American Journal of Economic and Business Management
e-ISSN: 2835-5199
Vol. 5 No. 8 August 2026

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

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Keywords:
competence; compensation; employee engagement; sustainable cooperative performance.

Abstract

This study aimed to analyze the effects of employee competence and compensation on sustainable cooperative performance, with employee engagement as a mediating variable at KSPPS BMT Alhikmah Semesta. Based on Resource-Based View (RBV) theory, human resources were positioned as strategic internal organizational assets. This causal quantitative study employed a survey method involving the cooperative's employee population. The sample was determined using purposive sampling, with the criteria of active employment, a minimum tenure of one year, and exclusion from top management, resulting in a final sample of 203 valid respondents. Data were collected using a five-point Likert-scale questionnaire and analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS 4.1.1.8. The results showed that competence, compensation, and employee engagement had positive and significant effects on sustainable cooperative performance. Competence and compensation also had positive and significant effects on employee engagement. Employee engagement partially mediated the effect of competence on sustainable cooperative performance but did not mediate the effect of compensation on sustainable cooperative performance because compensation exerted a dominant direct effect. This study contributes theoretically to the RBV literature and provides practical insights for cooperative management in formulating sustainable human resource strategies.

INTRODUCTION

Savings and Loan Cooperatives (KSPs) play a strategic role in expanding access to financing for micro, small, and medium-sized enterprises (MSMEs) that remain underserved by formal banking institutions, particularly as the national share of bank lending allocated to MSMEs remains below 20%. However, the overall performance of Indonesia's cooperative sector remains relatively low, contributing less than 1% to gross domestic product (GDP). Based on credit-scoring rankings issued by the Government Investment Agency (PIP) as of February 2026 for 48 partner KSPs, most cooperatives were classified within the medium- to low-performance categories (BBB to C). The assessment used a credit-scoring instrument based on indicators such as nonperforming loans (NPLs), the debt-to-equity ratio (DER), operating expenses to operating income (BOPO), return on assets (ROA), operating profit, and probability of default based on the Altman Z-Score. Among these partners, KSPPS BMT Alhikmah Semesta consistently remained in the lowest performance category (Rank C) for 13 consecutive months. This persistent performance stagnation indicates fundamental challenges in 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) represent a strategic asset that can provide organizations with a sustainable competitive advantage (Pahira & Rinaldy, 2023). Drucker, as cited in Kaswan (2022), emphasized that HR constitutes one of the most crucial assets for achieving competitive advantage, whereas Bernardin and Russell, as cited in Putri (2025), positioned organizational capability—derived from HR management practices—as one of the mechanisms that create competitive uniqueness. Conversely, suboptimal implementation of HR management can reduce productivity, increase human error, and weaken an organization'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 increasingly shifted toward flatter and more collaborative structures. Employee engagement has therefore become a critical factor in fostering a productive and innovative work environment. Pre-survey results involving 30 KSP employees revealed that compensation, with 60% of respondents expressing dissatisfaction, and employee competence, with 53.33% indicating suboptimal conditions, were identified as the two most critical problem areas.

Previous research has demonstrated that HR competence has a positive and significant effect on organizational performance (Ambarwati et al., 2023; Groenewald, 2024; Leweinzky, 2026; Pramudiya & Supriadi, 2025; Rehman & Solikhah, 2023). Conversely, Widigdo and Mardian (2024) stated that competence, as reflected in the human capital dimension, did not significantly affect organizational performance. Similarly, Wardhana et al. (2026) reported no significant effect of competence on organizational performance.

According to Sismiati et al. (2025), adequate compensation significantly improves organizational performance. Consistent findings were also reported by Ambarwati et al. (2023), Ampong (2024), and Masud et al. (2025). In contrast, Nurdin et al. (2025) found that compensation had no direct effect on organizational performance. Similarly, Irani et al. (2023) reported that compensation mediated by job satisfaction did not significantly affect organizational performance.

Studies by Mansor et al. (2023), Mishra et al. (2024), Poorani and Pradap (2024), and Saputra and Permana (2022) demonstrated that employee engagement had a positive and significant effect on employee and organizational performance. High levels of employee engagement can therefore contribute directly to improved organizational performance. In contrast, Budiarto et al. (2023) found that employee engagement had a negative and nonsignificant effect on employee performance, which may ultimately influence organizational performance.

Previous studies by Fadhilah et al. (2026), Leweinzky (2026), and Fajrin et al. (2025) indicated that employee competence had a positive and significant effect on employee engagement, which subsequently contributed to improved organizational performance. Conversely, Prayogi et al. (2023) reported no significant relationship between career competence and employee engagement.

Furthermore, Ferine et al. (2023), Hart-Akinsola and Wahua (2026), and Rahman et al. (2024) demonstrated that both monetary and nonmonetary compensation significantly influenced the extent of employee engagement within organizations. In contrast, Hendriks et al. (2023) and Malek et al. (2025) found that compensation did not significantly influence employee engagement.

Based on the identified phenomenon gap and pre-survey findings, further research is needed to examine the effects of employee competence and compensation on sustainable cooperative performance, with employee engagement as a mediating variable. Accordingly, this study aims to examine the effects of competence and compensation on sustainable organizational performance through the mediating role of employee engagement, particularly within the context of savings and loan cooperatives. The findings are expected to provide practical recommendations for strengthening HR management and governance in cooperatives while contributing to the development of knowledge within the Islamic microfinance ecosystem.

METHOD

This study employed a quantitative research method with a causal approach (Fateqah & Nuswardhani, 2024) to examine the effects of employee competence and compensation on sustainable cooperative performance, with employee engagement as a mediating variable. The study included competence and compensation as independent variables, sustainable cooperative performance as the dependent variable, and employee engagement as the mediating variable. Data were collected using a structured five-point Likert-scale questionnaire and analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS 4 to assess the direct and indirect relationships among the latent variables.

Table 2. Variable Operational

Variable	Indicators	Code
Competence (X1) (Ahmad et al., 2022) dan (Guo et al., 2024)	1. Understanding of regulations 2. Understanding of disbursement procedures 3. Acumen in credit feasibility analysis 4. Mastery of information systems 5. Mastery of digital reporting systems	C

Variable	Indicators	Code
	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 comprised all employees of KSPPS BMT Alhikmah Semesta, excluding top management. Participants were selected using purposive sampling based on active employment status, a minimum tenure of one year, and exclusion from top management positions. The minimum sample size was calculated using Slovin's formula with a 5% margin of error, resulting in a minimum requirement of 146 respondents. Online questionnaires were distributed through Microsoft Forms, yielding a final sample of 203 valid respondents after screening. Secondary data were obtained from PIP internal documents, academic literature, and relevant scientific journals.

Before the main data collection, a pilot study involving 30 employees from four PIP partner cooperatives in West Sumatra was conducted with institutional authorization under PIP Official Letter Number S-21/IP/IP.2/2026. The pilot test and supporting interviews indicated that the 24 questionnaire items were clearly understood and relevant to the cooperative context, supporting the instrument's suitability for the main data collection.

The data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM), including assessment of the measurement model, validity and reliability, the structural model, hypothesis testing, and mediation analysis. Based on the conceptual framework, the study tested whether employee competence, compensation, and employee engagement affected sustainable cooperative performance; whether competence and compensation affected employee engagement; and whether employee engagement mediated the effects of competence and compensation on sustainable cooperative performance.

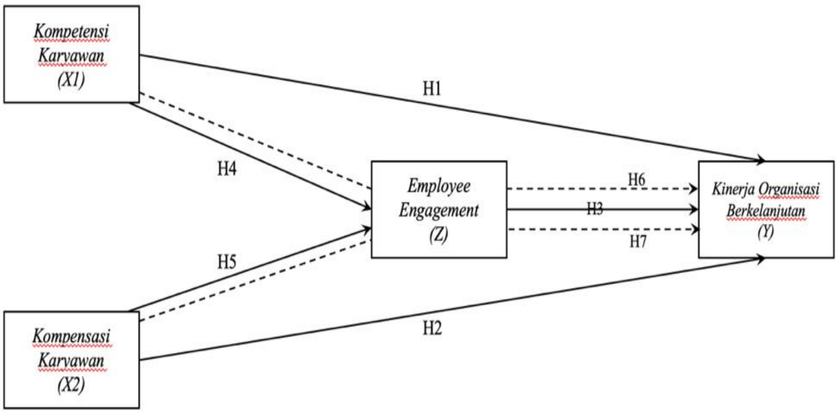

Figure 1 . Research Conseptual Framework

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

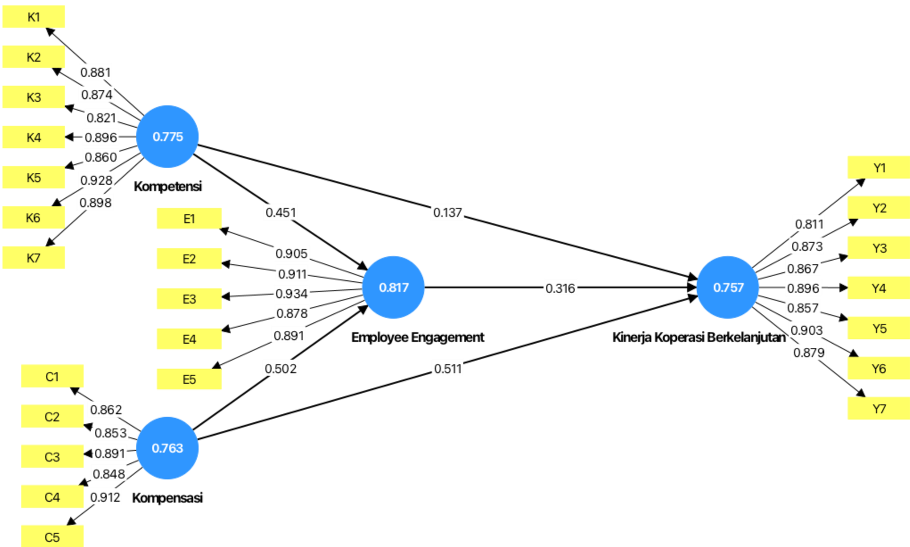

Figure 2. Outer Model Measurement (Loading Factor and AVE)

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
Sustainable Cooperative Performance	0,940	0,942	0,952	Reliable

Construct	Cronbach's Alpha	Rho_A	Composite Reliability	Remarks
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 R^2 = 0.763). Furthermore, Competence, Compensation, and Employee Engagement simultaneously account for 78.2% of the variance in Sustainable Cooperative Performance (Adjusted R^2 = 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)

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 had positive and significant effects on sustainable cooperative performance and employee engagement. Furthermore, employee engagement had a positive and significant effect on sustainable cooperative performance. Employee engagement partially mediated the effect of competence on sustainable cooperative performance but did not mediate the effect of compensation, indicating that compensation exerted a stronger direct effect without requiring the prior development of employee engagement. These findings support the Resource-Based View (RBV), which positions competence, compensation, and employee engagement as strategic internal resources that can contribute to sustaining the cooperative's competitive advantage.

Based on these findings, the management of KSPPS BMT Alhikmah Semesta is encouraged to prioritize integrity and work ethics as key components of employee competence development through continuous training in good governance and fraud risk mitigation. Management should also refine its wage structure and pay scale based on principles of fairness by conducting periodic job evaluations to ensure alignment between workload, responsibilities, and compensation. In addition, management is advised to adopt leadership practices that recognize employee achievements and to formulate long-term strategic plans that balance financial objectives with operational risk management, including the integration of service digitalization and Environmental, Social, and Governance (ESG) principles. Future research should examine contextual and leadership variables, such as transformational leadership, organizational culture, and perceived organizational support, alongside non-HR strategic factors, including service digitalization, risk management, intellectual capital, and good cooperative governance, to provide a more comprehensive understanding of the determinants of sustainable cooperative performance.

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