

## Impacts of Islamic Human Development Policies on Productivity of Employees: An Empirical Evidence from Banking Sector of Pakistan

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**Purpose** - The purpose of this paper is to investigate the relationship among human resource development policies and employee productivity in banking sector. This paper aims at providing guidelines for policy makers to develop HR policies in the light of Islamic teachings.

**Design/Methodology/Approach** - OLS regression is run to estimate impacts of employees' financial benefits and their branch strength on their productivity and the resultant impact on profitability of banks. Pooled data of almost all the banks operating in Pakistan during 2004 to 2009 has been used in this study. Data has been collected from audited reports published by each bank.

**Findings** - Regression results pointed out that salary per employee of a bank had positive and highly significant impacts on productivity of banking sector employees. Similarly, strength of employees in a branch also contributed positively in productivity of employees. However, this factor did not show statistically significant impact.

**Originality/Value** - This study has practical significance for human development management practitioners, academia, scholars, managers and general public as it provides inferences that guide them in decision making. This study is also linked with Islamic philosophy of human resource as Islamic stresses the need of timely and appropriate payments to the employees.

**Keywords** Human Resource, Employee Productivity, Branch Strength, Islamic Human Resource, Pakistan

**Paper Type:** Research paper

### 1. Introduction

HRM is considered as important part of labor economics. Firms in contemporary environment face contradictory objectives of cost reduction and high performance. Labor payments are substantial part of cost in all the firms, but it is single largest component in service firms like banks, telecom, hospitals and academic institutes etc. where large number of workers is required. In these firms, employees have direct contact with customers. There is great need of effective human resource strategies in service sector because of

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the nature of business having concurrent delivery and receipt of product (which is service in this case) from the employee and customer, respectively. Long term profitability of firms depends on number of “completely satisfied” customers (Jones & Sasser, 1995) whereas efficient service may be provided only with the satisfied employees through supportive HR management. Companies with better HRM policies exploit competitive advantages. These policies should focus on skill development and motivation to bring about commitment towards firms’ objectives among employees (Lawler, 1986). This is even more obligatory where employees have direct influence on customers and emotional workers are needed (Gutek, 1995, Hochschild, 1983).

Islamic teachings also reinforce need of safeguarding rights of workers. These teachings provide outline for the human resource policy makers in Islamic society. Islam has strictly forbidden exploitation of workers. It is, therefore, important for Muslim employers to provide workers with the wages and other incentives up to the level they deserve.

Just like many other countries of the world, research related with HR incentives and their impact on firm performance is limited to the manufacturing sector. Banking sector is the backbone of economy of every country. Performance of banking sector significantly impacts the overall economic performance of the country. Nevertheless, performance of banking firms is extremely dependent on the working of their employees.

In Pakistan, it has been noted that bank employees have to work till late hours and under the stress of responsibility and care. They are supposed to put best of their efforts to satisfy their clients in the current culture of deposit targets assigned to bank officers in most of the banking firms. In these circumstances, the employer should take necessary steps to improve the efficiency of workers. Although plenty of research has been done on impacts of HR policies, only a few prior studies have focused on HR policies for white collar jobs like banking except for executive pays (Murphy, 1999). Current study is an attempt on finding link between profitability of banks and the benefits provided to the bank employees.

## 2. Literature Review

Before the theories of modern capitalism on HR management, Islam has described the rights of workers centuries back in the form of clear instructions in number of Quranic verses and Hadiths. Islam strictly forbids the injustice to the workers and their ruthless exploitation under the modern capitalistic system. It has provided effective safeguards to the rights of workers. On the one hand Islam urges the capitalists to discharge the rights of the workers willingly and generously and on the other hand it grants the workers the right to secure their claims and interests. Islam safeguards the rights of workers and emphasizes that workers should be paid a fair wage. Islam does not permit the employers to infringe the rights of the workers. Under the Islamic system, wage rate shall be determined in light of the Quranic principle described as:

“You should not wrong anyone nor should anyone do wrong to you” (Al Baqrah, 2:279).

Under this rule, it is imperative that the employer should pay a wage which is not less than right of the nor should the employer be forced to pay a wage rate which puts unbearable strains on the business.

In Suarah Al Jatia, Allah says:

“Allah has created the heavens and the earth with the truth in order that each living being be rewarded for what it has earned. The people shall not be wronged at all!” (Al Jatia, 45:22).

This verse lays down the rule of just wage. None should be given a wage rate which is less than his labor and share in the production. If this is done, it would be unjust and wrong. Hence in fixing wage rate it shall be kept in mind that every person should get a wage in proportion to his labor.

Similarly, Allah Almighty addresses in Surrah Ale Imran:

“The everyone shall be recompensed in full for what he earned, and none shall be dealt with unjustly” (Ale Imran, 3:161).

Above mentioned verse describes the rule on the Day of Judgment that every man shall be fully recompensed for his deeds and none shall be treated unjustly by Allah.

Prophet Muhammad (SAW) also emphasized the rights of workers in His personal conduct and multiple Haiths. He (SAW) provided guideline for the employers by saying that:

“Those who work under you are your brothers. Allah has subordinated them to you” (Mishkwat). In another Hadith He (SAW) said that: “None of you can become a believer unless he likes for his brother the same as likes for himself”. In another very famous Hadith, He (SAW) emphasized the need of prompt payment to workers by saying that: “Pay wages to worker before his sweat dries up”. He (SAW) also asked employers to deal with workers in a courteous and decent manner and avoid their humiliation because Islam considers all men equal, honorable and respectable. Holy Prophet (SAW) advised the need of tolerance, job security and forgiveness by saying that: “Even if your servant makes seventy mistakes a day, forgive him”. Further He (SAW) observed that: “Whose torments human beings Allah Almighty shall torment him”.

There exists a growing body of literature on relationship between human resource policies and performance of firms. These studies are not only related to firms but also analyze the industry specific results. Earlier, HR policies were considered as micro concern of the firms, but in current scenario, under the holistic approach, it has become industry specific issue leading to competitive advantage. It is however interesting to note that most of previous studies selected manufacturing industries to evaluate impacts of HR practices although it is a fact that service firms are more dependent on labor force.

There are different approaches, with respect to the operations, adopted by researchers for the evaluation of banking sector performance. Most prominent approaches are intermediation, production and value added approaches. In production approach, banks are considered as a firm taking some inputs and converting them into outputs just like other manufacturing firms. Intermediation approach assumes that banks are just intermediaries which facilitate in converting deposits of savers into loans for investors using labor and capital. According to value added approach, banks have the objective of value maximization. This approach considers deposits, loans and earning assets, which have value addition impact in balance sheets, as output of banks. Rose (2002) pointed out various measures as proxies to evaluate performance of banks including ROA (return on assets), ROE (return on equity), Net Interest Margin, Earning per Share, Net

Bank Operating Margins. However, ROA and ROE are most widely used proxies of performance in banking research literature. Black and Lynch (2001) provided evidence that profit sharing for non managers resulted in higher productivity in US firms. They used profit sharing, self-managed teams, job rotation, unions, TQM, benchmarking, meetings and communications as independent HRM factors. Similar results were found in a study conducted by Cappeli and Neumark (2001) which pointed out significant impact of profit sharing and self management on productivity.

Cooke (1994) conducted a study in Michigan to evaluate impact of wages on value addition of firms. He found that the firms which increased the wages were in competitive advantage because of higher increase in value addition as compared to increase in wage rate as productivity of employees increased due to their higher level of satisfaction.

In an attempt to prove relationship between satisfied employees and higher profits, Heskett et al. (1997) used data of six companies and introduced the concept of “service profit chain”. They claimed that loyal and satisfied employees play their role in developing loyal and satisfied customers whereas loyal and satisfied customers bring about higher profits to firms due to higher sales revenues.

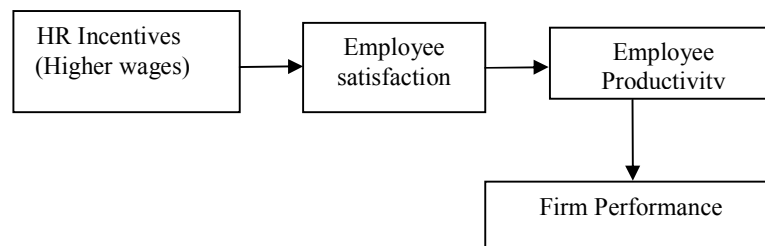
Dyer and Reeves (1995) introduced four categories of HR related performance measurement. Firstly, “employee outcome” shows impact of HR policies on behaviors of employees like turn over and absenteeism. Secondly, “organizational outcome” is related with productivity, quality, and other measures of operational performance of firm required for better profitability. Thirdly, “financial/accounting outcomes” are related with financial measures of performance like profits, revenues and costs etc. Last criterion “market-based outcomes” is related with impacts of HR practices on market value of the firm

Huselid (1995) used profitability, sales per employee and Tobin’s q ratio as measures of firm performance. He found that employee motivation and employee skills were having significantly positive impacts. Huselid and Becker (1996) also found similar results. Osterman (2006) postulated that high-performance firms pay higher wages in USA. He employed OLS to conclude that increased wages were due to higher productivity of employees.

Derely and Dotty (1996) also found positive relationship between profit sharing and employment security of loan officers on banks' ROA and ROE in USA. They used cross sectional framework for analyzing this relationship.

In the light of Islamic and modern economic theories discussed above, it may be concluded that there is need of research to find out relationship between HR policies and firm performance in banking sector of Pakistan. We may postulate that incentives to the employees motivates and satisfies them whereas motivated employees are in better position to satisfy customers and hence improve profitability of banks. Figure 1 below displays this relationship.

**Figure 1: HR Incentive- Firm Performance Model**



### **2.1 Hypotheses**

After analyzing the previous theories, we postulate that productivity of employees depends on two factors. First, the wages and incentive they are paid as it motivates them to work harder. Second, the number of employees in each branch as it leads to easy working environment in branch. Hence the following two hypotheses are tested in this study.

H1: Productivity of employees depends on the average wages and incentives they get.

H2: Productivity of employees depends on the employee strength in each branch.

## **3. Data and Methodology**

### **3.1 Source and Nature of Data**

This study utilizes secondary data available in the audited and printed annual reports of the banks working in Pakistan. Time series data ranging from 2004 to 2009 has been utilized. Data has been collected after acquiring annual reports from online sources,

branches and head offices of various banks. Cross sectional data of all the banks which exist currently without any merger or acquisition since 2004 to 2009 are pooled. Table 2 below displays descriptive statistics of variables used.

	N	Mean	Std. Deviation
EMPPROD	205	4313.40	2829.657
AVGSAL	205	567.86	391.33408
BRANCHSTRENGTH	205	23.73	22.79939

### 3.2 Model Specification

Current study introduces following model to validate the hypotheses.

$$EMPPROD = \beta_1 AVGSAL + \beta_2 BRANCHSTRENGTH + \varepsilon$$

Where

EMPPROD (EMPLOYEE PRODUCTIVITY) is measured by Total Earning / Number of Employees

AVGSAL (AVERAGE SALARY) = Total Expenses on Wages and Compensation / Number of Employees

BRANCHSTRENGTH = Number of Employees / Number of Branches

### 3.3 Methodology

Ordinary Least Square regression is used to estimate coefficients and test the hypotheses. Various previous studies including Freeman and Kleiner (2005), Huselid (1995), Ichinowski (1990), Bloom, Sadun and Van Reenen (2010), and Cooke (1994) adopted the method for analyzing impacts of HR practices on employee productivity.

## 4. Results and Findings

Table 3, Table 4 and Table 5 below show the OLS regression results calculated in SPSS software. These results indicate that average salary of employee has positive impact on their productivity. Similarly there is positive sign of regression

coefficient of branch strength which shows direct impact on employee productivity. However, it is important to note that relationship between average salary and employee productivity is statistical significant but insignificant for branch strength.

**Table 3: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.591 <sup>a</sup>	.349	.343	2293.54539

**Table 4: ANOVA<sup>b</sup>**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	5.708E8	2	2.854E8	54.258	.000 <sup>a</sup>
	Residual	1.063E9	202	5260350.452		
	Total	1.633E9	204			

**Table 5: Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1870.121	316.639		5.906	.000
	AVGSAL	4.269	.413	.590	10.341	.000
	BRANCHSTRENGTH	.797	7.086	.006	.113	.911

a. Dependent Variable:  
EMPPROD

These results are consistent with the findings of other studies on this issue (see, for example Huselid, 1995; Osterman, 2006; Cooke, 1994).

## 5. Conclusions and Recommendations

Above mentioned results point out that banking firms should adopt policies to motivate their employees. This is not only in line with the teachings of Islam to pay workers what they deserve but also it will cause an increase in employee productivity and hence better financial performance. Results also mention that banks with good wages per employee enjoyed comparative advantage in this period of tough competition among banking firms. There should be enough number of staff members in each branch to provide rationalized work burden on employees. It is therefore recommended to adopt employee friendly policies so that banking sector remains strong and stable. Moreover, these employee



friendly HR policies are coordinated with the Islamic teachings and instructions based on justice.

### NOTES & REFERENCES

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