

Leadership Perspective: Strategic HRM And Knowledge Management Capacity To Improve Organizational Innovation In The Islamic Banking Sector

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Abstract

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Purpose— This study analyses the role of Strategic Human Resource Management (Strategic HRM) and Knowledge Management Capacity in enhancing Organizational Innovation and improving organizational performance in the Islamic banking industry. Increasing competition requires Islamic banks to strengthen strategic human resource management and knowledge capabilities to sustain performance and competitiveness.

Design/methodology/approach— This study employs a quantitative approach using Structural Equation Modelling with Partial Least Squares (SEM-PLS). Data were collected through structured questionnaires from 360 employees of Islamic banks in Central Java and analysed using SmartPLS.

Findings—The results indicate that Strategic HRM has a positive and significant effect on Knowledge Management Capacity ($\beta = 0.668$; $p < 0.001$) and Organizational Innovation ($\beta = 0.339$; $p < 0.001$). Knowledge Management Capacity also significantly influences Organizational Innovation ($\beta = 0.571$; $p < 0.001$). Furthermore, Organizational Innovation significantly affects organizational performance ($\beta = 0.593$; $p < 0.001$). These findings suggest that effective strategic HR practices enhance knowledge capabilities and stimulate innovation within organizations.

Originality/value—This study contributes to the literature by integrating Strategic HRM, Knowledge Management Capacity, and Organizational Innovation within the context of Islamic banking, providing empirical evidence on how these factors interact to improve organizational performance.

Research implication/limitation—The study focuses on Islamic banks in Central Java, which may limit generalization to other regions or sectors. Future research may include broader samples and additional organizational factors.

Keywords: Strategic HRM, Knowledge Management Capacity, Organizational Innovation, Organizational Performance, Islamic Banking

JEL Classifications: M12, O31, D83



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1. Introduction

The Islamic banking sector has been one of the fastest expanding sectors of the financial industry in Indonesia. Indonesia, as the country with the world's biggest Muslim population, has huge potential for developing Islamic financial services (Aisah et al., 2024). The presence of Islamic banking institutions is expected to support financial inclusion, promote ethical financial practices, and contribute to sustainable economic growth (Muhammad & Nawawi, 2022);(Anggraeni & Yuliani, 2020);(Jermisittiparsert, 2021). Islamic banks function on the principles of Sharia, which prohibits interest (*riba*), promotes risk sharing, and favours productive economic activities. Therefore, Islamic banking has a crucial role to play not only in financial intermediation but also in fostering equitable economic development (Nurcahyo et al., 2025).

In recent years, the performance of Islamic banking in Indonesia has shown encouraging growth. Data from the Financial Services Authority (*OJK*) indicate that the total assets of Islamic banks reached approximately IDR 980.30 trillion by the end of 2024, reflecting a year-on-year growth of about 9.88 percent. In addition, Islamic banking financing increased to around IDR 643.55 trillion, demonstrating the sector's strong intermediation function in supporting economic activities. The industry's market share also increased to around 7.72 percent of the national banking sector, indicating gradual improvement despite intense competition from conventional banks (Lubis et al., 2023).

Furthermore, the growth momentum continued in 2025, where Islamic banking assets surpassed IDR 1,028 trillion, equivalent to more than USD 65 billion. This achievement represents the highest level recorded since the establishment of the Islamic banking industry in Indonesia. The sector also experienced significant increases in financing distribution and third-party funds, reflecting growing public trust in Sharia-based financial services. These developments show that Islamic banking has the potential to become a significant pillar in the national financial system (Yarsi et al., 2025). Despite this positive growth, Islamic banking in Indonesia still faces several structural challenges. One of the major issues is the relatively low market share compared to conventional banking institutions. Although the Muslim population in Indonesia reaches more than 87 percent of the total population, the penetration rate of Islamic banking remains relatively limited at around 7–8 percent. This gap highlights the discrepancy between the demographic advantage of Indonesia and the relatively slow adoption of Islamic banking services (Wiyawan et al., 2024).

Another challenge relates to the relatively low level of financial literacy and inclusion in the Islamic financial sector. According to recent reports, the literacy rate of Islamic finance in Indonesia is around 43.42 percent, while the financial inclusion rate is only about 13.41 percent, which is significantly lower than the inclusion rate of conventional financial institutions (Anin Dwita & Rozikan, 2022). This situation indicates that many people still lack adequate understanding of Islamic financial products and services, limiting the expansion of Islamic banking institutions. In addition to literacy issues, Islamic banks also face challenges related to innovation, competitiveness, and operational efficiency. Fintech platforms, digital banking and financial technology have rapidly evolved and changed the financial services market. In the digital world, Islamic banks should constantly reinvent their financial products and services to be competitive (Mergaliyev et al., 2021). Without strong organizational innovation and technological adaptation, Islamic banks may struggle to

compete with conventional financial institutions and fintech companies that offer more flexible and accessible financial services.

Human resource capability is another critical factor affecting the performance of Islamic banking institutions. The successful implementation of Islamic banking principles requires employees who not only possess professional banking competencies but also understand Sharia principles and Islamic financial contracts (Falat et al., 2023). Therefore, strategic human resource management plays an important role in developing employee competencies, fostering organizational learning, and encouraging knowledge sharing within the organization. Knowledge management capacity also becomes increasingly important in the modern banking environment (Vu, 2020).

Effective knowledge management enables organizations to create, share, and utilize knowledge to support decision-making, innovation, and Organizational Innovation. In Islamic banking institutions, knowledge management helps employees understand complex Sharia financial products, improve service quality, and enhance operational efficiency (Felfcio et al., 2014). Organizations with strong knowledge management systems tend to be more adaptive and innovative in responding to market changes.

Against this background of difficulties and opportunities, it is important that Islamic banking institutions increase their strategic human resource management and knowledge management capabilities to improve organisational innovation and performance (Guruh et al., 2025). By integrating these strategic capabilities, Islamic banks can enhance their competitiveness, improve service quality, and support sustainable growth in the Islamic banking industry in Indonesia (Dakhan et al., 2020). Therefore, this study aims to examine the role of Strategic Human Resource Management and Knowledge Management Capacity in improving Organizational Innovation through Organizational Innovation in the Islamic banking sector.

Furthermore, the consolidation of Islamic banking institutions in Indonesia has introduced additional complexities related to organizational governance and the integration of human resources. The merger of several state-owned Islamic banks into Bank Syariah Indonesia in 2021 was intended to enhance the competitiveness of the Islamic banking sector at both the national and international levels. Nevertheless, the merger process demands effective strategic management to harmonize organizational culture, knowledge management systems, and employee competencies originating from diverse institutional environments. In the absence of appropriate human resource strategies and effective knowledge management implementation, the organizational integration process may not achieve maximum performance effectiveness (Anjum et al., 2022).

Moreover, the shift towards digital banking services has dramatically transformed the operating landscape of the Islamic banking industry. To cater to the demands of customers in today's financial environment, banks must embrace new technology, exploit data analytics, and build novel service models in the process of digital transformation. Therefore, Islamic banks need to build the organisational capability to promote innovation and information sharing among their workers (Masum et al., 2018). Strategic HRM practices such as continuous training, knowledge development programs, and collaborative work environments are essential to support this transformation and ensure sustainable Organizational Innovation (Sunaryudanto & Rofiaty, 2024).

Another critical issue faced by Islamic banking institutions is the need to strengthen organizational innovation in response to increasing market competition. Innovation in financial products, service delivery systems, and digital platforms plays a crucial role in attracting new customers and retaining existing ones. In the context of Islamic banking, innovation must also comply with Sharia principles, which requires a deeper understanding of Islamic financial contracts and regulatory frameworks. Therefore, organizations must develop strong knowledge management capacity to ensure that employees can effectively generate and implement innovative ideas that align with Sharia values (Krisna et al., 2023).

Empirical studies on the relationship between strategic human resource management and knowledge management capacity with Organisational Innovation in the Islamic banking sector are still relatively limited, especially in the Indonesian context, despite the increasing importance of these variables. Most of the previous research have been more emphasised on the financial performance or customer happiness. There are few studies on the internal elements of the organisation that leads to innovation and performance improvement (Masruki et al., 2020). Therefore, this study seeks to fill this research gap by examining how Strategic HRM and Knowledge Management Capacity contribute to Organizational Innovation and ultimately improve Organizational Innovation in Islamic banking institutions in Central Java.

2. Literature Review

2.1 Knowledge Management Capacity and Organizational Innovation

Knowledge management has become a critical organizational capability in the modern knowledge-based economy (Ab. Wahab & Ismail, 2019). Organizations increasingly rely on the effective management of knowledge resources to maintain competitiveness and stimulate innovation (Ullah, 2014). Knowledge management can be defined as a series of organizational processes used to create, organize, store, distribute, and apply knowledge in order to enhance organizational effectiveness and performance. Within banking institutions, especially in the context of Islamic banking, knowledge management has an essential role in helping employees comprehend complex financial products, regulatory requirements, and Sharia-based principles. Effective management and dissemination of knowledge throughout the organization enable employees to develop creative solutions and generate innovative ideas that support organizational growth and sustainability (Felićio et al., 2014).

Organizational innovation refers to the implementation of new ideas, processes, systems, or products that significantly improve organizational performance and competitiveness. Innovation within organizations is often driven by the availability and accessibility of knowledge resources (Chahal & Bakshi, 2014). When employees are motivated to exchange knowledge, collaborate actively, and learn from one another, organizations are able to cultivate a work environment that promotes creativity and encourages experimentation. The processes of knowledge sharing and knowledge integration enable employees to merge existing expertise with new perspectives and insights, thereby stimulating innovation in service development, operational activities, and strategic decision-making within the organization (Liu et al., 2020).

In the Islamic banking sector, knowledge management becomes even more important due to the unique characteristics of Sharia-based financial products and services. Employees

must possess adequate knowledge regarding Islamic financial contracts such as *murabaha*, *mudarabah*, and *musharakah*, as well as regulatory standards governing Islamic banking operations (Nguyen et al., 2016). Effective knowledge management systems enable organizations to capture both explicit and tacit knowledge from experienced employees and transform it into valuable organizational assets. This knowledge can then be utilized to develop innovative financial products and service strategies that comply with Sharia principles while meeting customer needs (Chahal & Bakshi, 2014).

H1: Knowledge Management has a significant effect on Organizational Innovation

2.2 Organizational Innovation and Organizational Performance

Organisational innovation has emerged as a major determinant of success and sustainability for modern organisations. In a corporate climate that is becoming more and more competitive and dynamic, organisations are forced to continually develop new ideas, processes, and strategies in order to retain their competitive advantage (Chahal & Bakshi, 2014);(Riana, 2024). Organisational innovation is the deployment of a novel organisational method in business operations, workplace organisation or external interactions that has not been previously used by the firm and that has the objective of significantly improving the firm's performance (Sarfraz et al., 2023). Through innovation, organizations can adapt to environmental changes, respond to market demands, and improve their operational performance.

Innovation plays an important role in improving organizational performance by enhancing productivity, service quality, and customer satisfaction. Organizations that actively promote innovation tend to develop more efficient operational processes and more attractive products or services (Le et al., 2020). In the banking industry, innovation may involve the development of digital banking services, the improvement of financial products, and the enhancement of customer service systems. These innovations help banks improve their service delivery, increase operational efficiency, and ultimately strengthen overall organizational performance.

In the context of Islamic banking, organizational innovation is particularly important due to the need to balance modern financial practices with compliance to Sharia principles. Islamic banking institutions must continuously innovate in designing financial products, developing service systems, and implementing technological advancements while maintaining adherence to Islamic financial regulations (Nurchahyo, Isnawati, et al., 2024). Innovative approaches enable Islamic banks to expand their market reach, improve customer trust, and strengthen their competitiveness in the financial industry.

H2: Organizational Innovation has a significant effect on Organizational Performance.

2.3 Strategic HRM and Knowledge Management Capacity

Strategic Human Resource Management (Strategic HRM) plays a vital role in enhancing an organization's capability to manage knowledge effectively (Masum et al., 2018). Strategic HRM refers to the conscious linking of human resource policies and practices to organisational goals in order to build sustained competitive advantage. Strategic HR methods such as recruitment, training and development, performance management, and employee empowerment help organisations build a workforce that possesses the skills and

knowledge required to meet organisational goals (Maghsoudi et al., 2025). In knowledge-intensive industries such as banking, effective human resource strategies are essential for facilitating the creation and utilization of organizational knowledge.

Knowledge management capacity refers to an organization's ability to acquire, develop, store, share, and use knowledge to enhance organisational effectiveness. Strategic HRM strategies can offer significant assistance in this process by promoting a learning-oriented organisational culture and facilitating knowledge sharing among employees (Chen & Huang, 2009). Training programs, knowledge-sharing platforms, and collaborative work environments allow employees to exchange experiences and expertise, which contributes to the development of collective knowledge within the organization. When employees are encouraged to actively participate in learning and knowledge sharing, the organization becomes more capable of managing its intellectual resources (Sarfraz et al., 2023).

In the context of Islamic banking institutions, the role of Strategic HRM becomes even more important due to the complexity of Sharia-based financial products and regulatory frameworks. Employees must understand not only conventional banking operations but also Islamic financial principles and contracts (Wang et al., 2017). Strategic HR practices such as continuous professional development, Sharia compliance training, and knowledge transfer mechanisms enable employees to develop a deeper understanding and expertise in Islamic banking operations. As a result, organizations can strengthen their knowledge management systems and improve their ability to respond to dynamic market conditions.

Previous studies have demonstrated that organizations implementing effective Strategic HRM practices tend to possess stronger knowledge management capabilities. Strategic HR policies facilitate organizational learning, support knowledge creation, and promote knowledge sharing across departments (Wang et al., 2017). Consequently, organizations with well-developed HR strategies are more capable of building and sustaining knowledge management systems that enhance overall organizational performance.

H3: Strategic HRM has a significant effect on Knowledge Management Capacity

2.4 Strategic HRM and Organizational Innovation

Strategic Human Resource Management (Strategic HRM) plays a crucial role in encouraging innovation in contemporary organisations (Maghsoudi et al., 2025). Strategic HRM refers to the alignment of human resource policies, practices, and strategies with organizational goals to enhance organizational effectiveness and competitiveness. Through strategic HR practices such as recruitment, training and development, performance management, and employee empowerment, organizations can develop human resources that are capable of generating creative ideas and innovative solutions (Mahade et al., 2025). Employees who are supported by effective HR strategies tend to demonstrate higher levels of creativity and adaptability in responding to organizational challenges.

Organizational innovation is strongly influenced by the organizational environment and managerial practices that encourage creativity and experimentation. Strategic HRM contributes to the development of an innovative organizational climate by promoting employee participation, teamwork, and continuous learning (Masum et al., 2018). When organizations provide opportunities for employees to develop their skills and share ideas, employees become more motivated to contribute innovative solutions to improve

organizational processes and services. As a result, strategic HR practices can stimulate the emergence of innovative behaviors among employees.

In the banking sector, particularly in Islamic banking institutions, innovation has become increasingly important in responding to rapid changes in the financial industry. The emergence of digital banking, financial technology, and new customer expectations requires banks to continuously innovate in developing financial products and service systems (Masum et al., 2018). Strategic HRM can support this innovation process by ensuring that employees possess the necessary competencies, technological skills, and knowledge to develop innovative banking services (Masum et al., 2018). Furthermore, HR strategies that emphasize collaboration and knowledge sharing can accelerate the process of innovation within the organization. Previous studies have indicated that organizations implementing effective Strategic HRM practices tend to demonstrate higher levels of organizational innovation (Schulers, 2011).

H4: Strategic HRM has a significant effect on Organizational Innovation

3. Methodology

This research used a quantitative research approach to explore the association between Strategic Human Resource Management, Knowledge Management Capacity, Organisational Innovation, and Organisational Performance in the Islamic banking sector. Quantitative research was chosen because it enables researchers to objectively assess the relationship between variables and statistically test the hypothesised associations. The research approach was a survey method, and data were acquired through distributing structured questionnaires to the workers working in Islamic banking organisations. The questionnaire was measured on a Likert scale of strongly disagree to strongly agree to capture the respondents' impressions of each research variable.

The population of this study consisted of employees working in Islamic banking institutions in Central Java, Indonesia. The sample was determined using a purposive sampling technique to ensure that respondents had adequate knowledge and experience related to the operational activities of Islamic banking institutions. A total of 360 respondents participated in this study, consisting of employees from three major Islamic banking institutions in Central Java, namely Bank Syariah Indonesia, Bank Muamalat Indonesia, and Bank Jateng Syariah. These institutions were selected because they represent significant Islamic banking operations in the region and have a large number of employees involved in various banking activities.

The collected data were analyzed using Structural Equation Modeling with Partial Least Squares (SEM-PLS) with the assistance of SmartPLS software (Kwong-Kay, 2013). This analytical method was selected because it is appropriate for examining complex relationships among latent variables and is highly effective for predictive research frameworks. The analytical procedure involved assessing the measurement model (*outer model*) to evaluate the validity and reliability of the constructs, followed by testing the structural model (*inner model*) to examine the proposed research hypotheses (Hair et al., 2019). Through this approach, the study aims to identify the influence of Strategic HRM and Knowledge Management Capacity on Organizational Innovation and Organizational Performance in the Islamic banking sector.

Table 1. Data Responden

No	Characteristics	Category	Frequency	Percentage(%)
1	Gender	Male	198	55.0
		Female	162	45.0
2	Education Level	Diploma (D3)	72	20.0
		Bachelor (S1)	216	60.0
		Master (S2)	72	20.0
3	Age	20–30 years	108	30.0
		31–40 years	162	45.0
		41–50 years	72	20.0
		> 50 years	18	5.0
4	Work Experience	< 5 years	90	25.0
		5–10 years	162	45.0
		11–15 years	72	20.0
		> 15 years	36	10.0
5	Position	Staff/Officer	198	55.0
		Supervisor	90	25.0
		Manager	54	15.0
		Senior Manager/Branch Leader	18	5.0
		Total	360	100

Source(s): Primary data in bank, 2026

Table 1 illustrates the demographic profile of the respondents participating in this research, which involved 360 employees working in Islamic banking institutions across Central Java. Regarding gender composition, male respondents constitute the larger proportion with 198 employees (55%), whereas female respondents total 162 employees (45%). Based on educational attainment, the majority of participants possess a bachelor’s degree (S1), amounting to 216 respondents (60%). Meanwhile, respondents with a diploma (D3) and a master’s degree (S2) qualifications each account for 72 respondents (20%). These results demonstrate that Islamic banking institutions are predominantly staffed by employees with undergraduate educational qualifications, reflecting the professional competency standards commonly emphasized within the banking sector. Furthermore, the distribution of respondents based on age, work experience, and job position shows diverse characteristics. The majority of respondents are in the age group of 31–40 years, totaling 162 respondents (45%), followed by those aged 20–30 years with 108 respondents (30%). In terms of work experience, most respondents have 5–10 years of experience, accounting for 162 respondents (45%), indicating that many employees possess sufficient professional experience in the banking sector. Regarding job positions, the majority of respondents are staff or officers with 198 respondents (55%), followed by supervisors (25%), managers (15%), and senior managers or branch leaders (5%). This composition suggests that the respondents largely represent operational-level employees who are directly involved in daily banking activities and organizational processes.

4. Results and Discussions

This section describes the outcomes of the data analysis along with the discussion of the research findings associated with the proposed conceptual framework. The analysis aimed to investigate the relationships among Strategic Human Resource Management, Knowledge Management Capacity, Organizational Innovation, and Organizational Performance within the Islamic banking industry. Data obtained from 360 employees of Islamic banking institutions in Central Java were processed using the Structural Equation Modeling–Partial Least Squares (SEM-PLS) method supported by SmartPLS software.

The analytical procedure was divided into two primary stages: the assessment of the measurement model (*outer model*) and the assessment of the structural model (*inner model*). The evaluation of the measurement model was undertaken to determine the validity and reliability of the research constructs by analyzing indicators such as outer loading values, Average Variance Extracted (AVE), Composite Reliability (CR), and Cronbach’s Alpha. Subsequently, the structural model evaluation was performed to examine the proposed hypotheses through the interpretation of path coefficients, t-statistics, and p-values generated from the bootstrapping analysis procedure.

Table 2. Measurement Model Evaluation (Validity, Reliability, and Discriminant Validity)

Construct	Indicator	Outer Loading	Cronbach’s Alpha	Composite Reliability	AVE	HTMT	Result
Strategic HRM	X1.1	0.812	0.889	0.918	0.691	0.82	Valid & Reliable
	X1.2	0.865					
	X1.3	0.843					
	X1.4	0.792					
	X1.5	0.801					
Knowledge Management Capacity	X2.1	0.768	0.871	0.910	0.717	0.79	Valid & Reliable
	X2.2	0.846					
	X2.3	0.889					
	X2.4	0.912					
Organizational Innovation	Y1.1	0.781	0.903	0.925	0.673	0.84	Valid & Reliable
	Y1.2	0.826					
	Y1.3	0.768					
	Y1.4	0.809					
	Y1.5	0.871					
	Y1.6	0.884					
Organizational Performance	Y2.1	0.845	0.878	0.915	0.729	0.81	Valid & Reliable
	Y2.2	0.872					
	Y2.3	0.889					
	Y2.4	0.801					

Source(s): Primary data in bank, 2026

The table shows the measurement model evaluation which is aimed to analyse the validity, reliability and discriminant validity of the research constructs employed in this study. The validity of the indicators is determined by the outer loading values that indicate the strength of the association between the indicator and the latent construct. The results

show that all indicators have outer loading values beyond the recommended threshold value of 0.70, indicating that all indicators are able to effectively reflect each of its respective constructs. This result demonstrates that the indicators employed to measure Strategic Human Resource Management, Knowledge Management Capacity, Organisational Innovation and Organisational Performance have satisfactory convergent validity.

Furthermore, the reliability of the structures is tested using the Cronbach's Alpha and Composite Reliability values. The results reveal that all constructions have Cronbach's Alpha values over 0.70 and Composite Reliability values above 0.70, signifying a high level of internal consistency among the indicators within each construct. In addition, the Average Variance Extracted (AVE) values for all constructs are over the minimal threshold of 0.50, suggesting that the constructs are able to explain more than half of the variance of their indicators (Fornell & Larcker, 1981). These results indicate that the measurement model meets the criteria for reliability and convergent validity in the SEM-PLS study.

In addition to validity and reliability testing, discriminant validity is also examined by the Heterotrait-Monotrait Ratio (HTMT). The findings reveal that the HTMT values for all constructs are below the required threshold of 0.90, showing that each construct is empirically unique from the other constructs in the research model. This suggests that the constructs assess separate conceptual dimensions and do not strongly correlate with each other. The general outcome of the measurement model evaluation indicates that the research model has satisfied the necessary conditions of validity, reliability and discriminant validity and thus the study can be furthered to the stage of structural model evaluation.

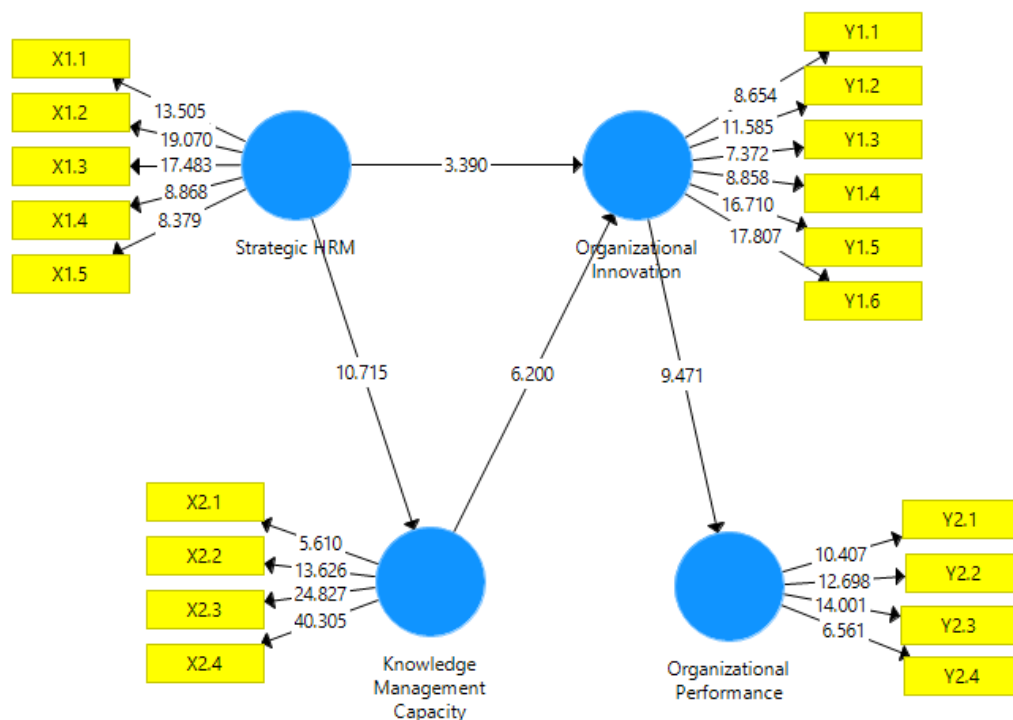


Figure 1. Structural Model of the Research Framework

Source(s): Authors' own work (2026)

Table 3. Structural Model Results (Direct and Indirect Effects)

Relationship	Effect Type	Original Sample (β)	T-Statistic	P-Value	Result
Strategic HRM → Knowledge Management Capacity	Direct Effect	0.668	10.715	0.000	Supported
Strategic HRM → Organizational Innovation	Direct Effect	0.339	3.390	0.000	Supported
Knowledge Management Capacity → Organizational Innovation	Direct Effect	0.571	6.200	0.000	Supported
Organizational Innovation → Organizational Performance	Direct Effect	0.593	9.471	0.000	Supported
Strategic HRM → Knowledge Management Capacity → Organizational Innovation	Indirect Effect	0.381	6.497	0.000	Supported
Knowledge Management Capacity → Organizational Innovation → Organizational Performance	Indirect Effect	0.338	6.204	0.000	Supported
Strategic HRM → Knowledge Management Capacity → Organizational Performance	Indirect Effect	0.226	5.998	0.000	Supported
Strategic HRM → Organizational Innovation → Organizational Performance	Indirect Effect	0.201	2.887	0.002	Supported

Source(s): Primary data in bank, 2026

4.1 Strategic HRM and Knowledge Management Capacity

The results of the structural model analysis indicate that Strategic Human Resource Management (Strategic HRM) has a positive and significant effect on Knowledge Management Capacity. This is evidenced by the path coefficient value of 0.668, with a t-statistic of 10.715 and a p-value of 0.000, which is below the significance threshold of 0.05. These statistical results indicate that the proposed hypothesis is empirically supported. The relatively high coefficient value suggests that Strategic HRM plays an important role in strengthening the organization’s ability to manage and utilize knowledge resources effectively (Mahade et al., 2025). The findings of this study imply that the implementation of effective strategic human resource management practices contributes significantly to improving the organization’s capability in managing knowledge. Strategic HR practices such as employee training and development, knowledge-sharing programs, and performance management systems encourage employees to continuously acquire and disseminate knowledge within the organization (Masum et al., 2018). When employees are supported by strategic HR policies, they are more likely to engage in learning activities, share expertise, and develop innovative solutions that contribute to organizational growth. In the context of the Islamic banking sector, knowledge management capacity is particularly important because employees must understand complex financial products and Sharia compliance regulations (Uddin et al., 2023). Strategic HRM can facilitate this process by providing continuous professional development programs and promoting knowledge-sharing cultures

within the organization. Therefore, the hypothesis stating that Strategic HRM positively influences Knowledge Management Capacity is supported (Mahade et al., 2025).

4.2 Strategic HRM and Organizational Innovation

The results of the structural model analysis indicate that Strategic HRM has a positive and significant effect on Organizational Innovation. This is evidenced by the path coefficient value of 0.339, with a t-statistic of 3.390 and a p-value of 0.000, which is below the significance threshold of 0.05. These findings demonstrate that the implementation of effective strategic human resource management practices contributes to the development of innovation within the organization (Sulastri et al., 2024). This result suggests that organizations that adopt strategic HR policies are more capable of encouraging employees to develop creative ideas and innovative solutions. Strategic HRM creates an organizational environment that supports learning, collaboration, and experimentation (Sulastri et al., 2024). Through training programs, teamwork, and employee empowerment initiatives, organizations can stimulate innovative behavior among employees and encourage them to contribute to organizational development. In the banking sector, particularly in Islamic banking institutions, innovation plays an important role in responding to rapid technological changes and increasing market competition. Strategic HRM helps organizations build a workforce that possesses the necessary competencies to develop innovative financial services and operational processes (Xie & Guo, 2024). Therefore, the hypothesis stating that Strategic HRM positively influences Organizational Innovation is supported.

4.3 Knowledge Management Capacity and Organizational Innovation

The results of the structural model analysis indicate that Knowledge Management Capacity has a positive and significant effect on Organizational Innovation. This is evidenced by the path coefficient value of 0.571, with a t-statistic of 6.200 and a p-value of 0.000, which is below the significance threshold of 0.05. These findings confirm that knowledge management capability plays an essential role in stimulating innovation within organizations (Uddin et al., 2023). Organizations that effectively manage knowledge resources are better positioned to generate new ideas, improve operational processes, and develop innovative products or services. Knowledge sharing, organizational learning, and information exchange among employees enable organizations to integrate existing knowledge with new insights (Zuñiga-Collazos et al., 2020). As a result, organizations can transform knowledge resources into innovative strategies that enhance organizational competitiveness. In the context of Islamic banking institutions, knowledge management capacity enables employees to better understand Sharia-based financial systems and develop innovative financial solutions that comply with Islamic principles (Ramadas & Felix, 2021). When organizations successfully manage and utilize their knowledge assets, they are more capable of creating innovation that improves organizational performance. Therefore, the hypothesis stating that Knowledge Management Capacity positively influences Organizational Innovation is supported (Nurcahyo, Widagdo, et al., 2024).

4.4 Organizational Innovation and Organizational Performance

The results of the structural model analysis indicate that Organizational Innovation has a positive and significant effect on Organizational Performance. This is evidenced by the path coefficient value of 0.593, with a t-statistic of 9.471 and a p-value of 0.000, which is below the significance threshold of 0.05. These findings indicate that organizations that actively implement innovation strategies tend to achieve higher levels of organizational performance (Fauzyah & Sirait, 2023). Innovation allows organizations to improve operational efficiency, enhance service quality, and develop competitive advantages in the marketplace. In the banking sector, innovation may involve the development of digital banking services, improvement of financial products, and enhancement of customer service systems (Awan et al., 2023). These innovations contribute to increased customer satisfaction, improved operational efficiency, and stronger organizational competitiveness. For Islamic banking institutions, organizational innovation is essential in responding to evolving customer needs and technological developments in the financial industry. By continuously developing innovative products and services that comply with Sharia principles, Islamic banks can improve their performance and strengthen their position in the financial market (Abdo et al., 2022). Therefore, the hypothesis stating that Organizational Innovation positively influences Organizational Performance is supported.

4.5 Strategic HRM, Knowledge Management Capacity, and Organizational Innovation

The results of the mediation analysis indicate that Strategic HRM indirectly affects Organizational Innovation through Knowledge Management Capacity. This is evidenced by the indirect path coefficient value of 0.381, with a t-statistic of 6.497 and a p-value of 0.000, which is below the significance threshold of 0.05. These results indicate that the indirect relationship between Strategic HRM and Organizational Innovation through Knowledge Management Capacity is statistically significant (Masum et al., 2018). This finding suggests that Knowledge Management Capacity serves as an important mediating mechanism through which Strategic HRM contributes to innovation development within the organization. Strategic HR practices such as training programs, knowledge-sharing platforms, and collaborative work systems enhance employees' ability to acquire and exchange knowledge (Masum et al., 2018). As knowledge resources increase, employees become more capable of generating innovative ideas that improve organizational processes and services. In the Islamic banking sector, knowledge management enables employees to combine their expertise in banking operations with their understanding of Sharia financial principles (Masum et al., 2018). This integration of knowledge ultimately supports the development of innovative financial services and operational strategies. Therefore, the hypothesis stating that Strategic HRM influences Organizational Innovation through Knowledge Management Capacity is supported.

4.6 Knowledge Management Capacity, Organizational Innovation, and Organizational Performance

The results of the mediation analysis indicate that Knowledge Management Capacity indirectly affects Organizational Performance through Organizational Innovation. This is evidenced by the indirect path coefficient value of 0.338, with a t-statistic of 6.204 and a p-value of 0.000, which is below the significance threshold of 0.05. These results demonstrate that innovation plays a mediating role in the relationship between knowledge management and organizational performance (Nurcahyo et al., 2025). Organizations that possess strong knowledge management capabilities can effectively transform knowledge resources into innovative ideas and strategic initiatives (Ingvaldsen & Engesbak, 2020). Through innovation, organizations can develop new services, improve operational efficiency, and enhance customer satisfaction. These improvements ultimately contribute to higher levels of organizational performance. In Islamic banking institutions, the ability to transform knowledge into innovation allows banks to develop financial products that meet market demands while maintaining compliance with Sharia principles (Ingvaldsen & Engesbak, 2020). Therefore, the hypothesis stating that Knowledge Management Capacity influences Organizational Performance through Organizational Innovation is supported.

4.7 Strategic HRM, Knowledge Management Capacity, and Organizational Performance

The results of the mediation analysis indicate that Strategic HRM indirectly affects Organizational Performance through Knowledge Management Capacity. This is evidenced by the indirect path coefficient value of 0.226, with a t-statistic of 5.998 and a p-value of 0.000, which is below the significance threshold of 0.05. These findings confirm that knowledge management capacity mediates the relationship between strategic HR practices and organizational performance. Strategic HRM contributes to the development of employee competencies, encourages knowledge sharing, and facilitates organizational learning processes. When organizations successfully manage knowledge resources, they are better able to improve decision-making processes, enhance operational efficiency, and develop competitive advantages (Uddin et al., 2023). As a result, the organization's overall performance improves. In the Islamic banking sector, knowledge management ensures that employees possess an adequate understanding of both financial and Sharia-based operational systems. This capability enables organizations to provide better services and maintain high standards of operational effectiveness (Lin et al., 2020). Therefore, the hypothesis stating that Strategic HRM influences Organizational Performance through Knowledge Management Capacity is supported.

4.8 Strategic HRM, Organizational Innovation, and Organizational Performance

The results of the mediation analysis indicate that Strategic HRM indirectly affects Organizational Performance through Organizational Innovation. This is evidenced by the indirect path coefficient value of 0.201, with a t-statistic of 2.887 and a p-value of 0.002, which is below the significance threshold of 0.05. These results demonstrate that organizational innovation plays a mediating role in the relationship between Strategic HRM and Organizational Performance (Saura et al., 2022). Strategic HR practices create a work

environment that encourages creativity, learning, and collaboration among employees. When employees are given opportunities to develop new ideas and innovative solutions, organizations become more capable of adapting to changing market conditions (Saura et al., 2022). This innovative capability ultimately leads to improved operational effectiveness and organizational performance. In the Islamic banking industry, innovation supported by strategic human resource practices enables banks to develop new financial products, improve digital banking services, and enhance customer experience. These innovations strengthen the competitiveness of Islamic banking institutions and contribute to improved organizational performance (Akim et al., 2024). Therefore, the hypothesis stating that Strategic HRM influences Organizational Performance through Organizational Innovation is supported.

Table 4. Interview Result of Islamic Leadership Perspective

No	Position	Interview Result
1	Supervisor	The informant explained that Islamic leadership emphasizes integrity (amanah) and responsibility in managing human resources. Strategic HRM practices are implemented through continuous training and mentoring programs that encourage employees to improve their competencies and share knowledge openly. According to the respondent, leaders who apply Islamic values such as honesty and fairness can foster a collaborative work environment that supports knowledge exchange and innovation within the organization.
2	Supervisor	The participant highlighted that knowledge management plays an essential role in maintaining service quality in Islamic banking. Leaders are expected to motivate employees to learn continuously and integrate Islamic ethical values into their daily tasks. This approach strengthens employee commitment and encourages innovative ideas to improve banking services and operational efficiency.
3	Supervisor	The interviewee stated that effective leadership in Islamic banking should combine professional competence with spiritual values. Strategic HRM policies that emphasize training, knowledge sharing, and teamwork help employees develop innovative solutions for customer needs while maintaining compliance with Islamic principles.
4	Manager	According to the manager, organizational innovation is strongly influenced by the leadership style adopted in the organization. Leaders who promote open communication and encourage employees to share ideas create an environment where knowledge can be effectively managed. Islamic leadership values such as ihsan and shura (consultation) also strengthen collaboration and decision-making processes.
5	Manager	The respondent emphasized that knowledge management capacity helps organizations transform employee knowledge into strategic resources. Through systematic documentation and knowledge-sharing platforms, employees are able to contribute ideas for innovation in financial products and customer services within Islamic banking institutions.
6	Manager	The informant noted that strategic HRM plays a critical role in developing innovative capabilities among employees. Recruitment, training, and performance evaluation systems are designed to support organizational

No	Position	Interview Result
		learning and knowledge development. Leaders are also expected to act as role models by practicing ethical leadership aligned with Islamic values.
7	Senior Manager / Branch Leader	The branch leader explained that organizational innovation in Islamic banking is closely related to leadership commitment in managing knowledge resources. Leaders encourage employees to exchange experiences and best practices through formal meetings and knowledge forums, which ultimately improve service innovation and operational performance.
8	Senior Manager / Branch Leader	The respondent highlighted that Islamic leadership promotes fairness, transparency, and accountability. These values help build trust among employees and strengthen collaboration across departments. As a result, knowledge sharing becomes more effective and supports the development of innovative banking services.
9	Senior Manager / Branch Leader	According to the interviewee, the integration of Strategic HRM and Knowledge Management Capacity creates a sustainable competitive advantage for Islamic banking institutions. Leaders who support learning culture and encourage creativity can significantly improve organizational innovation and performance.
10	Senior Manager / Branch Leader	The informant concluded that Islamic leadership perspective emphasizes balancing professional management practices with spiritual values. By strengthening Strategic HRM and knowledge management systems, Islamic banks are able to foster continuous innovation while maintaining ethical standards and compliance with Sharia principles.

Source(s): Primary data in bank, 2026

The interview results presented in Table 1.4 illustrate the perspectives of ten informants occupying supervisory, managerial, and branch leadership positions in Islamic banking institutions. Overall, the respondents emphasized that leadership grounded in Islamic values plays a crucial role in strengthening Strategic Human Resource Management (Strategic HRM) practices and enhancing Knowledge Management Capacity within the organization. Informants highlighted that leadership principles such as *amanah* (trustworthiness), *ihsan* (excellence), and *shura* (consultation) create a supportive organizational climate where employees feel encouraged to contribute ideas, share knowledge, and participate in continuous learning (Mujib et al., 2025). These values were perceived as essential foundations for promoting collaboration and fostering a culture of innovation in Islamic banking institutions (Tirno et al., 2023).

Furthermore, the participants explained that effective implementation of Strategic HRM policies, including employee training, mentoring, and performance evaluation systems, significantly contributes to improving knowledge capabilities among employees. Managers and supervisors noted that structured knowledge-sharing activities, such as internal discussions, cross-departmental meetings, and digital knowledge platforms, allow employees to exchange experiences and best practices (Reza Nurul Ichsan, 2020). This process not only enhances employees' competencies but also enables the organization to transform individual knowledge into strategic organizational assets. As a result, the organization becomes more capable of developing innovative financial products and

improving service quality in response to changing customer needs. From the leadership perspective, senior managers and branch leaders also emphasized that integrating Strategic HRM with Knowledge Management Capacity strengthens the organization's ability to achieve sustainable innovation and performance. Leaders play a key role in motivating employees, establishing ethical standards, and creating an environment that supports creativity and problem-solving (Hajiali, 2022). The findings indicate that when Islamic leadership values are consistently applied alongside effective human resource strategies and knowledge management practices, organizations are better positioned to enhance organizational innovation and maintain competitiveness in the Islamic banking sector.

5. Conclusion and Recommendation

This research was conducted to analyze the effect of Strategic Human Resource Management (Strategic HRM) and Knowledge Management Capacity on Organizational Innovation and Organizational Performance within Islamic banking institutions in Central Java. The results of the analysis demonstrate that Strategic HRM exerts a positive and significant influence on both Knowledge Management Capacity and Organizational Innovation. These findings indicate that the implementation of effective human resource management strategies contributes substantially to enhancing the organization's capability to manage knowledge and stimulate innovative behavior among employees.

In addition, the study findings reveal that Knowledge Management Capacity significantly affects Organizational Innovation. This suggests that organizations possessing effective knowledge management capabilities are better positioned to create new ideas, improve operational systems, and formulate innovative organizational strategies. Efficient knowledge management practices facilitate the sharing of information, exchange of experiences, and integration of organizational knowledge, which collectively encourage the growth of innovation within the institution. The study further indicates that Organizational Innovation has a positive and significant impact on Organizational Performance. This means that organizations that continuously promote and implement innovation are more likely to achieve superior organizational outcomes. Innovation contributes to greater operational effectiveness, improved service quality, and stronger competitiveness within the banking sector. In the Islamic banking context, innovation is also essential for developing Sharia-compliant financial products and services that align with the changing demands and expectations of customers. Overall, this research confirms that Strategic HRM and Knowledge Management Capacity play vital roles in enhancing Organizational Innovation and Organizational Performance in Islamic banking institutions. The integration of strategic human resource management practices with effective knowledge management systems can establish an organizational environment that supports continuous learning, creativity, and innovation. Therefore, Islamic banking organizations are encouraged to strengthen both their human resource management strategies and knowledge management practices in order to improve innovation capabilities and achieve sustainable organizational performance.

Declarations

Originality of the Manuscript

The submitted manuscript is an original work of the authors and has not been published previously, either in whole or in part, in any language or publication medium. The manuscript is not currently under consideration for publication elsewhere.

Authorship

All listed authors have made substantial contributions to the conception, design, execution, and/or interpretation of the study. All authors have reviewed and approved the final version of the manuscript and agree to its submission for publication.

Author Contributions

All authors contributed actively to the research process, including the study design, data collection, data analysis, manuscript preparation, and revision of the manuscript. All authors have read and approved the final manuscript.

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Data Availability Statement

The data supporting the findings of this study are available from the corresponding author upon reasonable request, subject to ethical considerations and data confidentiality requirements where applicable.

Declaration of Interests

The authors declare that there are no known financial interests, personal relationships, or other conflicts of interest that could have appeared to influence the work reported in this manuscript.

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