

# Examining the role of human capital and strategic management in Islamic perspective: A strategic approach for encouraging business sustainability

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## ABSTRACT

*This study examines and analyzes the effect of; (i) Human Capital in Islamic Perspective (HCIP) on Business Sustainability (BS); (ii) Strategic Management in Islamic Perspective (SMIP) on Business Sustainability, (iii) Mediation of Strategic Management in Islamic Perspective in relation to Human Capital in Islamic Perspective on Business Sustainability. This study uses Batik MSME respondents in Pekalongan City. Pekalongan is a Batik city who has the batik talents, qualified craftsmen, known worldwide, and have been passed down from one generation to the next. The target sample is 150 MSMEs. It is conducted purposively with a return rate of 116 questionnaires (response rate 77%). The data is collected through questionnaires and interviews with several owners or managers of MSMEs. The statistical technique uses Partial Least Square (PLS 3.3). This study finds that; (i) Human Capital in Islamic Perspective has no significant effect on Business Sustainability; (ii) Strategic Management in Islamic Perspective has significant effect on Business Sustainability, (iii) Strategic Management in Islamic Perspective mediates the effect of Human Capital in Islamic Perspective on Business Sustainability.*

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## Introduction

After the Covid-19 pandemic, MSME are increasingly required to survive in fierce competition era. Creative MSME are required to be able to utilize resources and technology optimally. MSME continue to be encouraged by the government to improve performance and competitiveness by competing in improving excellent services, especially after the Covid 19 pandemic. Creative economy actors, especially MSME, must be able to think outside the box optimally. One of five industries that is currently being the focus of government implementation in the post-Covid-19 era is the batik industry. Batik industry is increasingly expected by the government to be able to contribute the Indonesian economy towards the top 10 world economies in 2030.

However, the problems of creative MSME in Indonesia are very complex since they have limited resources, technology, capital, and competence. They are less fast and proactive in responding the demands of a highly turbulent global environment. They are constrained by some issues such as; protection of information systems, regulation of digital transactions, reporting of business records, reporting of taxes and finance/accounting (Kusuma et al. 2020). They also generally do not have good strategic planning or strategic management, especially when it comes to HR ownership (Armstrong, 2003; Muafi et al. 2019). Aytar and Selamat (2021) prove that there is a link between the level of education owned by MSME and awareness in the company's strategic management. Muafi et al. (2019; Conner & Ulrich, 1996) focus and prioritize several key human resource concepts that play a major role in creating organizational capabilities, including; ownership of a new strategic agenda; creation of competitive advantage; strategic HR; and business sustainability (business performance, environmental performance, and social performance).

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In recent years, there have been a number of important developments in the literature related to issues regarding HRM, particularly strategic HR. Several academics and practitioners have focused their attention on strategic HRM approaches (Armstrong, 2003; Muafi et al. 2019; Muafi & Uyun, 2021a, 2021b). This means that the approaches in the HRM function are not limited to the personnel function but are also extended to involvement in the overall strategic management process. Business strategy is strongly influenced by human resource factors (Allen & Wright, 2006; Boxall & Purcell, 2003; Muafi et al. 2019; Noe et al. 2006). Human resource strategy is expected to make the business strategy work. The business strategy must take into account the opportunities and constraints of human resources. Human resource strategy is a series that human resources use to help companies achieve their strategic goals (Allen & Wright, 2006; Boxall & Purcell, 2003; Muafi & Uyun, 2021a, 2021b; Noe et al. 2006).

This study focuses on the importance of having HR competencies in Islamic perspective (Human Capital in Islamic Perspective - HCIP) in improving strategic management in Islamic Perspective (SMIP) which have an impact on business sustainability in Batik MSME in Pekalongan City.

One of the main sources of livelihood for most people in Pekalongan City is Batik. In 2015, Pekalongan City has succeeded become a member of the World Creative Cities network and as the only city selected by UNESCO in the craft & folk art category in December 2014, Pekalongan has a branding as World's City of Batik (Adha, 2021). Pekalongan has been known to have a very large number of creative MSME which are spread evenly in almost every region. Besides that, Pekalongan is known as a city that has majority Muslim community which live side by side with non-Muslim communities and live in harmony with Arabs, Chinese and Indians ethnic (Muafi & Uyun, 2019). They have a talent as a designer or batik craftsmen who is very well known and passed down from one generation to the next. Unfortunately, based on observations in the field, most of them have not implemented strategic planning or strategic management perfectly, and do not have proper water sanitation or waste disposal so it is feared that it will have an impact on business sustainability.

Previous studies have proven that strategic management practices have a significant impact on company performance (Gjorgjeska et al. 2016; Mohamed & Mohamud, 2021; Monday et al. 2015; Plance, 2015) as well as on business sustainability (Lakshmi & Kennedy, 2017; Sebestova, 2013; Willerding et al. 2016). Study which links HCIP to SMIP, especially in improving Business Sustainability, is still very limited. This is expected to be able to fill research gaps and at the same time become research updates.

## **Literature Review**

### **Empirical Review and Hypothesis Development**

Human Capital in Islamic Perspective (HCIP), Strategic Management in Islamic Perspective (SMIP) and Business Sustainability (BS)

Armstrong (2003) explains that the main business issues that affect strategic HRM include: (1) company goals related to growth or decline, acquisitions, mergers, divestments, diversification, market/product development; (2) increasing competitive advantage through innovation that leads to product/service differentiation, productivity improvement, quality improvement/customer service, and cost reduction; (3) the need to develop a more positive and performance-oriented culture and (4) management culture in enhancing commitment, mutuality, communication, engagement, decentralization, and teamwork.

Strategic management provides greater opportunities for businesses to plan and manage business goals and desired resources so that business operations become more successful (Lončar, 2017; Mohamed & Mohamud, 2021). On the other hand, companies also need an aesthetic approach which is expected to provide a balance between work quality, creativity, and innovation so that it can have an impact on improving the relationship between stakeholders and the environment (Willerding et al. 2016). In a very high environmental turbulence, dynamic business models and strategies are needed for sustainable business improvement (Muafi et al. 2019; Sebestova, 2013). Likewise, the company's business strategy model must be supported by good human capital so that it can increasingly improve business sustainability (business, environmental, and social performance) (Singh et al. 2020; Ullah & Jahan, 2017; Yong et al. 2019).

Rukiah (2015) finds that there are three characteristics inherent in the sharia perspective HRM, namely: (1) kafa'ah, someone who has expertise or proficient at work in accordance with the description and responsibilities, (2) himmatul-'amal, someone who has high morale and serious in work; (3) amanah, someone who does not betray, responsible, and reliable in fulfilling his obligations in work. In addition, Hamsani et al. (2017) state that sharia-based HR can be measured by considering; knowledge, skills, attitude, moral commitment, and personal integrity.

Hamsani et al. (2017) conclude that four sharia competencies (knowledge, skills, moral commitment, and personal integrity) are able to improve OCB in an Islamic perspective (OCBIP). According to Šlaus and Jacobs (2011), all forms of capital including HC can deliver value, utility, and its application to human mental awareness, creativity, and social innovation. This makes human capital, including social capital, a major determinant of productivity and sustainability of a company's resources and business. (Piwowar-Sulej, 2021; Hacıoglu & Aksoy, 2021) adds that in developing the potential of human resources that can have an impact on business sustainability, you should not only focus on current needs because this will conflict and not be in line with SHRM principles in the long term. Training in environmental sustainability must not be neglected and must increase cooperation with external educational

institutions. Surprisingly, Saadi and Che Razak (2019) find that innovative HC do not mediate the effect of organizational change on organizational sustainability.

Previous studies have always emphasized that superior human capital is related to strategic management (Allen & Wright, 2006; Boxall & Purcell, 2003; Noe et al. 2006). Companies must optimally allocate their resources so that they can increasingly have business sustainability and sustainable competitive advantage (Hacioglu, 2019; Baker-III & Feldman, 1991; Covin & Slevin, 1989; Lakshmi & Kennedy, 2017; Muafi et al. 2019). When a company's HR is strategically integrated into a business sustainability strategy, it would be able to improve organizational performance (Lakshmi & Kennedy, 2017). Arshad et al. (2015) add that business sustainability is actually very closely related to the Islam concept, especially on social performance so that it can be used to increase support for organizations, especially the provision of Islamic-based microfinance and other forms of Islamic funding such as waqf, zakat, and saddaqa (charity). It is also closely related to the formulation of relevant strategic models in supporting the development of Islamic-based sustainable organizations. Islamic-based sustainable organizations plays an important role in promoting social and economic development. It seems that this achievement must be supported by a superior HCIP (Arshad et al. 2015; Bakir et al. 2015; Hashi & Bashiir, 2009). In Islam, it is believed that there is a relationship between Human-God, Human-Human and Human-Environment (Triangle relations) (Khairulyadi & Ahmad, 2017). This indicates that there is a close relationship between HCIP-SMIP and Business Sustainability.

In company management, Fontaine and Ahmad (2013) make an analogy with SMIP as a company controlled by a driver. The driver must determine where to go (vision), how to get to the destination (strategy), and how quickly to get to the destination (risks and benefits). However, SMIP emphasizes that on the way to driving a vehicle, the driver as a leader must be careful not to hit other vehicles (competitors) and obey traffic (government regulations). The driver must also maintain the safety of the passengers in the vehicle (stakeholders). All of this is done to maintain and improve the relationship between human-God, human-human and human-environment (Khairulyadi & Ahmad, 2017).

According to Fontaine and Ahmad (2013), the SMIP concept can be a solution to strengthen Islamic-based business practices because; (1) prioritize cooperation over competition, (2) have intrinsic not extrinsic motivation, such as money or seeking profit alone, (3) the perspective of the next life is not worldly, (4) a good driver is to encourage safety, not speed (quickly). Khalifa (2001) adds that there are three concepts that need to be understood in SMIP: 'Falah', 'Hikmah', and 'Rizq'. 'Falah' means bringing religion back into the realm of economics and business and personal interests are not prioritized. A successful business is not only seen from the aspect of wealth and profit. 'Rizq enlargement' means more emphasis on changing the concept of rationality and profit maximization. Not only focus on hard work, knowledge, competence and others but also 'Taqlwa' and 'Twakkul'. It could have implications too for infaq. While 'Hikmah' is a combination of Falah and Rizq. Based on the explanation, the hypothesis can be formulated, among others;

*H1. HCIP has positive impact on BS*

*H2. HCIP has positive impact on SMIP*

*H3. SMIP has positive impact on BS*

*H4. SMIP mediates HCIP against BS*

## **Research and Methodology**

The positivism approach is conducted to test and analyze causality relationships between variables on a value-free basis (Ahmad et al. 1989; Hair et al. 2014). This study uses a questionnaire as a form of survey and only focuses on the variables studied in relation to empirical issues. The answer choices use a Likert scale, namely; 5 (strongly agree) to 1 (strongly disagree) for the HCIP and SMIP variables. Meanwhile, BS uses 5 (very high) to 1 (very low) by comparing the performance of competing MSME in the last 3 years. The population used is all Batik MSME in Pekalongan City which are taken by purposive sampling. The sample criteria used are; (1) MSMEs that have been operating for at least 3 years, (2) are Muslim and (3) have a net income of at least 10 million per month. The target sample in this study is 150 Batik MSME. Based on the results of the distribution of the questionnaires, the questionnaire that is declared eligible for further processing and the complete answer is 116 MSME (response rate 77%). It has fulfilled the requirements as a survey research using the SEM model, namely 100-200 samples (Hair et al. 2014). Data analysis technique using Partial Least Square 3.3. The variables studied include 3 variables; HCIP, SMIP, and BS. Measurement of the three variables, among others;

1. HCIP uses five items namely; skill, knowledge, kafa'ah, himmatul-'amal, and trust. The questionnaire refers to and is developed from Rukiah (2015; Hamsani et al. 2017).
2. SMIP uses 12 items using the process approach in SM, namely; formulation, implementation, and evaluation. The questionnaire refers to and is developed from Fontaine and Ahmad (2013; Khalifa, 2001).
3. BS uses 7 items in which the questionnaire refers to and is developed from Šlaus and Jacobs (2011; Muafi & Uyun, 2021a, 2021b).

## Results

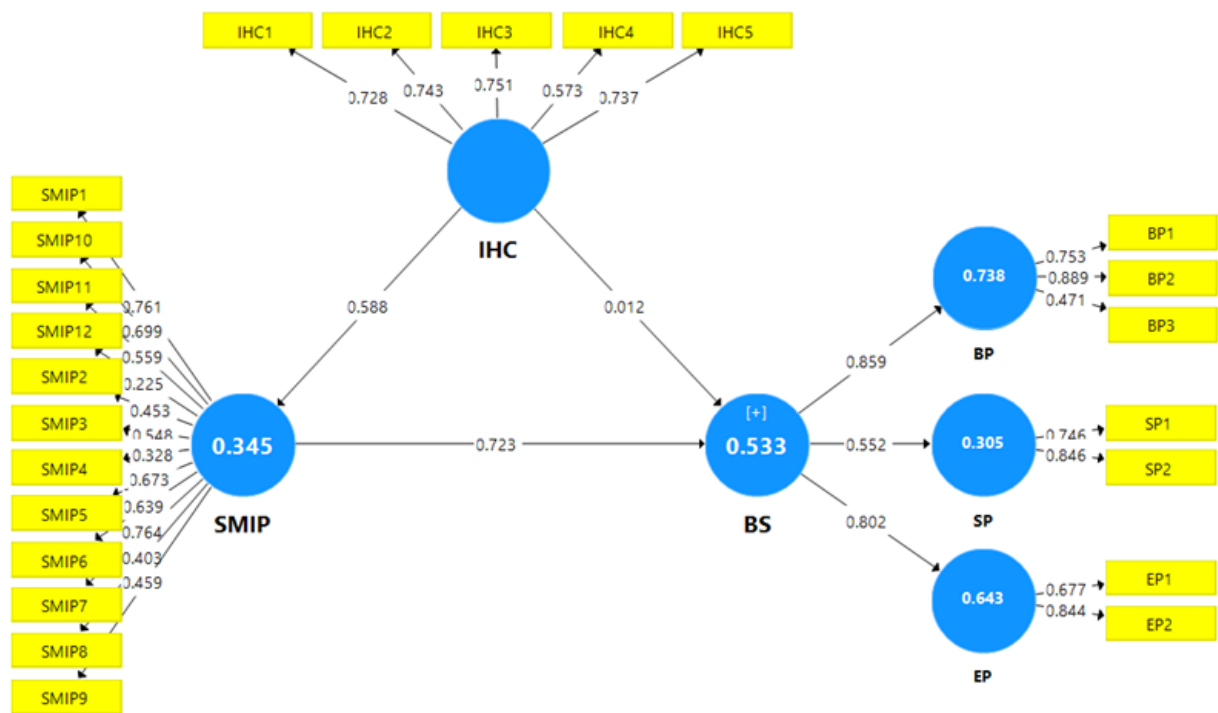
### Respondent Description

The majority of respondents have last education of high school (89%), being the owner and manager (77%), male (72%), having been operating for at least 3 years (82%), using synthetic coloring (87%), and have a net income of IDR 10 million to IDR 20 million (89%).

### Structural Equation Model

#### Evaluation of the Outer Reflective Construct Model

Based on the result of processing with Partial Least Square 3.3, the CFA analysis is generated with the first order construct and loading factor as shown in Figure 1 and Table 1.



**Figure 1:** Confirmatory Factor Analysis

**Table 1:** Loading Factor (Outer Loading)

	BP	EP	SP	HCIP	SMIP
BP1	0,753				
BP2	0,889				
BP3	0,471				
EP1		0,677			
EP2		0,844			
SP1			0,746		
SP2			0,846		
HCIP1				0,728	
HCIP2				0,743	
HCIP3				0,751	
HCIP4				0,573	
HCIP5				0,737	
SMIP1					0,761

Table Cont'd

<b>SMIP2</b>	0,453
<b>SMIP3</b>	0,548
<b>SMIP4</b>	0,328
<b>SMIP5</b>	0,673
<b>SMIP6</b>	0,639
<b>SMIP7</b>	0,764
<b>SMIP8</b>	0,403
<b>SMIP9</b>	0,459
<b>SMIP10</b>	0,699
<b>SMIP11</b>	0,559
<b>SMIP12</b>	0,225

Based on Table 1, it can be seen that there are a number of SMIP construct items that produce a loading factor value below  $< 0.70$ . While in BS construct, there are two items with a loading factor value below  $< 0.70$ , namely BP3 and EP1. Then in the HCIP construct there is one item with a loading factor value below  $< 0.70$ , namely the HCIP4 item. All items or indicators that have a loading factor value below  $< 0.7$  are declared invalid and must be eliminated from the research model.

Furthermore, after elimination, the full research model can be seen in Figure 2 and Table 2.

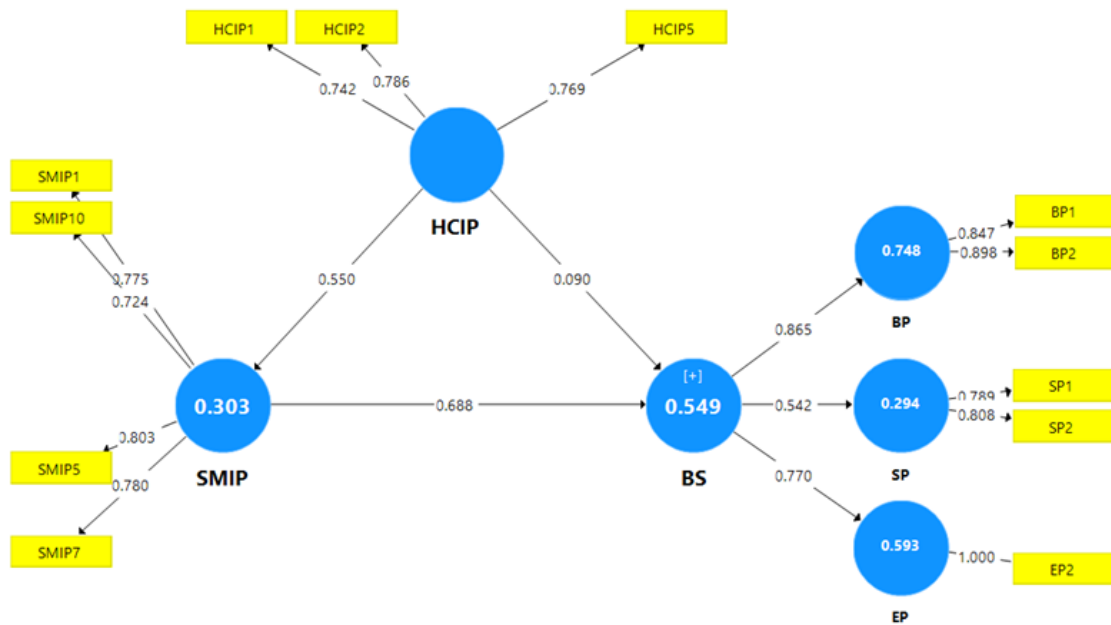


Figure 2: Full Model PLS

**Table 2:** Loading Factor (Outer Loading)

	<b>BP</b>	<b>EP</b>	<b>EP</b>	<b>HCIP</b>	<b>SMIP</b>
<b>BP1</b>	0,859				
<b>BP2</b>	0,887				
<b>EP2</b>		1,000			
<b>SP1</b>			0,827		
<b>SP2</b>			0,768		
<b>HCIP1</b>				0,740	
<b>HCIP2</b>				0,784	
<b>HCIP5</b>				0,772	
<b>SMIP1</b>					0,777
<b>SMIP5</b>					0,817
<b>SMIP7</b>					0,782
<b>SMIP10</b>					0,701

Based on Table 2, it can be seen that all constructs with items or reflexive indicators produce a loading factor value  $> 0.7$  which means that all items or construct indicators are declared valid.

Furthermore, reliability and validity testing can be seen in Table 3.

**Table 3:** Construct Reliability and Validity

	<b>Composite Reliability</b>	<b>Average Extracted (AVE)</b>	<b>Variance</b>
<b>BP</b>	0,865	0,763	
<b>BS</b>	0,859	0,670	
<b>EP</b>	1,000	1,000	
<b>HCIP</b>	0,809	0,586	
<b>SMIP</b>	0,854	0,594	
<b>SP</b>	0,778	0,637	

Based on the output construct reliability and validity in Table 3 shows that the AVE value generated by all reflexive constructs is above  $> 0.50$  so that it meets the requirements of convergent validity and reliability. The composite reliability value produced by all reflexive constructs is very good, above  $> 0.70$  so it can be concluded that all reflexive construct indicators are reliable or meet the reliability test.

### Hypothesis Test

#### Inner Model Evaluation

##### *Direct Effect Test*

**Table 4:** Mean, STDEV, T-Values, P-Values

	<b>Original Sample (O)</b>	<b>Standard Deviation (STDEV)</b>	<b>T Statistics ( O/STDEV )</b>	<b>P Values</b>	<b>Description</b>
<b>HCIP -&gt; BS</b>	-0,079	0,090	0,881	<b>0,379</b>	H1 rejected
<b>HCIP -&gt; SMIP</b>	0,548	0,075	7,313	<b>0,000*</b>	H2 accepted
<b>SMIP -&gt; BS</b>	0,691	0,074	9,349	<b>0,000*</b>	H3 accepted

Note: \*sign = significance  $< \alpha 0.05$

Based on Table 4 it can be seen that; (1) Human Capital in Islamic Perspective (HCIP) has no significant effect on Business Sustainability (**H1 is rejected**); (2) Human Capital in Islamic Perspective (HCIP) has significant positive effect on Strategic Management in Islamic Perspective (SMIP) (**H2 is accepted**), (3) Strategic Management in Islamic Perspective (SMIP) has significant positive effect on Business Sustainability (BS) (**H3 is accepted**).

#### Indirect Effect Test

**Table 5:** Mean, STDEV, T-Values, P-Values

	Original Sample (O)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values	Description
HCIP -> SMIP -> BS	0,379	0,075	5,058	0,000*	H4 accepted

Note: \*sign = significance <  $\alpha$  0.05

Based on the output in Table 5, it can be seen that Strategic Management in Islamic Perspective (SMIP) mediates the effect of Human Capital in Islamic Perspective (HCIP) on Business Sustainability (BS). This means that **H4 is accepted**.

## Discussion and Implication

The results prove that HCIP has no effect on Business Sustainability (BS) (**H1 is rejected**). It does not support previous theories from Šlaus and Jacobs (2011; Baker-III & Feldman, 1991; Covin & Slevin, 1989; Lakshmi & Kennedy, 2017; Muafi et al. 2019). Based on the results of the interview, it turns out that Batik MSME in Pekalongan have not paid attention to the relationship between HCIP and BS. This is reasonable considering they assume that the majority population of Pekalongan are batik craftsmen and have good skills, knowledge, abilities from the batik profession. Unfortunately, these three indicators have not been balanced with the nature of kafa'ah, himmatul-'amal, and trustworthiness perfectly. If you pay attention, most of the batik MSME do not have waste disposal and dispose the batik waste in the surrounding environment. This condition is very dangerous, especially when the Batik MSME uses synthetic dyes instead of natural colors. Toxic waste can damage nature and the surrounding environment. Likewise, it is feared that it will disturb the neighbors and cause disharmony between human relationships. It should not merely look for profit and short term. This condition can occur considering that on average they have the same complaint from the aspect of capital and human resources. Piwovar-Sulej (2021) suggests that the government and MSME have a high concern regarding developing the potential of human resources by providing training on environmental sustainability and providing spiritual enlightenment so that MSME truly apply Islamic concepts kaffah in the implementation of their business operations and SMIP. This supports Arshad et al. (2015; Bakir et al. 2015; Hashi & Bashiir, 2009) that business sustainability is significantly related to the Islam concept, especially Triangle relations concept (Khairulyadi & Ahmad, 2017).

The results prove that HCIP has significant positive impact on SMIP (**H2 is accepted**). It supports the theory and previous studies of Bakir et al. (2015; Arshad et al. 2015; Hashi & Bashiir, 2009). Likewise, several studies have proven that when a company has superior human capital, it could have a significant impact on strategic management (Allen & Wright, 2006; Boxall & Purcell, 2003; Noe et al. 2006). Batik MSME should have thought about having a superior HCIP. Aytar and Selamet (2021) prove that a high level of education provides a significant improvement in the company's strategic management. When having a superior HCIP, MSME are increasingly aware of having a vision and mission as well as an Islamic SWOT analysis by implementing business strategies on target in order to achieve BS. Muafi et al. (2019; Conner & Ulrich, 1996) emphasize the main role of HC in creating organizational capabilities in improving BS.

Furthermore, the results prove that SMIP has significant positive impact on BS (**H3 is accepted**). MSME must be able to use strategic management for the purpose of planning and managing business and resources so that they can be more successful (Lončar, 2017; Mohamed & Mohamud, 2021). Willerding et al. (2016) suggest that company management needs to emphasize the balance of aspects of work quality, creativity, and innovation with aesthetic aspects so that it can provide a balance of relationships between companies, stakeholders, and the environment. SMIP in this study used a three-stage approach; strategy formulation, implementation, and evaluation of strategies with an Islamic approach.

## Conclusions

This study examined and analyzed the effect of (i) Human Capital in Islamic Perspective (HCIP) on Business Sustainability (BS); (ii) Strategic Management in Islamic Perspective (SMIP) on Business Sustainability, (iii) Mediation of Strategic Management in Islamic Perspective in relation to Human Capital in Islamic Perspective on Business Sustainability. This study used Batik MSME respondents in Pekalongan City.

In setting the company's vision, mission, goals and SWOT analysis, it should not only consider worldly pleasures (for example, profit alone) but must also be oriented towards the next life and be conducted carefully (Fontaine & Ahmad, 2013), should not violate Allah's commands, and government regulations. Likewise, strategy implementation must prioritize cooperation not competition, have intrinsic not extrinsic motivation, and obey existing regulations so that everything is safe (Fontaine & Ahmad, 2013). Therefore, MSME should bring religion into every process and choice of business strategy that will be implemented. Not only pursuing profit but also benefiting the surrounding community (Khalifa, 2001). This is important in order to further improve BS in the future. Companies can operate not only profit-oriented but also have to consider environmental (planet) and social (people) performance so that the concept of triangle relations can be realized.

#### *Limitation and Future Research*

This research has limitations, among others:

- i. The sample is limited to Batik MSME in Pekalongan and is conducted purposively so that it is feared that it will not be able to generalize the portrait of Batik MSME in Pekalongan as a whole, especially when it is used to generalize creative MSME throughout Pekalongan.
- ii. When distributing the questionnaire, it is done by going directly to the respondents and some other using Google form. Questionnaires that use the google form have limitations, namely when the respondent has difficulty answering, the researcher cannot explain in detail even though the researcher's contact has been given.
- iii. The implementation of SMIP in MSME still uses a simple approach so that sometimes researchers have to explain further the purpose of SMIP. It is feared that the answers from the respondents could not truly reflect and describe SMIP so that it could affect the research results.
- iv. BS measurement should be re-explored by using a questionnaire that truly reflects 3 indicators, namely business, environmental, and social performance

Based on these limitations, the future research should;

- i. Conduct in-depth interviews related to the implementation of HCIP so that in the future they can be more careful, for example when carrying out the recruitment and training process as well as employee development. In the SMIP process, MSME should begin to develop several procedures and policies related to SMIP comprehensively and are expected to have an impact on BS.
- ii. It is necessary to examine and consider other variables related to the antecedents and consequences of SMIP. This is important so that the research model that has been produced can be successfully developed and implemented to improve BS.
- iii. It is necessary to explore 3 indicators from BS, especially those related to creative MSMEs so that they can have more perfect measurements and can be more implemented.
- iv. Exploring variables that take into account the local culture of the city of Pekalongan which is famous as a city where the people really appreciate cultural, religious, and ethnic differences. The practice of sharia management based on local wisdom can be a very attractive attraction for improving social, religious, and environmental performance.

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**Institutional Review Board Statement:** Ethical review and approval were waived for this study, due to that the research does not deal with vulnerable groups or sensitive issues.

**Data Availability Statement:** The data presented in this study are available on request from the corresponding author. The data are not publicly available due to privacy.

**Conflicts of Interest:** The author declares no conflict of interest with any other project team members, institutions or authors.

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