International Journal of Knowledge-Based Organizations
Volume 11 • Issue 1 • January-March 2021

Impact of Intellectual Capital and Total Risk Management on Bank Performance

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ABSTRACT

Bank performance is treated as a pivotal indicator of total economic stability of a country. Generally, the intellectual capital measurement is the study of the impact of intellectual capital on the banks performance and gives some proposal aiming to improve the efficiency of the banking industry. The TRM encompasses all the activities that affect its risk domain. Risks are generally defined by the adverse impact on profitability of several distinct sources of uncertainty. The prime focus of this study is to find out the relationship among intellectual capital, total risk management, and the performance of Bangladeshi listed banks. The result shows that bank performance has no statistically significant relationship with total risk management of the sample banks and level of investment on intellectual capital. Likewise, the findings of the study are as comparable with some other studies where the authors have found similar and/or different economic characteristics.

KEYWORDS

Bank Risk, Banks' Performance, Financial Leverage, Firm Size, Intellectual Capital, Market to Book Value, Return on Assets, Tobin's Q, Total Risk Management

INTRODUCTION

In the modern era, complexity of the environment in the areas of business competition, rising customer expectations of corporate performance, the need to be aware of the strengths and weaknesses of the organization and key performance indicators to continuous improvement is more evident. Throughout history our societies have observed four different socio-economic phases which include primitive society, agricultural society, industrial society, and information society in which we presently live. The resources of production diversify from one organization to another of this period. Before emerging the information society, the traditional factors such as land, labor, capital, natural resources, and entrepreneurship were crucial factors but after emerging the information society another three factors knowledge, information technologies and intellectual capital added with traditional factors (Kandemir, 2008; Kayacan & Alkan, 2005; Yalama, 2013).

In the new economic era, Intellectual Capital (IC) plays a vital role in financial performance of an organization. It is widely accepted that with the advent of solid knowledge based economy, the conventional bases sources of competitive advantage that depends on tangible assets in creating

DOI: 10.4018/IJKBO.2021010102

firm value and sustaining competitive advantage begun to erode (Maditinos, Chatzoudes, Tsairidis, & Theriou, 2011; Ordonez de Pablos, 2002; Shih, Chang, & Lin, 2010).

Accordingly, the potential for creating competitive advantage and long-term value lies more importantly in the efficient management of IC than in tangible assets. In knowledge-based industry like banking industry non-tangible and intellectual resources are highly focused (Shih et al., 2010). According to Ahuja and Ahuja (2012), an efficient utilization of IC is more crucial for accomplishing success in banking than other industries, asserting that delivering of high quality services by a bank depends on its investment in items related to IC such as its human resources, brand building, systems and processes. Al-Musalli and Ismail (2012), assert that “though physical capital is essential for banks to operate, it is the intellectual capital that determines the quality of services provided to customers.” Therefore, it becomes necessary for banks to manage their IC as efficiently as possible.

The chance of unfavorable outcomes may occur in an investment’s of an organization traded as a risk. Risk can also be defined as the intentional interaction with uncertainty. Risk management is courses of action by which firms identify determine, prioritize and alleviate the adverse effect of uncertainties (Chapman & Ward, 2003). Accordingly, risk management is a systematic approach to mitigate negative effect of any specific phenomenon. The approach that defines risk from only down perspective could leads to risk aversion. Risk aversion can be an individualistic behavior but in business it is impossible to avoid all kinds of risk. Most risk taking activities associated with opportunities. Hence, companies need to be intelligent enough in managing their risks not only to grab the benefit out of it but also to survive in business.

This study contributes significantly in that it provides Bangladeshi banks with a simple method in understanding and evaluating performance, as well as enhancing the management of Intellectual Capital and Total Risk. The IC and TRM literature will also help in deciding the potential role of IC efficiency in the financial performance of banks in Bangladesh, an emerging country which lacks such research. This paper is organized as follows. The second section presents the literature related to the study and hypotheses development. In the third section, we discuss the research methodology and data employed in the study. The fourth section presents the results of the study. Finally, we conclude the paper in the fifth section.

BACKGROUND

Theoretical Discussion of Intellectual Capital

This study initially intended to discover the proposed definitions for Intellectual Capital (IC) then the well accepted definition. If the firm’s competitiveness depends on some intangible assets like business reputations, trust of brand, uses of technology then these are treated as an intellectual assets for firm (Itami, 1987). Scholars define the concept of intellectual capital in different ways. Therefore, there is no single definition explaining the concept of intellectual capital. However, intellectual capital may be interpreted as the intangible assets which are not listed explicitly on a firm’s balance sheets but positively impact the performance and success of it (Brooking, 1996; Kayacan & Alkan, 2005; Mondal & Ghosh, 2012).

Consistent with this view, Mavridis and Kyrmizoglou (2005), asserted IC is treated an assets which create the potential value for the organization and the society as well; similarly, García-Meca and Martínez (2005), argue that IC is the crucial factors such as the knowledge, information, intellectual property and experience which generate to raise organizational assets. For Brennan (2001), IC is a combination of different intangibles assets of a bank i.e. an aggregation of patents, intellectual property rights, copyrights and franchises of the bank. On contrary A Pulic (2001) states that, favors the notion that IC consists of employees capability to create value which is added to the organization. In other words, IC is an intangible asset composed of both the knowledge and know-how that characterize an organization and give it a competitive advantage over other firms. While many definitions of IC have