therefore, ICT has not only provided infinite banking opportunities to expand product and services beyond reach, but also heightens the competitions and risks faced by banks in the financial system (Voon-Chong et al, 2010). This study basically seeks to investigate to what extent the commercial banks are efficient in terms of value creation efficiency and to see whether there is a relationship between the Value Added Intellectual Coefficient (VAIC) and financial performance. Hence, this study will include ICT efficiency as another component in the VAIC method.

5.2 Enhanced Executive Summary

This thesis evaluates the intellectual capital efficiency of commercial banks in Malaysia and aims to investigate whether the intellectual capital components have an impact on the financial performance of the commercial banks as well as to identify the intellectual capital components that drive the financial indicators of the commercial banks. The VAIC method used in the measurement of IC by Pulic

measures such as on the ability to discern trends and developments in ICT which was based on the FSMP (2001). In conclusion, the intellectual capital efficiency has proved to have increasing the financial performance of the commercial banks in Malaysia.

5.3 Introduction

The traditional ways of accounting measurements are normally used as the main financial performance indicators to measure the current position of a company for decision making and formulating strategies. However, this is no longer an adequate measurement tool in a knowledge-based economy (Roos, 1998; Chareonsuk, 2008). According to Roos (1998), the traditional accounting measurements are inadequate for strategic decision making. He suggested that the traditional accounting measures must be complemented to show the potential value created all the way through in an organization and intellectual capital generally represents the critical resource in the potential value creation process. Even though physical capital is vital for business operation, intellectual capital also plays a pivotal role to indicate corporate financial performance (Chan, 2009). More often, prior to the knowledge and globalization era, the business management style has changed in response to global competition where businesses operate in the world of intangibles and intellectual capital, identified as a set of intangibles (resources, capabilities and competence) that drives the organizational performance and value creation process (Bontis, 1998).

Knowledge is involved in creating value in an organization, which is manifested as intellectual capital that includes human capital, structural capital, intellectual assets and intellectual property (Seetharaman, 2004; Bontis, 1998). Many previous studies have focused on defining practical and reliable models to measure intellectual capital (Mavridis, 2004) as a driver for increasing a firm's value and competitive advantage. However, the most suitable measure of a firms' intellectual capital is still uncertain since every model has its own advantages and disadvantages. According to Mavridis (2004), intellectual capital measurements are divided into two groups. The first group focuses on the costs or expenses (process oriented) and the second group focuses on the profit or investment return (value oriented).

5.4 Brief Literature Review

Many studies have been carried out on the intellectual capital management of businesses and industry (Pulic 1998; Goh 2005; Bontis et al. 2000; Petty et al. 2000; Nerdrum et al. 2001; William 2000; Seetharaman et al. 2004). Specifically, Seetharaman et al. (2004) stated that intellectual capital represents the conversion of knowledge into value for a firm. Intellectual capital offers an effective mechanism to manage and develop an organization. It also serves as a practical indicator when benchmarking a company against other companies (Edvinsson, 1997). Intellectual assets include people, patents, processes and brand names which are the debit and intellectual capital as the credit or the equity invested in the intellectual assets (Seetharaman et al., 2004). Stewart (1997) defines intellectual capital as “the intellectual material-knowledge, information, intellectual property, experience which can be put to use to create wealth”. In defining intellectual capital, Bontis (1998) suggested that intellectual capital does not include intellectual property as Stewart (1997) argued, but it does involve the three major components which are human capital, structural capital and customer capital, as supported by the literature (Sveiby, 1997; Roos 1998; Edvinsson and Stenfelt, 1999).

According to Bontis (1998), human capital is one of the most important sources of innovation and strategic renewal whereby it helps the organization to produce tangible and informational outputs. Next, structural capital is involved in structuring intellectual assets and customer capital refers to the knowledge from customers, suppliers, the government or related industry associations. Other than that, previous work by Petty et al. (2000) and Edvinsson (1997), defined intellectual capital as the economic value of two categories of intangible assets of a company, which are structural capital and human capital. The term structural capital refers particularly to software systems, distribution networks and supply chains, while human capital includes all internal and external human resources in an organization namely staff, customers and suppliers.

Method of Intellectual Capital Measurement

Measurement of intellectual capital has been developed by many researchers, since it is a crucial issue in analyzing the level of efficiency (Pulic, 1998). There are 34 methods of intellectual capital measurement identified in previous literature (Sveiby, 2005; Chan, 2009). However, none of the IC