

Growth of Intellectual Capital in Private Banks of India during 1991-2013

Abstract

Intellectual capital is one of the intangible assets that provide a source of sustainable competitive advantage in organization. In fact, the components of the intellectual capital such as human capital, structural capital and customer capital should interact for establishing improved organizational performance. Intellectual capital is the currency of the future and is an organization's most important asset. Those who learn how to manage it effectively will realize accelerated performance and achieve the ultimate competitive advantage (Bontis, 2000). Therefore, the aim of this paper is to examine the trend of intellectual capital among Private sector banks and its impact on their banking industry's performance. The data analysis to measure the trend of intellectual capital; it was found that as increase level of intellectual capital in Private sector banks, banks' performance is also increase. The trend of intellectual capital shows positive relationship for Private sector banks.

Keywords: Intellectual Capital, Human Capital, Value Addition and Sales Turnover.

Introduction

The industrialized world is rapidly moving into an era where economic growth depends highly on knowledge. There has been an exponential growth in the capabilities of information technology during the last twenty years. It has increased international competition, and strengthened the need for continuous innovation. There has also been a tremendous growth in the services sector. More of what is produced and consumed today is intangible. These days, information technology skills, customer relationship skills and personal skills are given more emphasis than manual skills. Such skills provide a competitive advantage to the firms. In the past, raw materials, capital, land and machinery were considered to be the only valuable resources. Today, other resources such as brand, corporate routines, skills and creativity are considered no less important as these give a competitive advantage. The study carried out by the Brookings Institution on the value of non-financial companies brought out that in 1978 twenty percent of corporate value was attributable to intangible assets, whereas in 1998 this had increased to eighty percent. As the world has undergone this metamorphosis, practitioners, accountants and academics alike have felt the need to manage measure and report on the intellectual value of companies (Gray, 2001).

Intellectual capital is a package of useful knowledge which includes organization processes, technological patents, employees' skills and information about customers, suppliers and stakeholders. It deals with particular, reasonable, knowledgeable and substantial fruits of the mind (Kok, 2007). Intellectual capital can be defined as intangible assets which comprise of technology, customer information, brand name, reputation and corporate culture. These are invaluable to a firm's competitive power (Muhammad et al., 1998).

Intellectual capital significantly affects the performance of an organization. It has not only contributed in the creation of whole new types of business, but also provided various other ways of doing business. In fact, many companies such as those in the software field rely wholly on intellectual capital for generating revenue (Luthy, 2000).

There has been an increase in the number of research studies which have their focus on measuring and reporting intellectual capital (Marr et al., 2003). As the intellectual capital assets can influence the valuation of an enterprise in a big way, it is critical that executives have learnt to employ these assets to improve profitability and increase shareholder value (Muhammad et al., 1998). The systems used to measure intellectual capital assets should satisfy two main areas of performance, i.e., effectiveness and efficiency. We can measure effectiveness as the change in intellectual

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stocks and effects on business performance. In terms of the efficiency can be measured by taking into account the operating performance measures such as lead times, customer satisfaction, employee productivity, etc. (Gray, 2001).

Indian banking industry plays a dominant role in the financial sector of India. Banks constitute the backbone of a nation's financial system, performing manifold functions like liquidity, maturity and risk transformation. Indeed, it needs no gainsaying that the health of the economy is, in a way, the mirror reflection of the banking system, especially in bank-based financial systems such as ours. The existing banking structure in India, evolved over several decades, is elaborate and has been serving the credit and banking services needs of the economy. In India, banking sector performs three primary functions: the operation of the payment system, the mobilization of savings and the allocation of savings to investment projects. By allocating capital to the highest value use while limiting the risks and costs involved, the banking sector can exert a positive influence on the overall economy, and is thus of broad macroeconomic importance. The monetary and banking policies and external situation have influenced the evolution of Indian banking in diverse ways.

Objectives of The Study

The driving force of the paper is to analyze in detail, the growth of intellectual capital of private banks in India. In the recent times, the major upheaval in Indian banking was witnessed in the year 1991 when new economic policy in India was adopted. Therefore, the growth of intellectual capital of private banks in India since 1991 has been studied in the present paper. More specifically the objectives of the present papers are:

1. To study the growth of intellectual capital of private Banks since 1991-2013.
2. To analyze sales turnover, capital employed, value addition and human capital of private banks since 1991-2013.

Review of Literature

Intellectual Capital

Intellectual capital is defined as intangible assets that comprise of technology, customer information, brand name, reputation and corporate culture that are invaluable to a firm's competitive power (Low & Kalafut, 2002). To further classify it, intellectual capital usually consists of (1) tacit knowledge and innovativeness of the employees; (2) infrastructure of human capital (i.e. good working system, innovation) and improvement processes of structural capital; and (3) external relationships of the firm (i.e. customers' capital). These are the key drivers of organization performance and creation of future wealth (Bontis, Keow, & Richardson, 2000; Riahi- Belkaoui, 2003). Based on the definition given, intellectual capital can be divided into three important components: human capital, structural capital and capital employed.

Human Resources

Human capital can be defined as health, knowledge, motivation and skills, the attainment of

which is regarded as an end in itself (irrespective of their income potential) because they yield fulfillment and satisfaction to the possessor. It is also referred to the employee competence in creating both tangible and intangible assets by contributing in the continuous generation of knowledge and ideas. Unlike structural capital, human capital is always owned by the individuals who have it, unless it is recorded in a tangible form or is incorporated in the organization's procedures and structures (businessdictionary.com). Human capital is the firm's collective capability which helps to extract the best solutions from the knowledge of its individuals (Bontis, 1998). Unfortunately, people's departure can lead to the loss of corporate memory. But there are others who believe that such a departure may be considered good as it provides the firm a chance to get new perspectives from replacement employees. Thus, human capital is the sheer intelligence of the organization's members (Bontis et al., 2000).

Human capital is represented by the employees of an organization. Employees produce intellectual capital through their competence, their attitude and their intellectual agility. Competence includes skills and education; attitude is the behavioural component of the employees' work; and intellectual agility enables them to change the current practices and to think of innovative solutions to problems. The employees are considered the most important corporate assets in a learning organization, but they are not owned by the organization.

Structural Capital

The mechanisms and structures of the organization lend support to the employees in their quest for optimum intellectual performance which affects the overall business performance. Efficient systems and procedures of an organization contribute towards improving the intellect of an individual. Thus, the processes and packages appearing under the structural capital allow human capital to be used effectively for creating value. It includes the information systems and the management competencies which leverage human capital (Moslehi et al., 2006). Cabrita and Vaz (2006) consider structural capital as the skeleton and glue of an organization because it provides the tools (management philosophy, processes, culture) the required human knowledge. The concept of structural capital allows intellectual capital to be measured and developed in an organization (Bontis, 1998).

Structural capital can be classified further into organizational, process and innovation capital. The organization philosophy and systems form organizational capital which is used to leverage the organization's capability. Process capital includes the techniques, procedures, and programmes which enhance the delivery of goods and services. Innovation capital includes intellectual properties such as copyrights and trademarks, and intangible assets (Luthy, 2000).

Relationship Capital

Relationship capital depends highly on the loyalty of customer relations. Customer satisfaction, repeat business, financial well-being, and price

sensitivity are the indicators of customer capital (Luthy, 2000). Customer capital relates to clients, buyers and suppliers, brand names, the company's reputation and clients' opinion about the company. Customer capital emphasizes on having a close interaction with the customer. It also includes their satisfaction, continuity, price reactions, and good relationship with loyal customers. Customer capital can be created by accustoming clients to the activities of the company. The trust of customers is vital in the sense that it forms a permanent relationship with them. It also establishes a correlation with other companies through different networks, especially those adopting high technologies are highly dependent upon each other (Kolakovic and Holmik 2006).

Belkaoui (2003) considers customer capital as the firm's value of its franchise, and its prevailing relationships with the people or organizations to which it sells. Proper marketing channels and customer relationships contribute towards customer capital. Understanding the customers in an effective way makes someone a business leader. Customer capital demands more attention to develop since it is most external to the organization's core. Customer capital becomes more valuable with the passage of time. Long lasting relationships become a source of competitive advantage (Bontis, 1998; Hakansson and Snehota, 1995). Customer capital can be measured as a function of longevity (Bontis, 2002).

Methodolgy

This study focuses on the growth of intellectual capital in Private sector banks in India. The annual reports of the Private sector banks from the publications of 'Indian Banks' Association' like special issues, annual publications on 'Performance Highlights of Private sector banks for the year 1990-91 to 2012-13 were chosen for this study. The data obtained from secondary sources have been used to derive annual growth rate and compound growth rates for measure the performance of private banks. Sales turnover, value addition, capital employed and human capital indicators are selected for objective of the paper.

Results and Finding

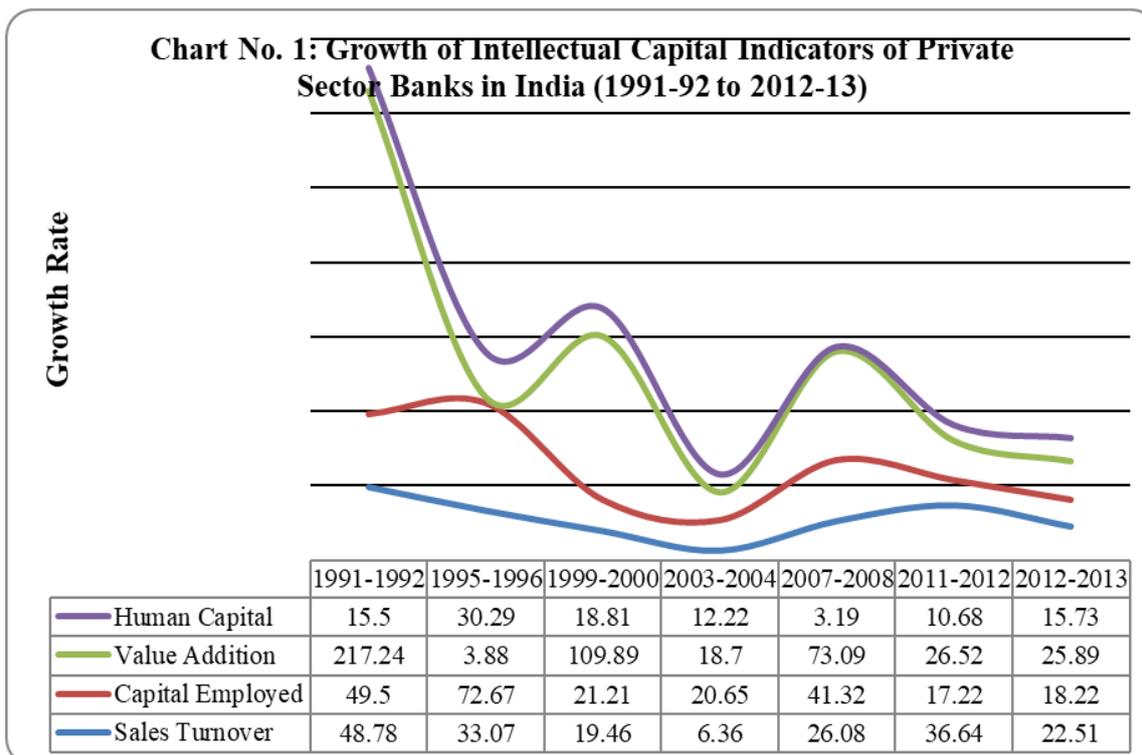
The private-sector banks in India represent a big part of the Indian banking sector. The private sector banks are divided into two groups by financial regulators in India, that is, old and new. The *old private sector banks* also referred as *private sector banks*, that existed prior to the nationalization in 1969

and the *new private sector banks* are those which have gained their banking license since the liberalization in the 1990s.

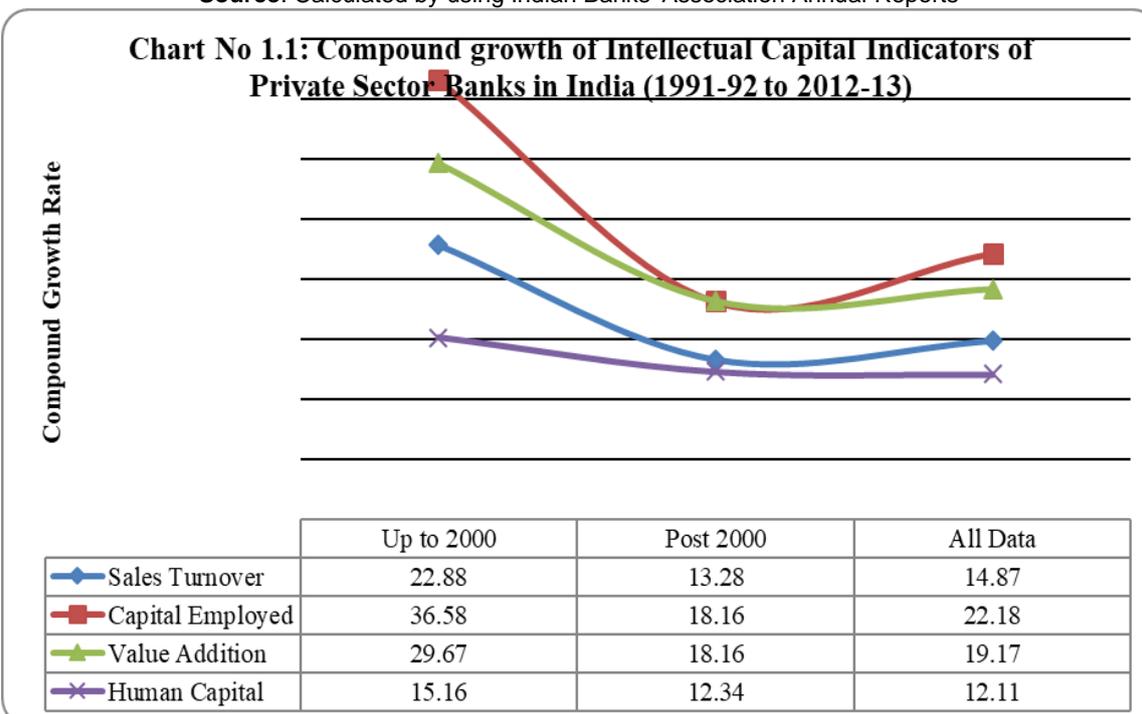
Private Sector Banks

Various growth and intellectual capital indicators of old private sector banks in India are presented in the chart No. 1. It has been observed from the table that *sales turnover* (sum total of interest earned and other income) of private sector banks has been increasing during the entire time span and has observed a positive growth rate except for one year (2004-2005) in which it had a negative growth rate. The total business or sales turnover of banks on which normally profitability rests is a crucial parameter to judge the efficiency of banks. If it grows year after year at an increased rate one can assume that the standing of the bank in the market has been improving. Sales turnover has increased 43 times over the time period under study. In chart No.1.1, overall sales turnover of private sector banks has an impressive trend growth rate of 14.87 percent per annum. Much of this growth, at the rate of 22.88 percent per annum, has been in the 1990s decade which later subdued and came down to 13.28 percent per annum.

Capital employed in the private sector banks, after reforms, has increased tremendously. The capital employed in private sector banks has registered an inspiring growth rate of 22.18 percent per annum. Much of this growth is attributable to 1990s decade; later it came down. *Value addition* of private sector banks has increased steadily while its growth rate has shown many fluctuations during different years. Largely, the value addition in private sector banks has increased at a trend growth rate of 19.17 percent. Most of the value addition growth has been in the pre 2000 period. Human capital of private sector banks has increased continuously but with fluctuating growth rates. Human capital has scored the highest growth rate of 30.29 percent in 1995-96. Inclusively, the trend growth rate of human capital in private sector banks has been recorded at 12.11 percent per annum during the time span of 1990-91 to 2012-13. *Thus it can be concluded that all the growth and intellectual capital parameters of private sector banks of India have shown a consistent and remarkable growth after financial reforms. Remarkable value addition and the resultant VAIC are the result of fast growing sales turnover and the capital employed.*



Source: Calculated by using Indian Banks' Association Annual Reports

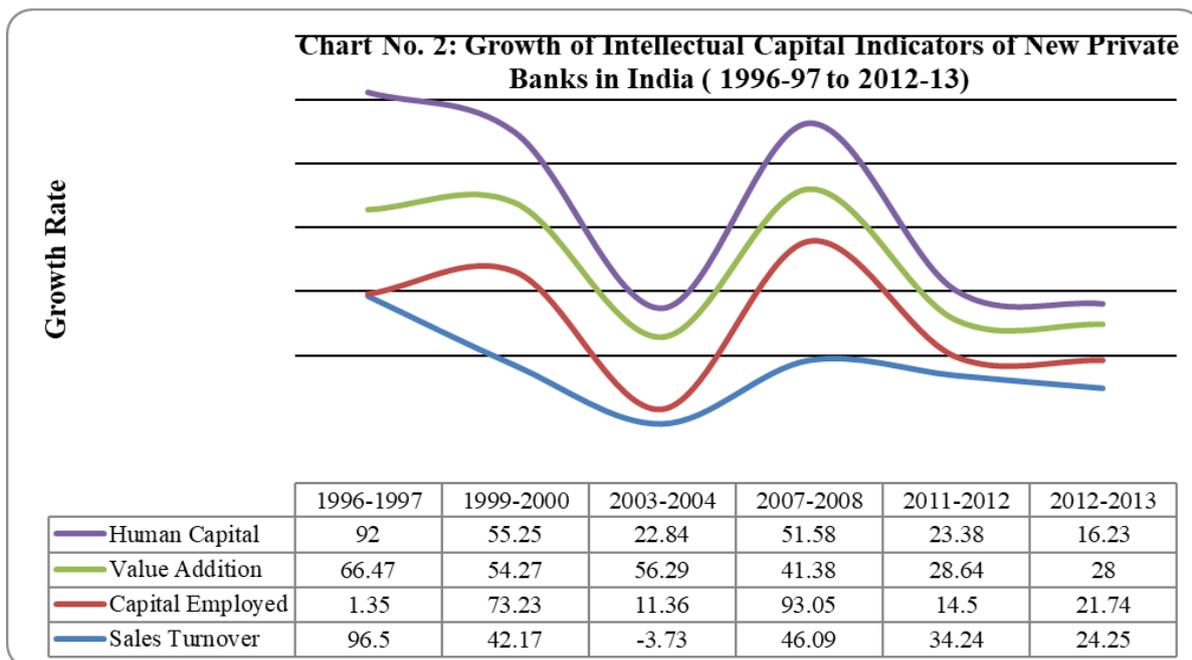


Source: Calculated by using Indian Banks' Association Annual Reports

New Private Sector Banks

Below chart No. 2 depicts various growth and intellectual capital indicators of new private sector banks in India. It is observed from the chart that sales turnover of new private sector banks has been increasing during the entire time span and has observed a positive growth rate except for the year 2003-04 and 2009-10; in which it had a negative growth rate. The total business or sales turnover of

banks on which normally profitability rests is a crucial parameter to judge the efficiency of banks. If it grows year after year at an increased rate one can assume that the standing of the bank in the market has been improving. Sales turnover has increased 152 times over the time period under study. Overall, sales turnover of new private sector banks has an impressive trend growth rate of 27.45 percent per annum.



Source: Calculated from Indian Banks' Association Annual Reports

Capital employed in the new private sector banks after reforms have increased tremendously. The capital employed in new private sector banks has registered an inspiring trend growth rate of 33.11 percent per annum. Value addition of new private sector banks has increased steadily while its growth rate has shown many fluctuations during different years. Largely, the value addition in new private sector banks has increased at a trend growth rate of 33.11 percent. Human capital of private sector banks has increased continuously but with fluctuating growth rates. Human capital has scored the highest growth rate of 92.00 percent in 1996-97. Inclusively, the trend growth rate of human capital in new private sector banks has been recorded at 37.96 percent during the time span of 1990-91 to 2012-13.

Conclusion

In the closing stage, it can be concluded that all the growth and intellectual capital parameters of private sector banks of India have shown a consistent and remarkable growth after financial reforms. Capital employed in the new private sector banks after reforms have increased tremendously. Remarkable value addition and the resultant value added intellectual coefficient are the result of fast growing sales turnover and the capital employed. The total business or sales turnover of banks on which normally profitability rests is a crucial parameter to judge the efficiency of banks. Private banks' performance have been increasing since past. This has been primarily because of over investment in financial capital and human resources and smaller customer base.

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