CHAPTER 1
INTRODUCTION

1.1 Background

Financial performance reflects as a measurement for a firm to evaluate its business performance that shows the overall financial health of the sector over a specific period (Naz et al., 2016) to accomplish a financial goal, which is to gain profitability (Tsai & Mutuc, 2020). Using financial ratios, many factors influence it, one of which is assets (Barathi, 2008). The firm expects it can bring benefits to the company economically in the future. According to RBV (Resource-based View), if a firm focuses on managing these internal resources to add value to its products and services, it will ensured the survival of a firm in the market because of competitive advantage (Barney, 1991; Peteraf, 1993; Dzenopoljac et al., 2016).

Commonly, there are two classifications of assets, which are tangible and intangible. Both of them are as important as they sound. However, these days, the rapid change of business environment has put business attention on the development of intangible (knowledge) assets (Khalique et al., 2019) or, in another term, Intellectual Capital (IC) (Goebel, 2015). A well-utilized IC can be a source of competitive advantage due to its innovative nature (Obeidat et al., 2017). According to McDowell et al. (2018), three components of IC are human capital (HC), customer or relational capital employed (CE), and structural or organizational capital (SC). Sometimes, there are additional or separate parts besides mentioned above, like innovation capital (Chen et al., 2004).

Many researchers have tried to analyze the relationship between IC on financial performance. Ozkan, et al., (2017) showed a positive correlation between IC and financial performance in their research in the Turkish banking sector. Remain in the same industry, Onumah and Duho (2019) proved that IC of the banking sector in Ghana has a positive and significant value on financial performance. They also added that among all the components of IC, only HC behaves like IC. While structural capital has a negative and insignificant value, on the other hand, capital

employed has a positive correlation, but the value is not significant. An increased and better-utilization of knowledge-based asset will have a beneficial influence on the performance of a company. The following research (Maditinos et al., 2011; Forte et al., 2019; Chowdhury et al., 2019; Weqar & Haque, 2020) stated the same. However, other researches also show uneven results in each of the IC components. For example, Mensah-Onumah & Tornam-Duho (2019) mentioned a positive correlation between financial performance to both customer capital and human capital but an inverse relationship with structural capital. Bansal & Singh (2020) stated that IC has an insignificant value on productivity and a significant value on profitability. Contrarily, Weqar & Haque (2020), in their study to India Central Public Sector Enterprise showed a weak relationship with firm profitability and market valuation yet, it acts as a strong predictor of productivity. Therefore, because of these inconsistent results, further research is needed regarding the influence of IC on financial performance.

To fill the research gap mentioned before it, thereby, this study introduces green innovation as a mediating variable of intellectual capital on financial performance. Just like the emerging concept of intellectual capital, green innovation, slowly becoming a trend for many businesses. The director of IDX, Hasan Yawzi stresses out how the good practice of sustainability is proved to push firm performance financially up in the long-term (Aguilera et al., 2013; Huang & Li, 2017; Adeel, 2019; Xie, 2019; Sebayang, 2021). Especially in the last 5-6 years, many investors are looking more for businesses that are eco-friendly to channel out their funds, as cited by Husaini (2020). To come to this understanding, Kong et al. (2016) found that green innovation can be one of a firm's actions because it touches all dimensions in sustainability theory. While green innovation results in better financial performance, it needs internal resources such as intellectual capital to exhibit a significantly higher radical and incremental in all parts of innovation performance (Han & Li, 2015; Agostini & Nosella, 2017).

This research continues prior researches, i.e. Soewarno and Tjahjadi (2020) study about measuring intellectual capital and financial performance of banking firms in Indonesia and Xie (2019) about the content of green innovation on

corporate profitability. Due to the lack of research regarding the mediating role of green innovation on intellectual capital and financial performance, this research develops a comprehensive framework that examines the mediating role of green innovation on intellectual capital and financial performance. This research also includes productivity and market value as financial performance measurements aside from profitability.

There are multiple reasons to study this topic in Indonesia, particularly in the manufacturing industry. First, among other IC components, HC proved to contribute a lot to firm performance (Onumah & Duho, 2019). But looking at the Human Capital Index (HCI) 2018, Indonesia was placed in the third quartiles with Brazil and the Philippines in the world and top 6 inside South East Asia. Second, Indonesian awareness to protect the environment is still lack in many ways. It shows in the Environmental Performance Index (EPI) 2020, Indonesia is ranked 116 out of 180 countries worldwide. Third, when talking about environmental problems, it seems like the development of a manufacturing business in Indonesia has become an issue. Recently, in 2019, there have been 47 factories from manufacturing companies that got administrative sanctions from Jakarta environmental officials due to air pollution (Antara, 2019) yet, there are more manufacturing companies across Indonesia that are publicly unknown and unregulated. Fourth, among other sectors, this sector dominates the list for about 30% and keeps adding. Hence, this research expects to contribute better insight into intellectual capital on financial performance through green innovation as a mediating variable.

Within this context, the purpose of this research is to provide empirical evidence about the resource-based view and sustainability theory on the relationship of intellectual capital and financial performance with the effect of green innovation as a mediating variable in manufacturing companies listed in Indonesia from 2015-2019. Based on the quantitative secondary data collected and run through WarpPLS7.0, our results show that green innovation failed to mediate between intellectual capital and financial performance. Even though intellectual capital has a significant effect on green innovation, there is no significant effect between green innovation and financial performance. Theoretically, this research contributes as a

reference for other researchers regarding the topic. It also expects the manufacturing industry to be proactive in developing intellectual capital and brings out the best practice of green innovation. The structure of this research is as follows: first is the explanation of existing theories. Then the methodology. Lastly would be results and discussion.

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