

## EFFECT OF HUMAN CAPITAL MANAGEMENT DRIVERS ON ORGANIZATIONAL PERFORMANCE IN KENYA

### A CASE OF INVESTMENT AND MORTGAGES BANK LTD

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#### ABSTRACT

*The skills and capacities that reside in people that are put to productive use can be a more important determinant of the nation's long term economic success and that of an organization. In Kenya, the contribution of the financial sector to Gross Domestic Product has remained unstable and showing slow growth. The sector also recorded a slow growth of 6.5 per cent in 2012 compared to 7.8 per cent in 2011. Investment and Mortgages Bank strive to achieve the best globally through effective utilization of human capital management drivers to attain sustainable competitive edge in the highly and globally competitive banking industry. The Bank's outstanding operational efficiency maintained at 34.8 per cent, making it one of the best in the Kenyan Banking Industry. The Bank's success relies heavily on human capital management drivers such as leadership practices, employee engagement, knowledge accessibility, learning capacity and workforce optimization. The main objective of the study was to establish the effect of human capital management drivers on organizational performance. The specific objectives are to: determine the effect of leadership practices, identify the effect of employee engagement, establish the effect of knowledge accessibility, investigate the effect of workforce optimization and determine the effect of learning capacity on organizational performance. The study was anchored on theory of Resource based view, human capital theory, goal theory and contingent leadership theory. The study adopted a case study research design and stratified random sampling. Qualitative and quantitative technique of data analysis was used. The study concludes that it is possible to use human capital management drivers to benchmark organizational capabilities, identify human capital management strengths and weakness, and link improvements in specific human capital management practices with improvements in organizational performance and obtain sustainable competitive edge.*

**Key words:** Human Capital, Human Capital Management Drivers and Organizational Performance

## INTRODUCTION

According to Odhong *et al.*, (2013), human capital was defined by Bontis *et al.*, (1999) cited in Baron and Armstrong (2007) as the combined intelligence, skills and expertise that gives the organization its distinctive character. This concept of Human Capital (HC) was initially formulated by Theodore Schultz in the early 1990, as a way of explaining the advantages of investing in education on a national scale (Afiouni, 2013) cited in Odhong and Were (2013). According to Omolo (2007), the concept of human capital has played an important role in the neoclassical analysis of labour markets. This is in particular in regard to the role it plays in wage determination. It has also come to dominate the economic analysis of the education. The emphasis on human capital in organizations reflects the view that market value depends less on tangible resources, but rather on intangible ones, particularly human resources (Kulvisaechana, 2006).

Human Capital Management is concerned with obtaining, analysing and reporting on data that informs the direction of value adding strategic, investment and operational people management decisions at corporate level and at the level of frontline management (Baron *et al.*, 2007) cited in Odhong *et al.*, (2013). The organizations strength and weaknesses in human capital management can be assessed by monitoring performance of HCM drivers and general, improvement or declines in organizations performance can be tied directly to improvements or decline in HCM practices (Bassi *et al.*, 2007). HCM drivers act as a catalyst for an effective human resource management. The HCM drivers influence how the process is used to generate particular outcomes. Research has shown that approaches will differ between organizations depending on their panned outcomes (Baron *et al.*, 2007). HCM drivers discussed in this study includes: leadership practice, employee engagement, knowledge accessibility, workforce optimization and learning capacity (Bassi *et al.*, 2007).

### Statement of the Problem

Human Capital Management is a key business initiative in the present globalised market place. Without insight into workforce and talent needs, organizational performance suffers. To align with critical and emerging business goals and metrics, the banking industry has to ensure that Human Resource has a strong understanding of the organization's emerging and core business issues and key metrics and performance indicators to determine what Human Resource - related data will be most useful in aligning and driving business performance (Global Human Capital Trend, 2014). According to CedarCrestone (2012), organizations with workforce management applications have 33 per cent higher operating income growth. The organization's success hence relies heavily on human capital management drivers, which includes: leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity.

Kenya's economic growth showed a slow growth from 4.6 per cent in 2012 to 4.70 per cent in 2013. The contribution of the financial sector to Gross Domestic Product (GDP), has also remained unstable. In 2010, for example, the contribution to GDP was 5.6 per cent; in 2011

increased to 6.3 per cent and in 2012, decreased to 5.2 per cent. The sector also recorded a slow growth of 6.5 per cent in 2012 compared to 7.8 per cent in 2011 (Republic of Kenya, 2013).

Investment and Mortgages Bank strive to achieve the best globally and be global leader through effective utilization of human capital management drivers to attain sustainable competitive edge in the highly and globally competitive banking industry. The Bank's outstanding operational efficiency maintained at 34.8 per cent, making it one of the best in the Kenyan Banking Industry (<https://www.imbank.com/about-us/annual-reports>).

### General Objective

To establish the effect of human capital management drivers on organizational performance.

### Specific Objectives

The specific objectives of the study are to:

- i. Determine the effect of leadership practices on organizational performance at I & M Bank.
- ii. Identify the effect of employee engagement on organizational performance at I & M Bank.
- iii. Establish the effect of knowledge accessibility on organizational performance at I & M Bank.
- iv. Investigate the effect of workforce optimization on organizational performance at I & M Bank.
- v. Determine the effect of learning capacity on organizational performance at I & M Bank.

## LITERATURE REVIEW

### Theoretical review

Theories are formulated to explain, predict and help in understanding phenomenon and in many cases to challenge and extend existing knowledge within the limits of the critical bounding assumptions (David, 2009). According to the researcher, the link between human capital and performance is based on the following theoretical strands discussed below:

### Resource Based View

Resource Based View (RBV) was articulated into a coherent theory by Wernerfelt (1984). The theory states that the organizational resources and capabilities that are rare, valuable, non-substitutable, and imperfectly imitable form the basis for a firm's sustained competitive advantage. RBV suggests that the firm can secure a sustained competitive advantage through facilitating the development of competencies that are firm specific, produce complex social relationship; are embedded in a firm's history and culture, and generate tacit organizational knowledge (Odhong *et al.*, 2013). This theory recognizes human capital as the most valuable, non-substitutable and imperfectly imitable resource that a firm can successfully utilize to achieve organizational productivity and competitiveness. Resource-based theory is linked to human

capital theory in that they both emphasize that investment in people adds to their value to the firm (Baron and Armstrong, 2007).

### Human Capital Theory

The origin of human capital goes back to emergence of classical economics in (1776) and thereafter developed a scientific theory. The idea of investing in human capital was first developed by Adam Smith (1776), who argued in the Wealth of Nations that differences between the ways of working of individuals with different levels of education and training reflected differences in the returns necessary to defray the costs of acquiring those skills. Economists such as Elliot (1991) developed the theory of human capital. He is concerned with human capital in terms of the quality, not quantity, of the labour supply. (Baron and Armstrong). After the manifestation of that concept as a theory, Schultz (1961) recognized the human capital as one of the important factors of national economic growth in the modern economy (Dae-bong, 2009).

The theory argues that a person's formal education determines his or her earning power. Human capital theory holds that it is the key competences, skills, knowledge and abilities of the workforce that contributes to organizations competitive advantage. It focuses attention on resourcing, human resource development, and reward strategies and practices. According to Human Capital Theory, education is an investment because it is believed that it could potentially bestow private and social benefits. Human capital theorists believe that education and earning power are correlated, which means, theoretically, that the more education one has, the more one can earn, and that the skills, knowledge and abilities that education provides can be transferred into the work in terms of productivity (Dae-bong, 2009).

### Conceptual framework

Conceptual framework is a pictorial representation where, descriptive categories are systematically placed in a broad structure of explicit propositions, statements or relationships between two or more empirical properties to be accepted or rejected (Were, 2013 In figure 1, the organizational performance is the dependent variable and the leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity are the independent variables.

### Independent Variables

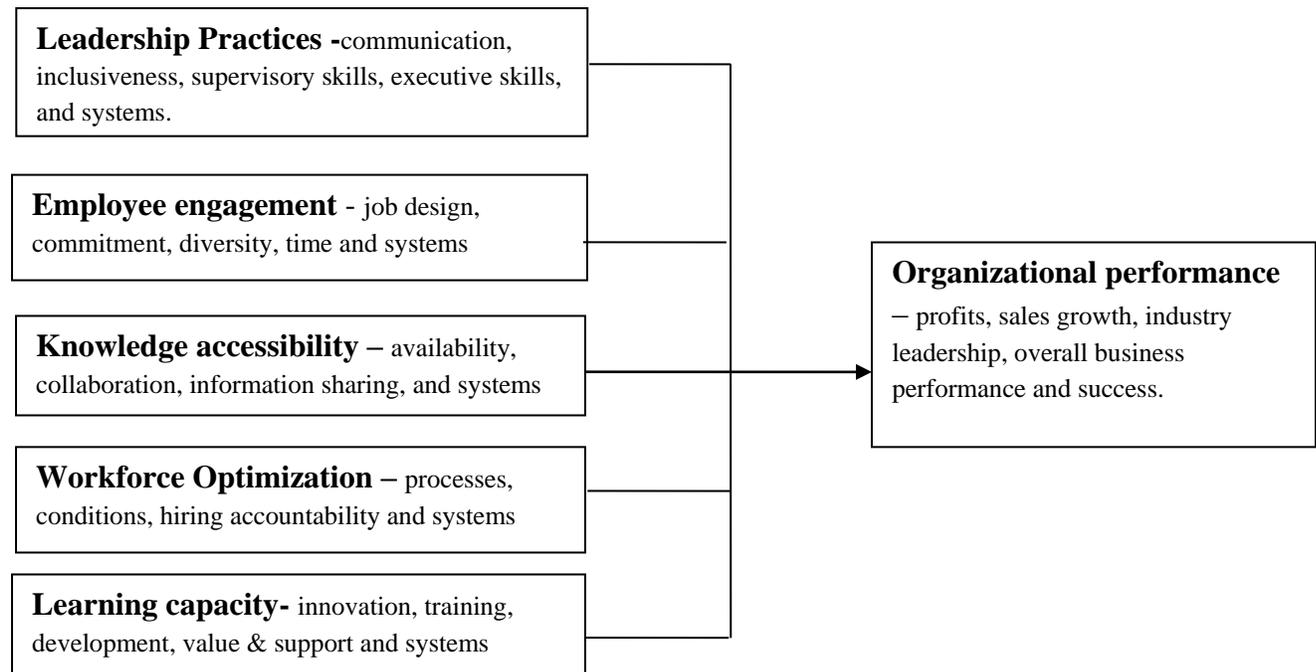


Figure 1: Conceptual framework

### Empirical Review

A research study conducted in 2010 by CFO Research Services reveals that human capital issues as a key culprit in failed and subsequent financial woes. In this survey of Finance and HR executives, the researchers explored how organizations are handling human capital issues related to transactional activity. The results of the study suggested that HR offers unique value and guidance, particularly in relationship to managing and pricing human capital assets which can significantly contribute to successful pre-and post transformational events (Hewitt, 2010).

McMurrer developed a system that allows executives to assess HCM and to use those metrics both to predict organizational performance and to guide organizations' investments in people. The framework is based on a core set of HCM drivers that fall into five major categories: leadership practices, employee engagement, knowledge accessibility, workforce optimization, and organizational learning capacity. By employing rigorously designed surveys to score a company on the range of HCM practices across the five categories, it's possible to benchmark organizational HCM capabilities, identify HCM strengths and weaknesses, and link improvements or back-sliding in specific HCM practices with improvements or shortcomings in organizational performance (Bassi *et al.*, 2007).

Bassi *et al.*, (2007) conducted a study on Human Capital and Organizational Performance: Next Generation Metrics as a Catalyst for change. The survey focused on the relationship between HCM metrics (for example, employee turnover rate) and subsequent organizational performance. The survey conducted across American Standard Organizations and results generalized. The empirical research revealed a core set of HCM drivers that predict performance are leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity.

Nzuve *et al.*, (2012) conducted a study on Human capital management practices adopted by the National Social Security Fund. The main objective of the study was to determine the extent to which Kenya National Security Fund (NSSF) had adopted the HCM practices. The study used the case study design that was based on a target population of 98 management staff in the human resource and administration department. Both content and quantitative analysis were used to analyze data. The researcher found that NSSF had implemented HCM practices but to a negligible extent. Some of HCM practices at NSSF includes: enhancing the organization's capacity through staff training and development and setting of clear performance standards

Bassi *et al.*, (2008) cited in Jamal (2011) suggested that HCM indicators have relationship with outcome of the organization and enhancement in skill level of individual, improvement in human capital management and elimination of information deficiencies will be used as policy objectives to compete in knowledge era. Royal Bank of Scotland (RBS) Group, for example, is an acknowledged leader in the field of human capital management that has retained consistency of HCM reporting and measurement from HR that has a significant focus on business impact (<http://www.accountingweb.co.uk>).

Royal Bank of Scotland recognizes that if it is to deliver its goal of being 'the world's most admired bank' and outperform others in the sector, the contribution and performance of its staff is the key differentiator. To achieve this objective, RBS places considerable importance on having HR policies in place that impact positively on staff. The Bank has been able to show that by improving employee engagement, measurable improvements in business performance and profit levels can result (Thomson, 2007).

Nzuve and Bundi (2012) conducted a study to determine the relationship between human capital management practices and performance of Commercial Banks in Kenya. The researchers used a cross sectional survey design as well as a correlation research. The study concluded that most commercial banks adopt human capital management practices to an average degree. The study further concludes that human capital management practices generally have a positive influence on performance as measured by both turnover growth and return on assets.

Olufemi (2009) conducted a study on human capital development practices and organizational effectiveness: A focus on the contemporary Nigerian Banking Industry. The main purpose of the study was to gain a better understanding of the theoretical and empirical relationship between Human Capital Development (HCD) practices and some dimension of organizational effectiveness of Nigerian Banks particularly after the banking sector reforms of June 2004.

Responses from survey were analysed using descriptive statistics and Pearson product movement correlation. The study found that involvement in HCD practices are found to correlate positively with organizational effectiveness.

## METHODOLOGY

The study adopted the case study as research design for this study. According to Kothari (2006), case study design is a way of organizing data and looking at the object to be studied as a whole. The study was conducted at I&M Bank head office branch that has a total workforce of 325 out of 681 distributed in 21 branches located in business and residential locations at all major financial centres in Kenya. Were (2013) argued that there are certain non-definite practices among social workers that a study can adopt and such practice suggest that if population is a few hundreds, 40 per cent or more sample will do; if many hundreds a 20 per cent will do; if above one thousand a 10 per cent will do and if several thousand a 5 per cent or less sample will do. The study takes 40 per cent of the total population of 325, which is 130 as population sample to be studied. The 130 employees was stratified and selected randomly. The stratified random sampling involves dividing the population into homogenous subgroups then taking a simple random sample from each group (Kombo and Tromp, 2006).

## RESULTS

Table 12 gives a summary of the results of correlation analysis. The variables considered were leadership practices, employee engagement, knowledge accessibility, workforce optimization, learning capacity and organizational performance.

**Table 12: Result of Correlation analysis for HCM drivers and organizational performance**

| Variable | Leader practices | Employee Engagement | Knowledge accessibility | Workforce optimization | Learning capacity | Organizational performance |
|----------|------------------|---------------------|-------------------------|------------------------|-------------------|----------------------------|
|----------|------------------|---------------------|-------------------------|------------------------|-------------------|----------------------------|

|                            |         |         |         |         |         |       |
|----------------------------|---------|---------|---------|---------|---------|-------|
| Leadership practices       | 1.0000  |         |         |         |         |       |
| Employee engagement        | 0.8598  | 1.0000  |         |         |         |       |
| Knowledge accessibility    | -0.7044 | -0.2710 | 1.0000  |         |         |       |
| Workforce optimization     | -0.5526 | -0.1050 | 0.741   | 1.0000  |         |       |
| Learning capacity          | 0.9247  | 0.8535  | -0.4902 | -0.5110 | 1.000   |       |
| Organizational performance | 0.0460  | -0.3437 | -0.6624 | -0.3055 | -0.1277 | 1.000 |

The results of the analysis show that there is a positive correlation between leadership practices and employee engagement. The correlation coefficient between the two variables was 0.86 implying a strong positive correlation between the two variables. Leadership practices entail effective communication, inclusiveness, executive skills, supervisory skills and systems. Positive attributes of these elements of leadership practices promotes effective employee engagement which is manifested in the work being effectively organized, the organization making good use of employees talents and skills, employees feeling secure in their jobs and recognized and the organization systems are aligned to rewarding and retaining good performers. The finding of the study is in tandem with the results of Jamal (2011) that leadership practices of the firm have a high significant correlation ( $r=0.74, p<.01$ ) with the organization performance.

The results presented in table 4.11, also indicates that there is a strong negative correlation between leadership practices and knowledge accessibility of the staff at I&M Bank. The correlation coefficient is -0.70. This finding is consistent with the results of the interviews conducted which indicated that most of the employees at the Bank do not have adequate necessary manuals and procedures and the tools necessary to do their jobs. Also information sharing was weak thereby undermining sharing, dissemination and feedback on best work improvement practices across the departments. Overall knowledge management systems that are useful in collecting information and making it available to employees were not in place. The results of this study is consistent with the results of Jamal (2011), that indicated a positive correlation between knowledge accessibility and organizational performance ( $p<0.05$ ), for employees and executive data set with ( $r=0.2, 0.62, p<0.01$ ). Huselid (2005) also found that knowledge accessibility and information sharing included in factor of employee skills and organization structure show a significant correlation with organizational performance.

The negative correlation between leadership practices and knowledge accessibility is also reflected in the negative correlation between employee engagement and knowledge accessibility. The correlation coefficient between the two variables is -0.27, implying a weak negative relationship. This is consistent with the finding on leadership practices and knowledge accessibility since weak employee engagement undermines knowledge accessibility. This result

is in tandem with Jamal (2011) results showing that employee engagement is highly significantly correlated ( $r=70, p<01$ ) with organizational performance.

The study results show that there is strong negative relationship between leadership practices and workforce optimization, but a weak negative relationship between employee engagement and workforce optimization. The estimated correlation coefficient between the variables are -0.55 and -0.11 for leadership practices and employee engagement when contrasted with workforce optimization, respectively. This implies that the processes and procedures for workforce optimization and employee engagement are weak in the organization. However, the correlation coefficient between knowledge accessibility and workforce optimization was found to be positive and strong. The estimated correlation coefficient was 0.74. This implies that the workforce optimization processes and procedures implemented at the I&M Bank supports knowledge accessibility within the organization.

The results presented in table 12 illustrate existence of strong and positive correlation between leadership practices, employee engagement and learning capacity. Leadership practices and learning capacity reveal a positive correlation coefficient of 0.92 implying that the two variables are moving in the same direction. This means that the leadership practices at the I&M Bank positively contribute to employee's learning capacity in terms of promoting innovation valuing learning and that a learning management system that automates the administration all aspects of training, learning events and competency management are in place. The correlation coefficient between employee engagement and learning capacity is positive and strong at 0.85, this implies that job designs, security of employees, optimal workloads and strategies to retain good performers is adding value to the organizations learning capacity.

The results presented in table 12 show that knowledge accessibility has a fairly strong relationship with organizational performance. The estimated correlation coefficient is -0.66. However, leadership practices, employee engagement, workforce optimization and learning capacity all have a weak relationship with organization performance. This is manifested in the estimated correlation coefficient of the respective variables, which are all less than 0.5.

The findings confirm that earlier observations made by Ramsey, *et al.* (2000), Guest *et al.*, (2003) and Armstrong (2010) cited in Ng'ang'a (2014), they were contented HRM is known as the central business concern, that shapes the behavior, attitudes, and performance of the employees, hence, HCM drivers are important tools for determining organizational performance.

The findings of this study reveal that the HCM drivers have a significant positive relationship with organizational performance with leadership and learning capacity taking the lead as the most important indicator and driver in achieving sustainable organizational performance. The study results also consistent with the results of Global Human Capital Trend (2014) that reveals leadership as the number one priority that enhance performance in the global trends survey.

The study result also consistent with that of Bassi *et al.* (2007) who suggested that HCM drivers have relationship with outcome of the organization and enhancement in skill level of individual, improvement in human capital management and elimination of information deficiencies will be used as a policy objectives to compete in knowledge era.

### Effect of HCM Drivers on Organizational Performance

Table 13 gives a summary of the regression results on the effect of HCM drivers on organizational performance. The results presented in table 13 shows that leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity jointly determine organizational performance at the I&M Bank. The F-statistic, which is a measure of joint determination has an estimated value of 5.66 and a probability statistic of 0.0002 (Prob > F=0.0002). This means that the five independent variables are jointly important in explaining the changes in organizational performance at the I&M Bank. The Adjusted R-squared is 0.2092 which means that the model explains 20.92 per cent of the changes in the organizational performance at the I&M Bank.

**Table 13: Regression result of effect of HCM Drivers on Organizational Performance**

| Variable                | Coefficient | Standard error | t-statistic | p-value |
|-------------------------|-------------|----------------|-------------|---------|
| Leadership Practices    | 0.2449      | 0.1020         | 2.40        | 0.012   |
| Employee Engagement     | 0.5132      | 0.1607         | 3.19        | 0.002   |
| Knowledge Accessibility | 0.4757      | 0.1564         | 3.04        | 0.003   |
| Workforce Optimization  | 0.4416      | 0.1073         | 4.11        | 0.000   |
| Learning Capacity       | 0.2516      | 0.1101         | 2.29        | 0.025   |
| Constant                | 0.3214      | 0.8267         | 0.3888      | 0.156   |
| Number of Observations  | 89          |                |             |         |
| F-statistic             | 5.66        |                |             |         |
| Prob > F                | 0.0002      |                |             |         |
| Adjusted R-squared      | 0.2092      |                |             |         |

The regression result presented in table 13, shows that leadership has a positive relationship with organizational performance. The coefficient of this variable is 0.2449 with a t-value of 2.40. According to the results the coefficient of this variable is statistically significant at 5 per cent level of significance. According to research conducted by the Work Foundation, involving 260 in depth interviews conducted with 77 business leaders from six high-profile organizations, found that outstanding leaders are highly motivated to achieve excellence and are focused on organizational outcomes, vision and purposes. The leaders also understand that they cannot create performance themselves but are conduits for performance through their influence on others (Armstrong, 2012).

The regression results show that employee engagement and organizational performance move in the same direction. According to the estimation, the coefficient for employee engagement is 0.5132. The parameter estimate has a t-value of 3.19 and a p-value of 0.002. This implies that the

coefficient of the variable is statistically significant at 1 per cent level of significance, thereby confirming that employee engagement is an important determinant of organizational performance. The study result is in tandem with Alfes *et al.*, (2010) cited in Armstrong (2012) who concluded that engaged employees perform better, are more innovative and are more likely want to stay with their employers, enjoy greater levels of personal well being and perceive their work load to be more sustainable. The result also consistent with Tzafirir (2006), who concluded that the aim of employee engagement practice is to improve the relationship between employees, the organization, teams, and work requirements, so as to create a better work environment.

The estimation results show that there is a positive relationship between knowledge accessibility and organizational performance. According to the estimation results, the coefficient of this variable is 0.4757. The parameter estimate has a t-statistic of 3.04 and a corresponding p-value of 0.003. This implies that the coefficient of the variable is positive and statistically significant at 1 per cent level of significance. The results, therefore, indicate that knowledge accessibility is an important determinant of organizational performance. This result is in line with Armstrong (2010), who found that innovation and knowledge transfer will in the long run help firms reduce costs, enhancing quality, and differentiating their products and services. This result is consistent with the result suggested by Seliem, Ashour and Bontis (2006) cited in Jamal (2011) that organizational performance in knowledge intensive industry was influenced strongly by human capital with distinctive capabilities like high level of intelligence, creative ideas, initiation, ambition and inimitability.

According to the estimation results, workforce optimization is an important determinant of organizational performance. As illustrated in table 13 the coefficient of this variable is 0.4416. The parameter estimate has a t-statistic of 4.11 and a p-value of 0.000. This shows that the coefficient of the workforce optimization variable is statistically significant at 1 per cent level of significant. This result shows that workforce optimization is an important determinant of organizational performance.

The estimation result presented in table 13 indicates that learning capacity of employees is an important determinant of organizational performance. The estimation results show the coefficient of the variable is 0.2516 and that it is positive. The t-statistic is 2.29 while the p-value is 0.025. The estimates confirm that the coefficient of learning capacity variable is statistically significant at 5 per cent level of significance. Ma Prieto and Revilla (2006) cited in Jamal (2011), also concluded that organizational financial performance varies with the configuration of organization learning capability by using f values has significance at 0.000.

The result presented in table 13 indicates that the coefficient of the constant is statistically insignificant. This confirms that there are no other important variables that determine the changes in organizational performance that was left out in the model. It, therefore, shows that the five HCM drivers namely, leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity adequately explain the changes in organizational performance. This is consistent with the coefficient of joint determination which was estimated

at 5.66 with a probability statistic of 0.0002. This result is consistent with that of Bassi *et al.*, 2007, the study illustrated the power of HCM to drive stock performance. The study result found that the higher HCM scores predict stock returns for financial firms.

## DISCUSSION

The study sought to establish the effect of human capital management drivers on organization performance in Kenya. The study draws findings on the human capital management drivers that included leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity. The study found that there is significant relationship between HCM Drivers and organizational performance. A total of 98 questionnaires were analysed for the purpose of answering the research questions. The study utilized Bassi and Mc Murrer 's frame work of HCM measurement system by using scores, correlation and regression analysis done to come out with the research findings.

The total response rate comprised 98 respondents who were 75.38% of the total sample size. The data was reliable since a coefficient value of between 0.842 and 0.933 was obtained on all the research variables. The study results shows that majority (74.49%) of the employees of I&M Bank who responded to the study questionnaire were in the age bracket of 18-35 years, 45.29% of the employees were males, 54.08 percent were females. This shows that, a relatively larger proportion of the employees of the Bank are females. The result shows that (75.5%) of the study respondents have first degree. The 30 of the 74 are male. Out of 24 with masters, 15 are males. The study results, therefore, shows that the five HCM drivers namely, leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity adequately explain the changes in organizational performance. This is consistent with the coefficient of joint determination which was estimated at 5.66 with a probability statistic of 0.0002.

## CONCLUSION

The study concludes that leadership practices, employee engagement, knowledge accessibility, workforce optimization and learning capacity enhance organizational performance. The study also concludes that it is possible to use HCM drivers to benchmark organizational HCM capabilities, identify HCM strengths and weakness, and link improvements or backsliding in specific HCM practices with improvements or shortcomings in organizational performance.

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