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Intellectual Capital as a Moderating Effect between Corporate Governance, and Firm Performance: A Conceptual Review

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Abstract This research hypothesized that intellectual capital had a moderating impact on the connection between corporate governance and company performance. Researchers and investors have been investigating, monitoring, and analyzing firm performance in light of the serious consequences of many corporate accounting scandals, such as Toshiba 2015, as well as the occurrence of numerous nations. After the economic crisis, the deterioration in corporate governance has shown that this lack of governance could have long-term macroeconomic consequences. As a result, good corporate governance practice is important to improve organizational efficiency, secure investor rights, strengthen investment climate, and promote economic development. The investment in expertise and intellectual capital has become one of the most significant assets required to increase its value, create a competitive advantage, and improve its performance. Along with corporate governance, intellectual capital is a key to business growth and can better explain disparities in the firm's financial performance. The findings of this study indicate that the role of intellectual capital as a moderator variable is designed to improve firm performance in combination with the structure of corporate governance, thereby promoting economic growth. Therefore, this study recommends that future research be conducted as a moderator of firm performance with the integration of corporate governance and intellectual capital. It may improve corporate governance practice, thus enhancing firm performance.

Keywords Corporate Governance, Firm Performance, Intellectual Capital

1. Introduction

Firm performance has been under reviewing, monitoring, and investigating by researchers and investors, specifically after the occurrence of a series of financial crises in Brazil, the Russian Federation, and the Asian countries such as Malaysia [1, 2]. In addition, the severe impacts of many corporate accounting scandals such as Enron 2001, American Insurance Group 2005, Bernie Madoff 2008, Lehman Brothers 2008, Saytam 2009 [3], and the latest known business scandal, Toshiba 2015, as well as the collapse of Thomas Cook in 2019 [4] have affected the landscape of economic in many countries around the world.

For growth and development, companies around the world indeed need funds in the form of investment by local and foreign investors. However, before making investment decisions, their financial assurance investors will investigate whether the organization is financially secure, safe, and can generate long-term profits [5]. It is well understood if shareholders are least keen to engage in

circumstances where the status of the company is detrimental. Unfortunately, this incompetence to attract sufficient investment often leads to unfavourable results for the business and economy of the country. Meanwhile, with financial scandals and crises emerging, confidence in public institutions, legislative bodies, and organizations was always weak. As a result, much emphasis has been placed on corporate governance in order to offer a mechanism to safeguard investors by encouraging sound management practices [6, 7].

The deterioration in corporate governance after the economic crisis has shown that this lack of governance could have long-term macroeconomic consequences. Within developing economies, corporate governance has become an issue and has contributed to requirements for better practices of corporate governance. The vigorous practice of corporate governance is important in order to improve organizational efficiency [8], securing investor rights, strengthening investment climate, and promoting economic development.

Corporate governance mechanisms and regulations have received considerable worldwide attention as they improve overall economic capabilities. In other words, the overall public gain to private and corporate stakeholders will be accomplished [9]. Good corporate governance legislation prevents financial problems and can reduce bribery, thus simultaneously increasing the company's overall growth. In addition, good governance also contributes to the country's development and overall economic prosperity by correctly applying the corporate governance frameworks, enhancing firm performance [21-25], and ensuring proper management practices protect the investors [10, 11].

Many studies indicate that good performance is affected by corporate governance mechanisms and elaborate that the good performance of the companies attracts the investments (McKinsey & Institutional Investors Inc., 2003). Accordingly, corporate governance mechanism practices and the adherence of this mechanism lead to efficient market function. Besides, it will give companies access to cheaper capital than traditional banking financing and help them mitigate financial risks. Furthermore, the successful application of corporate governance will lead to better performance and less economic crises, and, eventually, rapid economic growth [12, 13]

Most nations have, therefore, strengthened their corporate governance standards in order to encourage businesses to implement good corporate governance. These countries work to flourish and develop the corporate governance code based on the OECD principles of corporate governance that offer a general framework [14]. The OECD has pointed out that corporate governance is a crucial step in building public trust and fostering healthy and long-term international investment (OECD, 1999). Four (4) basic concepts were developed for the OECD principles: responsibility, transparency, fairness, and accountability. The rules and regulations allow for diversity and are mainly related to listed companies. They were organized into five (5) sections in 1999 and reviewed in 2004: the equitable treatment of shareholders and their rights, and corporate governance role of stakeholders' transparency, disclosure, and the responsibility of the board (OECD, 2004). Throughout public debates [15], the MENA countries seem to be still lagging behind the OECD standards. In these countries, the concept of corporate governance is hypothetically less prevalent than in Western nations. [16].

Besides the good practice of corporate governance, investment in expertise and intellectual capital also has become one of the most significant assets required to increase the firm's value, create a competitive advantage for the firm and improve its performance [17]. In the last decade, the issue of the subject of the knowledge-based asset (intellectual capital) has been of great interest to researchers. All immaterial properties of economic value, but not physical value, are in those tools, e.g., trademarks, patents, and goodwill. Therefore, intellectual capital is considered as a major factor in the performance of firms [18]. Within this context, the OECD (2006) reported that the measurement of intellectual capital factors is also closely linked to the processes of corporate governance. Oversight of risk policy and regulation, transparency, and reporting to shareholders, board strategies, and senior management oversight were included in this relation to corporate governance. Similarly, corporate governance is less likely to increase sound growth in the absence of intellectual capital [19].

According to Cheng and Chun [12], intellectual capital, along with good corporate governance, is a key to business growth and can better explain disparities in the financial performance of the firm. Complex and challenging environments, increasingly transforming the market, where new strategies are required to increase competitiveness by controlling intellectual capital, rather than traditional board monitoring [20, 21]. In this vein, the literature stream indicates that corporate governance is related to firm performance [22, 23]. However, the relationship between corporate governance and firm governance has conflicting empirical findings. While some experiments produce positive outcomes, some have had a negative link, and others have reported a slight one. Nonetheless, it may not be possible to distinguish between the type of information, the institutional structure of a country, and various time frames that contribute to various performance measures [24].

As mentioned above, the results of the corporate governance relationship were inconsistent with firm performance. Accordingly, this paper suggests extending and re-examining this relationship's significance; thus, a moderating variable is included between variables to identify and explain the mechanism over which the relationship between the independent and dependent variables [25]. Based on a suggestion by Stabryła [26], the

combined effect of corporate governance and intellectual capital could improve corporate value. Therefore, this paper suggests using intellectual capital as a moderator. It is hoped that the inserting of intellectual capital as a moderator will provide better-explained results and can become the guidance for forthcoming regulatory reforms on other governance variables.

As a research methodology, the current study concentrates primarily on the demographic attributes of corporate governance then Intellectual capital to limit the scope of the review. To aid in the review process, we established some criteria for the articles to be reviewed, including journals and international venues, research papers that focused primarily on corporate governance and intellectual capital and their impact on firm performance, research papers that described the procedures and methodologies are used to conduct the studies, such as quantitative or qualitative approaches, and this review excluded theoretical discussions. Additionally, relevant papers for this article were discovered via searches of internet databases such as "Science Direct, Google Scholar, Scopus, ProQuest, EBSCOhost Research, and Emerald Insight." The literature search focusing on studies was published in prestigious journals and conferences in the fields of accounting, management, business, and finance. This expectation expresses the testable hypothesis:

H1: the effectiveness of intellectual capital moderates the relationship between corporate governance and firm performance.

2. Literature Review

2.1. Board of Director

The board of directors is considered an important instrument for controlling management efficiency and defending investors' interests [27]. The board of directors is the first framework for corporate governance used in the present paper, which includes (board size, board meetings, board change, and CEO duality). The board of director is responsible for controlling the management's performance and therefore reducing agency costs to secure stakeholder interests. They can select, replace, and award management under their control [28].

Board size is the first important feature, and it has been studied extensively in relation to its impact on board efficiency [29, 30]. According to O'Connell and Cramer [31], the board member refers to the number of members of the board. The management committee is the primary organizational body in which management decisions are controlled.

Board meeting, on the other hand, refers to the number of meetings held over a year by the board, also the amount of time spent on managing activities by managers [32, 33]. In most corporate governance, no specific number of meetings is made compulsory. Nevertheless, the board of directors will meet at least four times a year [34]. There is a correlation between improved company performance and a higher frequency of board meetings. Previous studies have investigated how board effectiveness improves firm performance. The board's responsibilities, such as financial management and monitoring, require more time devotion. Thus, the high meeting frequency indicates board reactiveness and enables the board to discharge its monitoring function efficiently. Insufficient time could hinder board effectiveness in its monitoring function [35]. As mentioned above, the agency theory states that the board is responsible for monitoring and performance improvement [27]. The primary task of the members of the board is to achieve the goal of the shareholder and attain the goal of the owners.

Next, the change of the board is to provide the board with new blood to help it perform its tasks better. The board change applies to the one-year appointment of a new member of the board [36]. Moreover, different members provide a combination of knowledge and experience to improve performance in light of the resource dependence theory [37]. The current study expects the company's performance will increase with changing of the board of directors.

Another topic of great interest and a focus for analysis where the CEO simultaneously serves as a board of director are (CEO duality) [38, 39]. In the same vein, CEO duality is defined as the presence and influence of the CEO on the board of a firm [40]. The value in duality has mainly been shown to play a significant role in organizational success and governance [41]. According to agency theory, the regulation of the responsibilities of administrative should go together with the mechanisms to supervise management performance and guarantee that the authority delegation leads to the possible highest returns. Consistent with this argument is the finding that the concept of agency theory dictates the relationship between the characteristics of the board and the performance of the firm.

Furthermore, the method of agency theory expounds on the connection between the manager and the owner. In this regard, the board of directors is the primary mechanism for overseeing and is essential in tackling agency issues. Likewise, the ownership structure is also related to the agency theory, as it suggests that management should be owning shares in the company to prevent it from working for its interests. However, when management holds a large proportion of the company, it is also expected to work for its favour [42]. Hence, they found a positive relationship with firm performance [43].

2.2. Ownership Structure

Apart from the board of directors, the ownership structure is another significant corporate governance pillar since shareholders are members of listed companies. The

interests of every shareholder depend on the size of their shares because of the dispersed ownership structure. The structure of the company will, therefore, influence the performance of the company. Furthermore, the ownership structure term is defined as the owner's distribution of equity in respect of their capital and votes [44]. In this respect, the ownership structure is also linked to the theory of the agency. As noted, it implies that management should have shares in the company in order to prevent it from acting for its own purposes.

Nonetheless, it is expected that it would also work in management's favour when management owns a substantial share of the company [42, 45]. Hence, they found a positive relationship with firm performance [43, 46]. This paper used the managerial ownership, domestic ownership, and block shareholder ownership.

Managerial ownership is an important mechanism that aligns the interest of shareholders with management [47]. Consistent with the convergence of interest hypothesis, the managerial ownership makes the director avoid sharp practices as the managers bear the same loss with shareholders if their wealth suffers. As a result, managerial shareholding has the incentive to reduce agency costs and improve firm performance. The role of managers in improving firm value is significant, where the managers minimize the cost associated with agency conflict through quality disclosure, hence an improvement in firm value [48]. As noted by Jensen and Meckling [47], managerial ownership is another mechanism used in reducing agency problems.

In the same vein, local ownership is another part of the ownership structure. According to Claessens, et al. [49], Allen and Phillips [50], it was evident that control of businesses provided a number of significant advantages by reducing the cost of monitoring the firms or partnerships between companies and block-holders enterprises engaging in specific business agreements. In addition, Jensen and Meckling [47] consider that the rise in owner-largest shareholder ownership decreases the costs of the agency and, as a result, reduces the need to control earnings in order to ease and minimize contractual constraints which, will encourage and motivate controlling owners to increase operational profits. This indicates a good corporate governance activity that could affect the company's value on the market.

Block shareholding that owns a large unit of shares by individuals is another type of ownership structure [34]. Previous studies provide evidence suggesting that block shareholders are effective monitoring mechanisms. This type of shareholder can supervise and influence board structure through voting rights. Zhong, et al. [51] classified block shareholders to larger and small block shareholders by explaining the various influence wielded by each class. According to the study, the small block shareholders might decide to dispose of their shares when the company’s performance is no longer favourable. However, the shareholders may face some difficulties at the point of selling their shares due to the company's poor performance and, therefore, might rather decide to employ some monitoring strategy to improve managerial performance. By doing so, large block shareholders create more pressure on the managers to improve financial performance [52].

2.3. Intellectual Capital and Firm Performance

Measuring intellectual capital has been the objective of many research studies prior to 1990. The investigators in these studies will use basic methods to evaluate and quantify intellectual capital and put their results in financial statements to understand intellectual capital better. Like other business resources, intellectual capital must be represented in financial statements from an accounting perspective [53]. We can offer a fresh lens to see a company's hidden value by measuring and reporting an organization's intellectual capital [54]. To give a comprehensive view of a company's performance and organizational value, all aspects of the business must be taken into account. Intellectual capital should thus be precisely measured, but the data produced should also be appropriately utilized [55]. Before 1990, numerous research projects aimed to measure intellectual capital. Researchers will use basic methods to assess and quantify intellectual capital in these investigations, and financial statements will reflect the findings. Intellectual capital and a company's other resources must be recorded in the financial accounts from an accounting perspective [53]. We can provide a fresh perspective on an organization's hidden worth by assessing and reporting its intellectual capital [54]. It is also important to include all elements of a company in order to provide a complete picture of its performance and organizational worth. As a result, intellectual capital should be evaluated properly, but the knowledge it generates should be put to good use [55]. Riahi - Belkaoui [56], for example, looked at the impact of intellectual capital on US multinational companies. There were 84 companies in this study's sample. According to the study's findings, intellectual capital has been shown to be positively associated with the success of firms. Using profitability, productivity, and market value metrics, Firer and Williams [57] researched in South Africa on the connection between intellectual capital and the success of 75 businesses listed on the Johannesburg Stock Exchange. They came to the conclusion that there is no connection between the (VAIC) and the performance of the company. These findings suggest that South African businesses are less reliant on intellectual capital than their European counterparts, and that physical resources are more important in such nations when it comes to generating value. According to Bozbura [58], a sample of Turkish companies was chosen to investigate the relationship between intellectual capital components

such as people and relationships, and they came to the conclusion that these components have a significant positive relationship with the aforementioned market-to-book value ratio. According to Najibullah [59], the market value of Bangladeshi banks is positively linked with the three components of corporate intellectual capital, i.e., Human Capital, Capital Employed Efficiency, and Structural Capital Value added. Research conducted by Tan, et al. [60] found a strong correlation between intellectual capital and the financial success of Singapore-based firms. They found that (ROE), earnings per share (EPS), and yearly stock return are all positively related to (VAIC) and its components (ASR). According to Cohen and Kaimenakis [61], intellectual capital has a strong positive connection with small- and medium-sized business (SME) performance in Greece. Questionnaires used to assess intellectual assets had a different interaction than research techniques and models used on big corporations, it was found. In their 2009 study, Ghosh and Mondal [20] examined the link between Indian pharmaceutical and software firms' intellectual capital and financial success. For 80 of these firms, they found a strong correlation between intellectual capital and profitability and market value, two metrics used to assess the company's success. They found no such correlation between these two measures of success and productivity. According to F - Jardón and Martos [62], intellectual capital in Argentina's wood manufacturing sector correlates with profitability. According to their findings, just one component of intellectual capital (structural capital) has a substantial positive connection with profitability. Ting and Lean [21] looked at the connection between financial institutions' intellectual capital and their performance in Malaysia. They measured intellectual capital using the Value-Added Intellectual Coefficient technique and looked at how it related to return on assets (ROA). It turns out, according to the findings of this research, that the three components of intellectual capital have a strong positive connection with the profitability of these institutions. According to Zeghal and Maaloul [63], value-added was examined in the UK to see how it related to financial performance and market value of commercial and industrial firms. According to their findings, there is a strong link between a company's intellectual capital and its financial and economic success.

2.3. Moderating Effect of Intellectual Capital

Since Pulic (2014) implemented the Value-Added Intellectual Coefficient Model (VAIC) in 1997, it has been used for several business examinations to measure intellectual capital in organizational performance. Ante Pulic's VAIC separates it from the others because it is one of the first models focusing exclusively on the financial metrics of a company, i.e., the financial report details. According to Pulic [85], the VAIC model measures the company's total output of value-building and defines the extent and productivity of the organization's intellectual capital. In order to understand the overall efficiency of the value creation process and its portion of the output of intellectual capital, the formula for the VAIC model should be calculated as follows:

VAIC = ICE + CEE…1

(ICE) is the intellectual capital efficiency

(CEE) is the capital employed efficiency

(ICE) and (CEE) is calculated as follows:

ICE = (VA/HC) + (SC/VA) …2

CEE = VA/CE…3

(HC) is the human capital = employee expenses.

(SC) is structural capital = VA-HC.

(VA) is value-added = sum of the profit of operating, employee costs, depreciation, and amortization.

(CE) is capital employed = financial capital.

The VAIC calculates the amount of new value created per unit of human capital and capital employed. The VAIC index; generally, runs from 1 to 3, with the greater the coefficient, the more value created.

Intellectual capital has been the most important asset in the existence of a knowledge-based economy in which companies are able to sustain their business in the competitive capital market [86]. The combined effect of corporate governance and intellectual capital, [52] found, could significantly boost corporate value. In that sense, the OECD (2006) has stated that intellectual asset assessment and management are also closely related to corporate governance. This corporate governance link included risk policy and control supervision, accountability, reporting to shareholders, board strategy, and senior management monitoring. Similarly, [32] claimed that corporate governance is less likely to increase business productivity in the absence of high intellectual resources.

More specifically, [34] shown that intellectual capital, coupled with good corporate governance, is critical to company success and may better explain variations in financial performance. The worldwide developments in the economy, which include complicated and competitive situations, need modern methods to enhance profitability through managing intellectual capital rather than conventional board supervision of operations [35]. By using (VAIC) methodology, [36], [87] concluded that there was a relation between intellectual capital constituents and performance. As a result, intellectual capital is anticipated to act as a moderator in the link between corporate governance mechanisms and company performance.

Finally, from the discussion so far, this study proposed that the combined effect of intellectual capital and corporate governance can enhance firm performance efficaciously. Thus, consistent with this view, the conceptual framework for futuristic research is proposed in Figure 1.

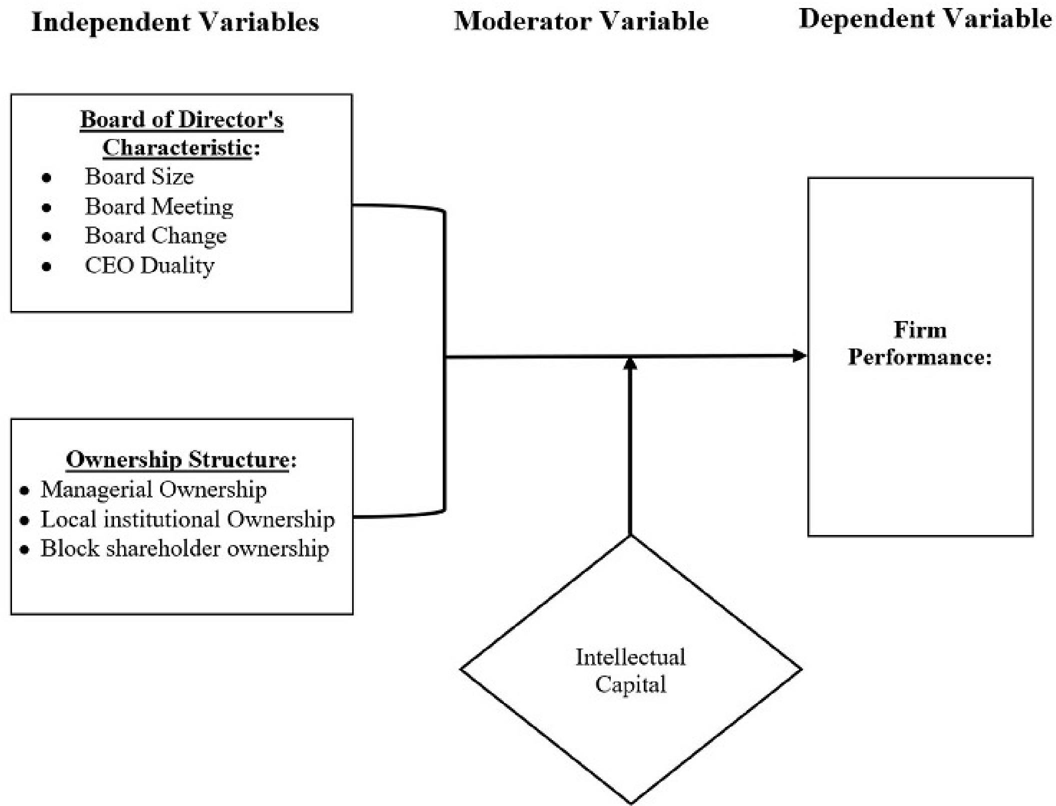

Figure 1. Research framework proposed

3. Conclusions

There are numerous studies on corporate governance; however, no study has been carried out to the best of our knowledge that contributes intellectual capital to the VAIC paradigm as mild with corporate governance. Therefore, the role of intellectual capital as a moderator variable makes a major contribution to this study. Furthermore, it conceptualizes how intellectual capital boosts firms' performance, combined with corporate governance structure, thereby promoting economic growth. From the discussion above, this study accepts the hypothesis that the effectiveness of intellectual capital moderates the relationship between corporate governance and firm performance.

Consequently, this study proposes that more research be performed to determine if integrating corporate governance and intellectual capital as a moderator with company performance can improve good corporate governance and, therefore, improve the firm's performance.

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