CHAPTER 1

INTRODUCTION

1.1 Background

In 2008, the world economy was shaken by series of financial institutions failure which affected not only the western continent but also the Asian continent. It began from the United States' low interest rate which created low housing mortgage, hence it leads the housing industry to become popular and investors began to participate in the market which caused a speculative boom in the US housing industry. Furthermore, as the housing prices gradually went up in 2002-2007 financial institutions were reaping billions in earnings in their commissions and the sale of housing securities. This attracted the financial institution giants to buy in the mortgage securities, in fact financial giants Fannie and Freddie Mae themselves owned almost half of the $12 trillion of the mortgage market (Thomas, & Order, 2010).

After the failure in the housing industry, what began from the US housing crisis the effect evolved from a national scale of the United States into a full scale global financial crisis (Fratianni& Marchionne, 2009). Many scholars referred the incident to be worst crisis since the Great Depression in 1930s. Its severity was not like the other financial crises, judging from the breadth and magnitude it covered not just a few, but almost all countries in the world (Kawai, 2009). This forced the federal government of United States to take aggressive actions in order to maintain control of the economy, the United States federal government took a lifesaving action by acquiring Fannie Mae (FNM) and Freddie Mac (FRE,) to prevent the two giants in the financial from going bankrupt. However, not so long after the government took over FNM and FRE, the illiquidity problem struck Lehman Brothers (which was the fourth biggest financial institution in the US) and forced them to bankruptcy and augmented further distress in the financial system (Labaton, 2008). The negative impact was particularly significant towards countries that made US the biggest export market that includes: China, Japan, Indonesia and German (Nezky, 2013). The ASEAN countries, notably Indonesia, Malaysia, Thailand, Philippines, and Cambodia in particular were quickly affected by the negative sentiments from the western economies, and the fall of the Dow Jones quickly worsen many countries stock index.

The International Council on Social Welfare (2010) emphasizes that the ASEAN region was affected by the 2008 crisis due to its export-dependent nature, the region growth in 2008 was only 4.3%, compared with 6.4% in 2007. Perkins (2010) also argued that the most affected sector of ASEAN economies is its export, this resulted in the fall of regions GDP growth and prosperity. Electronic exports in Malaysia and Singapore were particularly hurt by this incident, Singapore's export growth shrunk from 20% in the first quarter to 14% in the late 2008 (UNESCAP, 2008). Thailand also faced the equally same shrinkage in its export, an average of 20% in its three quarters and a drastic decline to 10% in the last quarter. Lastly, Indonesia was most affected in its G3 market consumption like: textiles, clothing, and agriculture. Philippines which relied on its export to industrial countries was probably the most affected by the crisis, where the inflation rate spiked almost to triple amount (UNESCAP, 2008). The statistical data in UNESCAP (2008) shows that the crisis also affected the construction, finance, agriculture, property, and service sector. Hence, since the 2008 financial crisis affected the ASEAN region, it will be used as the problem in this research. ASEAN is nominated as one of the most appealing investment region in the world (Chai, 2014).. As the 2008 financial crisis affected the physical assets of the companies in ASEAN region, the author seeks to find out the value of the companies intangible assets in times of the crisis, and whether it helps the company to generate future wealth.

In a world such of competitiveness and high technology as of today, knowledge and innovation plays a significant role in firms' value creation. To possess these knowledge in a firm would mean comparative advantage, and would contribute to the company with new innovations, technology and cost reducing method. These knowledge and innovations are one of the company's valuable assets, as they contribute to the company with intellectual resources which is not tangible. However, one of the problem with the accounting disclosure system is its limited recognition of intangible assets/nonphysical resources, hence it is difficult to measure the amount of investment made from these intangible factors. Some companies they possess very few physical properties due to their "knowledge intensive" background, and rely much more on their nonphysical assets in a form of intellectual property. By not disclosing its intangible resources, the company has failed to prove its real worth to its stakeholders, and even halt investors to invest.

Stewart (1997) also supported the argument that the traditional accounting system is inadequate in measuring intangible assets as it's too focused on historical costs rather than the company's potential in creating value. The mismatch between the firm's book and market value have led many business researchers and scholars to seek the reason behind it. Pal & Soriya (2012) founded in their studies that the difference between book and market value is due to the unrecorded intangible assets disclosure on their financial statements. However, the reason intellectual capital is not included in the financial statements is because it doesn't possess enough physical attributes (Joshi, Cahill, & Sidhu, 2010)

This research aims to find the effect of Intellectual Capital (IC) towards company's performance (EPS) in times of financial crisis. Thus the title of this thesis is:

IMPACT OF INTELLECTUAL CAPITAL TOWARDS COMPANY'S PERFORMANCE BEFORE AND AFTER FINANCIAL CRISIS: EVIDENCE FROM ASEAN

1.2 Scope

This thesis covers 40 companies from the ASEAN union as the subject for the research. The companies include the public and state-owned companies of the FTSE/ASEAN40 index, which will cover the companies from Indonesia, Malaysia, Singapore, Thailand, and Philippines. Hence, the study uses the financial statements of the companies from 2005-2011, and divide the timeframes into: before crisis (2005-2008) and after crisis (2008-2001)

1.3 Aims and Benefits

This study aims to investigate the impact of Intellectual Capital towards firms EPS, and to see whether its components significantly affect company's EPS, using the Value Added Intellectual Coefficient (VAIC) method on the sample of FTSE 40 ASEAN companies. The study is expected to give in depth understanding between the relationships of Intellectual Capital's and firms EPS. Furthermore, this study will also investigate the influence of each Intellectual Capital (IC) component: Human Capital Efficiency (HCE), Structural Capital Efficiency (SCE), and Capital Employed Efficiency (CEE) towards EPS and elaborate their significance towards one another.

This study benefits management to have better understanding of Intellectual Capital, to provide insights on how to manage Intellectual Capital, and the importance of disclosing Intellectual Capital towards shareholders of the company. Other than that, this paper will act as a future reference for further studies on Intellectual Capital.

This study benefits ASEAN companies by increasing awareness in Intellectual Capital, and will act as a future benchmark for disclosing Intellectual Capital towards its shareholders.

1.4 Research Questions

- Question 1: Does intellectual capital affect Company's EPS during before and after the financial crisis among ASEAN countries.
- Question 2: Which component of IC significantly affect company's EPS during before and after the financial crisis among ASEAN countries.

1.5 Thesis Structure

Chapter 1: Introduction

The first chapter of the thesis emphasize on the background matter of the problem, and explains the main purpose of the research that includes: research scope, research aim and benefits, and research questions.

Chapter 2: Theoretical Foundation

In this chapter, the author emphasizes on the theoretical aspects of Intellectual Capital that will be used later on in the study. This includes the discussion of the independent, dependent, and the control variables used in this study.

Chapter 3: Research Methodology

This chapter evaluates the method the research is conducted. It includes all the data that will be further used, data collection method, research design and hypotheses. This chapter also describes and quantitatively specifies the measurement method of each independent, dependent and control variables.

Chapter 4: Findings

The author will evaluate the analysis of the research in this chapter that includes discussion of the tests results, relationship between variables, and implications of the results.

Chapter 5: Conclusion

The last chapter of this study will summarize the research result and also include the limitations and further research recommendations.