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INTELLECTUAL CAPITAL AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN MALAYSIA

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ABSTRACT

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 (2001) is adopted and consists of the sum of human capital, structural capital and capital employed efficiencies. Nonetheless, this study has incorporated an additional component which is ICT efficiency as an important component for evaluating the intellectual capital efficiency of banks. This study is significant to the implementation of Financial Sector Master Plan (FSMP) by the banking institutions to enhance the level of operating efficiency and allow greater strategic focus on business operation in enhancing competition and innovation. This study will help the bankers to see how strong they are in intellectual capital efficiency compared to the foreign banks. The adoption of ICT in commercial banks has brought about many changes in the banking industry which had enhanced competitive pressures in the banking industry. Foreign banks in Malaysia are more innovative and move forward faster than domestic banks because they are able to leverage on the research and development initiative, expertise and off-the-shelf products, or introduce new systems that already have been tested by parent banks. As a result, foreign banks were more capable of identifying and reacting to changes in the market much faster than most domestic banking institutions. They were also able to open new distribution channels that operate beyond the traditional delivery methods for financial services. Therefore this study adds ICT in VAIC in order to study how efficient are the banks in terms of ICT efficiency. Data on calculating the VAIC are taken from 2001 until 2008 of 22 banks which collecting in their annual reports. The results of 22 observations showed that banks have relatively higher ICT efficiency than human capital, structural capital and capital employed efficiencies. Foreign banks are found to be more efficient during the years 2001 to 2006 and 2008, whilst domestic banks were better than foreign banks during the year 2007. Overall, domestic banks have improved and are highly competitive in the banking industry. In multiple regression model, by using panel least square method, the findings also revealed that capital employed efficiency was considered highly by the commercial banks for improving the financial performance of the banks. This implies that physical capital remains as a prominent factor in sustaining and boosting the banks' financial performance whilst human capital efficiency is considered highly by the commercial banks for increasing the profitability and the return on equity only. In addition, structural capital efficiency was proved to have a significant impact in raising the financial performance of the commercial banks, whilst ICT efficiency was considered by the commercial banks in improving the return on equity. This result is useful for the bankers and practitioners in decision making of both operational and strategic opportunities and for implementation of skill building 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.

Keywords: Commercial Banks; Financial performance; Intellectual Capital Efficiency; Value Added Intellectual Coefficient

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Chapter 1: Introduction

In the mid 1990s, Malaysia depended mostly on capital investment to lead the economic growth. It then initiated the strategy to shift from an input-driven to a productivity-driven mode (EPU, 2001). According to EPU (2004), the basis for this change was the declining marginal productivity of capital, reflected by the increasing capital output ratio. However, the change to a productivity-driven economy was slow due to the large investments with long development periods as well as the decline in output as a result of the 1997 financial crisis. The lack of skilled manpower and technology advancement also contributed to this phenomenon. Therefore, according to Economic Unit Planning (2004), Malaysia nowadays had become knowledge based economy which relates to the paradigm that focuses on intellectual capital as the key to success. The knowledge-based economy provides the platform to maintain a rapid rate of economic growth and improved international competitiveness so as to achieve the objectives of Vision 2020. It helps to strengthen Malaysia's capability to innovate; adapt and create indigenous technology; and design, develop and market new products. Basically, the knowledge-based economy will complement and accelerate the change from an input-driven to a productivity driven growth strategy, a major policy force which was initiated under the Seventh Malaysia Plan. Organization for Economic Cooperation and Development (OECD, 1996) defined a k-economy as an economy that is directly based on the production, distribution, and use of knowledge and information. However, ICT has not only provided vast banking opportunities previously beyond reach, but also heightens the competition and risks faced by banks in the financial system. Therefore, this study will look into the efficiency of the