

## Research Paper

# The Institutional Change Dynamics of Village-Owned Enterprises in East Java: Accelerating the Welfare of Rural Communities

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**Abstract.**

Village-owned enterprises are an institutional form, which embodies the participation of rural communities in the economy based on profit and mutual cooperation that is expected to be able to encourage village independence in economy. This definition will encourage how the institutional projections change and how adaptation is needed both from within the institution or from outside the institution. The dynamics in village-owned enterprises have various challenges to resolve the main problem regarding the quality of human resources and infrastructures. This article explains how the dynamics of institutional change and various forms of revitalization and growth of village-owned enterprises use the theory of institutional change approach. The study has found that village-owned enterprises in East Java have become a forum for managing every socioeconomic element into a single unit that produces economic value to improve the welfare of rural communities. Innovation and adaptation as well as human development have become the main drivers of village-owned enterprises sustainability and resilience in digitalized era.

**Keywords:** village-owned enterprises, institutional change, revitalization, welfare

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## 1. Introduction

Village-Owned Enterprises (or BUMDes in Indonesian; VE) are expected to be able to encourage village independence in economy. Village Business Entities are regulated in Law Number 6 of 2014 which focuses on regional and village governance. Article 87 paragraph (1) to (3) states that villages can form village-owned enterprises which are managed with a spirit of cooperation, and can run businesses in the financial sector and public services in accordance with the provisions of laws and regulations. The implementation of this law can be through the formation of a Village-Owned Enterprises, which is a business entity whose capital is wholly or partly owned by the village through direct participation that comes from village assets. This indicates a strong

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institutional influence between village administration and Village-Owned Enterprises development. These assets are specifically separated to manage assets, services and other businesses for the maximum welfare of the village community. The expected welfare is in the form of new job opportunities, an adequate business climate and easy access to various forms of community participation in the business entity (Daulay & Syaputra, 2019).

Village-owned enterprise institutions should be managed in a professional manner. This is because the main objective of the Village Owned Enterprise is generally to have a beneficial impact on the wider community of the village (Fitrianto, 2016). In addition, Village-Owned Enterprises are also assumed to provide indirect benefits, such as a new business climate in the vicinity of the establishment of the business entity. Thus, Village-Owned Enterprises will play a huge role in the overall economic growth of the village. The dynamics of large institutions also occur in the institutional of Village-Owned Enterprises. This is because any institution with a variety of forms can experience good changes or unwanted changes. These changes are influenced by both endogenous and exogenous factors from the institution itself. But the endogenous effects of institutional change often play a larger role. This is due to the nature of the institutions themselves where they survive and develop based on the values they have (Aoki, 2007).

In this research, it examines the dynamics of institutional changes in Village-owned Enterprise (VE) institutions within the scope of East Java Province. This province is experiencing a growth in the number of VE and this is accompanied by a fairly even distribution with various VE classifications. This shows the assumption that the institutions of each region experience changes and differences caused by various factors. Thus, this study will examine how the dynamics of change that occur in VE institutions in East Java Province.

## 2. Literature Review

### 2.1. Institutional Changes

Douglass North's theory of institutional change is a neoclassical approach to institutional economics. This is because he uses changes in relative prices that are reflected or not reflected in the market and entrepreneurial responses to those changes as causal forces to explain changes in institutions. This is because this approach is clearer and describes how implicit external influences in price changes and entrepreneurship as internal influences are able to provide changes in institutions (Dugger, 1995). This relative price

change illustrates how the influence of individuals in human interaction has an impact on the market. North also stated that the changes that occur cannot be avoided. This is because these changes involve how change agents interact with one another. However, these existing changes cannot occur completely if there is uncertainty in the market. This uncertainty causes reluctance to interact because the potential for profit is also low.

North's notion of "gradualism" is analyzed to show how he imagines a two-way effect (or extension) from informal to formal rules and vice versa, although this is not always explicit. This implicit depiction of influence is due to the potential for change due to things that are unexpected and tend to happen unintentionally. In addition, gradualism and continuity in institutional change appear to be a consequence of the persistence of informal constraints and a two-way relationship between institutional and organizational structures. This two-way influence shows how the influence that exists in institutions is difficult to manifest. This is due to differences in perceptions and thoughts between institutions and individuals, making it difficult for reciprocal changes to occur between institutions (Fiori, 2002).

The transformation of the two types of rules (formal and informal) often brings about conflict. This approach makes it possible to observe that institutional rules give rise to different views on institutional change. This difference in view illustrates how the influence of behavior and individuals is quite large in institutions. Formal and informal constraints are often conflicting choices for individuals, so it is difficult to imagine them in terms of mutual continuity or "expansion". This shows that there are different interests in these institutions. Broad meanings of formal and informal institutional constraints are more abstract and difficult to interpret clearly (Fiori, 2002). The dimensions of institutional change that occur within an institution are divided into two. These two dimensions include changes in configuration between economic actors which are the basis for institutional changes due to changes in individual factors such as interests in institutions. Furthermore, institutional changes are deliberately carried out with the aim of regulating the economic activities undertaken by these institutions (Yustika, 2012). These two dimensions indicate that the institution makes changes with the existence of certain goals either from the agency or from the agency or internal members of the institution.

Changes caused by exogenous institutional factors often cause shock to the institutional structure. This is due to the exogenous influence which is drastic and has a different value from what is in the institution. In the literature on institutional change, most scholars point to exogenous institutional shocks causing radical or sporadic

institutional reconstruction. This ignores shifts based on the institution's endogenous development which are often gradual and tend to be slow. Indeed, this gradual or incremental change can often be said to be a change when considering a somewhat longer time frame approach (Mahoney & Thelen, 2010). Change that is slow but in a short period of time will not be able to provide inherent institutional change because it is easily lost or has little effect. Prolonged and slow reconstruction is often associated with the company's endogenous development. This is also due to the value inherent in companies or institutions, it is often difficult to be able to adjust to changes in both human resources and through the conditions of their production resources.

Often institutional changes that occur in an institution are related to game theory which is often discussed in economics. The institutional changes that occur are always due to the presence of change agents from both inside and outside the institution itself. The change agent has a significant impact on every factor of institutional change. Actual institutional dynamics involve the interaction of economic, organizational, political and social factors (Aoki, 2007). Of these several factors will affect the domain so that large-scale and mutually sustainable changes can occur. Some of these domains of change are divided based on a multidisciplinary approach to science which includes a sociological approach and an economic approach.

1. The economic exchange domain, usually related with contract and the goodwill of the institution based on the transaction which has been occurred. This is the domain which transaction of each private goods between institutions occurred to generate some profit for each other.

2. The organizational exchange domain and organizational field, institutions can influence each other in interactions that are intentionally or unintentionally carried out. This is due to the role of institutions as actors in the economic-exchange domain so that it can be said to be the organizational-exchange domain. Interactions that are carried out indirectly will lead to the dissemination of information which will affect institutional changes. Often what happens is that each member provides information about the existence of a transaction and various economic activities, thus encouraging other companies to adjust.

3. The political exchange domain, political roles affect how the company performs and what it will do. Similar to the role of the government in organizing public goods procurement, the company interactions and collaborations that will be carried out, whether in transactions or other policies, will change and adjust.

4. The social exchange domain, social values and identical things in other social structures can encourage companies to adjust the social system of the community.

Transactions and various economic activities also get a choice between adjusting, looking for loopholes and opportunities, or avoiding social values if they are contradictory. Company policy will describe how the social exchange domain exerts its influence.

The institutional balance can change endogenously, either indirectly or directly. This can happen if it is done indirectly by making the institution more or less sensitive to exogenous shocks. This results in institutional behavior influencing the level of institutional change directly, assuming institutional enforcement becomes stronger even though it was previously weak, it produces change in the long term. Related behavior will no longer be self-enforcing or new institutional elements will be needed to support it. Such forms of shifting make institutions more or less sensitive to environmental changes and can make them less likely to impose themselves in certain environments. This is because the changes that occur are dominant in the endogenous structure of the institution so that the exogenous changes that occur only have a smaller role (Greif & Laitin, 2004).

## 2.2. Village-Owned Enterprises

Village-owned enterprises are an institution that is formed to accelerate the distribution and poverty alleviation in a village. Village-owned enterprises also play a role as a channeling agency for the welfare of village communities by involving village communities in economic activities in accordance with the exploration of the potential of the area (Agunggunanto, Arianti, Kushartono, & Darwanto, 2016). Common problems experienced by VE are limited capital to start a business so that VE are unable to run various types of business and lack of knowledge of the management in VE management, so that Village-owned Enterprise institutional performance in business development is less than optimal. The level of knowledge and insight of the village community is also low regarding the importance of forming a business group (Daulay et al., 2019). This causes a culture of innovation and institutional development to be low and tends to be rigid in exploring the potential that exists in the village (Agunggunanto, Arianti, Kushartono, & Darwanto, 2016). Participatory development patterns are solutions to problems in overcoming development inequality that is generally experienced by this Village-Owned Enterprise. The participation of the entire community in development, especially economic development, has been able to strengthen the joints of the village economy. (Sutrisna, 2020).

In other research, there are various keys in developing a Village-Owned Enterprise where some of these points include 1) Institutional governance is a key factor in determining the success of any type of Village-Owned Enterprise. This is because if this governance is maximal and professional it will spur profit growth and business reach to be achieved. 2) The sustainability of village-owned enterprises is strongly influenced by the scale and scope of the business. Village-owned enterprises that run internal businesses with outreach and local scale, generally face low risk so that they can run healthily and sustainably. Taking risks in this village-owned enterprise business requires quality human resources who are qualified in managerial fields so as to ensure the sustainability of the business being carried out. 3) Village-owned enterprises that grow out of social solidarity and local wisdom are much stronger and more sustainable than village-owned enterprises, which were born due to government intervention from above. This is because the initiatives carried out by the community often have long-term prospects and are in accordance with the desired direction of the joint. (Diartho, 2017).

Also, other research it examines how changes in Village-Owned Enterprises are related to local village government policies. Village-Owned Enterprises and Village Governments have a close relationship, because the Village Government is the supervisor of the activities carried out by VE. In decision making, VE uses a deliberation mechanism and the Village Government is the main stakeholder involved in the deliberation. The thing that is a challenge for VE and the Village Government is to maintain a balanced relationship, where the domination of one party over the other should be avoided. The different organizational culture between the village government and BUMDES allows for friction between the two institutional cultures. The relationship between the two parties will illustrate how inter-institutional influences are and how changes occur from exogenous influences. In addition to the exogenous influence of the village government, it can also be called an agent of institutional change from the existing VE (Anggraeni, 2016).

### 3. Research Method

The methodology used in this research is based on qualitative studies. Kirk and Miller define qualitative studies as a form of a particular tradition in social science which is based on observations of humans both in their area and in terms (Agunggunanto et al., 2016). This study uses a qualitative descriptive type of research with the aim of providing an overview of the development of BUMDES in East Java Province. The data collection technique used is the documentation technique where this was chosen because the

pandemic conditions did not allow for direct observation and interviews in the field. The data analysis technique used is to use data reduction techniques, data presentation, and drawing conclusions and data verification.

### 3.1. Data

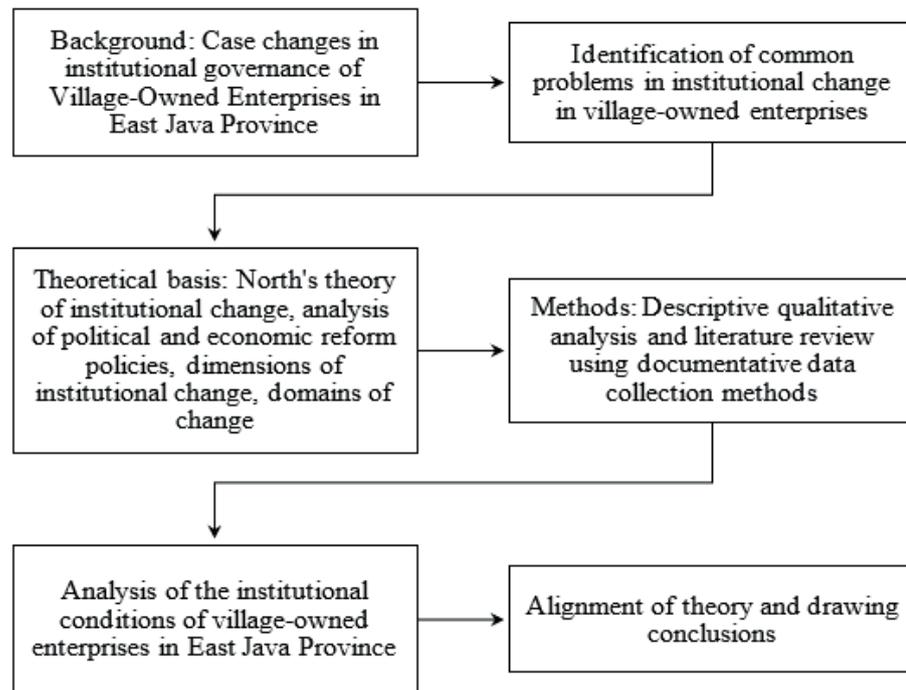
The data used is data from BPS and the East Java Village and Community Empowerment Service (DPMD). This type of data is secondary data where the data has been processed before publication. The data used includes data on the number of VE by type of business, the number of VE in each district, and the classification of VE developments. In addition, the data used from BPS is data regarding the Village Potential which describes the dynamics of change that occur in the village. Village Potential Data is the only source of regional data whose content varies and provides an overview of the development situation of a region (regional) within a certain period of time.

The data used also came from the results of interviews on this topic in various events where the interviewed party was an expert in their field and the interviewee was a credible press institution or media. This data collection was chosen because of restrictions due to the pandemic that exists in society today. In addition, this study also draws on the results of previous research interviews which can be used as a reference in developing scientific research so that it is easy to analyze the results of qualitative data that will be obtained. The framework from this research show from the graph below

## 4. Result and Discussion

### 4.1. Result

East Java Provincial DPMD data shows that the number of Village-Owned Enterprises in East Java Province reaches 6,099 units, which are spread over 30 districts and cities in East Java. Of the total number of villages, namely 8,031 villages, in various districts in East Java, only 24 percent do not have Village-Owned Enterprises or a total of 1,932 villages. The district with the most village-owned enterprises is Kediri Regency with 343 institutions, while the lowest is Kota Batu with 19 institutions. Batu City is the only city that has a Village-Owned Enterprise. On the other hand, Lamongan Regency has the largest number of villages without Village-Owned Enterprises, namely 218 villages, in contrast Kediri Regency is a city with the lowest villages without Village-Owned Enterprises, namely only 1 village. If classified based on the progress of their business,



**Figure 1:** Research framework.

3,325 Village-Owned Enterprises in East Java are classified as startup Village-Owned Enterprises, 2,280 Village-Owned Enterprises are classified as developing, and 494 Village-Owned Enterprises are classified as advanced business entities (DPMD Jawa Timur, 2020).

In national level, the digitalization of BUMDes is facing several challenges as there are less than 4% of BUMDes has access to digital infrastructure. According to Indonesia National Research and Innovation Agency data, there are around 51,134 Indonesian villages had BUMDes by 2021, and 1,852 of those used technology to advertise their goods (e-commerce). The COVID-19 Pandemic triggered the BUMDes' digital transformation, which is predicted to stimulate and accelerate digital transformation in other BUMDes (Indonesia National Research and Innovation Agency, 2022)

Based on data from DPMD East Java, the majority of Village-Owned Enterprises are engaged in financial services. The number of units reaches 4,109 Village-Owned Enterprises. The other largest numbers consist of Village-Owned Enterprises engaged in the trade sector with 640 business units, livestock with 582 business units, shops with 580 business units, leasing with 363 business units, agriculture with 343 business units, and several other sectors variety with a considerable amount. The dominance of

the type of financial service business illustrates the efforts to integrate Village-Owned Enterprises into the residents' economy.

Village-owned enterprises provide loan services for production and consumptive loans. This role is able to suppress the existence of moneylenders and various parties who try to exploit the community through harmful credit loans. In the trade sector, the role of Village-Owned Enterprises is in the form of trading partners for products native to the region and as an intermediary for product marketing with a wide variety of relationships owned by business entities. In addition, in the shopping sector, Village-Owned Enterprises provide services in the form of providing land for village MSMEs to own land to market products or as a place of production. Generally, this type of business is in a village-owned enterprise located in a tourism area. In the rental sector, Village-Owned Enterprises have a role in renting out both land, production equipment, or household consumption goods which require a large amount of money and are difficult to obtain by households themselves. Then for the agricultural sector, generally Village-Owned Enterprises play a role as a Village Unit Cooperative, the party that provides plant seeds, as well as the party that processes agricultural products.

The Village Law that was present in this era encouraged change and new enthusiasm in the establishment of village-owned enterprises. This has spurred every village in Indonesia to take advantage of official institutions from village-owned enterprises with the aim of increasing the prosperity of the village community. Several studies state that Village-Owned Enterprises, especially in East Java Province, show that the role of Village-Owned Enterprises in the regional economy is quite central. Village-owned enterprises also provide a strategic vision of how to increase the role of the village economy independently through the potential of the village. Village-owned enterprises have been recorded as being able to have a significant impact on the growth of micro group businesses in certain villages. Village-owned enterprises have also proven to be significant in promoting self-reliance for village communities (Fitrianto, 2016).

Efforts to improve the institutional quality of Village-Owned Enterprises include the roles of several related policy stakeholders. One of the parties involved is the role of the village government. In running its business, Village-Owned Enterprises have a relationship with the influence of the village government. This is reflected in how the form of the business, initial capital, and future business developments are influenced by deliberations with village government policies. Village funds received also have a special allocation for the development of Village-Owned Enterprises. For example, the role of the village government of Bumiaji in Kota Batu in the village-owned enterprise in the form of the establishment of an institutional structure, oversight of the management

given to the board, and providing suggestions and innovations that can be applied to Village-Owned Enterprises (Chintary & Lestari, 2016).

However, several existing studies show that the role of government in Village-Owned Enterprises is quite moderate in controlling the Village-Owned Enterprises. Participation from the village government in the development of Village-Owned Enterprises was initially quite large but it required continuity to maintain positive development (Asti & Cholid, 2018). The roles that were arranged in the establishment of Village-Owned Enterprises often cannot be carried out optimally so that they cannot provide the effect that is expected to encourage the development of Village-Owned Enterprises (Nardin, 2019). Often there were obstacles in the initial formation regarding the role boundaries between the management of Village-Owned Enterprises and the village government. This impedes an effective institutional transition to provide maximum role for Village-Owned Enterprises in the economy. In addition, there is research that focuses on the role of the Village Leader in how the overall control given by the government is regarding the running of the business. In this case, the village leader plays a role in ensuring how businesses in the community also feel the impact of the role of Village-Owned Enterprises so that welfare is more secure in accordance with the duties of the village leader (Agusliansyah, 2016).

Research carried out in Tlekung Village shows that there is a role for the government as a facilitator by being an intermediary between the Village-Owned Enterprises, especially the Satya Financial Management Unit, and a third party who assists in funding the business planned by the management of the Village-Owned Enterprise. The partnership in conducting this business is one of the efforts to diversify the business units that are supervised by Village-Owned Enterprises. Another role of the government in encouraging institutional change from Village-Owned Enterprises is budgeting grants to be managed as additional capital for efforts to improve the quality of business managerial (Suprojo, 2019). In this case, the government also plays a role in the formation of legal entities of Village-Owned Enterprises which can only be done by the village government as the founder of the Village-Owned Enterprises. The government can also intervene to prevent conflicts of interest in Village-Owned Enterprises due to the presence of third parties (Murwadji, Rahardjo, & Hasna, 2017).

Several studies have shown the same results regarding how the state of institutional change in Village-Owned Enterprises is regarding its own human resources. In general, institutional changes for the better are often hampered or even cannot occur due to the limited quality of qualified human resources. Village communities still have a low understanding of the importance of forming business groups for mutually beneficial

partnerships so as to improve the economy (Agunggunanto et al., 2016). The community also needs to understand how the managerial pattern of group businesses is to form and implement AD / ART, business plans, cash flow, financial reports so that the internal institutional structure is easier to control (Wibisono & Panuntun, 2020). Often also, Village-Owned Enterprises are also difficult to change due to dependence on village government policies so that this will lead to instability of the objectives of the business entity given the absence of independence from political interference in the village (Wulandari, 2019). It is also possible that it will cause continuous change without direction if there is a change of leaders and is prone to conflicts of interest by the authorities and management. In other studies, it shows that many villages are still not really ready to establish Village-Owned Enterprises. This is due to the insufficient internal influence of the village in establishing Village-Owned Enterprises. However, they also want it or not and must overcome this influence and strive to increase community participation in the establishment of Village-Owned Enterprises (Sudarso, 2018).

## 5. Discussion

Village-owned enterprises are a new form of business entity which encourages business ownership by local governments with the aim of maximizing efforts to improve the welfare of rural communities. This Village-Owned Enterprise has an institutional structure that is different from other forms of business in general because this business entity was established with the provisions and agreements of all village communities and facilitated by the village government in its implementation. The establishment of Village-Owned Enterprises also refers to the Village Law which emphasizes the autonomy of the village government in carrying out social, economic and village government life. This Village-Owned Enterprise is also emphasized to be more innovative and adaptive both in managing the business and developing the business ecosystem as well as regarding institutional structures to manage regional potential in order to maximize the welfare received by the community.

From the above study, institutional changes in Village-Owned Enterprises are things that must be done and are common in the implementation of any institution to achieve the objectives of establishing the institution. Referring to Fitrianto's research (2016), in implementing the institutional governance of Village-Owned Enterprises, there are various driving and inhibiting factors. These driving factors include (1) historical factors of establishment and effectiveness of institutional operations that are not just a formality of government so that they are able to adjust to the business economy in society, (2)

careful planning and direction regarding what will be achieved in a short period of time, medium, and long to determine the priority scale chosen by Village-Owned Enterprises, (3) and finally, the management mechanism by professional and willing to learn parties will encourage significant changes to the institution of Village-Owned Enterprises and prevent the existence of Corruption, Collusion and Nepotism. Meanwhile, the inhibiting factors that allow this to occur are (1) the narrow business scope and it is not possible to form a large business ecosystem will affect the efforts of Village-Owned Enterprises to meet the needs of rural communities and turn the wheels of the economy more quickly, (2) people's perceptions of accepting them. Village-Owned Enterprises are merely social institutions that have no influence on the economy so they often ignore the important role of Village-Owned Enterprises and instead consider this as a matter of course because of this assumption.

Based on several previous studies, institutional changes from Village-Owned Enterprises have occurred due to several things including (1) the influence of village government policies regarding the efforts that Village-Owned Enterprises will undertake on village excellence so that they are able to have economic value, (2) increased community needs will demand the efforts of the government and Village-Owned Enterprises to be able to meet the needs of local residents; (3) the existence of local government intervention through policies provided with adjustments to regional economic conditions so that it will affect politics in the village as well as the future policy direction of Village-Owned Enterprises; (4) partnerships to be carried out with third parties, either with industry, government, non-governmental organizations, and other institutions that play a role in encouraging institutions to adjust the partner work system.

Of all the problems that exist and have been studied, Village-Owned Enterprises have various efforts to resolve the main problem, namely regarding the quality of Human Resources, namely through the following ways

1. Aiding in managing Village-Owned Enterprises by policy makers, can also carry out assistance with the assistance of external parties such as non-governmental organizations, CSR from business institutions, and various parties that capable.
2. Establish performance standards and operational procedures to improve the performance of Village-Owned Enterprises. Performance improvements will support positive changes in the institutional structure of Village-Owned Enterprises (Diartho, 2017).
3. Implement an organizational value system that supports innovation such as flexibility, stability, rule oriented and autonomy. These values if applied will support the existence of an effective organizational structure and have a selling value in the form of modern and dynamic institutional influences (Kadir, Jopang, & Elwan, 2020).

4. Utilization of existing social capital in the community can support organizational capabilities in meeting community needs, especially organizations such as Village-Owned Enterprises (Adawiyah, 2018).

5. Maintain the business capital structure so that it can compete with other businesses. Thus, the competitive climate will encourage Village-Owned Enterprises to be more innovative and profit-oriented which will be felt by the community directly or indirectly (Fattah, 2017).

6. Village-owned enterprises are demanded to be more proactive in utilizing existing resources and facilities around their territory, thereby encouraging more positive institutional changes (Chintary et al., 2016).

## 6. Conclusion

Village-owned Enterprises (BUMDES) is one of the decentralization ways to create an independent economy and equitable welfare for the community. Changes in Village-owned Enterprises institutions have become essential, especially in response to the times. One thing that must be strengthened is on the internal side, namely developing quality human resources at Village-owned Enterprises in order to increase the value of each BUMDES itself, for example through fostering partnerships, CSR, implementing organizational values, managing social capital and business capital, and more. proactive and creative in managing the available resources. Though Village-owned Enterprises is not an institution that brings economic value, from an institutional point of view, Village-owned Enterprises becomes a forum for managing every socio-economic element into a single unit that produces economic value to improve the welfare of rural communities.

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