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## **Impact of Intellectual Capital on the Financial Performance of SMEs Operating in Tourism Sector of Azad Jammu and Kashmir Pakistan**

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**Abstract:** in contemporary business, environment intellectual capital is considered as one of the prime strategic assets for the success and sustainability of small and medium enterprises (SMEs). SMEs play a crucial in the development of national economy, generating revenue, providing employment and uplifting the social status of low-income group in the society. Azad Jammu and Kashmir has tremendous potential to explore new avenues to establish SMEs. Integrated Intellectual Capital Model was used to examine the impact of intellectual capital on the financial performance of SMEs. In this empirical study a total of 182 individuals were involved. The targeted respondents of study were selected through convenience sampling technique. Multiple regression analysis was used to test the six research hypotheses that were proposed to validate the Integrated Intellectual Capital Model. The empirical findings of this study revealed that the intellectual capital has significant contribution on the financial performance of SMEs. This study is a unique study in Azad Jammu and Kashmir region and it will be a milestone for potential researchers in this area.

**Keywords:** *Intellectual capital, integrated intellectual capital model, business environment, tourism sector, Azad Jammu and Kashmir, Pakistan*

### **Introduction**

Many researchers in the field of intellectual capital such as (Halim, Ahmad, Ramayah, & Hanifah, 2014; Henry & Watkins, 2013; Inkinen, 2015; Khalique, Bontis, Abdul Nassir bin Shaari, & Hassan Md. Isa, 2015; Khalique & Pablos, 2015; Khalique, Shaari, & Isa, 2014) are expressing their arguments that in contemporary business environment the ability of the small and medium enterprises (SMEs) to deliver and perform successfully is possible with the help of intellectual capital. SMEs plays a vital role in the economy of Pakistan in form of economic growth, employment, social uplifting, innovation, revenue collection, development of entrepreneurial culture, skills developments, export and import. Failure rate of SMEs in Pakistan had shout up from 90-95 percent at the initial five years due to mismanagement, lack of infrastructure, administrative skills, finance, social acknowledgement, international exposure and intellectual capital.

In contemporary business environment, several researchers such as (Daud & Yusoff, 2010; Ferreira & Franco, 2017a, 2017b; Halim et al., 2014; Khalique et al., 2015; Khalique & Pablos, 2015; Muhammad & Bontis, 2015; Musteen, Ahsan, & Park, 2017; Talebi, Rezazadeh, & Najmabadi, 2015) on the bases of their research and they concluded that the survival and sustainability of SMEs in based on the identification and utilization of intellectual capital. There is no doubt that researchers have proposed many intellectual

capital models to understand the nature of intellectual capital in SMEs. Due to overwhelming acknowledgement of intellectual capital in many organizations more specifically in high-tech SMEs (Khalique, Shaari, Abdul, & Isa, 2011) has proposed an Integrated Intellectual Capital Model (IICM) to identify and understand the applications of intellectual capital in SMEs. This model is based on six components namely, human capital, customer capital, structural capital, social capital, technological capital and spiritual capital.

### Literature Review

Intellectual capital is the intangible value of a business that is created through its components to enhance its organizational performance. Many researchers such as (Bontis, 1999; Bontis, Chua Chong Keow, & Richardson, 2000; Edvinsson, 1997; Khalique et al., 2014; Youndt, 1998) argued that intellectual capital is refer to the soft assets of organizations that will help to create value added products and services. They also stated that soft assets are based on education, knowledge, know-how, professional skills, customer loyalty, database, police, procedures, social senses, honesty integrity and intellectual agility. These soft assets are very crucial for the success of business.

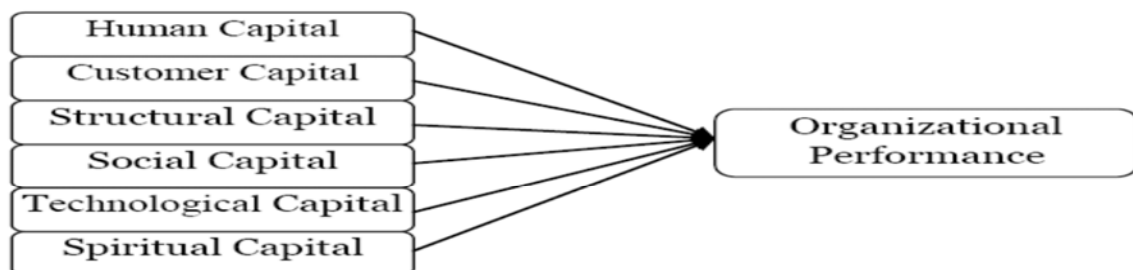
### Composition of Intellectual Capital

To understand a complex phenomenon of intellectual capital in depth (Khalique et al., 2011) proposed an Integrated Intellectual Capital Model (IICM) which is based on six components. Human capital refers to education, knowledge, skills, know-how and intellectual agility. Customer capital is mainly based on customer loyalty, satisfaction and brand. Structural capital refers to database, rules, police and procedures. Social capital based on organization’s transparency, corporate social responsibility, honesty and ethics. Technological capital includes, information system, knowledge and R&D. Spiritual Capital refers to the religious and ethical values in the organization (Bontis, 1999, 2001; Bontis et al., 2000; Bueno, Salmador, Rodríguez, & Martín De Castro, 2006; Chua, 2002; Daou, Karuranga, & Su, 2014; Edvinsson, 1997; Khalique et al., 2015; Khalique & Pablos, 2015; Khalique et al., 2014; Khalique et al., 2011; Youndt, 1998).

### Conceptual Framework

This study is based on intellectual capital theory (Khalique, Shaari, & Isa, 2013) which refer to the six components namely, human capital, customer capital, structural capital, social capital, technological capital and spiritual capital. These components are used as independent variables while business performance is employed as dependent variable. The conceptual Model is depicted in Figure 1.

Figure 1: Conceptual Framework



Source: Integrated Intellectual Capital Model (IICM2011)  
Khalique et al., (2011)

## Research Hypotheses

The main purpose of this study to test the following given research hypotheses;

- H1: Human capital has positive significant impact on the business performance of SMEs operating in tourism sector in Azad Jammu and Kashmir, Pakistan.
- H2: Customer capital has positive significant impact on the business performance of SMEs operating in tourism sector in Azad Jammu and Kashmir, Pakistan.
- H3: Structural capital has positive significant impact on the business performance of SMEs operating in tourism sector in Azad Jammu and Kashmir, Pakistan.
- H4: Social capital has positive significant impact on the business performance of SMEs operating in tourism sector in Azad Jammu and Kashmir, Pakistan.
- H5: Technological capital has positive significant impact on the business performance of SMEs operating in tourism sector in Azad Jammu and Kashmir, Pakistan.
- H6: Spiritual capital has positive significant impact on the business performance of SMEs operating in tourism sector in Azad Jammu and Kashmir, Pakistan.

## Research Methodology

This study is cross sectional in nature. The primary data were gathered through structured questionnaire developed by (Bontis et al., 2000; Khalique et al., 2015; Khalique & Pablos, 2015; Youndt, 1998). After cleaning and screening, a total of 182 respondents were involved in this study. The targeted respondents were selected through purposive sampling technique from Mirpur Azad Jammu and Kashmir, Pakistan.

## Results

Before analysis, the data were screened and cleaned. To check the internal consistency and reliability of each item of constructs Cronbach's alpha was performed. The values of Cronbach's alpha ranged between 0.647 and 0.931 indicating an acceptable degree of reliability (Nunnally, 1978) which is good for internal consistency. Table 1 demonstrated the results of Cronbach's Alpha value.

Table 1: Reliability of Constructs

Constructs	Items	Cronbach Alpha value
Human Capital	09	0.748
Customer Capital	08	0.779
Structural capital	08	0.884
Social Capital	08	0.831
Technological Capital	09	0.647
Spiritual capital	07	0.931
Organizational Performance	10	0.816

## Multiple Regression Analysis

In multiple regression model  $R^2$  results represent the amount of variance explained by the employed variables. Cohen (1988) stated that the  $R^2$  value between 0.02 and 0.12 is considered as weak, 0.13 and 0.25 is moderate while 0.26 and above is reflected substantial. The results of this study revealed that  $R^2$  value is 0.199 which means 19.9% of variance can be explained by the six components of IC. Therefore, these values could be considered as moderate (Cohen, 1988).

Moreover, as shown in Table 2 three direct relationship hypotheses out of six were supported. Human capital ( $b = 0.106, p < 0.05$ ) customer capital ( $b = 0.358, p < 0.01$ ) and

spiritual capital ( $b = 0.204, p < 0.05$ ) were positively significant with business performance of SMEs while structural capital ( $b = 0.034, p < 0.05$ ), social capital ( $b = 0.050, p < 0.5$ ) and technological capital ( $b = 0.082, p < 0.05$ ) were not positively significant. Thus H1, H2 and H 6 were supported while H3, H4 and H5 were not supported. The variance explained for each model is given in Table 2. This study produced the mixed results.

Table 2: Results of Multiple Regression Analysis

Variables	Organizational Performance		
	Unstand. Coefficients	t- value	Sig. level
Constant (b)	1.496	2.764	0.006
Human Capital	0.106	2.292	0.023
Customer Capital	0.358	5.137	0.000
Structural Capital	0.034	0.665	0.507
Social Capital	0.050	0.995	0.321
Technological Capital	0.082	1.003	0.317
Spiritual Capital	0.093	2.039	0.043
$R^2$	0.199		0.001
<b>F statistics</b>	<b>7.26</b>		<b>0.001</b>

Note: Unstandardized coefficients are reported along with t-statistics at  $p < 0.05$

## Discussion and Conclusion

This research was designed to determine how six components of intellectual capital effect on the financial performance of SMEs operating in tourism industry in Azad Jammu and Kashmir Pakistan. The results of this study suggested that the management and owners of SMEs need to understand the importance of intellectual capital in their organizations. This research strongly recommends a comparative study among different countries and sector to understand the application of intellectual capital in organizations and increase the credibility of the results.

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