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The mediating effect of profitability in the relationship between Intellectual Capital and Market value

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ABSTRACT

The purpose of this study is to investigate empirically the mediating effect of profitability in the relationship between intellectual capital and market value of companies listed in Bursa Malaysia for the period 2006-2011. This research wanted to establish the mediating effect of profitability on the relationship between intellectual capital and market value through panel data and the Generalized Method of Moments (GMM) model in a longitudinal design. In doing so, it applied Pulic's Value Added Intellectual Coefficient (VAIC™) method as the efficiency measure for measuring intellectual capital. In addition, Sobel's z-value, Aroian test, Goodman test, and Kenny and Boran approach which were used for testing the hypotheses for quantitative data was drawn from Malaysian listed companies. Profitability is a significant mediator (partial mediator) in the association between the intellectual capital and market value of the companies and increases the relationship between the two variables by 41.8 percent. This is the first study that shows the mediating effect of profitability in the relationship between the intellectual capital and market value of the companies in Malaysia..

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1. Introduction

The observed promiscuities in the pricing of assets, such as the known effects of accruals (Sloan, 1996) and assets growth (Cooper et al., 2008) have been considerably

The market value of a company is one of the indicators in the financial sector for evaluating the development of a country (Word bank, 2013). Reiter and Steensma (2010) believe that increasing the market value of a company is cause to the growth and development of the company which finally leads to GDP, economic growth, and development of the country. Malaysia intends to change into a developed country until 2020 by the Master Plan (2002), however, it is now far away from the developed countries in Asia such as Japan, China and the Rep of Korea in terms of development indicators as market capitalization or market value of the companies (World Bank, 2013). Therefore, identifying the factors influencing market value (MV) of the companies is the most important issue of Malaysia these days.

Some previous studies show that intellectual capital (IC) has a positive effect on MV (Niazi et al., 2012; Soedaryono and Prihartini, 2012; Maditinos et al., 2011; Firer & Williams, 2003). While some other studies do not show the positive effect of IC on MV (Mehralian et al., 2012; Chu et al., 2011; Wang, 2008). The research results of Khan et al. (2012); Pal and Soriya (2012); Soedaryono and Prihartini (2012) indicate that IC can increase the profitability of companies. This study argues that the positive relationship between IC and MV can be due to profitability, in other words, profitability has a mediating effect on the relationship between IC and MV. According to the Resource Based Theory (RBT), IC as an intangible asset can have effect on profitability (Barney, 1991). At the same time according to signal theory, profitability of the company sends a positive signal to investors which leads to an increase in the evaluation of market value of the companies (Connelly et al., 2011).

IC is one of the most important assets for the most of the companies, especially for the knowledge-based companies in this modern economy (Roslender & Fincham, 2004). IC is an organization's asset which is not recorded in a company's balance sheet (Abeysekera, 2008; Brennan, 2011) but has generated or will generate value to the organization in the future(Holland, 2003).

There is not any accepted public definition and classification of IC (Canibano et al., 2000; Andriessen, 2004; Chu et al., 2011). In one case, Edvinsson and Malone (1997) have categorized IC into two broad senses comprising human capital (HC) and structural capital (SC). They have defined IC as "the sum of all knowledge a company is that able to use in the process of conducting business to create value for the firm" (Edvinsson & Malone, 1997, p: 11). At the same time, they have defined HC as "the combined knowledge, skill, innovativeness, ability of the company's individual employees to meet the task at hand, company's values, culture, and philosophy" (Edvinsson & Malone, 1997, p:11) and SC has been defined as "the hardware, software, databases, organizational structure, patents, trademarks, and everything else of organizational capability that supports those employee's productivity - in other words, everything that gets left behind at the office when employees go home" (Edvinsson & Malone, 1997, p: 11).

In line with RBT, value IC as a resource depends on its efficiency or performance. It means that the performance of IC indicates the value of IC , therefore this research considers the performance of IC or Intellectual Capital Performance (ICP) to measure IC and