

## Conference paper

# IMPROVING COMPANY PERFORMANCE IN RURAL AREAS: INSTITUTIONAL THEORY APPROACH

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## Abstract.

Development in rural areas has become the focus of governments in many countries. This study aims to analyze the effect of institutional pressure and strategic orientation on financial performance. This study also examines social performance as a mediating variable. The research was conducted at village institutions, namely Village-Owned Enterprises in four regions in Riau Province, Indonesia. A total of 239 Village-Owned Enterprises were studied with 526 respondents, namely VOE managers. Questionnaires were distributed directly and via the internet. Questionnaires were sent via WhatsApp to the VOE manager. Structural analysis of the equation model with Warp PLs shows that all hypotheses are supported. Institutional pressure and strategic orientation affect financial performance, and social performance is a mediator variable

**Keywords:** institutional pressure, strategic orientation, social performance, financial performance

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## 1. INTRODUCTION

In many nations, the disparity between urban and rural growth has become a problem. However, because of their remote location and small population, rural areas have particular difficulties with economic development (1)(2). To overcome this, governments in various countries have begun to focus on rural development. For example, in England, Rural businesses dramatically increase their ability to export goods and services and increase their availability of exportable goods and services (3). In China, the government has even established township-village enterprises (TVEs) that actively improve the rural economy.(4)(5).

Since 2014, the Indonesian government has also passed legislation to create a Village-Owned Enterprise (VOE), a village-based economic entity with the purpose of boosting the prosperity of rural areas. VOE also intends to assist in the provision of public

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services, foster job growth and fair distribution of the village's economic resources, and raise village community income and village original income.

Until 2021, the number of VOE in Indonesia has grown by 57.273. However, of this amount, as much as 12.040 inactive VOE, or 21%, have not contributed (Kotawaring-inbaratkab.go.id, 2022). It shows that VOE is still not totally dependable as a tool for enhancing rural communities' economies.

The sustainability of economic institutions in rural areas has been a concern of many researchers worldwide. For example study(7)on social organizations in rural China found that institutional pressure is a factor that can affect the sustainability of the organization. Organizations will react to institutional pressures to keep them going.(8)Institutional pressure affects organizational performance (9)also proves that institutional pressure affects the company's economic performance. Nevertheless, research (10)shows that institutional pressure does not directly affect the company's economic performance.

The significance of strategic orientation as a factor in the performance of expanding businesses has been supported by numerous earlier research (11). In strategy, entrepreneurship, and marketing, strategic orientation is heavily employed (12). Companies who execute the proper planning strategy will be able to meet the challenges of evolving external environments (13). Research result (14) show that strategic orientation affects social and economic performance. The success of the company is impacted by strategic orientation, as shown by (11). The findings demonstrate that depending on the performance metric employed, there are different relationships between strategic direction and performance.

Based on this, this study seeks to investigate how institutional pressure and strategic focus affect VOE performance. This study also examines social performance as a mediation. Based on the inconsistency of research results regarding the effect of institutional pressure and strategic orientation on company performance.(15)suggests that the company will experience pressure from the surrounding environment. VOE as a social enterprise cannot be separated from regulations created for social purposes, namely improving services to the community.(16)It is also said that strategic orientation can affect social performance by creating customer satisfaction. Indicators of marketing orientation, entrepreneurship, and innovation impact increasing customer satisfaction, ultimately improving the company's economy.

In Indonesia, there is currently a dearth of studies examining how institutional pressure and strategic focus affect the performance of village-owned businesses. Therefore, this research becomes interesting. This research contributes to the government in improving the rural economy by strengthening village institutions.

## 1.1. Literature Review and Hypotheses Development

### 1.1.1. Institutional Theory

Institutional Theory put forward(17). He explained that the organization's formation was due to the pressure of the institutional environment that led to institutionalization.(15)distinguishes between three types of isomorphic stresses, coercive, mimetic, and normative, and argues that coercive and normative pressures usually exist in an interconnected relationship. In contrast, mimetic pressures act through structural equivalence. Governments, rules, and other institutions can compel people to embrace a structure or system through coercive power (18) (19) (20).

According to institutional theory, the creation of VOE is founded on rules that state that VOE are created to enhance the economy of rural communities by providing services and community development. Pressure from the environment requires VOE to meet the environment to gain legitimacy.(15)also stated that legitimacy is intended for business continuity. Therefore, one way to stay afloat is to adopt a strategic orientation. Strategy orientation is a way for VOE to respond to environmental needs. Strategic orientation aims to achieve a competitive advantage(11). Fulfilling institutional pressure and implementing strategic orientation impact improving business performance, not only social performance but also financial performance(16).

### 1.2. The Effect of Institutional Pressure on Performance

(15)argues that the company is influenced by pressure from the surrounding environment. The company will meet the demands of institutional pressure to gain legitimacy and business sustainability(21). The pressure from regulations requires VOE as a social enterprise to provide services to the community by constructing public facilities. Improved services will have an impact on social performance. Social performance is the achievement of corporate social responsibility to stakeholders. (22)states that achieving social performance can result in increased customer and employee satisfaction. Institutional pressure requires VOE as a social organization to meet stakeholder expectations.

A study (23)(10)proves that the institutional pressure from the environment causes companies to innovate their products. It proves that coercive pressure can meet the community's expectations as stakeholders. (24) proves that mimetic pressure impacts financial performance. Mimetic pressure from competitors causes VOE to study competitors to run a business. It has an impact on improving the reputation of VOE.(17) also

stated that normative pressure can encourage companies to improve their performance. Professional pressure causes VOE to continuously learn by conducting training in the management of VOE. Paying attention to institutional pressure will not only increase community and employee satisfaction, but it will also ultimately have an impact on increasing VOE sales.

**Hypothesis 1a: Institutional pressure affects social performance**

**Hypothesis 1b: Institutional pressure affects financial performance**

### 1.3. The Effect of Strategy Orientation on Performance

Strategic orientation describes how businesses react to elements in the commercial environment (25). Consequently, orientation is frequently used to forecast high-performing businesses with a competitive edge (11)(26). In line with institutional theory, implementing strategic orientation responds to environmental pressures that require companies to survive. Businesses that have a strategic perspective are better able to anticipate and adjust to anticipated external changes in the business environment.(27) Emphasizes that businesses with a start-up focus may act in a way that is more conducive to fostering competition. Therefore, small businesses require a strategic orientation for business continuity(11). (28)stated that customer-oriented companies tend to increase the company's innovation in services. Therefore, strategic orientation can improve social performance through service improvement. Research result. (13) emphasizes businesses will be able to handle the challenges of shifting external environments if they execute the appropriate planning strategy. Research result(16)shows that strategic orientation affects social performance and economic performance, and research (11)proves that strategic orientation affects the company's performance.

**H2a: Strategy Orientation Affects Social Performance**

**H2b: Strategy Orientation affects financial performance**

### 1.4. The Effect of Social Performance on Financial Performance

Globally, social responsibility serves as a performance metric for social enterprises. (29)(30). Suppose a company actively assumes environmental and social responsibility. In that situation, this will boost business reputation, employee and customer happiness, and ultimately bring in more clients and boost revenue. Of course, it enhances the business's financial performance (31). Thus, social responsibility must satisfy the demands and expectations of both internal and external clients (32). The connection

between corporate success and social performance focused on customer rights and benefits is thus investigated. It demonstrates how social performance will ultimately help to improve economic performance (33). Therefore, the following hypothesis

**H3: Social Performance affects financial performance**

**1.5. Social Performance Mediation**

Inconsistency in the results of previous studies regarding the effect of institutional pressure and strategic orientation on improving the company’s financial performance, we suspect that this relationship is mediated by social performance.(15)states that organizations are affected by pressures from regulations and surrounding institutions. The regulation stipulates that VOE, as a social organization, is intended to provide services to the community. Therefore, the pressure from regulations causes VOE to improve social performance by improving services to the community and the reputation of VOE. The improved social performance will increase the number of customers, which in turn will increase sales.

**H4: The effect of institutional pressure on financial performance is mediated by social performance**

Strategy orientation indirectly affects financial performance by increasing social performance. Businesses that prioritize strategy will prioritize market orientation, customer orientation, and entrepreneurial orientation. It encourages companies to innovate and improve services. Strategy orientation has an impact on the creation of company innovation(34)(35)(36). Innovations in products and services will impact meeting customer expectations(37). Improved customer satisfaction will promote the improvement of the company’s financial performance(33)

**H5: the effect of strategic orientation on financial performance is mediated by social performance**

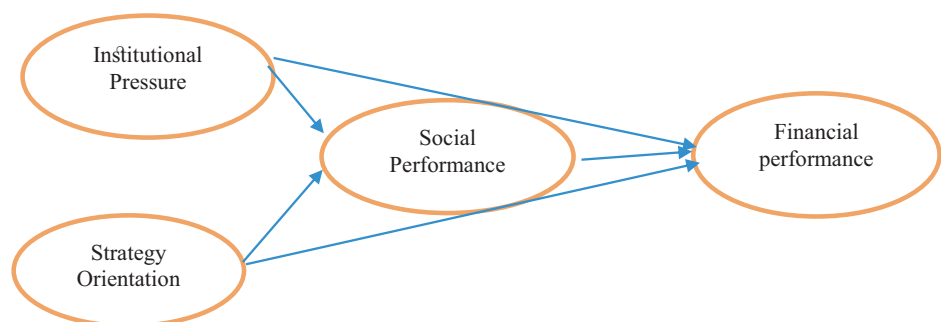


Figure 1: Conceptual Framework.

## 2. METHODOLOGY/ MATERIALS

### 2.1. Data

This study examines Village Owned Enterprises (VOE) in Riau Province, Indonesia. A total of 239 VOE were studied in four district : Bengkalis, Rohil, Kampar, and Pelalawan. The sampling technique used is proportional stratified sampling. VOE are selected based on their categories, namely VOE with basic categories, growing, developing, and advancing. Each VOE sent 3-4 questionnaires. Respondents in this study were VOE managers.

### 2.2. Variable measurement

The measurement of variables was developed based on previous research. A 5-point Likert scale, with 1 representing strongly disagree and 5 representing strongly agree, is used in the survey.

Financial performance using four indicators adopted and developed from research (22) has indicators of Profitability, Leverage, Assets, and Revenue Growth.

Social performance is measured by social achievement. It consists of 3 indicators of market share, increased employee satisfaction, Increased community satisfaction, and Improved reputation of VOE. The questionnaire was adopted from(22).

Institutional pressure is part of institutional theory. Indicators using(17) (38)normative, mimetic, and coercive. Coercive pressure, mimetic pressure, and normative pressure.

The strategy orientation was adapted from the indicators (39): analysis, future, and riskiness.

## 3. RESULTS AND DISCUSSIONS

Of the 600 questionnaires distributed, as many as 526 questionnaires can be processed with a response rate of 87.6%.

### 3.1. Descriptive statistics

In Table 1, descriptive data are shown.

TABLE 1: Descriptive Statistics and correlation between Latent Variables.

	mean	Std. Deviation	Institutional Pressure (X1)	Strategy Orientation (X2)	Social Performance Z	Financial performance Y
Institutional pressure (X1)	38.0722	3.38210	(0.630)	0.657	0.499	0.489
Strategy Orientation(X2)	44.3707	4.94209	0.657	(0.701)	0.602	0.581
Social Performance (Z)	33.1692	4.55065	0.499	0.602	(0.778)	0.731
Financial Performance (Y)	16.6540	2,54148	0.489	0.581	0.731	(0.857)

Source : Results of data processing with Warp pls

### 3.2. Outer Model Testing

#### 3.2.1. Validity and Reliability Test Results

Using a structural equation model with SEM-Warp PLS as the analysis method. The first stage of testing with Warp PLS is testing the outer model, which consists of testing the validity and reliability. The second stage is testing the inner model, which consists of testing the fit model and testing the significance(40)

After all invalid indicators are eliminated, the loading factor and AVE values are obtained above 0.5 (Table 2).(41). states that the loading factor above 0.5 can still be maintained in development research. The cross-loading value and the correlation between latent variables provide evidence of the discriminant validity test. Cross-loading shows that the indicator of each variable block is greater than the other blocks (Table 2). Each latent construct's AVE is bigger than the square of the correlation coefficient, according to the correlation between latent variables.This research shows that discriminant validity is met.(42).

Reliability testing shows that the Cronbach alpha composite reliability value is more significant than 0.8. This result shows good reliability (41).

### 3.3. Inner Model Testing (Structural Model)

To test the hypothesis, structural equation modeling (SEM) using maximum likelihood estimation was performed.

The results of the model fit test show that all the criteria have been met. And then, the hypothesis is tested.

TABLE 2: Measurement of Validity and Reliability.

		X1	X2	Z	Y	Cronbach Alpha	Composite Reliability
Institutional Pressure	X11	(0.692)	-0.111	0.090	0.068	0.808	0.855
	X12	(0.654)	-0.197	-0.092	0.032		
	X13	(0.619)	-0.011	-0.019	-0.093		
	X15	(0.591)	-0.138	0.235	-0.242		
	X16	(0.586)	-0.145	0.088	-0.104		
	X17	(0.596)	-0.081	-0.059	0.180		
	X18	(0.702)	0.039	-0.076	0.008		
	X19	(0.565)	0.307	-0.080	0.102		
	X110	(0.649)	0.350	-0.073	0.038		
	Strategy Orientation	X21	-0.046	(0.641)	0.294		
X22		0.019	(0.648)	0.043	0.105		
X23		0.263	(0.664)	-0.025	0.009		
X24		0.072	(0.684)	0.009	0.014		
X25		0.249	(0.668)	-0.021	-0.102		
X26		0.228	(0.689)	-0.115	-0.064		
X27		-0.261	(0.750)	-0.083	0.040		
X28		-0.265	(0.767)	-0.023	0.032		
X29		-0.227	(0.762)	0.019	-0.033		
X210		0.107	(0.680)	-0.105	-0.047		
X211		-0.041	(0.746)	0.033	-0.016		
Social Performance	Z1	0.199	-0.074	(0.731)	-0.046	0.906	0.924
	Z2	0.059	-0.029	(0.824)	-0.067		
	Z3	0.190	-0.239	(0.726)	-0.077		
	Z4	-0.146	0.009	(0.780)	0.116		
	Z5	-0.159	0.059	(0.772)	0.186		
	Z6	0.000	-0.035	(0.825)	0.009		
	Z7	-0.061	0.081	(0.801)	-0.107		
	Z8	-0.061	0.215	(0.755)	-0.015		
Financial performance	Y1	0.018	-0.003	-0.082	(0.905)	0.877	0.917
	Y2	0.011	-0.067	-0.076	(0.910)		
	Y3	-0.089	0.066	0.053	(0.887)		
	Y4	0.073	0.007	0.136	(0.713)		

Source : Results of data processing with Warp pls

### 3.4. Hypothesis test

Hypothesis testing uses p-value and path coefficient, as seen in table 4.



TABLE 3: Model Fit.

Indicator	Results	Criteria	Information
Average path coefficient (APC)	0.312, P<0.001	P= 0.05	significant
Average R-squared (ARS)	0.514, P<0.001	P= 0.05	significant
Average adjusted R-squared (AARS)	0.512, P<0.001	P= 0.05	significant
Average block VIF (AVIF)	1.859	acceptable if <= 5, ideally <= 3.3	acceptable
Tenenhaus GoF (GoF)	0.535	small >= 0.1, medium >= 0.25, large >= 0.36	Large

Source : Results of data processing with Warp pls

TABLE 4: Hypothesis Testing Results.

	Path Coefficient	P Value	Result
<i>Direct Effects</i>			
Institution Pressure Social Performance	<b>0.260</b>	<0.001	<b>Supported</b>
Strategy Orientation Social Performance	<b>0.451</b>	<0.001	<b>Supported</b>
Institution Pressure Financial Performance	<b>0.086</b>	<b>0.023</b>	<b>Supported</b>
Strategy Orientation Financial Performance	0.148	<0.001	<b>Supported</b>
Social Performance Financial Performance	<b>0.617</b>	<0.001	<b>Supported</b>
<i>Indirect Effect</i>			
Institutional Pressure Social Performance Financial Performance	0.160	<0.001	<b>Supported</b>
Strategy Orientation Social Performance Financial Performance	0.278	<0.001	<b>Supported</b>

Source : Results of data processing with Warp pls

The results of testing hypothesis 1a show the path coefficient value of 0.260 with p-value <0.001 (<0.05), which indicates hypothesis 1a is accepted, namely, institutional pressure affects social performance. The results of testing hypothesis 1b show the path coefficient value of 0.451 with p-value <0.001 (<0.05), which indicates hypothesis 1b is accepted, namely, institutional pressure affects financial performance. The results of testing hypothesis 2a show a path coefficient value of 0.086 with a p-value of 0.023 (<0.05), which indicates that hypothesis 2a is accepted, that is, institutional pressure affects social performance. The results of testing hypothesis 2b show the path coefficient value of 0.148 with a p-value of <0.001 (<0.05), indicating that hypothesis 2b is accepted, namely, strategic orientation affects social performance. The results of testing hypothesis 3 show the path coefficient value of 0.617 with p-value <0.001

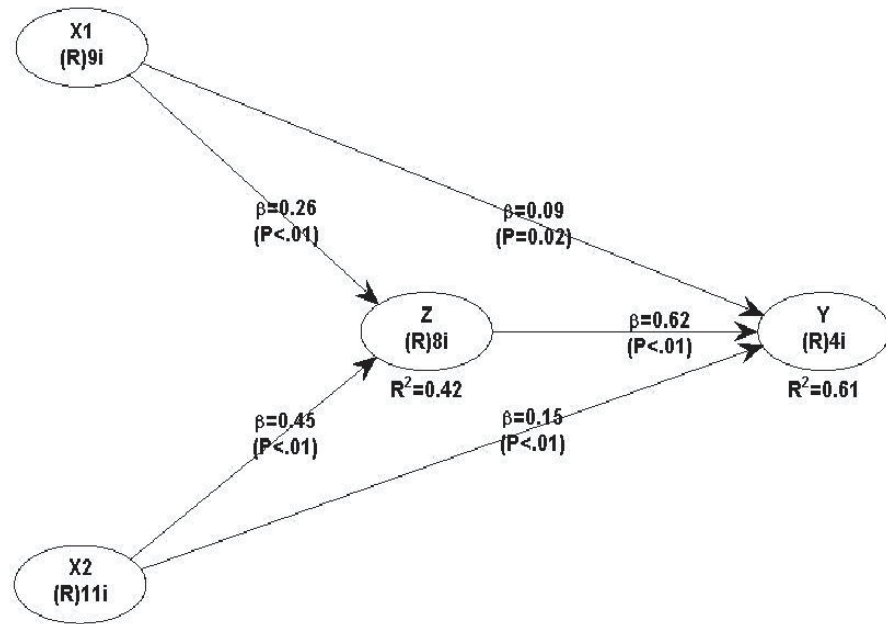


Figure 2: Full Structural equation model.

(<0.05), which indicates hypothesis 3 is accepted, namely, social performance affects financial performance.

The results of testing the mediation hypothesis are hypothesis 4. Namely, social performance mediates the effect of institutional pressure on financial performance showing a significant direct effect on social performance with a path coefficient of 0.260 and p-value < 0.001. The influence of social performance on financial performance is also significant, with a path coefficient of 0.617 and a P value <0.001. The indirect effect test results also show that the path coefficient value is 0.160 with a P value < 0.001. It can be concluded that social performance is a mediator in the relationship between institutional pressure and financial performance

Hypothesis testing results (H5) , namely Social Performance mediating the effect of strategic orientation on financial performance, shows a significant direct effect of institutional pressure on social performance with a path coefficient of 0.451 and p-value < 0.001. The influence of social performance on financial performance is also significant, with a path coefficient of 0.617 and a P value <0.001. The indirect effect test results also show that the path coefficient value is 0.278 with a P value < 0.001. It can be concluded that social performance is a mediator in the relationship between strategic orientation and financial performance

### 3.5. Discussion

This study confirms the role of institutional theory in VOE'S social organization. In line with (43), who explains that institutional pressure on company management practices can impact business performance. According to institutional theory, the surrounding environment will influence VOE management practices. Demands from the community, regulations and surrounding organizations cause VOE to take action to meet the needs of stakeholders. VOE provides satisfactory service to stakeholders by opening business units and establishing a sales network. Fulfillment of customer satisfaction is an indicator of improving social performance. Improving service to the community and increasing customer satisfaction is also a concern for VOE.

Additionally, institutional pressure can directly influence how well VOE perform financially. The regulations also stipulate that VOE are established to increase village income. It causes VOE also to learn how to manage VOE for business sustainability. VOE can imitate competitors or learn from professionals. The findings of this study are consistent with other studies (23) (44) (9) that institutional pressure affects improving the social and economic performance of the company.

The findings of the study also demonstrate that VOE' social and financial performance is impacted by the strategy's strategic direction. The social and financial performance of VOE can be enhanced by implementing an effective strategic orientation. (45) the business's strategy direction for fostering the right behavior to achieve outstanding performance is known as strategic orientation. Two strategic orientations are those toward the market and those toward innovation. The four dimensions of strategic orientation are employee orientation, market orientation, learning orientation, and entrepreneurial orientation. The performance of the business is influenced favorably by these four strategic orientation dimensions.

VOE, as an organization still classified as MSME, has started to run a business by paying attention to strategic orientation. Observation results show that VOE has formed and developed business units following community needs. Many VOE have an increasing number of customers from time to time. Therefore, the strategic orientation implemented by VOE impacts social performance by improving services and financial performance by increasing the amount of VOE income. The research results (11) prove that strategic orientation affects business performance in MSMEs.

The results also prove that social performance is a mediator for institutional pressure on the financial performance of VOE. This research shows that an increase in financial performance occurs through social performance. Coercive pressures such as pressure

from regulations, the community, and other institutions such as the government have an impact on improving the social performance of VOE through improving services and the reputation of VOE. Likewise, mimetic pressure from competitors and pressure from professionals will give birth to BUMde's creative ideas in creating products that suit the community's needs. (43). The social performance also significantly and favorably influences the VOE' financial performance. Support (31) that a firm's active adoption of environmental and social responsibility will ultimately lead to a greater number of customer groups and higher revenues, in addition to increasing employee, customer, and corporate reputation levels.

#### 4. CONCLUSION AND RECOMMENDATION

According to the study's findings, institutional pressure and strategic focus have an impact on VOE' social and financial performance. The relationship between institutional pressure and orientation to the financial success of VOE is mediated by social performance.

In conducting the research, the researcher found several limitations, namely not being able to investigate VOE extensively. Researchers only examined four regions in Riau Province, so the study results could not be generalized more broadly.

The study also only examines the impact of institutional pressure and strategic orientation on the social and financial performance of VOE without analyzing the effect of the dimensions of each variable. Therefore, further research can analyze the impact of coercive, mimetic, and normative pressures and strategic orientation based on its dimensions, such as market orientation, entrepreneurial orientation, and innovation.

This research supports institutional theory(17), which states that the organization will react to the environment in its operations. Whether pressure from regulations, competitors, or professionals, causes VOE to adopt practices to maintain business continuity. Strategy orientation is one of the ways adopted by VOE to meet pressure from institutions.

This research suggests that stakeholders make policies for VOE to improve their performance. For example, regulations regarding the management of VOE provide training to improve its performance of VOE.

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