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Driving Sustainable Performance in Islamic Microfinance: Competence, Compensation, and Employee Engagement

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Keywords:
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Abstract

This study aims to analyze the influence of employee competence and compensation on sustainable cooperative performance, with employee engagement as a mediating variable in KSPPS BMT Alhikmah Semesta. Based on the Resource-Based View (RBV) theory, human resources are positioned as an organization's internal strategic asset. This causal quantitative research uses a survey method on the cooperative employee population. The sample was determined through purposive sampling with the criteria of active employees, a minimum working period of 1 year, and not peak management, with a final sample of 203 valid respondents. Data collection was conducted using a 5-point Likert scale questionnaire and analyzed using Partial Least Squares-Structural Equation Modeling (PLS-SEM) through SmartPLS 4.1.1.8. The results of the study show that competence, compensation, and employee engagement have a positive and significant effect on the performance of sustainable cooperatives; competence and compensation also have a positive and significant effect on employee engagement; Employee engagement partially mediates the influence of competence on sustainable cooperative performance, but does not mediate the effect of compensation on sustainable cooperative performance because compensation has a dominant direct impact. This research provides a theoretical contribution to the RBV literature and practical input for cooperative management in formulating sustainable human resource strategies.

INTRODUCTION

Savings and Loan Cooperatives (KSP) play a strategic role in expanding access to financing for MSMEs underserved by formal banking, where the national banking credit allocation to MSMEs remains below 20%. However, the performance of Indonesia's cooperative sector generally remains low, contributing less than 1% to the GDP. Based on credit scoring ranking data from the Government Investment Agency (PIP) as of February 2026 across 48 partner KSPs, the majority of cooperatives fall into the medium to low-performance categories (BBB to C). This measurement utilizes an innovative credit scoring instrument grounded in indicators such as NPL, DER, BOPO, ROA, Operating Profit, and probability of default (Altman Z-Score). One partner, KSPPS BMT Alhikmah Semesta, has consistently remained at the lowest performance rank (Rank C) for 13 consecutive months. This performance stagnation indicates fundamental issues within the aspect of Human Resource (HR) management.

Table 1. KSP Performance based on MSME Financing Credit Rating on PIP

No	Rating/Rating	Total KSP
1	AAA	7
2	AA	1
3	A	0
4	BBB	5
5	BB	15
6	B	6
7	CCC	0
8	CC	0
9	C	14
Total		48

Source: PIP (2026)

Human Resources (HR) as a strategic asset can provide a sustainable competitive advantage for organizations (Pahira & Rinaldy, 2023). Drucker in (Kaswan, 2022) emphasizes that HR is the most crucial asset for a company's competitive advantage, whereas Bernardin and Russell in (Putri, 2025) position organizational capability—arising from HR management practices—as one of four mechanisms of competitive uniqueness. Conversely, sub-optimal implementation of HR management can reduce productivity, increase human error, and weaken the company's financial position (Siregar & Wardhani, 2023).

HR management also serves as a driver of employee engagement (Widigdo et al., 2026). In modern organizational contexts, traditional hierarchical approaches have shifted toward flatter and more collaborative structures. Employee engagement has become a critical aspect of fostering a productive and innovative work environment. Pre-survey results among 30 KSP employees revealed that compensation (60% dissatisfied) and employee competence (53.33% sub-optimal) were identified as the two most critical problem areas.

Prior research demonstrates that HR competence exerts a positive and significant effect on organizational performance (Ambarwati et al., 2023; Groenewald, 2024; Leweinzky, 2026; Pramudiya & Supriadi, 2025; Rehman & Solikhah, 2023). Conversely, Widigdo & Mardian, (2024) state that competence (manifested through the Human Capital dimension) does not affect organizational performance. The absence of an effect of competence on organizational performance was also documented in a study by Wardhana et al., (2026).

According to research by Sismiati et al., (2025), adequate compensation significantly enhances organizational performance. Consistent findings were also reported by Ambarwati et al., (2023); Ampong (2024); and Masud et al., (2025). On the other hand, research by Nurdin et al., (2025) indicates that compensation has no direct effect on improving organizational performance. Similarly, Irani et al., (2023) state that compensation mediated by job satisfaction does not affect organizational performance.

Studies by Mansor et al., (2023); Mishra et al., (2024); Poorani & Pradap (2024); and Saputra & Permana (2022) assert that employee engagement has a positive and significant impact on employee and organizational performance. High employee engagement directly benefits and contributes to improved organizational performance. Meanwhile, research by Budiarto et al., (2023) indicates that employee engagement exerts a negative and non-significant impact on employee performance, ultimately affecting organizational performance.

Prior research by Fadhilah et al., (2026); Leweinzky (2026); and Fajrin et al., (2025) indicates that employee competence exerts a positive and significant impact on employee engagement, which contributes to the improvement of organizational performance. Conversely, Prayogi et al., (2023) state that there is no relationship or impact between career competence and employee engagement.

Furthermore, Ferine et al., (2023); Hart-Akinsola & Wahua (2026); and Rahman et al., (2024) demonstrate that compensation—both monetary and non-monetary—substantially affects the extent of employee engagement with the organization. On the other hand, Hendriks et al., (2023); and Malek et al., (2025) find that compensation does not significantly influence employee engagement.

Based on the phenomenon gap and pre-survey findings, it is essential to conduct research on the influence of employee competence and compensation on sustainable cooperative performance, with employee engagement as a mediating variable. This study aims to examine the effect of competence and compensation on sustainable organizational performance, utilizing employee engagement as a mediating variable, particularly within the context of savings and loan cooperatives. The results of this study are expected to offer practical suggestions and recommendations for HR management governance in cooperatives, while advancing novelty within the Islamic microfinance ecosystem.

METHOD

This study employs a quantitative research method utilizing a causal relationship approach (Fateqah & Nuswardhani, 2024) to examine the effect of employee competence and compensation on sustainable cooperative performance, with employee engagement serving as a mediating variable. The study involves four main variables: competence (X1) and compensation (X2) as independent variables, sustainable cooperative performance (Y) as the dependent variable, and employee engagement (Z) as the mediating variable. Data were collected using a structured questionnaire with a 5-point Likert scale (1–5) and analyzed using Partial Least Squares-Structural Equation Modeling (PLS-SEM) via SmartPLS 4 software, given its suitability for testing causal relationships among latent variables as well as direct and indirect effects through a mediating variable.

Table 2. Variable Operational

Variable	Indicators	Code
Competence (X1)	1. Understanding of regulations 2. Understanding of disbursement procedures	C

Variable	Indicators	Code
(Ahmad et al., 2022) dan (Guo et al., 2024)	3. Acumen in credit feasibility analysis 4. Mastery of information systems 5. Mastery of digital reporting systems 6. Integrity and adherence to SOPs 7. Member empowerment orientation	
Compensation (X2) (Zhao et al., 2022)	1. Satisfaction with direct economic compensation 2. Availability of indirect economic compensation 3. Direct non-economic compensation 4. Opportunities for indirect non-economic compensation 5. Perceived fairness in compensation	K
Employee Engagement (Z) (Pöysä et al., 2022)	1. Vigor / Work enthusiasm 2. Dedication 3. Absorption / Full involvement 4. Employee pride 5. Focus on task completion	E
Sustainable Cooperative Performance (Y) (Faria et al., 2024)	1. Work productivity 2. Work effectiveness 3. Work commitment 4. Work relationships 5. Employee welfare 6. Concern for business sustainability and organizational success	Y

Source: Various sources of theories (2026)

The study population comprises all employees of KSPPS BMT Alhikmah Semesta (excluding top management). Sample selection was conducted using a non-probability sampling method with a purposive sampling approach based on the following inclusion criteria: (1) active status as an employee; (2) a minimum tenure of one year; and (3) non-holding of top management positions. The minimum required sample size was calculated using Slovin's Formula with a 5% margin of error, yielding a minimum requirement of 146 respondents. This requirement was subsequently fulfilled through the distribution of online questionnaires via Microsoft Forms, resulting in a final sample of 203 valid respondents following a screening process based on tenure criteria. Secondary data were obtained from PIP internal documents, academic literature, and supporting scientific journals.

Prior to main data collection, a pilot study was conducted involving 30 employees across four PIP partner cooperatives in West Sumatra (KSPPS BMT Ayyasi, KSPPS BMT El-Itqan, KSPPS BMT Korong Gadang, and KSU Gapoktan Albasiko II), supported by PIP Official Letter Number S-21/IP/IP.2/2026. Findings from the pilot test and in-depth interviews confirmed that all 24 questionnaire items were clearly understood and highly relevant to the operational context of cooperatives, thereby establishing instrument validity for primary data collection.

In general, the testing procedure in PLS analysis encompasses the measurement model design (outer model), validity and reliability testing, structural model design (inner model), as well as hypothesis testing and mediation analysis. Figure 1 illustrates the conceptual model of this study. Based on this framework, the research hypotheses are formulated as follows: (1) H1: Employee competence has a positive and significant effect on sustainable cooperative

performance; (2) H2: Employee compensation has a positive and significant effect on sustainable cooperative performance; (3) H3: Employee engagement has a positive and significant effect on sustainable cooperative performance; (4) H4: Employee competence has a positive and significant effect on employee engagement; (5) H5: Employee compensation has a positive and significant effect on employee engagement; (6) H6: Employee engagement mediates the effect of employee competence on sustainable cooperative performance; and (7) H7: Employee engagement mediates the effect of employee compensation on sustainable cooperative performance.

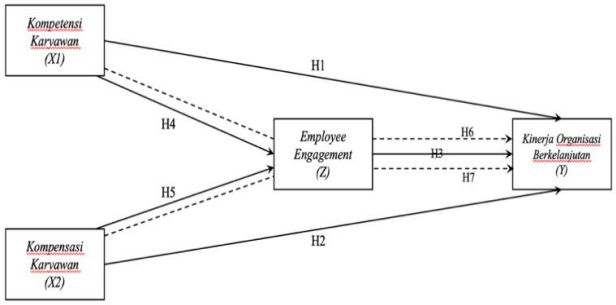

Figure 1. Research Conseptual Framework

RESULTS AND DISCUSSION

Respondents Characteristic

Out of 217 respondents who completed the questionnaire, 14 did not meet the minimum tenure requirement of one year, resulting in a final eligible sample of 203 respondents. The respondents were predominantly male (73.89%). In terms of age distribution, the largest proportion fell within the 25–35 age bracket (67%). Furthermore, 81.77% of respondents held a Bachelor's degree (S1/D4), and 47.29% had a tenure exceeding six years. Regarding job positions, 76.85% of respondents were operational staff, while the remainder comprised branch managers and operational heads.

Outer Model Measurement Convergent Validity

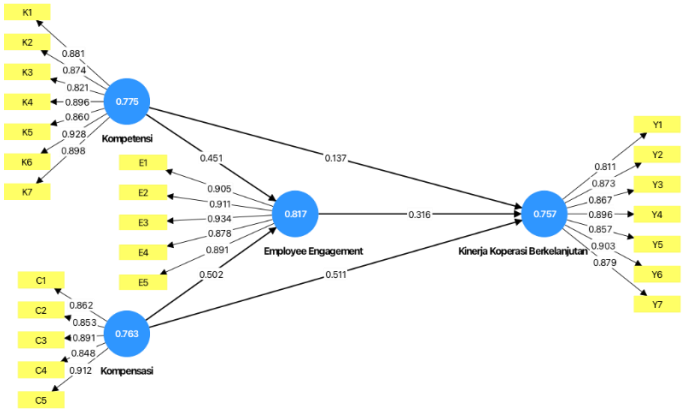

Figure 2. Outer Model Measurement (Loading Factor and AVE)
Source: Data processed by author (2026)

The convergent validity test results obtained via outer loadings (Figure 2) demonstrate that all 24 indicators exceed the threshold value of 0.70, with loadings ranging from 0.811 to 0.934. This confirms that each indicator validly represents its underlying construct. Furthermore, the Average Variance Extracted (AVE) values for all constructs exceed the 0.50 threshold, thereby confirming adequate convergent validity at the construct level.

Outer Model Measurement Discriminant Validity

Discriminant validity was evaluated using cross-loadings, the Fornell-Larcker criterion, and the Heterotrait-Monotrait ratio of correlations (HTMT). The cross-loading results indicate that each indicator exhibits the highest loading value on its respective assigned construct compared to its loadings on other constructs.

Table 3. Cross-Loading

Indicator Code	Competence (X1)	Compensation (X2)	Employee Engagement (Z)	Sustainable Cooperative Perfomance (Y)	Remarks
K1	0.881	0.610	0.647	0.644	Valid
K2	0.874	0.596	0.687	0.608	Valid
K3	0.821	0.580	0.653	0.579	Valid
K4	0.896	0.575	0.690	0.647	Valid
K5	0.860	0.683	0.769	0.744	Valid
K6	0.928	0.594	0.716	0.666	Valid
K7	0.898	0.580	0.723	0.648	Valid
C1	0.533	0.862	0.679	0.713	Valid
C2	0.616	0.853	0.689	0.717	Valid
C3	0.588	0.891	0.739	0.757	Valid
C4	0.639	0.848	0.717	0.790	Valid
C5	0.618	0.912	0.715	0.781	Valid
E1	0.754	0.735	0.905	0.740	Valid
E2	0.762	0.703	0.911	0.760	Valid
E3	0.719	0.730	0.934	0.780	Valid
E4	0.640	0.779	0.878	0.758	Valid
E5	0.719	0.720	0.891	0.759	Valid
Y1	0.612	0.669	0.649	0.811	Valid
Y2	0.666	0.705	0.684	0.873	Valid
Y3	0.674	0.725	0.709	0.867	Valid
Y4	0.646	0.761	0.765	0.896	Valid
Y5	0.596	0.801	0.747	0.857	Valid
Y6	0.664	0.803	0.799	0.903	Valid
Y7	0.647	0.771	0.746	0.879	Valid

Source: Data processed by author (2026)

The Fornell-Larcker criterion (Table 4) shows that the square root of the AVE for each construct (diagonal values) is greater than its correlation with any other construct, thereby fulfilling the requirements for discriminant validity.

Table 4. Fornell-Larcker Criterion

Construct	Employee Engagement	Sustainable Cooperative Performance	Compensation	Competence
Employee Engagement	0,904			
Sustainable Cooperative Performance	0,840	0,870		
Compensation	0,811	0,862	0,873	
Competence	0,795	0,739	0,686	0,880

Source: Data processed by author (2026)

Initial HTMT evaluation detected a value of 0.920 between Compensation and Sustainable Cooperative Performance, exceeding the conservative threshold of 0.90 and indicating potential perceptual overlap among respondents. Cross-loading analysis revealed that indicator Y5 ("management policy supports work-life balance") exhibited the smallest loading difference and conceptual overlap with the Compensation dimension. Consequently, item purging was performed on Y5 in accordance with recommendations by Henseler et al., (2015). Post-purging HTMT results (Table 5) showed a reduction in the HTMT ratio to 0.904. Furthermore, inferential testing via bootstrapping confirmed that all 95% bias-corrected confidence intervals did not include the value of 1, thereby establishing discriminant validity for all constructs.

Table 5. HTMT After Item Purging Indicator Y5

Construct	Employee Engagement	Sustainable Cooperative Performance	Compensation
Employee Engagement			
Sustainable Cooperative Performance	0,879		
Compensation	0,869	0,904	
Competence	0,837	0,783	0,730

Source: Data processed by author (2026)

Outer Model Measurement Composite Reliability

Reliability testing (Table 6) demonstrates that all constructs exhibit Cronbach's Alpha, rho_A, and Composite Reliability values exceeding the 0.70 threshold, thereby confirming that the research instrument is reliable and internally consistent.

Table 6. Reliability

Construct	Cronbach's Alpha	Rho_A	Composite Reliability	Remarks
Employee Engagement	0,944	0,944	0,957	Reliable

Construct	Cronbach's Alpha	Rho_A	Composite Reliability	Remarks
Sustainable Cooperative Performance	0,940	0,942	0,952	Reliable
Compensation	0,922	0,923	0,941	Reliable
Competence	0,951	0,953	0,960	Reliable

Source: Data processed by author (2026)

Inner Model Measurement Multicolinearity Test (VIF)

The Variance Inflation Factor (VIF) test results (Table 7) indicate that all VIF values remain well below the conservative threshold of 5.00, thereby confirming that the structural model is free from multicollinearity issues.

Table 7. Multicollinearity Test (VIF) Results

Pathway	VIF
Employee Engagement → Sustainable Cooperative Performance	4,262
Compensation → Employee Engagement	1,891
Compensation → Sustainable Cooperative Performance	2,965
Competence → Employee Engagement	1,891
Competence → Sustainable Cooperative Performance	2,756

Source: Data processed by author (2026)

Inner Model Measurement Model Fit Test (SRMR)

The SRMR value of 0.050, for both the saturated model and the estimated model (Table 8), falls below the threshold of 0.08, thereby demonstrating that the research model achieves a good fit.

Table 8. Standardized Root Mean Residual (SRMR)

Models	Original Sample (O)	Sample Mean (M)	95% Limit	99% Limit
Saturated Model	0,050	0,038	0,051	0,058
Estimated Model	0,050	0,038	0,051	0,058

Source: Data processed by author (2026)

Inner Model Measurement Determinant Coefficient (R2)

The coefficient of determination (Table 9) indicates that Competence and Compensation simultaneously explain 76.3% of the variance in Employee Engagement (Adjusted R2 = 0.763). Furthermore, Competence, Compensation, and Employee Engagement simultaneously account for 78.2% of the variance in Sustainable Cooperative Performance (Adjusted R2 = 0.782), with both values falling into the strong category.

Table 9. Coefficient of Determination (R^2)

Endogenous Variable	R-Square	R-Square Adjusted	Interpretation
Employee Engagement	0,765	0,763	Strong
Sustainable Cooperative Performance	0,786	0,782	Strong

Source: Data processed by author (2026)

Inner Model Measuremenet Bootstrapping Direct Effect

Hypothesis testing conducted via the bootstrapping procedure (Table 10) demonstrates that all five direct effect hypotheses are accepted at the 5% significance level (t-value > 1.96 and p-value < 0.05).

Table 10. Hypothesis Test Results (Direct Effect)

Pathway	Coefficient (O)	T-Statistics	P-Value	Conclusion
Competence → Sustainable Cooperative Performance	0,171	2,327	0,010	Significant Positive (H1 accepted)
Compensation → Sustainable Cooperative Performance	0,481	3,528	0,000	Significant Positive (H2 accepted)
Employee Engagement → Sustainable Cooperative Performance	0,303	2,191	0,014	Significant Positive (H3 accepted)
Competence → Employee Engagement	0,451	3,531	0,000	Significant Positive (H4 accepted)
Compensation → Employee Engagement	0,502	3,845	0,000	Significant Positive (H5 accepted)

Source: Data processed by author (2026)

Inner Model Measuremenet Bootstrapping Indirect Effect

Mediation analysis (Table 11) reveals that employee engagement significantly mediates the effect of competence on sustainable cooperative performance (H6 is supported). However, it does not significantly mediate the effect of compensation on sustainable cooperative performance (H7 is rejected), as compensation exerts a dominant direct effect on sustainable cooperative performance.

Table 11. Mediation Test Results (Indirect Effect)

Pathway	Coefficient (O)	T-Statistics	P-Value	Conclusion
Competence → Employee Engagement → Sustainable Cooperative Performance	0,137	2,251	0,012	Significant (Partial Mediation, H6 accepted)
Compensation → Employee Engagement → Sustainable Cooperative Performance	0,152	1,632	0,051	Insignificant (Not Mediating, H7 rejected)

Source: Data processed by author (2026)

Discussion

The Effect of Competence on Sustainable Cooperative Performance

Competence has been proven to exert a positive and significant effect on Sustainable Cooperative Performance. Skill capacity, technical knowledge, and employee operational expertise are reflected in their ability to efficiently manage microfinance, cooperative governance, and member services, thereby minimizing operational risks. This finding supports the Resource-Based View (RBV) framework, which positions competence as an internal capability that is valuable, rare, and hard-to-replicate. This result aligns with the findings of Gunawan & Gunawan, (2019); Hapsari, (2023); Natsir et al., (2024); Pramudiya & Supriadi (2025); Rejeki & Widigdo (2021); as well as Shofiyah et al., (2025) all of which confirm the positive influence of competence on organizational performance.

The Effect of Compensation on Sustainable Cooperative Performance

Compensation was also proven to exert a positive and significant effect on Sustainable Cooperative Performance, exhibiting the largest path coefficient among the other predictor variables. Fair salary structures, target-based incentives, and welfare benefits motivate employees to deliver their best efforts while simultaneously functioning as a rare human resource retention capability for the organization. This finding confirms the empirical results of Ambarwati et al., (2023); Ampong (2024); Anggara & Kasmir (2025); Masud et al., (2025); as well as Widigdo & Ali (2025).

The Effect of Employee Engagement on Sustainable Cooperative Performance

Employee Engagement exerts a positive and significant effect on Sustainable Cooperative Performance. Emotional attachment, pride, and employee dedication drive extra-role behaviors for the sustainability of the cooperative. From an RBV perspective, engagement is treated as an intangible psychological asset that is valuable, rare, and nonsubstitutable. This finding is consistent with Mishra et al., (2024); Saimin et al., (2024); Saputra & Permana (2022); as well as Vovk & Vovk (2024).

The Effect of Competence and Compensation on Employee Engagement

Competence and compensation individually exert positive and significant effects on Employee Engagement. Competent employees tend to possess higher self-efficacy, which transforms into emotional work engagement (Isah et al., 2022; Leweinzky, 2026; Pramudiya & Supriadi, 2025). Meanwhile, fair and transparent compensation policies foster a perception of being valued, which cultivates employee commitment and engagement (Anggara & Kasmir, 2025; Siregar & Wardhani, 2023).

The Mediating Role of Employee Engagement in the Effect of Competence on Sustainable Cooperative Performance

The mediation test results indicate that Employee Engagement partially mediates the effect of Competence on Sustainable Cooperative Performance. This suggests that employee technical competence is channeled both directly and indirectly through the strengthening of work engagement prior to impacting performance. This outcome aligns with previous studies by Fadhilah et al., (2026); Salsabila & Lo (2023); Sanela et al., (2026); Suryawati & Nugraha (2024).

The Mediating Role of Employee Engagement in the Effect of Compensation on Sustainable Cooperative Performance

Conversely, Employee Engagement fails to mediate the effect of Compensation on Sustainable Cooperative Performance; the impact of compensation is predominantly direct, without requiring the prior formation of emotional engagement. This phenomenon is presumably linked to the nature of financial compensation as a hygiene factor that prevents dissatisfaction but does not necessarily generate long-term motivation—particularly within cooperative career structures that tend to be limited for non-founding professional staff. While this finding diverges from the majority of prior studies, such as Anggara & Kasmir, (2025); Salsabila & Lo (2023); and Siregar & Wardhani (2023), but aligns with Malek et al., (2025); Nurdin et al., (2025); Rehman & Solikhah (2023) and Suwondo, (2025) , who observed that psychological mediating variables can become non-significant when the direct effect of the primary variable is overwhelmingly strong.

CONCLUSION

Both competence and compensation exert positive and significant effects on sustainable cooperative performance as well as employee engagement; furthermore, employee engagement positively and significantly impacts sustainable cooperative performance. Employee engagement partially mediates the effect of competence on sustainable cooperative performance, but fails to mediate the effect of compensation, as compensation exerts a dominant direct impact without necessitating the prior formation of an emotional bond. These findings reinforce the Resource-Based View (RBV) framework, which positions competence, compensation, and employee engagement as internal resources that are valuable, rare, inimitable, and non-substitutable (VRIN) for sustaining the cooperative's competitive advantage.

Based on these findings, it is recommended that the management of KSPPS BMT Alhikmah Semesta prioritize the enforcement of integrity and work ethics as a key pillar of employee competence development through continuous training on good governance and fraud risk mitigation. Management should also refine the wage structure and scale based on fairness principles by conducting periodic job evaluations to ensure alignment between workload and compensation. Additionally, management is advised to adopt leadership styles that emphasize appreciation for employee achievements and formulate long-term strategic plans that balance financial targets with operational risk management, including the integration of service digitalization and Environmental, Social, and Governance (ESG) principles. Future research is encouraged to explore contextual and leadership variables—such as transformational leadership, organizational culture, or perceived organizational support—alongside non-HR strategic variables like service digitalization, risk management, intellectual capital, and good cooperative governance to provide a more comprehensive understanding of the determinants of cooperative business sustainability.

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