THE IMPACT OF INTELLECTUAL CAPITAL ON BUSINESS ORGANIZATION

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ABSTRACT

The main purpose of this research is to examine the components of intellectual capital and how intellectual capital affects business organizations. The study also examines how the intellectual capital items are accounted for in the financial statements. Literature review and theoretical framework are used in describing the three components of intellectual capital, how they are recognized in the financial statements of an entity and the impact that they have in the business organization.

Secondary sources of data such as journals and books are used in the study to qualitatively analyze the impact that the intellectual capital has on the business organization. Results of the qualitative analysis indicate that intellectual capital impacts the business organization in various ways such as enhancing the competitive advantage, facilitating innovation, enhancing the competency of the employees and increasing the organizational performance. Financial managers could make use of this research to gain insights on the categories of intellectual capital including the intellectual capital items to be included in the financial statements and those that should not be included.

Keywords: Intellectual Capital, Business Organization.

INTRODUCTION

Intellectual capital tends to be an important resource and a key contributor to the economic success and value creation in a business. Intellectual capital is an intangible value driver in an organization that brings about future benefits. In the current markets, competition is high and the buyers have become more informed. Also, the modern business environment is quite dynamic and the business organizations are facing many changes. The survival of many businesses depends on their willingness and ability to adapt to such changes (Chrisman et al. 2015). Through intellectual capital, the firms are able to quickly adapt to the changes and remain competitive in the markets. Intellectual capital has increasingly become a source of competitive advantage due to innovation (Obeidat et al., 2017).

In the business environment of today, intellectual capital is one of the most critical factors that bring about development and competitiveness in organizations. Intellectual capital tends to be intangible in nature and there tend to be challenged when it comes to determining its value. Commonly used ways of defining and describing intellectual capital include in terms of creating value and enhancing the competitive advantage and the success of an organization (Obeidat et at., 2017). The intellectual capital assists in creating wealth and in the production of other high valued assets. Intellectual capital in a business includes the wealth of the ideas and the ability for innovation which highly determines the future of the firm. In the past, individuals believed that organizational performance was dependent on the financial and expense items. However, this approach no longer holds researchers have come to the assumption that the success of organizations is highly dependent on the intellectual capital items which contribute to organizational performance.

According to Yang (2009), intellectual property has three main elements which include the human capital, the structural capital and the relational capital. Human capital includes the skills and the creativity of the workers which is increased through investments in the in the training programs. Human capital includes the skills and expertise of the employees in an organization. If the employees are more efficient, they are likely to boost the performance of the business. Structural capital is also a component of intellectual capital which includes the non-human assets in an organization (Daum, 2003). It consists of the copyrights, the patents, procedures and rules, and policies that aid in decision making. Relational capital refers to the relationship of the firm with the external stakeholders (Subramaniam, 2005). This includes the trust, the experience and the knowledge which forms the critical relationship between a business and the customers. It's the relational capital that prevents external stakeholders such as customers from abandoning the commercial relationship (Daum, 2003).

Intellectual capital is not a new concept for the organizations it exists in a few decades that focuses upon developing organizational performance with the help of available resources; however; there are a number of studies conducted that supports this concept such as Engstrom et al. (2003); Kim et al. (2012) and Sharabati et al. (2013): A study conducted in the hospitality industry that concluded human and structural capital are the main features to increase the organizational performance. Previous studies that are being conducted by Bontis, 1998; Bontis et al., 2000; Seleim et al., 2004; Wang & Chang, 2005; Cabrita & Bontis, 2008; Kamukama et al., 2010; Sharabati et al., 2010 endorse that there is a significant positive relationship between the intellectual capital and organizational performance. In the current research; the research gap will be bridged by using the three independent variables that are human, structure and relational capital. The previous studies focuses upon two factors that are human and structure while the third variable that is relational is not being considered by the previous studies and currently researchers are using these three variables in order to develop the different conclusion in different situation to come up with the better solution to the society or the industrial sector regarding increasing the organizational performance through the use of intellectual capital.

On the basis of the above discussion the research tries to answer the following question and sub-question:

Q1. Is there any impact of intellectual capital on business organization performance?

Q2. It there any impact of human capital on business organization performance?

Q3. Is there any impact of structural capital on business organization performance?

Q4. Is there any impact of relational capital on business organization performance?

THEORETICAL FRAMEWORK

Human Capital

Human capital is one of the components of the intellectual property. Human capital includes professional competence, social competence, employee motivation and also the leadership ability. Professional competence is the experience and the expertise that has been gained in a business and in the career of the employees. Factors that contribute to professional competence include training, higher education opportunities, practical experience through working, courses and seminars. Social competence, for example, includes the interpersonal skills, the ability to relate well with others, ability to communicate and the ability to discuss in a constructive way; Social competence enhances good cooperation and learning ability of the employees (Swart, 2006).

Employee motivation tends to play an important role in an organization. Motivated employees are more willing and committed to taking on tasks. Such willingness to perform leads to more productivity in an organization. Business invest in motivating the employees through various methods such as through offering fair compensation, involving the employees in decision making, offering bonuses, commissions, promotion opportunities and freedom to make decisions. Leadership ability is also a component of intellectual capital. Leaders with high ability to lead are those that can perform their administrative tasks in a seamless way (Subramaniam, 2005). Also, leadership ability includes the ability to develop and communicate strategy and vision as well as implement it.

According to Bontis (1998), Human capital is the knowledge of people in a firm. According to Swart (2006), Human capital tends to be mobile and do not belong to any certain organization since the employees are the ones that own the human capital. Research by Swart (2006) shows that human capital is critical since it is a strategic source of creativity and innovation in a business; Human capital is viewed as the foundation of intellectual capital and is a key component in the performance of the intellectual capital activities. Research conducted by Joia (2007), indicate that human capital tends to be the key driver of growth in a firm. Proper management of the human capital could help in generating other intellectual assets within a business. Some human capital can be specific to certain industries. This is because some employees are trained and have experience in certain fields such as accounting, engineering, and medicine. Employees who have professional knowledge in certain areas may be required to register with certain professional bodies so as to demonstrate the level of knowledge and skill. Organizations may require the employees to have a professional qualification in certain areas since such employees may contribute more in the value creation process in the firm.

Organizations have no ownership of the employees or the skills and competencies of the workers. The future economic benefits of the employees may not be easily determined since there is the risk of high employee turnover. Whenever the employees quit, they do not leave the skills and knowledge that they have acquired but rather they leave with their competencies. The only thing that the organization can be left with is structural capital that may have been gained from the human capital (Swart 2006).

Estimating the human capital presents a lot of challenges which contributes to the lack of a reliable value that can be used in monitoring the performance of a firm based on the employment of the human capital. It's thus difficult to compare the human capital performance of one organization with another. There is also the problem of monitoring the future economic benefits that are likely to be contributed by the human capital. This makes it impossible to recognize the human capital in the balance sheet. Human capital cannot be included in the financial statements since the future benefits that accrue are hard to estimate (Zambon, 2017). It’s important for the businesses to acquire information regarding the human capital that could aid in allocating the human resource in a more effective manner (Youndt, 2004).

Human Capital and Organizational Performance

Human capital is the most innovative feature for the organization to act according to the environmental changes that contribute the organizational performance through their knowledge, experience, and capabilities applied to improve the organizational efficiency (Tarus and Sitienei, 2015). In recent studies, it is suggested that human capital is the most influential part of increasing organizational performance adequately (Tarus and Sitienei, 2015).

Structural Capital

Structural capital includes product innovation, corporate culture, management instruments, IT and explicit knowledge, internal cooperation, and process optimization. Product innovation brings about a better future for an organization. This is because innovation ensures that new products are brought into existence which enhances the competitiveness and the survival of the organization. Product innovation gives rise to patents and copyrights among others. Corporate culture is also part of the structural capital. Corporate culture relates to the values and the norms that influence knowledge transfer and job interactions. A good corporate culture ensures that there is compliance to policies and it sets the habit of innovation and improvements. Management instruments tend to support the effort of the leaders and influences the way that decisions are made and it includes the communication channels used during decision making. Process optimization relates to the continuous improvement of the internal procedures and processes. Internal cooperation refers to how the workers in the organization are able to cooperate and exchange information.

Structural capital include various elements such as the processes, the systems, structures, the intellectual assets as well as various intangible assets the structural capital includes the non-human knowledge in the organization such as the proprietary software, the computer programs, the databases, the organizational culture, and structure, trademarks patents among others (Choong, 2008). The structural capital includes those elements and assets that can be distinguished from the human capital within a firm. The structural capital tends to depend on human capital since it's developed by the human capital. For example, the patents are developed by individuals within an organization (Joia, 2007).

As opposed to the human capital which lies with the employees within the organization, structural capital is the knowledge that is owned by the organization. Structural knowledge remains in the organization even when the employees leave the organization. The human capital is applied in the organization to generate the structural capital which is used by an organization in increasing the competitive advantage and in creating value. The structural capital tends to make the people work better and in a smarter way. According to a study by Youndt (2004), the value creation process involves the transformation of the human capital into structural capital and the structural capital aids the employees in the value creation process (Subramaniam, 2005).

Structural capital tends to be stored in the organizational databases and it's used in the processes in an organization. Structural capital includes the organization know how which is usually used in the daily routines and is reflected in the documents and policies in the within an organization. Structural capital aids in creating a competitive advantage and it includes two main categories which are the organizational infrastructure and the intellectual property within an organization. The infrastructure of an organization includes the processes, rules, and processes. Intellectual property may include the trademarks, the patents among others.

Structural Capital and Organizational Performance

Structural capital is also an important part of the organizational performance because the processes, internal culture, management, and technological knowledge and other features contribute towards the development of the improved performance of the organization (Herzog, 2011). Therefore; researchers are considering the structural capital as a part of the intellectual capital that boost the organizational performance considerably (Gamal et al, 2011).

Relational Capital

Relational capital includes; customer relationships, the supplier relationships, the public relationships, and the investor relationships. Customer relationships refer to the relationship between the organization and its customers. Aspects such as good customer service enhance the good relationship with the customers. Supplier relationships relate to the relationship with the suppliers including the current and potential suppliers. Managing the supplier relationships involves undertaking activities that improve relations during purchasing. Businesses take actions that improve the investor relationships such as those that provide accurate information to the investors to aid them in decision making.

Relational capital, for example, tends to be determined by the communication between the organization and the customers; some of the elements in customer capital include the market share, the profit made per customer and the rate of customer retention. Relational capital involves the knowledge that is available in various relationships within the organization

For purposes of achieving a competitive advantage, long-term and strong relationships are very important. Such relationships need to be close. Relationships with the customers, for example, can be defined as an intangible asset if a contractual relationship exists (Daum, 2003). For example purchase and sales, orders can be identified as an intangible asset and may even sometime be recognized in the financial statements. Relationships with the customers and the suppliers that meet the criteria for recognition are included in the financial statements in a separate way from the goodwill. The purchase orders, for example, can be measured in a reliable way based on the amount of order made and hence they can be recognized in the financial statements. There are certain relationships that cannot be recognized in the financial statements (Nahapiet, 2000). This includes relationships such as customer loyalty and other relationships with the suppliers (Joia, 2007). Such relationships are not identifiable since it's hard to reliably measure their worth. Relationships such as customer loyalty are difficult to measure and control in terms of the future benefits that they are likely to bring into an organization (Subramaniam, 2005).

Relational Capital and Organizational Performance

Relational capital is based upon the relationship of the organization with the outside and inside of the organization; therefore; it is necessary to have the good relations with the customers, suppliers, public, investors, and others because they give their best information and valuable feedback based upon the organizational performance (Asiaei and Joush, 2015). Therefore; it is important for the researchers to include the relational capital as a part of the intellectual capital that increases the organizational performance.

Theory of Human Capital

The experts who focus in the area of economics or business management they consider the efforts or performance of the individuals highly credible in the organizational performance similarly; quality of the workers increases the efficiency or quality of the organizational operations (Martin de Castro et al, 2013). Smith (1776); suggested that individual or worker efficiency, knowledge, ability, capability and intellectuality in the production process of the organization is the evidence to get boosted the organizational performance adequately. Currently; employees of the organizations are considered as the human capital that increases the overall performance because of their commitment and dedication to using their abilities and knowledge in the development of organizational efficiency and performance (Edvinsson, 2013). The theory is based upon the human should be considered as the capital for the organization as other assets are being used to perform the activities of the organization such as tangible and intangible assets that constitutes the capital for the organization similarly; in the case of the employees they are also being considered as the human capital for the organization and contributes to the organizational development and increases the performance as well (Briner et al., 2012).

LITERATURE REVIEW

There has been a lot of research that has been conducted regarding the intellectual capital and its impact on organizational performance. For example, Bontis, (2003) conducted a study on the relationship between intellectual capital and organizational performance. In his study, Bontis established that a mutual relationship does exist among the elements of intellectual capital and the capital has a positive relationship with business performance. Swart, (2006) did an evaluation on intellectual capital and established that intangible assets are important in the creation of a competitive advantage. In his study, Swart, (2006) also established that intellectual capital can help in solving the challenges that face businesses in the dynamic economy

A study by Youndt (2004), indicate that intellectual capital is the most critical component in promoting organizational effectiveness. Also intellectual capital is the most important factor that can ensure the survival of any organization or institution. According to Choong (2008), intellectual capital refers to the intellectual assets that have been captured, formalized and even leveraged. The intellectual materials help in creating wealth and they help to produce high valued assets. Intellectual capital in a business includes the wealth of the ideas and the ability for innovation which highly determines the future of the firm. According to, Swewart (2008), intellectual capital refers to skills, knowledge, experience and customer relationships that offers an organization with a competitive advantage over the competitors.

According to a study by Daum (2003) intellectual capital can be classified into 3 main components which include human capital, the structural capital and the relational capital. Studies indicate that the 3 components of intellectual capital do support each other. Human capital according to some studies refers to the capacity of the employees and individuals within an organization to offer solutions to the customers. Structural capital, on the other hand, transforms knowledge into assets of the organization such as patents, trademarks, software databases among others. Relational capital ensures that relations with the customers, suppliers and other stakeholders are nurtured.

Although intellectual capital is difficult to measure, it is real and it provides real value. In the past, the accountants may have assumed intellectual capital through ignoring it or writing off the intellectual capital assets. In the current environment, however, accounting standards such as International Accounting Standards allows recognition of the intellectual capital assets such as the patents and the development costs based on their future economic benefits. A company like Microsoft is highly valued due to its intellectual capital (Joia, 2007).

Even with the increased importance and emphasis of the intellectual capital. The accounting framework remains more focused on the tangible assets and some intangible assets and excludes some intangible assets that are crucial to an organization. Intangible assets that are recognized in the financial statements are only those that are in compliance with certain conditions as stipulated by the International Accounting Standard Board. The conditions by the IASB stipulate that for the intangible assets to be recognized they must be identifiable and measurable. According to Youndt (2007), the non-recognition of some of the intellectual assets in the financial statement may result into some differences between the value of a business and the book value and the actual value of the organization.

Some intellectual capital cannot be recognized in the financial statements. Intellectual capital such as the skills of the employees cannot be easily measured and hence they are not included in the financial statements. Measurement of human capital can involve a lot of subjectivity. Businesses invest in the human capital mainly through offering training and developing the employees. Assigning values to the growth and skills of the employees can be very difficult. For example, it can be very difficult to estimate cash flows that might come from human capital. Difficulties that are present in measuring the cash flows make it quite difficult when it comes to estimating the actual value of the human capital (Daum, 2003).

The IASB, for example, puts some very strict measures for an asset to be included in the financial statements. The requirements that are put in place by IASB are important since they ensure that the management cannot manipulate the information in the financial statements. If the measures were not present, there are some managers who would deliberately manipulate the financial statements by overvaluing intellectual property to deceive the users of the financial statements.

Many of the intellectual capital items pose difficulties when it comes to measuring. This is because they cannot be reliably measured and they are not verifiable. The IASB provides the framework for the presentation of the financial statements which requires the reliability of the information to be presented. Reliable information is the information that can be evidenced by the transactions that it represents. This condition makes it quite difficult for the recognition of the internally developed intellectual capital items (Swart 2006).

Research conducted by the Organization of Economic Cooperation and Development, (2009) indicates that investing in intellectual capital brings about many benefits to an organization. Such benefits include more competent employees, motivated workers, increased customer loyalty, competitive advantage and better utilization of the company resources for a better outcome. Given the benefits that come about from investing in intellectual capital, the managers have to identify the intangible resources that are important in creating and maintaining a competitive advantage within the organization (Daum, 2003). The management can use the experiences of other organizations to gain knowledge of the intangible resources.

Mahoney & Kor (2015), claim that businesses increasingly understand how intellectual capital is important in creating economic value and power. Joia, (2007) states that successful organizations of today are those that recognize that intellectual capital plays an important role in creating value as well as leverage. In order to survive in the marketplace that has become more and more competitive, organizations need programs of continuous improvement so as to improve the competencies of the employees. Also, organizations need to have effective systems and processes that are effective and efficient (Nahapiet, 2000).

FINDINGS

Intangible Assets

Many companies account for some intellectual capital such as the intangible assets in the organizations. Intangible assets may include the patents and the copyrights in the organization. Companies that use international financial reporting standards, for example, may account for intellectual capital such as research and development costs. Human capital may also include assets such as brand image, trademarks among others.

Intellectual and especially the intangible assets bring better future performance. However, there are some rules in accounting that restrict the recognition of some intangible assets. Some intangible assets, therefore, cannot be included in the financial statements. Many costs that are incurred in developing the intangible assets tend to be charged as expenses in the income statement. This tends to understate the profits since the costs will still bring about future economic benefits. According to Zarowin, (1999), intangible assets should not be recognized in the balance sheet since there is no certainty of the future economic benefits that the assets are likely to bring in.

International accounting standards, for example, view the intangible assets as the promise for future benefits (IAS 38). It, therefore, requires for the intangible assets to be recognized only when future benefits are likely to flow and the costs are measurable. If the criterion is not met, then the asset cannot be recognized as an intangible asset. There are many intellectual capital assets in an organization. Despite this, only a few are required to be accounted for in financial reporting. Examples of the intangible assets that can be accounted for include; the goodwill, the patents, copyrights, research and development costs, software, licenses, and brands.

Some intellectual capital is recognized in the financial statements. This is especially the unidentifiable intangible assets that cannot be recognized individually. Examples of such assets include the investments that are made in areas such as advertising, in customer lists and in-training programs (Choong, 2008).

Good Will

Goodwill is an example of an intellectual capital that may emanate from the reputation of the trademark of a company. Companies with a good reputation, high status, and loyal customers may be valued more than the value of the assets. Goodwill is thus the difference between the book value and the sale price. An acquiring company, for example, has to recognize the value of goodwill in the balance sheet. There are factors within an organization that may increase the value of goodwill (Youndt, 2004). Examples include highly skilled and competent staff as well as product development. Also aspects such as successful advertising campaigns, loyal customers and trademarks can increase the value of goodwill. Goodwill has the capability of bringing in future profits to an organization (Swart, 2006).

Goodwill is an intangible asset that tends to be recognized as a long-term asset. The Generally Accepted Accounting Principles (GAAP) and the international financial reporting standards (IFRS) requires a constant evaluation of goodwill which should be at least a year and the recording of any impairments. Impairments of goodwill, for example, can come about when the market value of the goodwill falls is below the historical cost. Factors that could bring about impairments may include economic depressions, a more competitive environment, and declines cash flows among others (Choong, 2008).

Patents

Business organizations do invest in protecting their ideas through patents. Ideas and developed products are easy to imitate. Patents protect the business organizations from such imitation that may affect competitiveness. Patents are intangible assets since they lack the physical substance and they provide long-term value to the business organizations. Patents are important to business organizations since they help in protecting ideas that are new and original; for example, they can be used in projecting physical devices, products, and even software. Through patents, the business organizations get exclusive rights to produce with the limited competition since the competitors are not allowed to copy the ideas (Bontis, 1998). When recording the patents, the businesses have to record the patents at the initial asset cost of the patent. The initial patent cost, for example, includes the registration fees, the documentation, and legal fees. In practice, the expenses of acquiring the patents may be quite small and many times they are charged to expenses and the patents are hardily recorded as assets unless they have been purchased from other companies. For those companies that buy the patents from others, the asset price is recorded at the purchase price of the patent (Daum, 2003).

Patents tend to be amortized and expensed over the useful life through the straight-line method. Also for those patents that reduce in value or fail to provide value, impairment of the patents have to be recognized in order to reduce as well as eliminate the carrying amount of the patent. Also, patents can be derecognized if an organization stops using the patented idea. In such a case, the business organization has to credit the patent asset account and debit the accumulated amortization account.

Trademarks

A trademark refers to a sign, symbol or even phrase that helps in distinguishing the goods of a certain business organization. Some examples of trademarks include the brand names, the slogans, and even logos. Through the trademarks, business organizations can be easily identified and distinguished from the competitors. The slogan, brand name, and even logos help the customers to easily identify the products of an organization and set the products apart from those of the competitor (Joia, 2007). Trademarks can last for a very long time unlike the patents and the copyrights that may expire after some years. Some trademarks are registered however, it’s not mandatory to register them. Some are established through the common-law rights. Business organizations that federally register the trademarks that more advantages than those that fail to do so. For example, for those that federally register the trademarks, the public is noticed of the organization’s ownership of the mark. Registering trademarks involves checks that are thorough that enables the organizations to have a unique mark that does not resemble any other marks (Daum, 2003).

Since trademarks have the potential of bringing in future economic value to an organization, they are assets to an organization. For the trademarks that are created internally, the value tends to limit to the amount used in the registration fees, documentation and legal fees. Some expenses incurred in the creating trademarks cannot be capitalized. This includes expenses such as advertising costs, the promotional costs, and salaries. Such costs are included as expenses during the period in which they were incurred.

Copyrights

Some authors and business organizations may invest in copyrights to protect certain works from being copied Copyrights are a form of intellectual property protection that is provided by the laws in the United States (Nahapiet, 2000). Copyright protection is for original works that involve authorship whether published or unpublished. Examples of original works that could be protected through the use of the patents include the paintings, the literary works, the movies, software among others. The copyrights offer legal protection for a certain period of time. For example, they should last for periods that include the life of the author plus another 70 years. Registering the copyright is important since it offers public records for the copyrights claims. Such registration tends to be important since it offers evidence during any infringement lawsuits (Subramaniam, 2005).

Copyrights help in protecting the time, the effort and the creativity of the author. According to the Copyright Act, the authors who are owns copyrights have the rights to display or perform their work to the public, to disseminate copies, to transfer ownership of their work, and to prepare derivative work which involves preparing other works that are based on the original works (Daum, 2003). For those authors that create work for companies during employment, they are not owners of the copyrights. Instead, the copyrights are owned by the employers who had requested and commissioned the work. This is a situation known as work made for hire (Bontis, 1998). This situation can also be present in the author of the work is an independent contractor who has been hired to create certain work.

When accounting for the copyrights, it's important to note they may not necessarily have value for the entire period of protection. The value of the copyrights may thus decline with time. It's thus important to establish the useful life of the patents. This involves determining the period in which the patent is likely to bring in substantial value for the involved business or individual. Once the useful life has been established, the copyright can be amortized over the useful life. In many cases, the copyrights are amortized through the straight-line basis. At the end of the useful life of the copyright, it no longer has the ability to generate any more revenues.

Research and Development

Business organizations invest in research and development which involves activities that create and improve the products and processes. Research and development is intellectual capital that contributes to the improvement and the development of new products. Through investing in research and development organizations are able to increase their competitiveness in the market. Activities involve research and development includes; researching to get new knowledge, formulating new product designs, developing new technologies, modifying processes among others. Research costs are those costs that relate to investigation involved in gaining scientific knowledge. Development costs, on the other hand, involve costs incurred in applying the research and findings in designing new products (Joia, 2007).

Under the GAAP, the costs incurred in research and developments are expensed in the period in which they were incurred. There is a problem with recording the research and development costs as an asset given that the future economic benefits associated with research and development costs tend to be quite uncertain. Under the IFRS, the research costs are expensed just like the US GAAP. However, the development costs are capitalized and amortized. There is, therefore, a difference in accounting for the development costs under the GAAP and the IFRS. Under the IFRS, the research costs are separated from the development costs and the development costs are capitalized. Under the US GAAP, there is no capitalization of the development costs and instead, they are classified as expenses in the income statement.

Accounting for Intellectual Property

In general, intellectual property is accounted for on the basis of whether they have been acquired internally or externally. For those intangible assets that have been acquired externally, it's quite easy to determine the costs since its equal to the amount of acquiring such an asset. For example, goodwill is recognized at its cost which is included in the balance sheet. However, there is difficulty involved in recognizing the intangible assets that are developed internally. Many of the internally acquired intangible tends to be expensed. This includes the intangibles such as the advertising costs, the training costs, the research costs and the goodwill that is developed internally. Due to the difficulty in measuring the internally developed intangibles, many of them are not included in the balance sheet. The acquired intangible assets tend to be stated at their fair value.

According to Subramian (2005), the intangible assets can either be capitalized if they can be easily matched with future revenues or they can be expensed in the year in which they are created. For example, when creating the patents, there are costs involved such as legal and documentation costs. The future revenues likely to be generated from the patents cannot be easily determined. If this is the case, then the costs are accounted for as expenses and the patent is not recognized in the balance sheet. When acquiring intangible assets such as goodwill, future revenues can be estimated due to loyal customers. Good reputation among others. In such a case, the goodwill is capitalized and included in the balance sheet as an asset (Daum, 2003).

IMPACT OF INTELLECTUAL CAPITAL ON BUSINESS ORGANIZATION

Innovation

Intellectual property contributes to innovation and innovation process in the business organizations. For example, research contributes to ideas which are further developed to bring about new products and improve the existing ones. Improvement and development of new products lead to commercialization where the products or services are sold in the markets. Each component of intellectual capital contributes to the innovation process. For example, human capital contributes to professional competence and motivation that allows the employees to be innovative and have the drive to turn ideas into products. Human capital has contributed to processing innovation where the organizations are able to perform their activities by using imaginative means.

According to a study by Nahapiet (2000) intellectual capital is seen to have a positive impact on innovative capacity. For example, human capital tends to contribute to the incremental and radical innovation. In the competitive environment of today, organizations cannot create wealth unless they actively get involved in innovating which is achievable through intellectual capital. Human capital for examples relates to the exposure, the experience and the creative capabilities of the employees. The better the human capital the more the ability to innovate and bring forth superior output.

Competitive Advantage

In current business environment, intellectual capital gives a competitive advantage to the business organizations. Through intellectual capital, it's possible for businesses to have successful strategies that cannot be copied easily. For example, businesses can register trademarks, patents and even copyrights which hinders competitors from imitating the products and the works of the business. Human capital brings about a competitive advantage since employees are able to add value to the organization through unique skills can capabilities that they acquire through experience and training. Competence of the employees brings forth innovation and product development (Stewart 1998).

The management of an organization should strive towards recruiting as well as grooming the best team in an organization so as to get a competitive advantage in the organization. In addition, it's important to ensure that knowledge is appropriately stored through intellectual assets which can further improve the competitive position of an organization. Intellectual assets of an organization create value and also increase the financial worth in the organization.

Research and Development

Intellectual property facilitates research and development. For example through human capital, organizations are able to invest in research and development which helps improve the current products and develop new products. Businesses are able to create internal knowledge by investing in research and development. Research and development contribute to more revenues and profitability in an organization. Research and development also contribute to improved processes in an organization. The more the ability to invest in research and development, the more the potential that an organization can add value to its growth. Organizations with highly skilled and competent employees are able to engage in research and developments since the human capital can engage in research to discover ideas and areas of improvement. Without intellectual capital such as the skills and expertise of employees, it's difficult to engage in research and development and efforts investments in this area cannot be fruitful. Both human capital and structural capital positively contributes to research and development which adds value to an organization and ultimately enhances the survival of an organization by increasing the competitive advantage of an organization (Choong, 2008).

Business Performance

Intellectual capital brings forth better business performance both in qualitative and quantitative terms. In quantitative terms, intellectual capital contributes to more profitability, return on assets and on investments. Another quantitative aspect in business that increases due to intellectual capital includes the customer retention rate and the market share. Quantitative aspects include customer loyalty and satisfaction and employee satisfaction. According to Subramien (2005), intellectual capital brings about innovation that in return leads to the competitive advantage which ultimately increases the performance of the firm. Intellectual capital is thus positively related to business performance.

An exploratory study by Bontis (1998) shows that the organizations that are able to manage their intellectual capital well are able to perform better and higher than others; Organizations that have better management, functionality, a better culture, and better training programs are also seen to make higher profits. Many businesses, especially in the developed countries, have leaned towards better intellectual capital management to boost their profitability (Swart 2006). In the past, the organizational performance was more dependent on the financial and expense items. However, this approach no longer holds researchers have come to the assumption that the success of organizations is highly dependent on the intellectual capital items which contribute to organizational performance (Youndt, 2004).

Intellectual property improves business performance in areas such as profitability, productivity, and market value. According to Chong (2008), the higher the value of the intellectual property, the higher the productivity of an organization; also the high value of intellectual property contributes to higher profitability and subsequently this increases the market value of the organization. Intellectual capital such as the patents and trademarks causes the market value of the businesses to increase than the value of the physical as well as financial assets (Subramaniam, 2005).

Value Creation

According to Swart, (2006) the value that is created by the intellectual capital has become more than that created by the tangible assets. The service sector, for example, has been able to significantly grow and even exceed other sectors due to investments in intellectual capital. Intellectual capital contributes to changing an organization from an ordinary business to being a leader in the field and in the industry. Through proper utilization of the intellectual assets, an organization can grow into the status of being the industry leader. Managers that are able to effectively manage the intellectual capital can be able to come up with better strategies, processes and even methods of running the businesses to enhance the financial and non-financial performance of the business.

Organizational Strategy

Organizational strategy depends on the competence, skills, and expertise of the individuals in an organization. Employees who are competent and experienced are able to come up with proper strategies that can propel the organization forward (Choong, 2008). The strategy includes the activities that have to be undertaken in achieving the corporate vision. The various components of intellectual capital have to be properly managed so as to achieve the organizational vision. Proper management of intellectual capital allows the formulation of proper strategies that enable the achievement of the organizational objectives. A business environment that allows the free flow of knowledge is a position to come up with better strategies to enhance survival. Business organizations can only remain competitive if they are able to constantly create, update and effectively utilize knowledge intellectual capital to overcome the operational and the technical challenges. Failure to update intellectual capital and blend it with the existing knowledge can only lead to the failed organization (Subramaniam, 2005).

Competence and Capability

Intellectual capital enhances competence and capability within an organization. For example, those employees are well endowed with capabilities are able to share their expertise with others which increases the competence within an organization. Information sharing among the employees helps them to work towards achieving common goals. The collaboration enhances synergy within the organization which ultimately leads to higher organizational performance. Interactions among the employees create transformed knowledge and through information sharing, an organization is able to achieve the predetermined goals (Daum, 2003). Organizations need to create an environment that allows information sharing to allow the transfer of knowledge among the employees. Transfer of knowledge allows the development of capabilities which eventually lead to better processes and structure within the organization (Bontis, 1998).

CONCLUSION

From the study, it's clear that intellectual capital provides immense value to a business organization. Intellectual capital items such as the intangible assets ensure that products, ideas, and concepts are not imitated in the market which offers an organization with a better competitive advantage (Subramaniam, 2005). For the intellectual capital items to be recognized in the financial statements, they must be identifiable and measurable. Intellectual capital items such as employees' skills and competencies cannot be recognized in the financial statements since it's not possible to measure them. The research shows that intellectual capital also contributes to innovation. Skilled and experienced employees are able to come up with new ideas and apply them to improve products and processes. Intellectual property is positively linked with business performance (Bontis, 1998). For example, it contributes to more profitability, higher return on assets and higher return on investments. In addition to the quantitative aspects, intellectual capital improves customer loyalty and satisfaction. Given the benefits that come about from investing in intellectual capital, the managers have to identify the intangible resources that are important in creating and maintaining a competitive advantage within the organization. The management can use the experiences of other organizations to gain knowledge of the intangible resources. Businesses that are in a position to manage their intellectual capital in a better way are able to perform well than others (Stewart, 1998). Organizations that have better management, functionality, a better culture, and better training programs are also seen to make higher profits. Many businesses, especially in the developed countries, have leaned towards better intellectual capital management to boost their profitability

Organizations are learning more on intellectual capital items for competitive advantage than on the tangible asset in the business organizations (Joia, 2007). Proper utilization of intellectual capital can change the organizations from being ordinary businesses to being the industry leaders. The managers that are in a position to effectively manage the intellectual assets are able to enhance both the financial and non-financial performance within an organization. Intellectual capital also improves the organizational strategy (Swart, 2006). For example, the employees that are highly competent are able to come up with better strategies that help propel the organizations in the right direction. Organizations can only remain competitive if they are able to constantly create, update and effectively utilize knowledge intellectual capital to overcome the operational and the technical challenges.

LIMITATIONS

The research has certain limitations and that is as follows: The research is based upon the theoretical and conceptual review and data was collected through books and journals and no empirical evidence has been brought into account hence the possibility of the generalization is questionable. Moreover, the research question was answered by a comprehensive literature review however the arguments are just limited to the refereed literature and practically no primary or secondary data was collected.

FUTURE AREA OF RESEARCH

It is suggested to the future researchers to conduct the study using the variable of sharing knowledge that will bring new findings for the study. The study is based on the theoretical review, it is suggested that future research should use the interviews as a research tool or use the quantitative method which will include the questionnaire to collect the primary data for the study. The empirical analysis will give a better understanding of the phenomena and help analyze the conceptual model of the study and generalize the research findings which will be a valuable addition in the existing body of knowledge regarding the intellectual capital research in the contemporary organizational setting.

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