The Relationship between Human Resource Management and Islamic Microfinance Providers' Performance: The Mediatıng Role of Human Capital

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Abstract

The current study has three objectives. Firstly is to examine the relationship between the performance of Islamic Microfinance Institution with human resource management; secondly to assess whether human capital is associated with the Microfinance Institutions' performance and finally, to investigate whether human capital mediates the relationship between human resource management and Microfinance Institutions' performance. Data was collected via survey questionnaires. The result of regression analysis showed that there was significant, positive association between the human resource management and human capital with performance. However, human capital was found to be insignificant to mediate the relationship bertween human resource management and Microfinance Institutions' performance. The result implies that effective Islamic human resource management processes cum excellent human capital leads to enhancement of performance. Nevertheless, human capital alone does not affect the relationship between human resource management and Microfinance Institutions' performance. The result indicates that there are other organizational capital which should be considered to explain this relationship.

Key Words: human capital, human resource management, Microfinance Institutions, performance

1.0 Introduction

Human capital (HC) tagged along with other organizational capital has been approved as key resources necessary for driving any organization towards optimal economic efficiency and productivity (Nahapiet and Ghoshal, 1998). HC could be defined as a set of skills, knowledge and expertise of individuals which are used in developing the output of an organization. From management perspective, HC is defined to comprise of knowledge base, learning abilities, experience, and how these elements are used together by members of an organization to achieve the corporate goals of the company. Being the main source of raw intelligence of an organization (Nicholson and Kiel, 2004; Bontis, Dragonetti, Jacobsen, and Roos, 1999), HC continues to remain as the basic foundation, on which all other intellectual capital is built (Nicholson, and Kiel, 2004), as such forming the key element that drives the decision-making process made by the management of an organization.

In Islamic context, the meaning of HC is the ability and experience of human being to fulfil his objective and responsibility in this world and the hereafter (Abdullah, 2012).

In addition, the aim of human capital development in Islam is to achieve the quality and competence to fulfil the responsibilities and duties of human being. In order to become competence, Islam focuses on human capital development. This is in order to achieve varieties of knowledge and skills. These skills and knowledge in return will contribute to the core competences and competitive advantages of the organizations. Apart from that, achieving good skills and competence may contribute to the development of the society, which is praiseworthy in Islam.

2.0 Literature Review

2.1 Human Resource Management

Human Resource Management (HRM) is about the practices of an organization that focuses on recruitment, management, and providing direction for the people who work in the organization. HRM is an important part of an organization's internal interactive process and it does reflect employees' cultural characteristics or personal belonging (Tayeb, 1997). In Islam, Shariah law becomes a guidance and will take place in daily activities of the muslims. Therefore, the Islamic approach of HRM refers to the performing of basic HRM functions which is recruitment, selection, performance appraisal, training, and compensation in accordance with guidelines as prescribed in the holy book of the Qur'an and Hadith (Hashim, 2010). Apart from that, the value of trustworthiness, responsibility, sincerity, discipline, dedication, diligence, cleanliness, co-operation, good conduct, gratitude and moderation are believed to act as guiding principles for HRM (Branine and Pollard, 2010).

In the process of recruitment, Islam has set certain principles to comply with. There are justice, competency level, honesty and assignment of works according to employees capacities. Islam prohibits favouritism in recruitment since it infringes the ethical principles of justice (Al-'Adl), fulfilment of contract with the employer to look after the interest of the organization (Ifa Al-'Aqd), and the right of others in dealings (Khan, Farooq, and Hussain, 2010). Besides that, in Islamic management it is compulsory for the management to declare the compensation and wages of the employees upon recruitment. The wages given must be fair for both employers and employees. This action will prevent labour exploitation exist in the organizations (Hashim, 2010).

Islam stresses that employees should be given fair, adequate and reasonable wages depending on their work and several factors such as, keeping in view the quality and quantity of work, needs and requirement, and the overall economic condition of the society (Hashim, 2010). On top of that, the Islamic principles of ethics in HRM indicate that compensation should be in parallel to the contribution of the employees. This is in accordance to the Principle of Fair Compensation as outlined in Qur'an (83:1-3);

> *"Woe to those who deal in fraud, those who take the full measure when they receive from others, but give less when give them in measure or weight"* (as quoted in Khan, Farooq, and Hussain, 2010).

Besides, the events of favouritism of employees are also prohibited with regards to the pay and promotion since it is against the Islamic principles of people's rights and justice and fairness. Therefore, it can be concluded that Islamic HRM are equipped with values and norms of Islam that provide justice and fairness to society regardless of positions. Hence, if the principles of Islamic HRM are strictly followed by the organizations, it will contribute to the firm competitiveness and performances.

From researchers point of view, HRM practices has been influenced on the natures of the countries. Apart from that, HRM's scope and practices are also different among organizations. There are four major areas in HRM policy which are; reward systems, employee influence mechanisms, job design and work organization, and lastly the employee selection and development (Khan, Farooq, and Hussain, 2010; Walton and Lawrence, 1985). Basically, conventional HRM is founded by principles of ethics. Thus, it is the must for every organizations to have this kind of plan in order to have an accurate estimate of the number of employees required, with matching skill requirements to accomplish organization goals (Khan, Farooq, and Hussain, 2010). In addition, HRM is needed to determine the types of knowledge and skills possess in the workforce to carry out the firm's strategy, identify hiring and training needs, and align the performance management system with strategic goals (Walton and Lawrence, 1985). On top of that, HRM also ensure that strategy is implemented in ways that are perceived as fair. In the recruitment process, the employees will be hired based on skills and competency. The compensation will be notified to employees upon the recruitment process. Further, employees are also entitled to rewards that will be given based on their performance.

3.0 Research Design

3.1 Sample and Data Collection

The target group of this research is the financial institutions that offer microfinance products as well as the microfinance institutions in Malaysia. Data were collected with the aid of questionnaires. The questionnaires used five Likert-scales which ranged from one (1) strongly disagree and five (5) strongly agree. The questionnaires were distributed by mail. The respondents were given two weeks to return the questionnaires.

3.2 Instrumentation

The questionnaire consists of a total of seventy-four (74) items, divided into four main parts. Part One (1) is on the human resource management that comprises four (4) sections being recruitment (Section A), selection of employees (Section B), performance evaluation (Section C) and training and compensation (Section D). In addition, Part Two (2) is on human capital measurements. There are three (3) sections in Part Two which are knowledge and competencies (Section A), employees' attitude (Section B) and employees' spiritual value (Section C). Part Three (3) gauges information on the organisation's performance. Finally, Part Four (4) gathers information on the respondents' profiles.

4.0 Findings and Analysis

4.1 Realibility Test

A reliability test using Cronbach's alpha coefficient was conducted to check the internal consistency of the scales used in the survey instrument (Pallant, 2010). The reliability results indicate the extent to which set of variables are consistent with what they intended to measure. To be considered acceptable, the Cronbach's alpha coefficient of scale should be above 0.7. However, values above 0.8 are preferable (Pallant, 2010).

Table 1 is the summarised results for reliability test. The reliability coefficients on HRM, HC and microfinance institutions' performance (MFPerf) presented are above 0.8. These indicate that, data used for this study meet good internal consistency and the reliability level required for significant analyses.

Table 1: Table of Reliability Statistics

Items	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
HRM	.940	.941	29
HC	.902	.919	29
MFPerf	.811	.846	7

4.2 Normality Test

The assumption of data normality is vital for certain statistical tests to be valid and it is a prerequisite for much inferential statistical technique in order to reduce risk of error. The data is assumed to be normally distributed when the significant level is more than 0.05 by using Kolmogorov-Smirnov test while the value is zero (0) or in a range between 2.58 to -2.58 by using skewness and kurtosis. In addition, according to the central limit theorem, sample distribution of bigger samples which is more than thirty (30) tend to be normal regardless of population distribution, and it is more evident as the sample count increases (Field, 2009).

Table 2 summarises the results for test of normality using Kolmogorov-Smirnov test. The Kolmogorov-Smirnov test was used to assess the normality distribution of scores for HRM, HC and MFPerf (Pallant, 2010). Therefore, p-value of more than 0.05 indicates a significant value, while p-value of less than 0.05 suggests a violation of the assumption of normality (Pallant, 2010).

Table 2: Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Stat	Df	Sig.	Stat	df	Sig.
HRM	.134	59	.010	.906	59	.000
HC	.134	59	.010	.937	59	.004
MFPerf	.163	59	.000	.930	59	.002

a. Lilliefors Significance Correction

Based on the summarised result of tests of normality in Table 2, the significant values for HRM, HC and MFPerf are below 0.05 (p value < 0.05). As referred to the central limit theorem, it assumed that all variables are normally distributed even though the significant value of all variables is less than 0.05 as the sample of the study is 59 which is more than thirty (30) (Field, 2009). Thus, the variables are retained for further analysis. Besides, this study also uses statistical analysis of skewness and kurtosis to determine the normality of data.

The value of skewness for all variables ranged between 2.58 to -2.58. Thus, the data is assumed to be normally distributed.

4.3 Correlation Analysis

Table 3 reports the result on the Pearson correlation coefficient analyses. This test was performed to examine the degree of which any relationship exists between variables (Field, 2009). Moreover, it was also conducted to ensure multicollinearity does not exist between variables (Mohd Radzi and Md Nor, 2012).The case of multicolliearity exists when two or more predictors have a strong correlation (Field, 2009).

Based on the results presented in Table 3, there is a significant positive correlation between HRM and HC at r = 0.869 (p value < 0.01). The results also indicate a positive significant correlation between MFPerf with HRM as well as HC at p-value < 0.01 with r = 0.698 and r = 0.679 respectively. Thus, this indicates that excellence HRM process and procedures cum quality HC will lead to the enhancement of performance. Overall result as presented in Table 3 shows that the correlations between variables are moderate, indicating that there is non-exintence of multicollinearity problems.

Table 3: Pearson Correlation Test Results

	HRM	HC	MFPerf
HRM	1		
HC	.869**	1	
MFPerf	.698**	.679**	1

** Correlation is significant at the 0.01 level (2-tailed).

4.4 Regression Analysis for Mediation

This regression analysis was carried out in order to examine the relationship between HRM and HC towards MFPerf. The summary of multiple regression results is presented in Table 4. There are four regression model developed in the current study. Model 1 is developed to test the relationship between HRM and HC while, Model 2 examines the relationship between HRM and MFPerf. On the other hand, Model 3 tests the relationship between HC and MFPerf. Finally, Model 4 tests the mediation effect of HC on the association between HRM and MFPerf.

Table 4: Regression Analyses for Mediation

Model 1

$HC = \beta 0 + \beta 1HRM + e$ 2

$MFPerf = \beta 0 + \beta 1HRM + e$

3

$MFPerf = \beta 0 + \beta 1HC + e$

4

$MFPerf = \beta 0 + \beta 1HC + \beta 2HRM + e$

IV/DV	HC	MFPerf	MFPerf	MFPerf
Intercept	0.757	0.042	0.636	0.105
HC	-	-	0.840***	0.295
HRM	0.869***	0.698***	-	0.441*
R2	0.755	0.487	0.383	0.508
Adj. R2	0.751	0.478	0.372	0.491
F-statistics (p-value)	175.819***	54.061***	35.363***	28.94 ***
Df	(1,57)	(1,57)	(1,57)	(2,56)

Note: ***significant at 0.01 level; **significant at 0.05 level; *significant at 0.10 level

Based on the result of Model 1 presented in Table 4, HRM is significantly associated with HC with adjusted R-squared of 75.1% (F-value = 175.819; p-value <0.01). Hence, with this condition, it reveals that the HRM explains 75.1% of the variance of HC in microfinance institutions. Positive relationship signifies that good and effective Islamic HRM in microfinance institutions would produce better and excellence human capital.

Therefore, Islamic HRM is a strong contributor to good and excellent performance of HC. Hence, the improvement in HRM will increase the performance of HC.

On the other hand, Model 2 shows that HRM is significantly related to MFPerf with adjusted R-squared of 47.8% (F-value = 54.061; p-value <0.01). This impliesthat HRM explains 47.8% of the variance in microfinance institutions' performance. Positive relationship signifies that microfinance institutions which possess effective HRM may record better performance from others.

On top of that, the regression result in Model 3, suggests that there is significant positive relationship between HC and MFPerf (p-value <0.01). This reflects that knowledgeable, competent and innovative people who worked in the organization contribute to enhancing performance of the microfinance institutions.

4.5 Human Capital (HC) as Mediating Variable in the Relationship between Human Resource Management (HRM) and Performance (MFPerf)

This section examines whether HC mediates the relationship between HRM and performance of Islamic Microfinancing Institutions. HC comprises stock of knowledge such as competencies, experience and expertise embedded in human resources. Thus, HRM requires capable and talented employees which lies in HC in order to translate the knowledge into effective organisation performance.

In order to test the above, the estimation on the regression equation was undertaken based on the following steps as recommended by (Baron, and Kenny, 1986). First, the mediator is regressed on the independent variable. So in this context, HC is regressed against HRM (Model 1, Table 4). Second, the dependent variable is regressed on the independent variable i.e. regressing MFPerf on HRM (Model 2, Table 4). Thirdly, the dependent variable is regressed on both the independent variable and mediating variable. So, in this step the performance is regressed against HC and HRM (Model 4, Table 4).

In order to establish mediation, there are four conditions to be met (Baron, and Kenny, 1986). First, the independent variable significantly affects the mediating variable. Second, the dependent variable is significantly affected by the independent variable. Thirdly, the mediating variable must significantly influenced the dependent variable. The fourth condition is that the effect of the independent variable on the dependent variable is reduced when regress together with mediating variable.

As indicated in Model 1 Table 4, HRM explains a significant amount of variance in HC ($\beta = 0.869$, $p < 0.01$) and MFPerf in Model 2 ($\beta = 0.698$, $p < 0.01$). Hence, the first and second conditions for mediation are met. As displayed in Model 3 Table 4, when HC is added into the regression equation, the HRM beta coefficient drops from 0.698 to 0.441 nevertheless, the effect of HC on MFPerf is not significant. This result indicates that HC is not a significant in mediating the relationship between HRM and MFPerf.

The significance level for the indirect effect of the independent variable on the dependent via the mediator can also be tested using Soble Test[1] (Baron, and Kenny, 1986). Sobel Test[1] [1]is a statistically rigorous method to assess mediation (MacKinnon, Lockwood, Hoffman, West, and Sheets, 2002).

5.0 Summary of the Results

Human capital encompasses individual economic value (Edvinsson, 2002). It represents the stock of individual knowledge such as competency and intellectual agility (Roos, Roos, Edvinsson, and Dragonetti, 1997). However, the human intellectuality and competency is inadequate to ascertain the effectiveness of HRM and organisation performance. The results showed that HC alone could not contribute towards core competence of microfinance organizations.

HC requires other organizational capital support such as structural capital (Bontis, Keow, and Richardson, 2000; Hamzah and Selamat, 2007). Thus, strong processes and organisational value embedded in structural capital is required to assist in human capital development and in turn ensure efficiency or quality service and thus will translate into higher microfinance institutions performance.

[1] Calculation for the Sobel test: An interactive calculation tool for mediation tests (computer software) can be retrieved at *www.psych.ku.edu/preacher/sobel/sobel.htm*

Corporate value does not arise directly from any of intellectual capital elements, but only from the interaction between all of them (Benevene and Cortini, 2010). In addition, high value human capital does not always lead to high organizational value (Baron, 2011). All forms of organizational capital must be evaluated and analysed to explain how people drive business performance. Therefore, it can be concluded that human capital is indirectly influencing firm performance. Further, the conventional human capital theory mainly focuses on the development of institutional education, skills and expertise whilst HC from the Islamic perspective is more towards measuring the ability and experience of the human being in fulfilling his objective and responsibility as a trustee in this world and the hereafter. Eventually, the aim of human capital development should be to achieve the economic growth as it assumed human being is a field of investment which can lead to the maximum profit by a well mode of investment (Abdullah, 2012).

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