

Human Capital Development as the Strategy of Improving Organizational Performance: Empirical Evidence from Indonesian SMEs

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Abstract. This study aims to verify whether human capital can mediate the relationship between HRM practices and organizational performance. The respondents of this study consisted of 65 Jambi batik entrepreneurs who were drawn randomly. The data collected were analyzed using the SEM method with the PLS approach. The results of data analysis show that (1) training has a positive and significant effect on human capital, (2) training has a positive and significant effect on organizational performance, (3) human capital has a positive and significant effect on organizational performance, (4) human capital mediates the relationship between training and organizational performance, (5) compensation has a positive and significant effect on human capital, (6) compensation has a positive and significant effect on organizational performance, and (7) human capital mediates the relationship between compensation and organizational performance. This finding has implications for the theory of the relationship between HRM practices and organizational performance. These findings further clarify how HRM practices affect organizational performance. Based on these findings, Jambi batik entrepreneurs are advised to improve organizational performance through the application of HRM practices that can increase human capital. Future researchers are advised to use other variables as mediators.

Keywords: HRM practice, training & development, compensation, human capital, UKM

INTRODUCTION

Jambi batik industry has great potential to contribute to employment and regional income or Gross Domestic Product (GDP). However, this industry did not experience encouraging growth in terms of asset growth and employment. Based on data from the Jambi Provincial Industry Office, currently, Jambi's batik business consists of 264 units. 68% of them fall into the category of micro-industry. While the remaining 5% belong to the medium industry and 24% are included in the small industry category. Meanwhile, there are none included in the big industry or 0%. This shows that the asset growth of the Jambi batik industry is low. In addition, the absorption of labor is also low. Currently, there are 1205 workers in the Jambi batik industry. This amount is only 0.07% of the total workforce in Jambi Province at this time. This data could be better if the development of the Jambi batik industry is growth-oriented.

To improve organizational performance (OP) including that of small industries such as the Jambi batik industry, it is necessary to know the factors that influence it. One of the factors that can influence is HRM practice. Empirical research proves that companies that implement HRM practices (HRMP) well have the potential to have high performance.

However, experts and researchers find there is controversy and inconsistency in the results of research on the relationship between HRM practices and OP. For example, Armstrong & Taylor (2014) suggests that how HRM practices affect knockouts is not clear. In other words, there is still a missing link or black box between these two constructs. The same thing was also conveyed by (Guest et al., 2000). According to them, there is no belief that HRMP has a significant effect on OP, even though hundreds of studies have been conducted. Even Sabiu, Ringim, Mei, & Joarder (2019) concluded that the results of empirical research on the relationship between HRMP and OP were controversial and inconsistent. Several studies have found that HRMP has a significant effect on OP. However, other studies have revealed that this relationship is not significant.

Therefore, there is a need for a mediation approach. According to Baron & Kenny (1986), the mediation approach can clarify the unclear relationship between two constructs. The question is what constructs can be used to mediate the relationship between HRMP and OP. To answer this question, the Baron & Kenny principle can be used. According to them, a construct can be used as a mediator if the construct is related to the independent variable and the dependent variable as well.

Based on this principle, it is believed that human capital can be a mediator in the relationship between HRMP and OP. It is based on the definition of HRMP. HRMP are managerial policies and activities aimed at increasing the contribution of HR to the achievement of organizational goals. From this definition, it is clear that human capital is a potential mediator. In addition, based on a search of previous studies, the use of human capital as a mediator, especially in the context of small industries, has never been done.

Based on the description above, the purpose of this study is to verify whether HRMP has a direct effect on human capital and organizational performance and to verify whether human capital can mediate the relationship between HRMP and OP.

LITERATURE REVIEW

Conceptually, HRM practice is defined as the productive use of individuals to achieve organizational goals. HRM practices can also be interpreted as managerial policies and activities aimed at increasing employee contributions in achieving organizational goals (Mondy & Martocchio, 2016; Stone, 2009; Watson, 2010; Werther & Davis, 1996). Organizations that implement HRM practices effectively have the potential to have higher performance compared to organizations that do not implement them (Armstrong, 1999; Simarmata, 2020). Khan & Khan (2012) measure HRM practices with four dimensions, namely recruitment, training, compensation, and performance appraisal. However, this study only focuses on two of them, namely training and compensation.

Training is a teaching process to provide employees with new skills needed to complete their current job (Ahmad & Manzoor, 2017; Dessler, 2017; A. S. Khan & Rasheed, 2015). This needs to be done because of environmental changes that result in changes in the way of working (Gamage & Sadoi, 2008). According to Elnaga & Imran (2013), training can bridge the gap between current employee performance and the performance expected by the organization.

Human Capital is attributes that are owned or attached to employees. Some researchers say that human capital is what employees take with them when they leave the workplace.

Because it is inherent in employees, the company cannot control these attributes. What the company can do is to manage this capital as effectively as possible so that it can benefit the company (Abualoush et al., 2018; Lawler, 2008). Human Capital is an intangible asset that is inherent in employees. Previous research has revealed that organizations that have high-quality employees are more likely to achieve organizational success than companies that do not have high-quality employees. Therefore, improving employee competence is necessary to improve employee performance.

Tovstiga & Tulugurova (2007) said that competence is one component of human capital. To deal with the changing business environment, employee competencies need to be improved. One strategy to improve employee competence is through training. The researcher concludes that effective training can significantly improve employee competence. Armstrong argues that effective HRM practices will improve employee performance and then improve organizational performance.

Organizational performance is a combination of company effectiveness and efficiency (Daft, 2000; Rezaei et al., 2011). Effectiveness is defined as the company's ability to achieve organizational goals. Meanwhile, efficiency is the ratio of the use of resources to the achievement of organizational goals. Traditionally, organizational performance is measured from a financial perspective. However, some experts criticize this measurement because it cannot comprehensively reflect the success of the organization. Kaplan & Norton (1992) argue that comprehensive organizational performance measurement is a measurement that involves both financial and non-financial aspects. Based on this thinking, the following hypotheses can be developed:

- H1: Training has a positive and significant effect on human capital.
- H2: Training has a positive and significant effect on organizational performance.
- H3: Human Capital has a positive and significant effect on organizational performance.
- H4: Human Capital mediates the effect of training on organizational performance.

Another aspect of human capital is compensation. According to Armstrong & Murlis (2007), compensation is anything that employees receive from the company in return for their sacrifices to the organization. Compensation can be either financial or non-financial. Compensation is all things that employees get in return for their sacrifices to the company. Compensation can be financial such as salary, wages, or commissions. Compensation can also be in the form of non-financial such as awards for work performance. Compensation is financial and/or non-financial rewards that employees receive from the company. Compensation can increase motivation and commitment to the company if the compensation is attractive, competitive, fair, and reasonable. In addition, compensation can be a source of employee job satisfaction. Compensation that has the characteristics above will bring satisfaction to employees. On the other hand, compensation that does not have the above characteristics will disappoint employees. Therefore, the policy on compensation system is an important factor in HRM practice (Geiger & Cashen, 2007; Huang et al., 2002; Roos et al., 2004; Terpstra & Honoree, 2003).

Research shows that compensation can increase employee motivation which in turn improves organizational performance. Based on this thought, the following hypotheses can be developed:

H5: Compensation has a positive and significant effect on human capital

H6: Compensation has a positive and significant effect on organizational performance.

H7: Human Capital can mediate the effect of compensation on organizational performance

METHOD

Primary data is the main data in this study. This primary data was obtained by distributing questionnaires to respondents consisting of 65 Jambi batik entrepreneurs. This study uses inferential statistics in the form of SEM causality analysis with the PLS approach. Figure 1 below shows the research model.

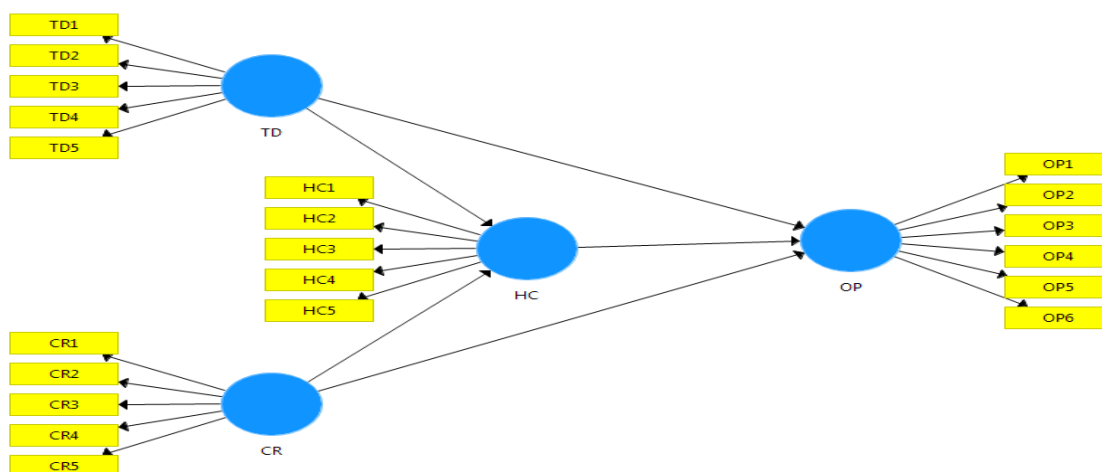


Figure 1
Research Model

This study involves four latent variables, namely (1) training & development and (2) compensation & rewarding as independent variables, (3) human capital as a mediator variable, and (4) organizational performance as the dependent variable. Table 1 shows the operationalization of these variables.

Tabel 1
Operationalization of Variables

Variables	Definition	Indicators	Scale
Training & Development	Employee competency improvement programs in the form of knowledge, skills, and abilities to deal with changes in current and future ways of working (Gamage & Sadoi, 2008)	Programmed Sustainable As needed Improving competence Increase motivation	Ordinal
Compensation & Rewarding	Financial and/or non-financial reward that employees receive from the company in return for their sacrifices to the company	competitive according to the sacrifice fair and reasonable according to work performance motivating	Ordinal
Human Capital	Intangible assets in the form of competence and	Skilled Motivated	Ordinal

	motivation inherent in employees (Tovstiga & Tulugurova, 2007)	Creative Innovative Adaptive	
Organizational Performance	A combination of company effectiveness and efficiency	Sales Growth Capital growth Profit growth Market growth Asset growth Labor growth	Ordinal

Source: abstracted (2021)

RESULTS AND DISCUSSION

Characteristics of respondents: In terms of gender, respondents were dominated by women with a total of 65% while men only amounted to 35%. This shows that the Jambi batik industry, which was originally a home industry, can still be identified with women. However, the role of men has begun to strengthen. In terms of age, respondents are dominated by those aged 46 – 55 years with a percentage of 60%. This shows that Jambi batik entrepreneurs are generally of productive age. Meanwhile, only 5% of respondents aged 30 years and under indicate that the younger generation is not much interested in getting into the batik business. In terms of education, respondents are dominated by those with high school education and below. Respondents with high school education reached 60%. While those with junior high school education are only 16%. What is interesting is that respondents with undergraduate education reached 24%. This shows that human resources in the Jambi batik industry have improved in terms of education.

Table 2
Respondent Profile

Variables	Indicators	Total	%
Gender	Male	23	35
	Female	42	65
	Total	65	100
Age (in year)	≤ 35	3	5
	36 – 45	6	9
	46 - 55	39	60
	≥ 56	17	26
	Total	65	100
Level of Education	Junior High	10	16
	Senior High	39	60
	BachelorDegree	16	24
	Total	65	100

Source: primary data (2021)

Variable Description. In general, the research variables are in the good category with an index above the average (50%). Specifically, it can be concluded that the practice of HRM, especially when viewed from the aspect of training and compensation, has not been effectively implemented. This has an impact on the low achievement of organizational performance (67%). But what is interesting is that human capital is considered quite good.

This shows that the respondents have quite good motivation and competence. Table 4 summarizes the description of the research variables.

Table 3
Variable Description

Variables	Index (%)
Training & Development (TD)	69
Compensation & Rewarding (CR)	65
Human Capital	71
Organizational Performance	67

Source: primary data, processed (2021)

Measurement Model Analysis Results: Analysis of the measurement model or outer model is carried out to ensure the validity and reliability of the instrument. Validity consists of convergent validity and discriminant validity. Convergent validity is seen from the loading factor value with criteria of 0.7 and above. Meanwhile, discriminant validity is seen from the AVE value with the criteria of 0.5 and above. Instrument reliability is measured by the composite reliability value with the criteria of 0.8 (Joseph F. Hair et al., 2019). Table 2 summarizes the results of the outer model analysis.

Table 4
Result of Outer Model Analysis

Variables	Codes	Loading factor	AVE	Cronbach's Alpha	Composite Reliability
Training & Development	TD1	0,812	0,818	0,943	0,957
	TD2	0,942			
	TD3	0,965			
	TD4	0,936			
	TD5	0,857			
Compensation & Rewarding	CR1	0,727	0,656	0,868	0,905
	CR2	0,753			
	CR3	0,852			
	CR4	0,909			
	CR5	0,797			
Human Capital	HC1	0,890	0,848	0,955	0,965
	HC2	0,908			
	HC3	0,932			
	HC4	0,938			
	HC5	0,936			
Organizational Performance	OP1	0,900	0,831	0,959	0,967
	OP2	0,926			
	OP3	0,890			
	OP4	0,937			
	OP5	0,917			
	OP6	0,899			

Source: Smart PLS 3 output (2021)

Table 4 shows that all items have a loading factor value above 0.7. This shows that the construct meets the conditions of convergent validity. Meanwhile, the AVE value is above 0.5 which means the construct meets the discriminant validity requirements. Table 2 also shows that the Cronbach's Alpha value is above 0.6 and the Composite Reliability value is above 0.8 which means the research instrument meets the reliability requirements.

Structural Model Evaluation Results: An inner model analysis is also carried out to see the relationship between models. Inner model evaluation is done by looking at the value of r square, size effect (f^2), Q square, and fit test (Joseph F. Hair et al., 2017).

From Table 5 and Figure 2, it can be seen that the R square for human capital is 0.653. This shows that human capital can be explained by the training and compensation variables by 65.3% while the remaining 34.7% is explained by other variables which are not examined in this study. It also shows that training and compensation have a strong influence on human capital. Table 5 and Figure 2 also show that the R Square for the organizational performance variable is 0.874. This means that 87.4% of organizational performance can be explained by the variables of training, compensation, and human capital. While the remaining 12.6% is explained by other variables which are not examined in this study. This also means that training, compensation, and human capital have a very strong influence on organizational performance.

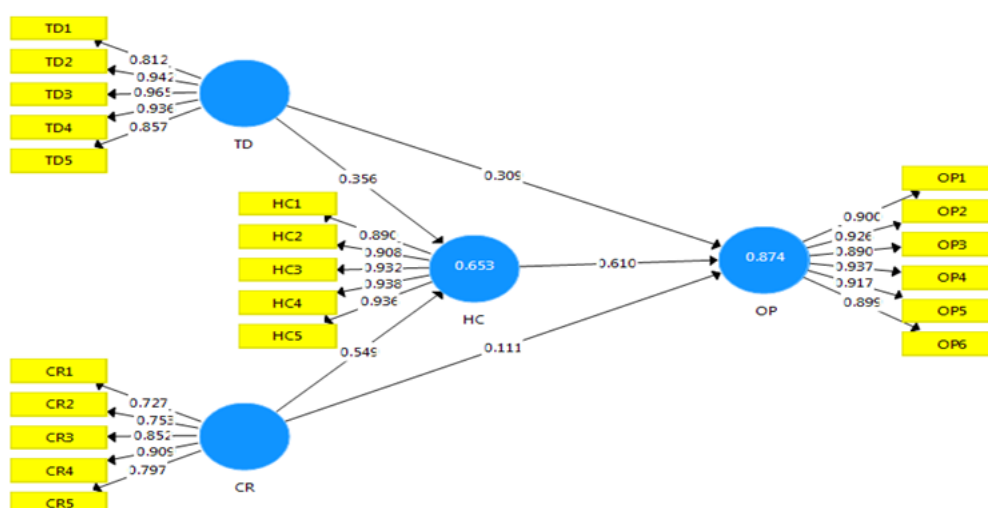


Figure 2
Structural Model

Table 5
R Square

	R Square
Human Capital	0,653
Organizational Performance	0,874

Source: SmartPLS 3.0 output (2021)

Table 6
Size effect (f^2)

	CR	HC	OP	TD
CR		0,579	0,041	
HC			1,021	
OP				
TD		0,243	0,405	

Source: Smart PLS 3.0 output

The f^2 test was conducted to determine how strongly exogenous variables affect endogenous variables with the criteria of strong influence if the value of $f^2 = 0.35$, sufficient if $f^2 = 0.15$, and weak if $f^2 = 0.02$ (Joe F. Hair et al., 2014). From table 6, it can be seen that the f^2 value of the relationship between compensation and human capital is 0.579, which means that compensation has a strong influence on human capital. The value of f^2 in the relationship between compensation and organizational performance is 0.042, which means that compensation has a weak influence on organizational performance. The f^2 value of the relationship between training and human capital is 0.243, which means that training has a strong enough influence on human capital. The f^2 value of the relationship between training and organizational performance is 0.405, which means that training has a strong influence on organizational performance. The value of f^2 in the relationship of human capital to organizational performance is 1.021, which means that human capital has a very strong influence on organizational performance.

The Q^2 test was conducted to determine the predictive relevance. From manual calculations, it is known that the value of Q^2 is 0.956. This shows that organizational performance in the Jambi batik industry can be predicted by training, compensation, and human capital by 95.6%.

The model fit test (GoF) was conducted to determine the overall fit of the model with the criteria of GoF small = 0.1, GoF medium = 0.25, and GoF large = 0.38 (Tenenhaus et al., 2004). Based on manual calculations, the results of GoF can be seen in table 7.

Table 7
Goodness of Fit Test

Variables	GoF Result	
	$R^2 = 0,653$	$R^2 = 0,874$
Training & Development	0,731	0,846
Compensation & Rewarding	0,654	0,757
Human Capital	0,744	0,861
Organizational Performance	0,737	0,852

Source: manually processed (2021)

From table 7, it can be seen that the GoF value for all constructs is above 0.38. This means that the structural model meets the goodness of fit. Thus, the structural model formed is robust so that hypothesis testing can be carried out.

Direct Effect Hypothesis Test: Hypothesis testing is carried out to confirm whether the proposed hypothesis can be accepted or not. Exogenous has a positive effect on endogenous if the path coefficient value is positive. Meanwhile, the effect is declared significant if the T-statistic value is above 1.67 and the P-value is less than 0.05. From table 7, it can be seen that all path coefficient values are positive, the T-statistic values are above 1.67, and the P-values are less than 0.05. Thus, it can be concluded that all proposed hypotheses can be accepted. In other words, the hypothesis which says that training has a positive and significant effect on human capital is supported (**H1**), training has a positive and significant effect on organizational performance is supported (**H2**), human capital has a positive and significant effect on organizational performance is supported (**H3**), compensation has a positive and significant effect on human capital is supported (**H5**), and compensation has a positive and significant effect on the organizational performance is supported (**H6**).

Mediation Test: The main objective of this study is to prove whether human capital can mediate (1) the relationship between training and organizational performance, and (2) the relationship between compensation and organizational performance. Figure 2 demonstrates the result of bootstrapping process that shows the significance of the indirect effect. Additionally, Table 8 also shows the significance of the indirect effect.

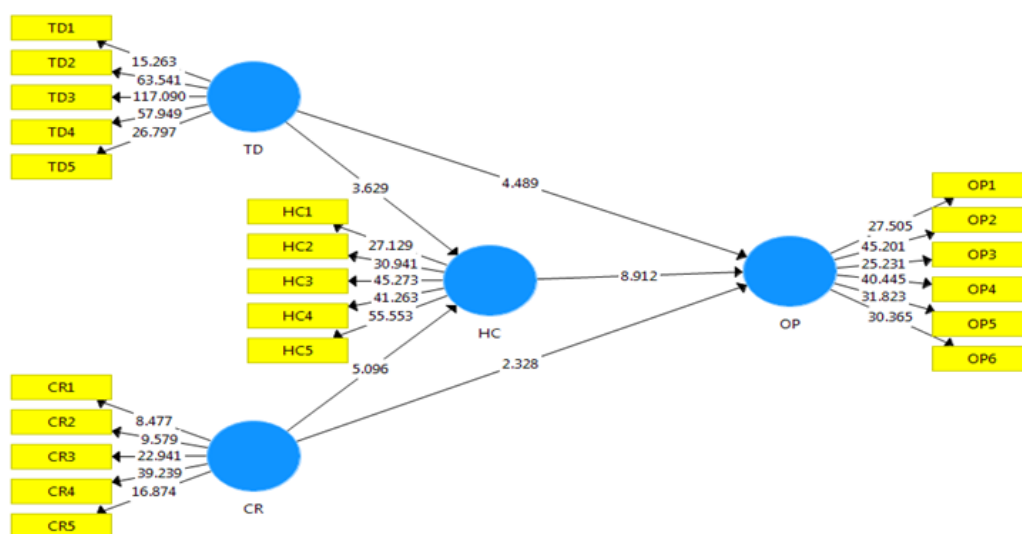


Figure 3
Boostrapping Output (2021)

Table 8
Indirect Effect

	Original Sample (O)	T Statistic (O/STDEV)	P Values
CR -> HC -> OP	0,335	4,347	0,000
TD -> HC -> OP	0,217	3,140	0,002

Source: SmartPLS output (2021)

From table 8, it can be seen that the T-statistical values are all above 1.96 and the P-values are less than 0.05. Thus it can be concluded that human capital can mediate the

relationship between training & development and organizational performance in a positive and significant way (**H4**). Human capital can also mediate the relationship between compensation and organizational performance in a positive and significant way(**H7**). When analyzed further, it can be seen that the effect of compensation is stronger than the effect of training on organizational performance.

Discussion: Basically, HRM aims to increase the contribution of employees to the achievement of organizational goals. This also applies to small organizations such as Jambi batik businesses. However, this study found that the practice of HRM in the Jambi batik industry did not run effectively. This can be seen from two aspects, namely the training program and the compensation system. The training program does not run effectively because there is no regular and unsustainable schedule. Meanwhile, the compensation system does not work effectively because it only focuses on financial compensation, while non-financial compensation has not received adequate attention. The low effectiveness of HRM practices has an impact on the effectiveness of achieving organizational goals. This can be seen from the low performance of the organization according to the respondents' assessment.

This study proves the importance of the role of human capital in improving organizational performance. This is due to the empirical evidence about the significant influence of HRM practices on organizational performance through human capital. This proves that the mediation approach fills the gap between HRM practices and organizational performance. Thus, the black box that exists between HRM practices and organizational performance is increasingly revealed and the relationship is clearer.

This article discusses the influence of training and compensation on human capital and organizational performance, either directly or indirectly. Apart from training and compensation that affect Human Capital and Organizational Performance, there are many other factors, including: 1) Creativity: (Desfiandi et al., 2017), (Yacob et al., 2020), (Richardo et al., 2020), (Christina Catur Widayati et al., 2020), (Prayetno & Ali, 2020b), (C.C. Widayati et al., 2020); 2) Knowledge: (Desfiandi et al., 2017), (Prayetno & Ali, 2020a), (Mukhtar et al., 2016); 3) Leadership: (Limakrisna et al., 2016), (Bastari et al., 2020), (Ali et al., 2016), (Elmi et al., 2016); 4) Organizational Commitment: (Limakrisna et al., 2016), (Harini et al., 2020), (Prayetno & Ali, 2017); and 5) Supply Chain Management: (Harini et al., 2020), (Desfiandi et al., 2019), (Sulaeman et al., 2019), (Mappesona et al., 2020), (Ridwan et al., 2020), (Mulyani et al., 2020).

CONCLUSIONS AND RECOMMENDATIONS

Based on the above analysis, several conclusions can be formulated as follows:

- 1) training has a positive and significant effect on human capital, which means the more effectively the training program is implemented, the better the human capital is;
- 2) training has a positive and significant effect on organizational performance, which means that the more effectively the training program is implemented, the higher the organizational performance is;
- 3) human capital has a positive and significant impact on organizational performance, which means the better thuman capital, the more effective the organization in achieving its goals;

- 4) human capital can mediate the effect of training on organizational performance, which means that the effect of training on organizational performance will be stronger if mediated by human capital;
- 5) compensation has a positive and significant effect on human capital, which means the better the compensation system, the better human capital,
- 6) compensation has a positive and significant impact on organizational performance, which means that if the compensation system is implemented effectively, the organizational performance will be higher;
- 7) human capital can mediate the effect of compensation on organizational performance, which means the influence of the compensation system will be stronger on organizational performance if mediated by human capital.

The findings of this study have implications for the literature on the model of the relationship between HRM practices and organizational performance. The findings of this study further clarify the relationship between HRM practices and organizational performance and further narrow the theoretical and empirical gap in the study of the relationship between HRM practices and organizational performance.

To the practitioners of the batik industry, the findings of this study provide the following recommendations: To improve organizational performance, the entrepreneurs must pay attention to the implementation of training programs that can improve employee competencies effectively and compensation system policies that can increase employee motivation. Meanwhile, it is recommended that future researchers research different contexts to obtain a more comprehensive understanding of the relationship between HRM practices and organizational performance.

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