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INTELLECTUAL CAPITAL AND BANKING SECTOR OF PAKISTAN

MUHAMMAD KHALIQUE
LECTURER
FACULTY OF ECONOMICS AND BUSINESS
UNIVERSITI MALAYSIA SARAWAK
MALAYSIA

JAMAL ABDUL NASSIR BIN SHAARI
SR. LECTURER
FACULTY OF ECONOMICS AND BUSINESS
UNIVERSITI MALAYSIA SARAWAK
MALAYSIA

DR. ABU HASSAN MD. ISA
PROFESSOR & HEAD
DEPARTMENT OF ACCOUNTING AND FINANCE
FACULTY OF ECONOMICS AND BUSINESS
UNIVERSITI MALAYSIA SARAWAK
MALAYSIA

MOHAMMED ALKALI
RESEARCH SCHOLAR
FACULTY OF ECONOMICS AND BUSINESS
UNIVERSITI MALAYSIA SARAWAK
MALAYSIA

ABSTRACT

At the early years of 21st Century intellectual capital was appeared as a most important and prime asset of an organization to take competitive advantages in the market. Building on the literature, related theories and organizational capabilities, this paper attempts to develops and tests a conceptual framework that identify the influence of intellectual capital on the organizational performance of banking sector in Islamabad, Pakistan. This study employs quantitative analyses. For sample selection random sampling technique was used. The data were collected through structured questionnaires form. To investigate the influence of intellectual capital on the organizational performance of banking sector, Pearson Correlation and Multiple Regression were employed. The main conclusion from this study was derived; intellectual capital has positive significant influence on the organizational performance of banking sector in Islamabad, Pakistan. The contribution of this study is particularly valuable for international intellectual capital researchers. This study also offers recommendations regarding empirical applications of intellectual capital in banking sector.

KEYWORDS

Intellectual capital, human capital, customer capital, structural capital, Organizational performance.

INTRODUCTION

In a knowledge-based economy the performance and survival of organizations are determined by the speed at which the organization develops their intellectual capital. Intellectual capital is considered as the knowledge based competencies and the major competitive advantage of organization exist in its intellectual capital. In production-based economy land, labor, capital and physical assets have vital role while in a knowledge-based economy intellectual capital has a pivot position. Lonnqvist, Kujansivu and Sillanpaa (2008) argue that in a knowledge-based economy intellectual capital (IC) is an important source of wealth creation in organizations as well as in society more generally. In addition they argue that in some industries or business services intellectual capital has more values than of its traditional assets. Shaari, Khalique and Isa (2010) stipulate that intellectual capital is recognized as the most important source of competitive advantage of various organizations which lead to increase the business performance and a country's economic growth. According to Cohen and Kaimenakis (2007), Chong and Lin (2008) and Tovstiga and Tulugurova (2009) intellectual capital is appeared as the most vital source to enhance the organizational performance of organizations.

Despite the importance of intellectual capital in financial organizations; Shih, Chang and Lin (2010) identified that there are little studies that focused on the relationship of intellectual capital with the organizational performance of banking industry. Banking industry is a backbone of economy and it has very important for the development of economy. The role of banking industry in economy is highly acknowledged and appreciated. Mavridis (2004) pointed out that banking sector around the world has grown as a knowledge concentrated sector in dynamic and competitive environment.

Mavridis (2004) and Kubo and Saka (2002) argue that the banking sector can be a good sector for the research of intellectual capital. They supported that this sector is base on knowledge intensive and its entire staff are moreover are identical intellectually and professionally. According to Cabrita and Bontis (2008) from the last decade, the banking sector has been undergoing dramatic change in both structural and technological advancement. These threats are pushing top management to restructure their business strategies. This notion is also supported by Bhartesh and Bandyopadhyay (2005) who pointed out that it is essential for organizations to understand their intellectual capital and should need to be properly managed if the organizations want to stay in competitive environment. Therefore, it is essential that the top level management of the banking industry learns to employ the intellectual capital effectively and efficiently to improve their organizational performance in a knowledge-based economy.

Pakistan is situated in South Asia. Pakistan is a developing country and sixth largest populous country in the world. Pakistan has India and China, the two most populous countries of the world, her neighbor. Due to its large population size, it is a potential attraction market for many commercial activities (Ahmed and Ahmad, 2008). There is no-doubt that a well structured, efficient organized and feasible financial system is a prerequisite for the economic development of any economy. Anwar, Shabir and Hussain (2010) identified that the financial sector is performing a critical role in the development activities and economic growth

of country. A well structured and based on efficient networking banking sector and stock market lead faster growth over the period as compared to those countries having poor financial system (Levine 1997). Beck, Demirguc-Kunt and Levine (2000) and Ang (2008) also has similar findings and they concluded that the role of banking sector is highly correlated with the development of economic activities.

The financial sector of Pakistan comprises on commercial banks, foreign banks, development finance institutions, microfinance companies, leasing companies, investment banks, discount houses, housing finance companies, venture capital companies, mutual funds), modarabas, stock exchanges and insurance companies (Ahmed and Ahmad, 2008). Financial sector of Pakistan faced revolutionary changes therefore, a wide scoped program of reforms were launched in 1990 to neutralized these challenges, but the pace of these reforms were enhanced manifold since 2000 (Anwar et al., 2010). Ahmed and Ahmad (2008) argued that in Pakistan the financial sector plays a formidable role in economic development. The role of financial sector in the development and progress of country's economy is highly acknowledged but in this scenario Pakistan seems to be bit unlucky due to lack of well established financial infrastructure (Rehman and Raouf, 2010). Many researchers recommended that in a knowledge-based economy intellectual capital is a critical factor for the success of the organizations. Few studies were found in banking sector that focused on the role of intellectual capital towards the organizational performance of banking industry. These studies include that conducted by Makki and Lodhi (2008), Sharri et al., (2010) and Kamath (2010) which were mainly considered the secondary data and used Value Added Intellectual Coefficient (VAIC) method. Therefore, in Pakistan there is a great dearth of research in the field of intellectual capital. This study mainly based on three components of intellectual capital namely, human capital, customer capital and structural capital which attempt to investigate the impact of the components of intellectual capital on the organizational performance of banking industry in Pakistan.

LITERATURE REVIEW

It is widely accepted that intellectual capital is a most important and vital asset for the survival of organizations in a competitive environment. Intellectual capital (IC) of a organization consists of a number of different intangible resources such as employees competences, skills, brands, patents, working environment, database, procedures, social values, intellectual property, industrial property and honesty (Edvinsson and Malone, 1997; Roos et al., 1997; Lonqvist et al., 2008; Khalquie et al., 2010b). In addition Lonqvist et al. (2008) argued that intellectual capital management (ICM) is a concept that includes various managerial approaches that can be utilized to measure, evaluate, control or develop a company's IC.

Shih et al. (2010) reported that the term intellectual capital was first introduced by Galbraith (1969), as a form of knowledge, intellect, and brainpower activity, which used knowledge to create value. In a knowledge-based economy the role and contribution of intellectual capital is widely accepted. Stewart (1997) pointed out that intellectual capital is referred as to the accumulation of all knowledge, skills and expertise of employees that can lead to take competitive advantages. Edvinsson and Sullivan (1996) also argue that intellectual capital is essentially defined as the knowledge assets that can be converted into value. In addition, Bontis (1998) illustrated that intellectual capital comprises three components: human capital, customer capital and structural capital. In intellectual capital field many researchers produced different models of intellectual capital such as Ismail (2004) proposed that intellectual capital model is based on human capital, customer capital, structural capital, technological capital and social capital. Ismail (2005) illustrated that intellectual capital model is based on human capital, customer capital, structural capital and spiritual capital. In the same way, Khaliq, Shaari and Isa (2011a) proposed an integrated intellectual capital which is based on human capital, customer capital, structural capital, social capital, technological capital and spiritual capital. Past studies found that the components of intellectual capital have significant impact on the performance of organizations. Despite the importance of the other components of intellectual capital towards the performance of organizations the researcher apply only three components namely human capital, customer capital and structural capital in this study.

Human capital is the life blood of intellectual capital and source of innovation. It is mainly consist on the individual abilities, knowledge, know-how, talent, education, skills and experiences of employees in organizations (Bontis, Keow and Richardson, 2000; Edvinsson and Malone 1999; Shaari et al., 2010). Human capital is a critical factor that creates intellectual capital in organizations. Organizations cannot own human capital; it can be only hired in the form of employees. Customer capital is another most important component of intellectual capital which also includes the organization's relationship with customers. The fundamental purpose of this capital is to increase customer satisfaction, customary loyalty, organization's reputation, brand image (Bontis 1998; Edvinsson and Malone 1999; Stewart 1997, Khaliq, Shaari, Isa and Ageel (2011b). Well established customer capital can lead to good organizational performance.

Structural capital is a Skelton of an organization. Like other components it is also one of the most important components of intellectual capital. It comprises on the internal structure of the organization such as the processes, procedures, guidelines and rules. It includes all non-human storehouse of knowledge in organizations including organizational competitive intelligence, routine, formula, policies, procedures and databases (Salleh and Selamat, 2007; Cabrira, 2009; Khaliq, et al., 2011b).

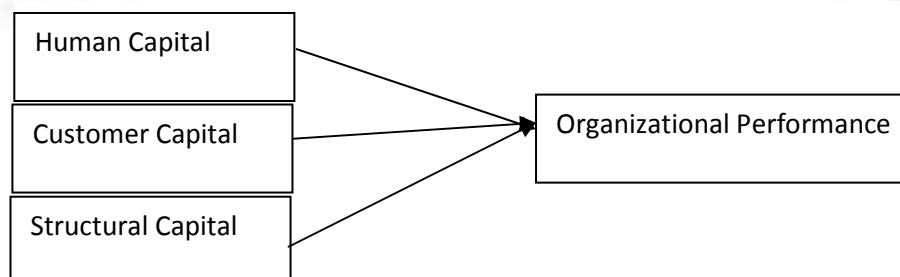
RELATIONSHIP OF INTELLECTUAL CAPITAL WITH ORGANIZATIONAL PERFORMANCE

Past studies found that intellectual capital has significant influence on the performance of organizations. Bontis (1998) and Khaliq, Shaari and Isa, (2011b) stipulated that the components of intellectual capital are the main sources of firm competitive advantage and superior performance. Bontis, (2002), Pablos, (2004) and Wang and Chang, (2005) identify that the impact of the components of intellectual capital on performance of organizations have different magnitudes. It has been found that intellectual capital has significant impact on the organizational performance (Bontis, 1998; Bontis et al., 2000; Cabrira and Bontis, 2008). In developed economies the concept and applications of intellectual capital has got significant attention. However, in developing economies the term intellectual capital is at embryonic stage. For example in Malaysia Bontis et al., (2000) started the research in intellectual capital domain. The findings of Bontis et al., (2000) suggested that intellectual capital has significant positive impact on the performance of organizations. Likewise, Goh (2005), Ting and Lean (2009), Muhammad and Ismail (2009) found the significant affect of intellectual capital on the organizational performance in Malaysian banking industries. In Bangladesh, Najibullah (2005) and Shiu (2006) concluded that intellectual capital has significant role increasing the performance of banking industry. In the summary, many literatures have indicated that intellectual capital has significant positive role enhancing the performance of banking industry.

CONCEPTUAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

The main aim of the study was to identify the influence of the components of intellectual capital namely human capital, customer capital and structural capital on the organizational performance of banking sector in Pakistan. Researchers agreed that the intellectual capital is positively associated with the organizational performance of organizations (Bontis et al., 2000; Huang and Wu, 2010). The conceptual framework for this study is mainly based on three predictor variables namely human capital, customer capital, structural capital and one predicted variable, that is, organizational performance. It is hypothesized that there is a direct and positive association between intellectual capital and organizational performance (Stewart, 1997, Bontis et al., 2000, Huang and Wu, 2010; Khaliq et al., 2011b). The relationship between the variables is depicted in Figure1.

FIGURE 1: CONCEPTUAL FRAMEWORK



To achieve the objectives of the study following four research hypotheses were formulated.

Hypothesis 1: Human capital has positive association with organizational performance of banking sector in Pakistan

Hypothesis 2: Customer capital has positive association with organizational performance of banking sector in Pakistan

Hypothesis 3: Structural capital has positive association with organizational performance of banking sector in Pakistan

Hypothesis 4: Intellectual capital (human capital, customer capital and structural capital) has positive impact on the organizational performance of banking sector in Pakistan.

RESEARCH METHODOLOGY AND SAMPLE SIZE

The population of the study based on commercial banks in Islamabad. The banking sector was selected because this sector is considered as knowledge-intensive. The structured questionnaire based survey having 28 items was used to collect the data from targeted respondents. The amended version of Bontis, (1998), Ismail (2005), Young et al., (2007), Tovstiga and Tulugurova (2007) and Choudhury (2010) questionnaires items were used for this study. The amendments were made to ensure that the constructs is relevant to this research in Pakistani context. A total 400 set of questionnaires were distributed and 235 set of complete questionnaires were returned. Fifteen questionnaire forms were discarded due to incomplete information. Finally, 220 respondents were participated in the study with the net response rate was 55% which was consider as satisfactory.

RELIABILITY OF THE RESEARCH INSTRUMENT

Prior to the data analysis the data were screened and cleaned, to ensure the reliability of the instrument, Cronbach Alpha was used. Cronbach Alpha value is widely used to check the reliability of the construct. The results showed that human capital had a coefficient of 0.811, customer capital of 0.754, structural capital of 0.851 and organizational performance of 0.876. All constructs had showed above the suggested value 0.5 (Nunnally and Bernstein, 1994; Nunnally, 1974). Therefore, on the basis of reliability test it was assumed that the scales used in this research is reliable to capture the constructs. Reliability of the constructs is shown in Table 1.

TABLE 1: RELIABILITY TEST OF CONSTRUCTS

Variables	Number of items	Cronbach Alpha
Human Capital	5	0.811
Customer Capital	5	0.754
Structural Capital	5	0.851
Organizational Performance	12	0.876

FINDINGS

To test the first three research hypotheses Pearson correlation was applied. Table 2 shows that all of the predictor variables have positive and significant relationship with the organizational performance of banking sector. The findings represent that structural capital has more positive relationship with organizational performance as compared to other variables. The results of the study depict that the value of the Pearson correlation human capital is the second variable and customer capital is the third variable that shows positive relationship with organizational performance. Therefore, the findings supported the first three research hypotheses of the study. The findings also show that the coefficient correlation value of variables were below 0.9. It demonstrates that there is no multicollinearity in the study variables. The result of Pearson correlation is depicted in Table 2.

TABLE 2: PEARSON CORRELATION

Variables	HUC	CUC	STC	ORGP
Human Capital (HUC)	1			
Customer Capital (CUC)	0.397**	1		
Structural Capital (STC)	0.492**	0.459**	1	
Organizational Performance (ORGP)	0.486**	0.456**	0.507**	1

** . Correlation is significant at the 0.01 level (2-tailed).

REGRESSION ANALYSIS

To test the research hypothesis 4 of this study, multiple regression analysis was used. Namvar, Fathian, Akhavan and Gholamian (2010) argue that the coefficient of determination (R²) indicates the goodness of the fit of the regression model. The findings of the study showed that 36.9% (R square = 0.369) of the variance in organizational performance was jointly explained by the three independent variables (F = 19.11; Sig. = 0.01). The result revealed that the research hypothesis 4 is also supported. It concludes that the model is useful. The results of multiple regression are indicated in Table 3.

TABLE 3: MODEL SUMMARY: AGGREGATE EFFECT OF INDEPENDENT VARIABLES ON THE DEPENDENT VARIABLE

Variables	Dependent Variable: Organizational Performance		
	Unstandardized Coefficients	t- value	Significant level
Constant (β)	1.33	-	-
Human Capital	0.206	2.760	0.007
Customer Capital	0.217	2.446	0.016
Structural Capital	0.265	2.813	0.006
R-value	0.608		
R ² -value	0.369		
Std. Error of Estimate	0.458		
F value	19.11		0.000

Note: Unstandardized coefficient are reported along with t statistics at *=P<.05

The findings indicates that all variable namely human capital, customer capital and structural capital have significant impact on the organizational performance of banking sector at 95% confidence level with unstandardized beta coefficient of 0.206 (p = 0.007), 0.217 (p = 0.016) and 0.265 (p = 0.006) respectively.

CONCLUSION

The findings of this study express that there is a positive relationship between the components of intellectual capital (human capital, customer and structural capital) and organizational performance. The research evaluates the role of intellectual capital is highly significant to enhance the performance of organizations. Similarly the results of multiple regression also suggested that the components of intellectual capital has jointly significant positive impact on the organizational performance. The findings of this study supported that intellectual capital has dazing affect in enhancing the performance of banking sector in Pakistan. The findings of the study will be helpful to the policy makers to understand and apply their organizational intellectual capital effectively and efficiently. Further the findings of this study may provide foundation for policy guideline for organizations to explore and strengthen their intellectual capital to be established as a well developed financial sector. Undoubtedly, a well developed financial sector is essential to economic development and sustainable development of the economy.

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