

# The Determinants of Human Capital Effectiveness of Islamic Banking in East Kalimantan - Indonesia

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## Abstract

The aim of this study is to evaluate the impact of human resource practices, organizational culture and transformational leadership on organizational learning, knowledge management and human capital effectiveness of Islamic banking in East Kalimantan. The study uses 130 samples from 934 employees of Islamic banking in East Kalimantan population. Partial Least Square modeling is employed to confirm the theory as well as describe the relationship between variables. The result of this study showed that human resource practice, organizational culture and transformational leadership respectively have positive and significant influence on organizational learning. However, human resource practice variable has no positive and significant influence on knowledge management. While organizational culture, transformational leadership and organizational learning variables showed positive and significant impact respectively. Human resource practice, transformational leadership and organizational learning variables showed no significant impact to the human capital effectiveness, while organizational culture and knowledge management variables displayed significant impact to the human capital effectiveness. It can be stated that efforts to improve of human capital effectiveness of Islamic banking in East Kalimantan can only be done through improved organizational culture and knowledge management. This study limitations were based on a cross-sectional design, therefore further research suggested to use a longitudinal design to confirm the causal relationships between variables. Prior research still have differences in measuring human resource practices that are relevant to knowledge management, and carried out in different industrial sectors. The scarcity in the context of human capital effectiveness, which no study has investigated, is the Islamic organization culture in several companies. This study addresses this gap by finding new models with creating Islamic value in developing organizational culture.

**Keywords:** human capital effectiveness, human resource practice, knowledge management, organizational culture, organizational learning, transformational leadership

## 1. Introduction

Human capital is a component of intellectual capital and one of the most important resources for the company to improve the effectiveness and efficiency of the organization. Human capital consists of competence, a positive attitude and intellectual agility as the basic capital for companies' comparative advantage. Based on condition, it is indicated that the main problem of the Islamic banking industry is in terms of human resources and knowledge management capability.

The lack of knowledge and skills on sharia principles make barriers and challenges that must be addressed. Thus it takes an integrated strategy for managing knowledge through knowledge management integrated with human resources strategy, organizational culture and other approaches.

The existence of Islamic banking is a reflection of needs for the banking system that contributes to the stability of the national financial system. Industry also reflects demand for people who need an alternative banking system that is provided with Islamic principles.

Services, quality, and products diversity as a hallmark of Islamic banks must be supported by reliable human resources in knowledge about the Islamic economy. Products development is completely according to the rules and principles of Islamic economy and constantly evolving meeting the needs of modern society.

To perform the development process, the human resources of Islamic banks should have the competence as finance and banking expert, detailed with knowledge about the various types of financial instruments and banking.

## 2. Literature Review

Prior research suggests that human resource management plays an important role in facilitating organizational learning. Lin and Kuo (2007) measure the human resource practice based on the assessment, placement, training and development, workflow, rewards and compensation. Their research found that human resources practice has a direct and significant impact on organizational learning and knowledge management capability.

Valle *et al.* (2011) summarize several studies and show organizational culture as values, beliefs and assumptions with members of the organization. The influence of behavior is important in the process of organizational learning, either coaching or acting as a barrier (Davenport and Prusak, 1998).

Linked to the role of leadership research in learning organizations, Loon *et al.* (2012) use five dimensions of transformational leadership includes idealized influence attributed, idealized influence behavior,

individualized consideration, inspirational motivation, and intellectual stimulation. Other studies that proved the influence of human resource management practices are Lin and Kuo (2007), Ooi *et al.* (2009) and Kuo (2011).

Culture is an experience shared by individuals in creating a system of meaning, values, and beliefs that influence and shape individual and group behavior. Organizational culture which is invisible and intangible may be the most influential on the effectiveness of knowledge management initiatives (Davenport and Prusak, 1999; Lee and Choi, 2003).

Empirical support that successfully proves a link between leadership and knowledge management is performed by Mohamed *et al.* (2006). Ju *et al.* (2006) found that levels of organizational learning has a significant impact on the integration of knowledge, knowledge management capabilities, and the company's ability to innovate.

Human resource practice enables forming of employee skills, abilities, values, beliefs, attitudes and behaviors through recruitment, outreach and develop a pool of human enterprise (Fong *et al.*, 2011). Leaders who are considered having ideal characteristics influence always have more desire to engage in risk-taking work activities and thus, they are more influential, effective, and are willing to trust their employees (Bass, 1985). Budiharjo (2011) mentions that the learning organization is one right approach to develop human resources in anticipating the future.

In the context of the organization ability, the combined knowledge infrastructure is suggested, such as advanced technology, organizational structure, and culture of the organization and the knowledge management process of deciding the success or knowledge management effectiveness (Gold *et al.*, 2001).

Based on the previous explanations, this study aims to test the following hypotheses:

- 1) Human resource practice is positively related to organizational learning of Islamic banks in East Kalimantan.
- 2) Organizational culture practice is positively related to organizational learning of Islamic banks in East Kalimantan.
- 3) Transformational leadership practice is positively related to organizational learning of Islamic banks in East Kalimantan.
- 4) Human resource practice is positively related to knowledge management of Islamic banks in East Kalimantan.
- 5) Organizational culture is positively related to knowledge management of Islamic banks in East Kalimantan.
- 6) Transformational leadership practice is positively related to knowledge management of Islamic banks in East Kalimantan.
- 7) Organizational learning is positively related to knowledge management of Islamic banks in East Kalimantan.
- 8) Human resource practice is positively related to human capital effectiveness of Islamic banks in East Kalimantan.
- 9) Organization culture is positively related to human capital effectiveness of Islamic banks in East Kalimantan.
- 10) Transformational leadership is positively related to human capital effectiveness of Islamic banks in East Kalimantan.
- 11) Organizational learning is positively related to human capital effectiveness of Islamic banks in East Kalimantan.
- 12) Knowledge management is positively related to human capital effectiveness of Islamic banks in East Kalimantan.

### **3. Research Method**

This study was designed to analyze the relationship between the variables used, including the practice of human resource management, organizational culture, transformational leadership, organizational learning, knowledge management, and human capital.

This study uses a quantitative approach. Thus, the logic used is hypothetical verification. The approach begins with deductive reasoning to derive the hypotheses, and then testing in the field. The conclusions drawn based on empirical data. Thus, there are more emphasis on quantitative research indices and empirical measurement. Quantitative researchers feel "to know what is not known" so that the developed design is always a plan of activities that are a priori and definitive.

#### **3.1 Population and Sample**

The population in this study were all 934 employees of Islamic Banking in East Kalimantan. The similarity of job characteristics are applied to all bank employees in each branch. Therefore, the sampling is done on the employees of Islamic banking in East Kalimantan. The stratified proportional sampling is used to get sample of

130 respondents.

### 3.2 Data Analysis and Result

In this study, the data analysis uses the Partial Least Square (PLS) approach, which is more predictive. PLS is also used to explain the relationship between latent variables. PLS can simultaneously analyze the constructs formed with reflective and formative indicators.

**Table 1. Outer Loading, Statistics Descriptive and Convergent Validity**

Construct	Indicator	Mean	Stdev	Loading
Human Resource Practice (HRP)	Recruitment and selection (REC)	3.698	0.540	0.714
	Training and development (TRA)	3.707	0.586	0.728
	Compensation (COM)	3.669	0.683	0.619
	Performance appraisal (PA)	3.833	0.541	0.805
	Teamwork (TMW)	3.793	0.718	0.686
Organizational Culture (OC)	Dominant organizational characteristics (DOM)	3.738	0.636	0.746
	Management of employees (MAN)	3.787	0.492	0.738
	Organization glue (GLUE)	3.756	0.628	0.751
	Strategic emphases (STE)	3.687	0.551	0.694
	Criteria of success (CRI)	3.677	0.658	0.575
	Creating Islamic value (VAL)	4.010	0.597	0.531
Transformational Leadership (LEAD)	Attributed charisma (ATC)	3.883	0.626	0.833
	Idealized behaviors (IDE)	3.813	0.640	0.749
	Inspirational motivation (IMO)	3.646	0.697	0.627
	Intellectual stimulation (INT)	3.715	0.592	0.648
	Individualized consideration (IND)	3.929	0.574	0.661
Organizational Learning (OL)	Information-sharing patterns (INF)	3.859	0.520	0.800
	Inquiry climate & learning practices (CLI_PRA)	3.869	0.470	0.888
	Achievement mindset (ACH)	3.490	0.646	0.722
Knowledge Management (KM)	Knowledge acquisition (KAC)	3.780	0.546	0.848
	Knowledge sharing/ distribution (KSD)	3.754	0.502	0.761
	Learning, interpretation and improving (LIM)	3.926	0.447	0.795
Human Capital Effectiveness (HCE)	Competences (CMP)	3.921	0.485	0.771
	Attitude (ATT)	3.851	0.455	0.797
	Intellectual agility (AGI)	3.810	0.470	0.809

Through the above analysis, it is shown that the measurement of each variable outer loading studies have range from 0.531 until 0.888, so that all indicators as a measure of a construct have convergent validity.

**Table 2. Inter – construct Correlations and Discriminant Validity**

Scale Items	HRP	OC	LEAD	OL	KM	HCE
REC	<b>0.719</b>	0.155	0.195	0.235	0.191	0.147
TRA	<b>0.734</b>	0.421	0.291	0.381	0.367	0.248
COM	<b>0.624</b>	0.271	0.249	0.309	0.162	0.257
PA	<b>0.812</b>	0.289	0.313	0.318	0.264	0.207
TMW	<b>0.692</b>	0.229	0.110	0.214	0.187	0.167
DOM	0.418	<b>0.752</b>	0.379	0.333	0.409	0.477
MAN	0.263	<b>0.744</b>	0.446	0.451	0.473	0.363
GLUE	0.298	<b>0.756</b>	0.392	0.419	0.374	0.308
STE	0.211	<b>0.699</b>	0.328	0.261	0.308	0.433
CRI	0.278	<b>0.580</b>	0.331	0.309	0.353	0.324
VAL	0.138	<b>0.535</b>	0.238	0.267	0.237	0.172
ATC	0.333	0.423	<b>0.840</b>	0.505	0.559	0.408
IDE	0.257	0.399	<b>0.755</b>	0.470	0.551	0.367
IMO	0.309	0.334	<b>0.632</b>	0.531	0.524	0.325
INT	0.152	0.254	<b>0.653</b>	0.365	0.411	0.255
IND	0.115	0.448	<b>0.666</b>	0.353	0.451	0.400
INF	0.442	0.361	0.495	<b>0.806</b>	0.506	0.226
CLI_PRA	0.364	0.496	0.640	<b>0.895</b>	0.571	0.428
ACH	0.216	0.357	0.377	<b>0.728</b>	0.432	0.425
KAC	0.339	0.516	0.650	0.643	<b>0.855</b>	0.534
KSD	0.262	0.373	0.511	0.424	<b>0.767</b>	0.449
LIM	0.224	0.400	0.542	0.415	<b>0.801</b>	0.455
CMP	0.176	0.368	0.322	0.279	0.374	<b>0.777</b>
ATT	0.252	0.404	0.363	0.332	0.458	<b>0.803</b>
AGI	0.266	0.461	0.481	0.430	0.565	<b>0.815</b>

Through the analysis results in Table 2, it is shown that the correlation between construct and each indicator of latent variable is greater than with other latent variables. It can be concluded that the model meets

the discriminant validity. Two other tests to assess the discriminant validity are via composite reliability and Cronbach alpha. Results of Composite Reliability and Cronbach alpha present that all have a value above 0.70. Thus it can be stated that all the latent variables have a good level of reliability.

Finally, a summary of the result of the model tests for the decomposed model and the composite model are shown in Figure 1 and Table 3.

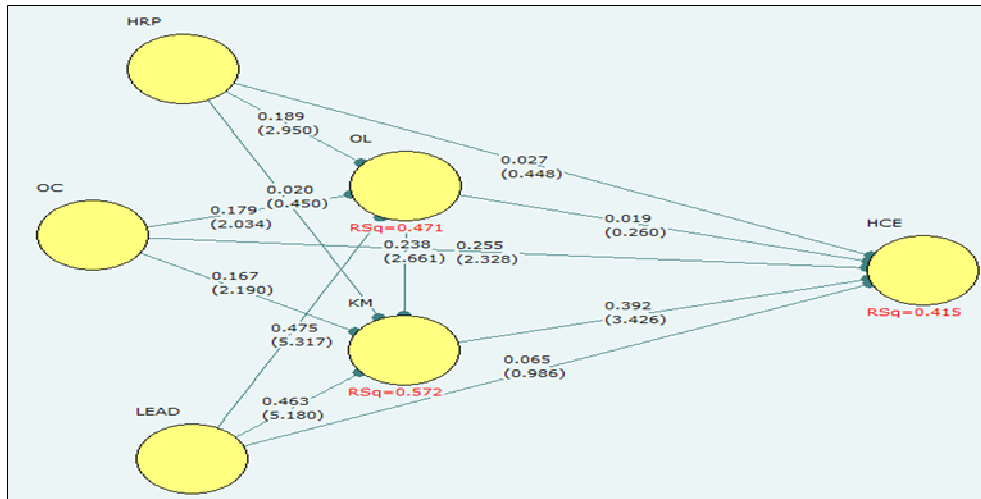


Figure 1. The Results at the Dimensional Level

Table 3 : Summary of Results for the Model Tests

Hypotheses	Path	coefficient	t statistics	p value	Remarks
H <sub>1</sub>	HRP --> OL	0.189	2.950	0.004	** p ≤ 0.05
H <sub>2</sub>	OC --> OL	0.179	2.034	0.044	** p ≤ 0.05
H <sub>3</sub>	LEAD --> OL	0.475	5.317	0.000	*** p ≤ 0.001
H <sub>4</sub>	HRP --> KM	0.020	0.450	0.653	Not significant
H <sub>5</sub>	OC --> KM	0.167	2.190	0.030	** p ≤ 0.05
H <sub>6</sub>	LEAD --> KM	0.463	5.180	0.000	*** p ≤ 0.001
H <sub>7</sub>	OL --> KM	0.238	2.662	0.009	** p ≤ 0.05
H <sub>8</sub>	HRP --> HCE	0.027	0.448	0.655	Not significant
H <sub>9</sub>	OC --> HCE	0.255	2.328	0.021	** p ≤ 0.05
H <sub>10</sub>	LEAD --> HCE	0.065	0.986	0.326	Not significant
H <sub>11</sub>	OL --> HCE	0.019	0.260	0.795	Not significant
H <sub>12</sub>	KM --> HCE	0.392	3.426	0.001	** p ≤ 0.05

Three lines on the model coefficients proved significant organizational learning. This implies that good human resource practices, organizational culture and transformational leadership are the factors that positively and significantly affect organizational learning. Thus, an increase in human resource practices, organizational culture and transformational leadership will have implications on improving organizational learning. Transformational leadership is the dominant variable affecting organizational learning. This study supports Camps *et al.* (2011) findings, which measures the dimensions of transformational leadership by articulating a vision of the future, fostering group work-oriented, set high expectations, challenging thinking follower, support the individual needs of followers and act as role models to find that there is a positive relationship between transformational leadership with learning, employability and employee performance (Loon *et al.*, 2012).

Based on these findings, it can be stated that knowledge management can be encouraged through organization culture, transformational leadership and organizational learning. While human resource practice does not have strategic implications in relation to knowledge management in Islamic banking in East Kalimantan. The coefficient value on each track also proved that leadership is the dominant factor that influences knowledge management, followed by organizational learning, and the last is the organizational culture.

The third model puts human capital effectiveness as an endogenous variable, and human resource practices, organizational culture, transformational leadership, organizational learning and knowledge management as exogenous variables. Based on the results obtained by analysis of determination coefficient of 0.415, it can be interpreted as the ability of the model to explain variations of human capital effectiveness amounted to 41.50%, while the remaining 58.50% influenced by other factors outside the model of the five lines that were tested. Only the organizational culture and knowledge management are proved to significantly affect

the human capital effectiveness, while three other variables namely human resource practice, transformational leadership and organizational learning are not proven to have significant effect on the effectiveness of human capital. Based on these results, it can be stated that efforts to improve the effectiveness of human capital in Islamic banking in East Kalimantan can only be done through improved organizational culture and knowledge management.

#### 4. Conclusion

Based on the results of the analysis of SEM-PLS, it is indicated that four out of twelve hypothesis are proved insignificant. Thus, this study only proved eight path coefficients that will be discussed further below. This study provides evidence that successful human resource practices, organizational culture, and transformational leadership, have a positive and significant impact on organizational learning in Islamic Banking in East Kalimantan. Organizational learning could be strengthened by creating a learning environment that supports learning and leadership orientation.

Based on the findings of this study, it can be stated that the knowledge management can be encouraged through organizational culture, transformational leadership, and organizational learning, while human resource practice does not have strategic implications in relation to knowledge management in Islamic banking in East Kalimantan. The coefficient value on each track also proved that leadership is the dominant factor that influences knowledge management, followed by organizational learning, and the last is the organizational culture.

Many companies are not successful in the program due to lack of knowledge management, there is not even a concrete support from the management. Leadership support is a key of success of knowledge management, which has been demonstrated in this study. Islamic Banking in East Kalimantan should improve the practice of human resources in order to have strategic implications in relation to knowledge management to create a competitive advantage among companies. Islamic banking should be able to provide the human resources that completely understand the ins and outs of Islamic banking itself through a recruitment system and targeted objective. Lack of understanding and commitment to sharia will cause implementation of Islamic banks is being polluted by conventional culture which is not syar'i and contrary to the nature of the business. The bankers who were not sharia Islamic banking background in science are only focus on conventional products, by affixes sharia and modified for subsequent sale with the label of sharia. Thus, the development of Islamic banking products are only found matching with conventional banking products. If this trend continues, it will lead to degradation products of Islamic banking in the future.

The third model puts human capital effectiveness as an endogenous variable, while human resource practices, organizational culture, transformational leadership, organizational learning and knowledge management as exogenous variables. From the five lines that were tested, only the organizational culture and knowledge management, which proved to significantly affect human capital effectiveness, while three other variables namely human resource practice, transformational leadership and organizational learning are not proven to have significant effect on the effectiveness of human capital. Based on these results, it can be stated that efforts to improve the effectiveness of human capital in Islamic banking in East Kalimantan can only be done through improved organizational culture and knowledge management.

Islamic banking in East Kalimantan should improve the recruitment system of Islamic banking so that workers are not filled by workers from the conventional banking, which in turn leads to a lack of human resources that really understand the ins and outs of Islamic banking. The lack of human resources that have the knowledge and skills to understand the principles of sharia makes barriers and challenges that must be addressed. Leaders needed in Islamic banking in East Kalimantan should be not only reliable in managing financial banking, but also be a role model as well versed in the science of sharia.

Islamic Banking in East Kalimantan should facilitate organizational learning process to create valuable human capital that is necessary to adapt to dynamic environment for organizational learning. It is one of the appropriate approaches to develop human resources for anticipating the future and increase competitive advantage.

However, further research can expand the object of research into other business sectors, or do a comparison of the results by taking samples of the comparators in the conventional banking sector to obtain broader generalization of the models tested.

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