# THE EFFECT OF INTELLECTUAL CAPITAL AND EXECUTIVE COMPENSATION ON FINANCIAL PERFORMANCE
## (STUDY ON BASIC MATERIALS SECTOR COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE 2018-2021)

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**Abstract.** This study aims to determine the effect of intellectual capital and executive compensation on financial performance in Basic Materials Sector Companies listed on the IDX based on financial statement data for 201 8-2021. The data was tested using the panel data regression method. The population used is Basic Materials Sector companies listed on the Indonesia Stock Exchange (IDX) during 2018-2021. This study used purposive sampling method and obtained 35 companies during 4 years of observation. The results of this study show that intellectual capital as measured by VAIC has a positive and significant effect on financial performance and partial executive compensation also affects financial performance. Companies in the basic materials sector are expected to provide internal evaluations to maximize the management of intellectual capital owned and the efficiency of using company assets to improve financial performance in order to be able to foster competition in companies in the basic materials sector. Issuers should also take into account the level of executive compensation for key management in order to advance the financial performance of an issuer by (agent).

**Keywords**: financial performance; intellectual capital; executive compensation

## I. INTRODUCTION

A company in carrying out its business aims to get optimal profits in order to provide value to shareholders and also to various related parties. Value to shareholders can be in the form of dividends, gains, and so on, but the company's financial performance can be the basis for investors to assess investors' perspectives on the company so that it can improve the performance of a company. Nevertheless, companies must indicate the importance of increasing product competitiveness, innovation, and the ability to compete with other parties. Therefore, the financial statements presented are a reference that must be considered to maintain good company performance [1]. The financial performance of a firm can reveal if it is a good or terrible corporation. By analyzing financial performance using specific ratios, one can determine the company's financial health [2]. Proxies used by companies to assess financial performance can be measured by profitability ratios. In this case, the profitability ratio used is the return on assets (ROA). The theory that forms the foundation of this study is resource-based theory, which explains that if a firm has high-quality resources and enjoys a competitive advantage, it signifies that the issuer's resources are excellent, allowing them to maximize the company's financial success. Additionally, agency theory also supports a company's financial performance. This idea illustrates the contractually established agency relationship between the manager and the funder.

In 2021, one of the cement companies, namely PT Cemindo Gemilang Tbk (CMNT), experienced a decrease in net profit by 52.9% which reached IDR 221.54 billion compared to 2020 which resulted in a net profit of IDR 471.34 billion, which was caused by an increase in expenses that exceeded the increase in revenue of PT Cemindo Gemilang Tbk (CMNT). Not only that, another phenomenon also occurred in PT HK Metals Utama Tbk (HKMU), a go public company engaged in aluminum products and building basic materials, which suffered a loss of IDR 234 billion in 2021 due to the Omicron variant of Covid-19 and the slow recovery of the market [3]. Based on the phenomenon above, the company has not been able to increase its profitability because in 2021 Indonesia is still affected by a deadly virus and at the same time enters the new normal era (new order of life). However, the demand for goods and services in the form of services applied by companies related to basic materials to produce finished goods is still decreasing, due to the reduced purchasing power and production capacity of the company. This affects the development of company in the basic materials sector, which negatively affects the company's financial performance. One of the elements that can affect a company's financial success is intellectual capital. It refers to intangible assets that can increase the company's competitive advantage through employee-owned knowledge resources and expertise, with the goal of enhancing competitors' competitive skills and enhancing financial performance [4].

Companies that suffer losses are based on the phenomenon of researchers, which demonstrates that the connection between financial performance and intellectual capital is weak and ineffective, leading to a decline in company profits where the company has not been able to

implement intellectual capital effectively. If a company uses intellectual capital well, it will be able to compete and gain a competitive edge because intellectual capital is a unique resource that cannot be imitated by other company. This is what makes intellectual capital a crucial resource for company to build value-added company that will ultimately generate profits for the firm. Companies with a competitive advantage will undoubtedly be able to compete and thrive in the business world, and by effectively utilizing intellectual capital, there won't be any morefirm that experience losses as a result of declining profits **[5]**. performance can be influenced by intellectual capital; namely intellectual capital affects the company's financial performance **[6]**. Then, the research run by **[7]** shows that intellectual capital has a significant effect on financial performance. The payment of compensation may take the form of wages or salary, bonuses, or employee benefit plans. With compensation, management will make better use of the company's people resources to boost earnings **[8]**.

Companies that suffer losses based on the phenomenon of researchers also demonstrate that the relationship between financial performance and executive compensation is still ineffective. The company has not been able to align the interests of financiers with management, so employees and key management are not motivated to work better, which has an impact on lowering company profits. If the company is able to align the interests between financiers and management well, one of which is by providing compensation to key management, it will make the company's executives or employees more active in working so that the company will be able to generate profits for the company. Then, of course, it will also reduce conflicts of interest between shareholders and management and the company will not experience a decrease in profits **[9]**. Gomez dan Meija 1998 in **[9]** research on the effect between executive compensation and the company's financial performance has been carried out for more than 70 years and there are more than 300, but studies on this topic in Indonesia are still limited. Research related to executive compensation and company financial performance has produced a variety of conclusions, including in research **[10]** that executive compensation has a positive influence on financial performance (ROA). Later in the study **[11]** explains that executive compensation has a significant influence on the company's financial performance as measured by ROA and ROE.

## A. Resourced Based Theory

Rumelt 1984 in **[12]** resourced based theory explains that a company has distinctive, special, and unique resources as a basis for competing and excelling and can optimize the company's financial performance. The competition that occurs in the company is superior when the company utilizes its assets reasonably so that financial performance is positive and stable. Suseno 2010 in **[13]** One of the efforts that can advance the company's financial performance by combining visible assets and invisible assets. To gain an advantage in competing, companies must be able to increase and utilize the company's source of capital, namely intellectual capital.

## B. Agency Theory

Agency theory is a parameter for showing the relationship related to the financial performance of an enterprise with executive compensation. Jensen & Meckling 1976 in **[9]** Agency relationship is a contract where the financier (principal) hires a manager (agent) to manage resources efficiently and effectively and get profits for the company. One of the main components of agency theory is financiers and managers who have different goals. This agency conflict arises from differences in interests from both sides. Therefore, an agreement is needed as an employment contract.

## C. Financial Report

The primary tool used by issuers to provide necessary parties with financial data is financial statements. Both internal and external stakeholders to the organization who require information from financial statements are parties in need. The goal of financial statements is to provide information about the company's financial position, which includes assets, liabilities, and equity, financial performance, which includes income that can be deducted for business expenses, and changes in the company's financial position, which includes the rise and fall of the company's assets, liabilities, and equity, which aids investors in making investment decisions **[1]**. Financial statements consist of statements of financial position, income statement, statement of changes in capital, statement of cash flows, and notes to financial statements.

## D. Financial Performance

Financial performance refers to a company's ability to successfully complete a performance within a given time frame. Profit is a metric in financial performance that is used to assess a company's long-term viability. The profit is obtained from the utilization of the company's resources. Financial performance is an influential aspect for capital owners to decide to invest in a company. Effective financial performance is financial performance whose profit development is positive and stable, companies that have had careful and significant preparation will be able to obtain efficient financial performance. The proxy used for financial performance is ROA **[14]**.

## E. Intellectual Capital

Intellectual capital is an intangible asset in the form of knowledge owned by the company so that if managed effectively it will generate value for the company and gain an advantage in the competitive world. In this study, the parameters used Value Added Intellectual Coefficient (VAIC) are calculations that use indirect methods in calculating how effective intellectual capital and employee competence are to produce value based on the correlation of three main elements including human capital is a trait found in humans which includes personality and knowledge in doing a job can create value, Capital employed is a bond established between the company and business partners, and structural capital is the company's ability to carry out company habits and company structure in providing support to employees related to production activities to obtain optimal intellectual and overall business performance **[15]**.

H1: Intellectual capital positively affects financial performance

**F. Executive Compensation**

Executive compensation is feedback that is shared with executive-level employees for having worked on their obligations and having held large tasks in a company. The purpose of executive compensation is to provide job satisfaction to executives and employees so that they can motivate them to be more disciplined [16]. One of the variables in this study that affects a company's financial performance is executive compensation. The total executive compensation that has been authorized by the board of directors and the board of commissioners is computed using the natural logarithm formula. The Notes to the Financial Statements (CALK), which relate to the compensation or transactions of the associated parties, state the overall executive compensation.

H2: Compensation has a positive effect on financial performance.

## II. RESEARCH METHODS

This research uses quantitative methods. Quantitative research is structured scientific research because evidence in research consists of numbers and studies that use statistics related to parts and phenomena and their relationships [17]. The type of research carried out is descriptive research, which is research to explain related to an event by accurately describing facts related to the object studied with the population or sample data that exists [18]. This research uses a case study strategy. The goal is to delve deeper into the causes of events and the conditions of the current situation, as well as the ecological relations of certain social units of a transparent nature [18].

The study's research subject is a company in the basic materials sector that will be listed on the Indonesia Stock Exchange in the years 2018 through 2021. The Indonesia Stock Exchange lists 91 companies in the basic materials sector. The criteria utilized in this study were as follows since purposive sampling was employed: 1) Basic materials sector companies listed on the Indonesia Stock Exchange in 2018-2021. 2) Basic materials sector companies that are consistently listed on the Indonesia Stock Exchange in 2018-2021. 3) Basic materials sector companies that consistently present financial statements for 2018-2021. 4) Basic materials sector companies that consistently present financial statements denominated in rupiah for 2018-2021. 5) Basic materials sector companies that consistently provide information on the amount of executive compensation for 2018-2021. With a four-year research period, the study's total sample size was 140, made up of 35 basic materials sector companies listed on the Indonesia Stock Exchange.

Dependent variables or also called consequential, bound, endogenous variables are variables that are the main focus of research, because dependent variables are phenomena that need to be explained [19]. This research is a bound variable is financial performance proxied with Return On Assets (ROA) which describes how a company's ability to profit from assets invested in a company (D. P. Lestari & Sulastri, 2021). In measuring financial performance [14] by formula:

$$ROA = \frac{\text{Net Profit After Tax}}{\text{Total assets}} \times 100\%$$

The dependent variable may be positively or negatively impacted by independent variables. These variables may also be referred to as independent, predictor, external, or other terms that describe the phenomena used to understand or predict dependent variables (Paramita et al., 2021). The study's free variables are intellectual capital $(X_1)$ and executive compensation $(X_2)$.

Value Added Intellectual Coefficient (VAIC) is a calculation that uses an indirect method in calculating how effective intellectual capital and employee competence are to produce a value [15]. To measure intellectual capital [20] using the formula:

$$VAIC = VACA + VAHU + STVA$$

Executive compensation describes the incentives or rewards distributed to the board of directors or managers for their achievements towards improving the financial performance of a company. To measure executive compensation [21] Use the formula as follows :

$$KE = Ln\,(Total\ Executive\ Compensation)$$

Information:
KE: Executive Compensation

Panel data regression analysis is a method for simulating how predictor variables affect response variables over time in various observed areas of a research item [22]. The following describes the panel data regression analysis model used in this investigation:

$$Y = \alpha + \beta 1 X 1 it + \beta 2 X 2 it + e$$

Information:
| | |
|---|---|
| Y | = Financial Performance |
| $\alpha$ | = Constant |
| $X_1$ | = Intellectual Capital |
| $X_2$ | = Executive Compensation |
| $\beta 1, \beta 2$ | = Regression coefficient |
| e | = Error Term |
| i | = Company |
| t | = Time |

## III. RESULTS AND DISCUSSION

**1. Descriptive Statistics**

Descriptive statistical analysis is a statistic that is useful in providing an overview of the object under study using population data or samples based on facts, without making a study and producing a conclusion that applies globally [17]. Table 1 shows 140 observational data and there are maximum, minimum, mean, and standard deviation values that have been carried out for the variables of financial performance, intellectual capital, and executive compensation as table 1.

**Table 1 Descriptive Statistics**

| | N | Mean | Min | Max | Std. Deviasi |
|---|---|---|---|---|---|
| Financial Performance | 140 | 0.022269 | -0.499162 | 0.154319 | 0.074240 |
| Intellectual Capital | 140 | 0.990610 | -112.4867 | 26.35743 | 10.62945 |
| Executive Compensation | 140 | 22.93189 | 20.27240 | 26.08484 | 1.146392 |

*Source: Data processed by author, 2022*

The table of descriptive statistical results explains the value of each research variable, the ROA value in the lowest financial performance of -0.499162 obtained by PT Waskita Beton Precast Tbk (WSBP) in 2020 this is due to the profit after tax obtained is very low and experienced a fairly large loss, while the highest ROA value of 0.154319 was produced by PT Panca Budi Idaman Tbk (PBID) in 2020. When viewed from the average ROA value of 0.022269 and the standard deviation of 0.074240, it can be obtained that the sample data has data that is not grouped or varied.

In the table of descriptive statistical results, the value of VAIC derived from the results of three elements, namely value added employed, value added human capital, and structural capital value added, as well as the calculation of VAIC obtained from the lowest intellectual capital of -112.4867 produced from PT Gunawan Dianjaya Steel Tbk (GDST) in 2020, this condition is due to the very low value added intellectual coefficient and the inefficiency of intellectual capital of a company, while the highest value of VAIC related to intellectual capital was generated by PT Berlina Tbk (BRNA) of 26.35743 in 2021. Judging from the average VAIC of 0.990610 with a standard deviation of 10.62945, it can be concluded that the sample data has varied or ungrouped data. Furthermore, in the table of descriptive statistical results, the Ln value of total compensation in executive compensation was the lowest of 20.27240 obtained by PT Alakasa Industrindo Tbk (ALKA) in 2021, this condition was caused by the total compensation to executives was very low, while the Ln value of the highest total compensation to executives of 26.08484 was generated by PT Trias Sentosa Tbk (TRST) in 2021. Judging from the average Ln total executive compensation of 22.93189 with a standard deviation of 1.146392 it can be concluded that the sample data has data not varied or grouped.

**2. Classical Assumption Test**

The goal of the classical assumption test is to ensure that the regression equation derived is accurate. Only a multicollinearity test and a heteroskedasticity test were employed in this investigation as the classical assumption test.

a) Multicollinearity Test

The multicollinearity test has the purpose of testing whether regression models found there is a correlation between exogenous variables. Regression models are said to experience multicollinearity when the correlation coefficient has a > 0.8, but if < 0.8 then there is no multicollinearity

problem. The following are the outcomes of the test for independent variable multicollinearity between executive compensation and intellectual capital.

**Table 2 Multicollinearity Test Results**

| | IC | KE |
|---|---|---|
| IC | 1.000000 | -0.001011 |
| KE | -0.001011 | 1.000000 |

*Source: Eviews 12, 2022 Output Results*

According to table 2 test outcomes utilizing EViews 12, it can be seen that the results of the multicollinearity test at the value of the correlation coefficient in each exogenous variable are not > 0.8 so that in this study there is no multicollinearity.

b) Heteroscedasticity Test

Heteroscedasticity test carried out in testing variance inequalities in regression models [23]. In this heteroscedasticity test, decision making is made if the probability value of significance is > 0.05, then heteroscedasticity does not occur, but if < 0.05, heteroscedasticity occurs. Here are the results of the heteroscedasticity test study in this study.

**Table 3 Heteroskedasticity Test Results**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | -0.150272 | 0.183678 | -0.818127 | 0.4152 |
| IC | -0.000443 | 0.000236 | -1.881529 | 0.0627 |
| KE | 0.007791 | 0.009010 | 0.972652 | 0.3330 |

*Source: Eviews 12, 2022 Output Results*

Table 3 shows the probability value (p-value) of independent variables, namely intellectual capital ($X_1$) and executive compensation ($X_2$) > 0.05. Therefore, it can be concluded that the data in this study explain that each variable has a probability value of > 0.05, which means that in this study there is no heteroskedasticity.

**3. Panel Data Regression Analysis**

The fixed effect model is the best suitable model for this investigation, according to model testing that has been done (FEM). The fixed effect model's outcomes utilizing the EViews 12 program are shown below.

The regression equation of the panel data in this study can be determined using the fixed effect model (FEM) test findings as follows:

$$Y = -1.058719 + 0.001458X_1 + 0.047076X_2 + e$$

Information:

Y : Financial Performance (ROA)
$X_1$ : *Intellectual Capital* (IC)
$X_2$ : Executive Compensation (KE)
e : Error Term

**Table 4 Model-Fixed Effect Model Test Results**

Dependent Variable: ROA
Method: Panel Least Squares
Date: 12/14/22   Time: 21:37
Sample: 2018 2021
Periods included: 4
Cross-sections included: 35
Total panel (balanced) observations: 140

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | -1.058719 | 0.406871 | -2.602101 | 0.0106 |
| IC | 0.001458 | 0.000522 | 2.795199 | 0.0062 |
| KE | 0.047076 | 0.017742 | 2.653318 | 0.0092 |

Effects Specification

Cross-section fixed (dummy variables)

| | | | |
|---|---|---|---|
| R-squared | 0.560927 | Mean dependent var | 0.022269 |
| Adjusted R-squared | 0.407465 | S.D. dependent var | 0.074240 |
| S.E. of regression | 0.057147 | Akaike info criterion | -2.664706 |
| Sum squared resid | 0.336380 | Schwarz criterion | -1.887272 |
| Log likelihood | 223.5294 | Hannan-Quinn criter. | -2.348780 |
| F-statistic | 3.655149 | Durbin-Watson stat | 2.020723 |
| Prob(F-statistic) | 0.000000 | | |

*Source: Eviews 12, 2022 Output Results*

The following description fits the given equation:
1. The value of the constant of -1.058719 means that if the variable exogenous intellectual capital and executive compensation is worth 0, then the financial performance variable (ROA) in the sample owned by the basic materials sector company is worth -1.058719.
2. The value of the intellectual capital coefficient of 0.001458 shows that if there is an increase in intellectual capital by one unit, then the financial performance variable (ROA) gets an increase of 0.001458.
3. The value of the executive compensation coefficient of 0.047076 shows that if there is an increase in executive compensation by one unit, then the financial performance variable (ROA) gets an increase of 0.047076.

**Table 5 Coefficient of Determination Results**

| | | | |
|---|---|---|---|
| R-squared | 0.560927 | Mean dependent var | 0.022269 |
| Adjusted R-squared | 0.407465 | S.D. dependent var | 0.074240 |
| S.E. of regression | 0.057147 | Akaike info criterion | -2.664706 |
| Sum squared resid | 0.336380 | Schwarz criterion | -1.887272 |
| Log likelihood | 223.5294 | Hannan-Quinn criter. | -2.348780 |
| F-statistic | 3.655149 | Durbin-Watson stat | 2.020723 |
| Prob(F-statistic) | 0.000000 | | |

*Source: Eviews 12, 2022 Output Results*

Table 5 shows the adjusted R square value of 0.407465 or 40.74%. This means that the independent variables of intellectual capital and executive compensation are able to explain or influence the dependent variables of financial performance that are proxied using an ROA of 0.407465 or 40.74%, while the remaining 59.26% is explained by other variables.

**Table 6 Simultaneous Test Results**

| | | | |
|---|---|---|---|
| R-squared | 0.560927 | Mean dependent var | 0.022269 |
| Adjusted R-squared | 0.407465 | S.D. dependent var | 0.074240 |
| S.E. of regression | 0.057147 | Akaike info criterion | -2.664706 |
| Sum squared resid | 0.336380 | Schwarz criterion | -1.887272 |
| Log likelihood | 223.5294 | Hannan-Quinn criter. | -2.348780 |
| F-statistic | 3.655149 | Durbin-Watson stat | 2.020723 |
| Prob(F-statistic) | 0.000000 | | |

*Source: Eviews 12, 2022 Output Results*

Table 6 shows prob(F-statistic) values of $0.000000 < 0.05$. This shows that H1 is accepted, meaning that the exogenous variables in this study, namely intellectual capital and executive compensation, have a simultaneous or overall effect on endogenous variables, namely financial performance (ROA) in basic materials sector companies listed on the Indonesia Stock Exchange in 2018-2021.

**Table 7 Partial Test Results**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | -1.058719 | 0.406871 | -2.602101 | 0.0106 |
| IC | 0.001458 | 0.000522 | 2.795199 | 0.0062 |
| KE | 0.047076 | 0.017742 | 2.653318 | 0.0092 |

*Source: Eviews 12, 2022 Output Results*

**4. The Effect of Intellectual Capital on Financial Performance**

Table 4 describes intellectual capital which shows a probability value of $0.0062 < 0.05$ and has a positive regression coefficient value of 0.001458, then H0 is rejected Ha is accepted so that partially the intellectual capital variable has a positive effect on financial performance variables in basic materials sector companies listed on the Indonesia Stock Exchange in 2018-2021. This is consistent with the researchers' hypothesized relationship between intellectual capital and financial performance in basic materials sector firms listed on the Indonesia Stock Exchange in 2018–2021.

According to statistical research, intellectual capital contributes to the improvement of issuers' financial performance, so the more intellectual capital an issuer has, the better its financial performance. In this instance, the company is able to make the most of its available resources, such as the employees' creativity and innovation to add value to the business and raise an issuer's net profit.

This is supported by research conducted by [6].The role of intellectual capital is one of the most important things for an issuer because if the information and knowledge goes well and can carry out cooperation with outside parties, the company will be considered successful. Research [2] intellectual capital that has a high value, then the production power and profit generated will increase and will affect financial performance.

**1. The Effect of Executive Compensation on Financial Performance**

Table 4 explains that executive compensation shows a probability value of $0.0092 < 0.05$ and has a positive regression coefficient value of 0.047076, then H0 is rejected

Ha is accepted so that partially the executive compensation variable has a positive effect on the financial performance variable in basic materials sector companies listed on the Indonesia Stock Exchange in 2018-2021. This is consistent with the researchers' hypothesized relationship between executive compensation and financial performance in basic materials sector firms listed on the Indonesia Stock Exchange in 2018–2021.

The high return on assets of a company illustrates that the higher the profit obtained by the issuer, the higher the total executive compensation that will be distributed to executives, so that it will provide job satisfaction to executives and employees and be able to motivate more disciplined workers. According to statistical analysis, executive compensation calculated by the natural logarithm of total executive compensation has a positive effect on financial performance. This is supported by research conducted by **[9]** executive compensation is a description of countermeasures related to the influence between the owner of the company (principal) on the company's executives (agents) in adjusting the wishes of the two in order to advance the financial performance of an issuer. Another study revealed that the issuer cannot be known as a stand-alone part, but must be seen as a stable unit and an existing source of energy, consisting of the manpower of all existing employees, which can be efficient in improving the company's financial performance **[8]**

## IV. CONCLUSION

The 21st century teacher competency development model is a model that guides teachers to improve professional competence so that they are able to face the millennial generation who are getting closer to technology every day. For this reason, in order to provide quality education to students in this information age, teachers are required to have the necessary technological skills in order to be able to take advantage of the power of computers and related technologies for effective teaching.

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