Enhancing financial performance by applying Knowledge Management Practices

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ABSTRACT

The basic theme of this research is to find out how Knowledge Management (KM) practices influence organizational performance, innovation and superior financial performance, So that managers can give value to knowledge for achieving financial stability. Knowledge management practice, innovation, organizational performance and financial performance are defined through extensive review of literature. As it is a conceptual paper, so it emphasizes on the linkages of given variable with help of previous results extracted from different researches. Finally through literature analysis we found that knowledge management practices improve financial performance of organization through enhancing innovation and organization performance. Limitation of this study is that, due to short period of time data cannot be collected, quantitative research is not possible and other performance measures are difficult to be included in it. Practically, study will benefit the manager of the organization, who should implement knowledge management practices in their organization to achieve improved financial performance through innovation. Paper is a combination of different views sorted through different research papers on knowledge management. Author discuss all these views with own ideas and try to find out a generalized solution for achieving financial performance, which is mostly main focus of managers.

Keywords: Knowledge Management practices, organizational performance, innovation, financial performance

Paper type: conceptual paper

Introduction:

There is a lot of work done on knowledge management in recent few years as it is an emerging concept in the world at business level. Knowledge management is very useful resource for organization and, it plays an important role in the success of any organization. Firms with better knowledge management capabilities are often more innovative and perform better (Darroch, 2005). Through knowledge management awareness can be created in the Organization.

A KPMG consulting group did a survey of 423 leading organizations of Europe and America. The result showed that 70% of them were trying to implement knowledge management somewhere in the organizations (KPMG, 2000); whereas 64% of the 1000 British firms implementing the knowledge management, while 24% are at introduction stage (Moffett et al., 2003). Although it is a growing concept, but there is still much needed to develop and implemented in knowledge management practice, so that knowledge management can be effectively used by organization to perform better. Knowledge management is so far not a wide shared concept and definition (Ibrahim and Reid, 2009), the shared concept of knowledge management results in better performance.

In Pakistan knowledge management is a very new idea. Many of our managers are not familiar with the word knowledge management. However knowledge management practices produce creativity in the organization which leads to better performance. Managers in Pakistan are more performance oriented. They tend to increase the financial power of their organization that they can enable themselves to compete at world level. Unfortunately they do not emphasize on research and development, because innovation and creativity comes from widely shared knowledge practices, which is lacking here in Pakistan. Therefore the main focus is to investigate that either knowledge management improves the financial stability of the organization if yes then practically this is gold mine for managers.

Implementing knowledge management practices is not an easy task. Knowledge is a continuous flow but it may be not well systematic because sharing and implementation of knowledge management is different at different management levels (Carneiro, 2000). It is necessary to have a well systematic path for knowledge management practices which can be shared and implemented easily. For successful implication of knowledge management, there must be a performance measurement tool (Wei et al., 2009) .The organizational culture and implication of knowledge management positively associated with the firm’s competitive performance (Tseng, 2010).Knowledge management practices have direct relation with organizational performance which further enhances financial performance (Zack *et al.*, 2009). Knowledge management practices, when implemented in the organizations tend to increase the capabilities of the workers, managers, change in practices which make differences. Changes are made for production procedures, quality assurance which leads in high sale and profit.

The basic objective of the study is to conceptualize the relationship between knowledge management, innovation, and organizational performance resulting into financial performance. As knowledge management is not very popular in Pakistan, our main motive is to point out how knowledge management enhances financial performance and how organizations’ managers in Pakistan will benefit from our research and implement knowledge management practices to bring innovation to enhance the performance of organization and enhanced organizational performance results in improved financial performance.

The rationale behind this research study is to see the impact of knowledge management practices. How these practices work together to contribute in organization’s overall performance, proper implementation of knowledge management practices produce creativity and innovation, innovation influence organizations to achieve better performance, increase in organizational performance results in productivity and improved financial performance.

Conceptual model and literature review:

Knowledge management practices influence organizations in performance outcomes like financial outcomes and non financial outcomes (Rhodes *et al*., 2008), but here we take financial performance alone. As the main object of any business organization is to maximize profit, so other non financial outcomes helps firm to maximize their financial outcomes. Not only knowledge management practices have direct relation with organizational performance but organizational performance also influences financial performance significantly (Zack *et al.*, 2009). Innovation also comes from better knowledge management practices, however sometimes innovation can be considered as the part of organizational performance, but mostly innovation and agility have been found significantly mediating the knowledge management usage on organizational performance (Khalifa *et al.*, 2008).knowledge management enhances the decision making capabilities of the organization(Chong *et al*., 2010). Knowledge management practices have direct relationship with innovation, firm performance and financial performance, while innovation also impacts on performance of organization and financial performance. It is considered that if organizational performance increases, financial performance tend to increase upward.

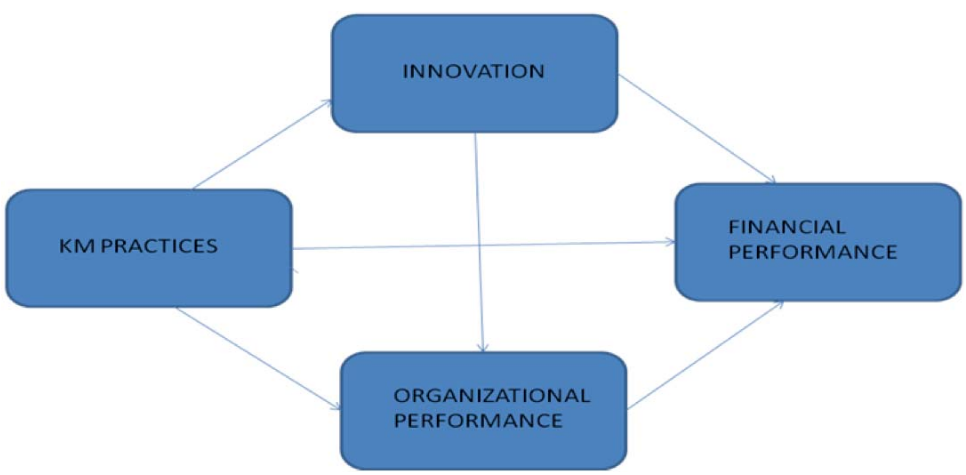

Fig. (i) Proposed model

Knowledge management practices are well systematic way to organize people in an organization. They may be individuals or in groups and using organizational knowledge through means of technology (Abdullah *et al.*, 2006). Organizing people is what they already know, what they tend to learn and what is their response to new technology, are they task oriented, what their decision making capability is and how much they use it? It also refers to the way knowledge flows and shared in the organizational environment. Knowledge in communities works freely and creates awareness about how the whole work is done in a specific environment. Better collaboration and understanding of the manager with workers establishes the core values of knowledge management (Gooijer, 2000). Knowledge flow easily from person to person, organization to organization, society to society, people adopt knowledge to which they can benefit themselves. Knowledge management practices include organizing, sharing and using knowledge in such a way that it creates value and increase organizational performance (Ibrahim and Reid, 2009). Knowledge management practices increase performance in terms like achieve competitive advantage, capability enhancement and can be financial achievement. Such activities of the organizations that are linked with knowledge management and are observable called KM practices (Zack et al., 2009).

Literature review helps us to gather some KM practices,

1. Development, share and protection of existing knowledge.

2. Continuous learning and creativity of the knowledge.

3. A culture that enhances R&D, creativity and share of knowledge.

4. An overall regard for value of knowledge and learning in an organization.

(Zack et al, 2009; Marques D. and Simon F., 2006)

The main objective of organization performance is to retain or sustain competitive advantage. There are some other indicators of organizational performance and they are based on financial and non financial outcome like, cost reduction, sales volume, customer satisfaction rate, product development capabilities and new competencies (Rhodes *et al.*, 2008). Organization performance measures through competitiveness, creativity and organizational knowledge parameters (Zaheer et al., 2010). Organizational performance focuses on product leadership, customer intimacy and operational excellence (Zack *et al*, 2009). Organizational performance consists of growth, operational efficiency, stakeholders' satisfaction and competitive advantage (Marques D. and Simon F., 2006). Service or product quality is also a measure of organizational performance.

Innovation is a social process through which organizations adopt a series of major changes (Caroll, 1995). Technological advancement brought innovation in different areas of management practice and formal organizational structures (Drejer, 2000; Joahnessen *et al.*, 2001). Process of establishing and implementing new knowledge is known as Innovation. Innovation is the key to open the heart of knowledge management. Knowledge management is little bit a new concept, so creativity or innovation is an important factor influenced by the Knowledge Management.

Innovation is the ability of an organization that how it develop new ideas and implement these ideas to improve their production procedure, quality and service, advancement in product line and technology enhancement (Hung *et al.*, 2010). Organizations are successful, who uses both incremental and radical innovation (Plessis, 2007). Innovation includes how something is new to the world, new for firm itself, newness of products in existing range, improvement in existing products, how much change brought in products to reduce cost and reposition of existing products (Darroch, 2005).

When an organization works in more than one value discipline, competitive advantage and superior financial performance of this organization is matter (Treacy and Wiersema, 1995). Measuring return on asset, equity and other profitability includes in financial performance (Zack *et al.*, 2009). Tangible and intangible resources of the organization effects the output i.e. innovation with mediate effect of organizational routines that finally results in superior financial performance (Darroch, 2005).Financial performance measure how much increase in profit from previous five years to now, how your financial position is different from your competitors, what would you expect to be financially in next five years. Return on asset, return on equity, cost reduction and asset utilization are tools to measure the financial performance.

Organization having good learning and sharing knowledge environment is performance oriented (Morales *et al.*, 2008; Jimenez *et al.*, 2008).knowledge management have positive relation with organizational performance, agility and innovativeness mediates the effect of knowledge management but knowledge management also have direct relation with organizational performance (Khalifa *et al*., 2008). Organizations want to perform better i.e. increase competitive advantage then workers and managers must adopt and share knowledge management continuously (Singh and Soltani, 2010).effective use of knowledge management is now very important for organizations to maintain competitive advantage (Abdullah *et al.*, 2006). From the above discussion we find that organization that adopts Knowledge Management practices positively related to organizational performance.

The economy which rely on knowledge have basic factor of innovation which is further linked with a new and improved set of knowledge (Beesley and Cooper, 2008).Transfer of knowledge management is based on good communication and culture of trust in the organization among the employees that is necessary to organization innovation (Rhodes *et al.*, 2008).the firm with better knowledge management capabilities will more innovative (Darroch, 2005). Knowledge creation and sharing between suppliers, partners and creativity through close relation with customer feedback enhance innovation capabilities (Khalifa et al., 2008). Knowledge can be share through formal and informal way in an organization; knowledge sharing enhances the innovation (Taminiau et al. 2009). Knowledge acquisition by organization and continuous flow of that acquired knowledge in the organization results in innovativeness (Mu et al., 2008).Knowledge and innovation are positively associated with each other (Forrester, 2000). From all this discussion we conclude that firms that manage Knowledge efficiently and effectively are likely to be more innovative.

Knowledge management improves the financial performance i.e. profit, rare at corporate level but mostly at local level (kalling, 2003). Knowledge management with mediating effect of innovation results in superior financial performance (Darroch, 2005; Rhodes *et al*., 2008). Knowledge management have direct relation with organizational performance and financial performance (Zack *et al*., 2009). So from this we result that knowledge management has a direct correlation with financial performance.

Enhanced Innovativeness will result in increased organizational performance (Khalifa *et al.*, 2008). Firms with high innovative capabilities achieve better response from the culture and environment; achieve more competitive advantage that will enhance organizational performance (Morales *et al.*, 2008). Innovation in sense that organization is more technology oriented and gives positive response to change, adopt and implemented accordingly results in higher organizational performance (Rhodes *et al.*, 2008). Social interaction, trust and motivation enhances the sharing of knowledge which further enhance the innovation result in overall organization performance (Brachos *et al.*, 2007) .If the organizations want to survive in the long run then they tend to respond quickly and meet the challenges efficiently, these all tools of innovation which prepare the organization to handle the environmental changes, so organization perform better and can survive in long run (Jimenez *et al.*, 2008). So finally Innovation has a positive effect on organizational performance.

When an organization improve its capabilities and work performance in terms of sale, cost reduction, quality assurance, creativity in R&D and manpower capabilities then it enhances the financial performance of the organization. When organization at whole increases its capabilities and work in more than one value disciplines then its competitive advantage and financial performance tend to increase(Treacy and Wiersema,1995).Measuring return on asset, equity and other profitability includes in financial performance. Organizational performance has direct relation with financial performance (Zack *et al.*, 2009). So organization performance is positively related to Financial Performance.

Resources and capabilities results in innovation and significantly which impacts on outcomes such as financial performance (Darroch, 2005).Innovative capabilities like process and production capabilities tend to increase financial performance (Rhodes *et al.*, 2008). So it is hypothesized that Innovation influenced Financial Performance.

Methodology:

The knowledge management practice, innovation, organizational performance and financial performance are defined through extensive review of literature. Further their linkage between each other through different supportive literature is discussed. As it is a conceptual paper, so it emphasizes on the linkages of given variable with help of previous results extracted from different researches. Paper is a combination of different views sorted through different research papers on knowledge management. Author discuss all these views with own ideas and try to find out a generalized solution for achieving financial performance, which is mostly main focus of managers.

Discussion

Organizational performance directly influenced by production innovation and process innovation. Organizational factors have positive correlation with innovation and knowledge it also has positive and significant correlation with innovation capability. Knowledge management basically starts from interpretation, intuition and experience of knowledge for groups as well as individuals, that finally systemize the organizational knowledge and this knowledge communicated and transferred continually throughout whole organizational levels. Positive relationship between organizational performance and innovation were found in which non financial performance has higher coefficient value, which increases competitive power and productivity of employees as determinants of organizational performance (Rhodes *et al.*, 2008). There are some advantages of knowledge based system. These advantages includes time saving, quality improvement, application of practical knowledge, replication, consistency, reporting facilities, updating knowledge, cost saving and productivity of the organization (Abdullah *et al.,* 2006). Organizations who adopt knowledge based system have increased productivity, cost saving and application of practical knowledge. So they are more performance oriented.

There are some research articles which results in improved financial performance through knowledge management, i.e. profit. Organizational knowledge mainly based on knowledge of individuals, value and norms to support the organization this knowledge can be shared though aggressive absorption and application of creativity in knowledge. Hence, the knowledge of individuals effects over all knowledge of organization. Managing the norms and values in an organization can be done through formulating strong strategies which helps to create clear performance objectives. Hence, knowledge management improves performance (Kalling, 2003). Our theoretical model suggests that knowledge in an organization is not merely necessary but the creativity and innovation in this knowledge is also very important to enhance the performance. Reviewing and refining the knowledge means you create and activate your knowledge that creates value for organization e.g. Intel continuously upgrade and improved the speed and design of micro processor and position of LCD (Bhatt, 2000).

Poor quality leads to customer dissatisfaction which results in reduction of sales turnover. The quality enhancement of products results in reduction of customers complaints which lead to high sales turnover. This means that innovation in product quality results in improved financial performance (Ibrahim and Reid, 2009). When organizations bring innovation in product quality and production techniques, it increases customer satisfaction which leads to high sales turnover and turn into enhanced financial performance. Measuring the organizational benefits of knowledge management is so difficult, not only for private but for public sector too organization accesses their performance whose motive is not only profit maximization but also social benefits, as knowledge management act as actions which support integration and collaboration (Gooijer, 2000).

According to Zack *et al.,* (2009) Knowledge management practices have significant relationship with organizational performance effect is 0.496 and organizational performance also has significant relationship with financial performance with effect of 0.327, whereas the relationship between knowledge management practices and financial performance is non-significant in nature with effect of 0.004. This non-significant relationship proposed that organizational performance fully mediates the whole relationship. It means knowledge management practices influence organizational performance that further enhances financial performance (Zack *et al.*, 2009), but innovation also mediates the relationship of knowledge management practices and financial performance according to Darroch, 2005. Both mediating factors have relationship as innovation has significant relationship with organizational performance (Khalifa *et al.*, 2008).

Conclusion:

The basic objective of the study is to conceptualize the relationship between knowledge management, innovation, and organizational performance resulting into financial performance. As knowledge management is not very popular in Pakistan, our main motive is to point out how knowledge management enhances financial performance and how organizations' managers in Pakistan will benefit from our research and implement knowledge management practices to bring innovation to enhance the performance of organization and enhanced organizational performance results in improved financial performance. It is comprehensive idea for the managers to adopt this conceptual frame work for increasing the financial performance of organization through innovativeness. Managing knowledge management practices in an organization improves the capabilities of the organization.

Practically our study will be benefitted for the manager of the organization, who should implement knowledge management practices in their organization to achieve improved financial performance through innovativeness. organization change their production methods and bring innovation in their product and service line, that helps organization to improve their performance in product line, technology, specialized workforce and satisfied customers which further results in high sales turnover this means organization strengthening their financial position.

Limitation in this study is that due to short period of time, data collection was not possible to quantify the results. So this study can be conducted through quantitative analysis by collecting data and using SPSS and AMOS software. Future research can be conducted in other regional areas and it may include other performance indicators as well.

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