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A STUDY ON IMPACT OF INTELLECTUAL CAPITAL ON ORGANIZATION'S PERFORMANCE

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Abstract

The main purpose of this research is to examine the components of intellectual capital and how intellectual capital affects business organizations. The study also examines how the items of intellectual capital are accounted for in the financial statements. Literature review and theoretical framework are used in describing the three components of intellectual capital, how they are recognized in the financial statements of an entity and the impact that they have in the business organization. Secondary sources of data such as journals and books are used in the study to analyze the impact that the intellectual capital has on the business organization. Results of the analysis indicate that intellectual capital impacts the business organization in various ways such as enhancing the competitive advantage, facilitating innovation, enhancing the competency of the employees and increasing the organizational performance. Financial managers could make use of this research to gain insights on the categories of intellectual capital.

Keywords: *Intellectual Capital, Innovation, Competency, Human Capital*

Introduction

Intellectual capital tends to be an important resource and a key contributor to the economic success and value creation in a business. Intellectual capital is an intangible value driver in an organization that brings about future benefits. In the current markets, competition is high and the buyers have become more informed. Also, the modern business environment is quite dynamic and the business organizations are facing many changes. The survival of many businesses depends on their willingness and ability to adapt to such changes . Through intellectual capital, the firms are able to quickly adapt to the changes and remain competitive in the markets. Intellectual capital has increasingly become a source of competitive advantage due to innovation .

In the business environment of today, intellectual capital is one of the most critical factors that bring about development and competitiveness in organizations. Intellectual capital tends to be intangible in nature and there tend to be challenged when it comes to determining its value.

According to Yang , intellectual property has three main elements which include the human capital, the structural capital and the relational capital. Human capital includes the skills and the creativity of the workers which is increased through investments in the in the training programs. Human capital includes the skills and expertise of the employees in an organization. If the employees are more efficient, they are likely to boost the performance of the business. Structural capital is also a component of intellectual capital which includes the nonhuman assets in an organization. It consists of the copyrights, the patents, procedures and rules, and policies that aid

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in decision making. Relational capital refers to the relationship of the firm with the external stakeholders . This includes the trust, the experience and the knowledge which forms the critical relationship between a business and the customers. It's the relational capital that prevents external stakeholders such as customers from abandoning the commercial relationship

Theoretical Framework

Human Capital

Human capital is one of the components of the intellectual property. Human capital includes professional competence, social competence, employee motivation and also the leadership ability. Professional competence is the experience and the expertise that has been gained in a business and in the career of the employees. Factors that contribute to professional competence include training, higher education opportunities, practical experience through working, courses and seminars. Social competence, for example, includes the interpersonal skills, the ability to relate well with others, ability to communicate and the ability to discuss in a constructive way; Social competence enhances good cooperation and learning ability of the employees.

Employee motivation tends to play an important role in an organization. Motivated employees are more willing and committed to taking on tasks. Such willingness to perform leads to more productivity in an organization. Business invest in motivating the employees through various methods such as through offering fair compensation, involving the employees in decision making, offering bonuses, commissions, promotion opportunities and freedom to make decisions.

Organizations have no ownership of the employees or the skills and competencies of the workers. The future economic benefits of the employees may not be easily determined since there is the risk of high employee turnover.

Estimating the human capital presents a lot of challenges which contributes to the lack of a reliable value that can be used in monitoring the performance of a firm based on the employment of the human capital. It's thus difficult to compare the human capital performance of one organization with another. There is also the problem of monitoring the future economic benefits that are likely to be contributed by the human capital. This makes it impossible to recognize the human capital in the balance sheet. Human capital cannot be included in the financial statements since the future benefits that received are hard to estimate . It's important for the businesses to acquire information regarding the human capital that could aid in allocating the human resource in a more effective manner .

Human Capital and Organizational Performance

Human capital is the most innovative feature for the organization to act according to the environmental changes that contribute the organizational performance through their knowledge, experience, and capabilities applied to improve the organizational efficiency . In recent studies, it is suggested that human capital is the most influential part of increasing organizational performance

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Structural Capital

Structural capital includes product innovation, corporate culture, management instruments, IT and explicit knowledge, internal cooperation, and process optimization. Product innovation brings about a better future for an organization. This is because innovation ensures that new products are brought into existence which enhances the competitiveness and the survival of the organization. Product innovation gives rise to patents and copyrights among others. Corporate culture is also part of the structural capital. Corporate culture relates to the values and the norms that influence knowledge transfer and job interactions. Structural capital include various elements such as the processes, the systems, structures, the intellectual assets as well as various intangible assets the structural capital includes the nonhuman knowledge in the organization such as the proprietary software, the computer programs, the databases, the organizational culture, and structure, trademarks patents among others . The structural capital includes those elements and assets that can be distinguished from the human capital within a firm. The structural capital tends to depend on human capital since it's developed by the human capital. For example, the patents are developed by individuals within an organization.

Structural Capital and Organizational Performance

Structural capital is also an important part of the organizational performance because the processes, internal culture, management, and technological knowledge and other features contribute towards the development of the improved performance of the organization . Therefore; researchers are considering the structural capital as a part of the intellectual capital that boost the organizational performance considerably.

Relational Capital

Relational capital includes; customer relationships, the supplier relationships, the public relationships, and the investor relationships. Customer relationships refer to the relationship between the organization and its customers. Aspects such as good customer service enhance the good relationship with the customers. Supplier relationships relate to the relationship with the suppliers including the current and potential suppliers. Managing the supplier relationships involves undertaking activities that improve relations during purchasing. Businesses take actions that improve the investor relationships such as those that provide accurate information to the investors to aid them in decision making.

Relational capital, for example, tends to be determined by the communication between the organization and the customers; some of the elements in customer capital include the market share, the profit made per customer and the rate of customer retention. Relational capital involves the knowledge that is available in various relationships within the organization.

For purposes of achieving a competitive advantage, long-term and strong relationships are very important. Such relationships need to be close. Relationships with the customers, for example, can be defined as an intangible asset if a contractual relationship exists . For example purchase and sales, orders can be identified as an intangible asset and may even sometime be recognized in the financial statement.

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Relational Capital and Organizational Performance

Relational capital is based upon the relationship of the organization with the outside and inside of the organization; therefore; it is necessary to have the good relations with the customers, suppliers, public, investors, and others because they give their best information and valuable feedback based upon the organizational performance . Therefore; it is important for the researchers to include the relational capital as a part of the intellectual capital that increases the organizational performance.

Theory of Human Capital

The experts who focus in the area of economics or business management they consider the efforts or performance of the individuals highly credible in the organizational performance similarly; quality of the workers increases the efficiency or quality of the organizational operations . Currently; employees of the organizations are considered as the human capital that increases the overall performance because of their commitment and dedication to using their abilities and knowledge in the development of organizational efficiency and performance . The theory is based upon the human should be considered as the capital for the organization as other assets are being used to perform the activities of the organization such as tangible and intangible assets that constitutes the capital for the organization similarly; in the case of the employees they are also being considered as the human capital for the organization and contributes to the organizational development and increases the performance as well .

Objectives of the Study

1. To study the concept of Intellectual Capital
2. To understand the theoretical framework of intellectual capital.
3. To study the impact of intellectual capital on organization performance

Findings

Intangible Assets

Intangible assets may include the patents and the copyrights in the organization. Companies that use international financial reporting standards, for example, may account for intellectual capital such as research and development costs. Human capital may also include assets such as brand image, trade.

Goodwill

Goodwill is an example of an intellectual capital that may emanate from the reputation of the trademark of a company. Companies with a good reputation, high status, and loyal customers may be valued more than the value of the assets. Goodwill is thus the difference between the book value and the sale price. An acquiring company, for example, has to recognize the value of goodwill in the balance sheetmarks among other.

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Patent

Business organizations do invest in protecting their ideas through patents. Ideas and developed products are easy to imitate. Patents protect the business organizations from such imitation that may affect competitiveness. Patents are intangible assets since they lack the physical substance and they provide long-term value to the business organizations. Patents are important to business organizations since they help in protecting ideas that are new and original; for example, they can be used in projecting physical devices, products, and even software.

Trademarks

A trademark refers to a sign, symbol or even phrase that helps in distinguishing the goods of a certain business organization. Some examples of trademarks include the brand names, the slogans, and even logos.

Copyrights

Some authors and business organizations may invest in copyrights to protect certain works from being copied Copyrights are a form of intellectual property protection that is provided by the laws in the United States . Copyright protection is for original works that involve authorship whether published or unpublished. Examples of original works that could be protected through the use of the patents include the paintings, the literary works, the movies, software among others.

Research and Development

Business organizations invest in research and development which involves activities that create and improve the products and processes. Research and development is intellectual capital that contributes to the improvement and the development of new products. Through investing in research and development organizations are able to increase their competitiveness in the market. Activities involve research and development includes; researching to get new knowledge, formulating new product designs, developing new technologies, modifying processes among others. Research costs are those costs that relate to investigation involved in gaining scientific knowledge. Development costs, on the other hand, involve costs incurred in applying the research and findings in designing new product

Under the GAAP, the costs incurred in research and developments are expensed in the period in which they were incurred. There is a problem with recording the research and development costs as an asset given that the future economic benefits associated with research and development costs tend to be quite uncertain. Under the IFRS, the research costs are expensed just like the US GAAP. However, the development costs are capitalized and amortized. There is, therefore, a difference in accounting for the development costs under the GAAP and the IFRS. Under the IFRS, the research costs are separated from the development costs and the development costs are capitalized. Under the US GAAP, there is no capitalization of the development costs and instead, they are classified as expenses in the income statement.

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Impact of Intellectual Capital on Business Organization

Innovation

Intellectual property contributes to innovation and innovation process in the business organizations. For example, research contributes to ideas which are further developed to bring about new products and improve the existing ones. Improvement and development of new products lead to commercialization where the products or services are sold in the markets.

Competitive Advantage

In current business environment, intellectual capital gives a competitive advantage to the business organizations. Through intellectual capital, it's possible for businesses to have successful strategies that cannot be copied easily. For example, businesses can register trademarks, patents and even copyrights which hinders competitors from imitating the products and the works of the business.

Research and Development

Intellectual property facilitates research and development. For example through human capital, organizations are able to invest in research and development which helps improve the current products and develop new products. Businesses are able to create internal knowledge by investing in research and development. Research and development contribute to more revenues and profitability in an organization. Research and development also contribute to improved processes in an organization. The more the ability to invest in research and development, the more the potential that an organization can add value to its growth. Organizations with highly skilled and competent employees are able to engage in research and developments since the human capital can engage in research to discover ideas and areas of improvement

Value Creation

According to Swart, (2006) the value that is created by the intellectual capital has become more than that created by the tangible assets. The service sector, for example, has been able to significantly grow and even exceed other sectors due to investments in intellectual capital. Intellectual capital contributes to changing an organization from an ordinary business to being a leader in the field and in the industry.

Conclusion

From the study, it's clear that intellectual capital provides immense value to a business organization. Intellectual capital items such as the intangible assets ensure that products, ideas, and concepts are not imitated in the market which offers an organization with a better competitive advantage. For the intellectual capital items to be recognized in the financial statements, they must be identifiable and measurable. Intellectual capital items such as employees' skills and competencies cannot be recognized in the financial statements since it's not possible to measure them. The research shows that intellectual capital also contributes to innovation. Skilled and experienced employees are able to come up with new ideas and apply them to improve products and processes. Intellectual property is positively linked with business

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performance . For example, it contributes to more profitability, higher return on assets and higher return on investments. In addition to the quantitative aspects, intellectual capital improves customer loyalty and satisfaction.

Limitations

The research has certain limitations and that is as follows: The research is based upon the theoretical and conceptual review and data was collected through books and journals and no empirical evidence has been brought into account hence the possibility of the generalization is questionable. Moreover, the research question was answered by a comprehensive literature review however the arguments are just limited to the refereed literature and practically no primary or secondary data was collected.

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