

## **Does organizational level capabilities is important to sustainability performance? A case study on Village Owned Enterprises in Indonesia**

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**Abstract:** This study aims to examine the effect of organizational level capabilities (organizational capabilities, marketing capabilities and technical capabilities) on sustainability performance. Data was obtained through questionnaires distributed to 121 directors of Village Owned Enterprises. Data was analyzed by using structural equation model-partial least square (SEM-PLS). Results showed that organizational capability has a significant effect on sustainability performance. The findings also indicate that marketing capabilities and technical capabilities also have a positive effect on sustainability performance. This study suggest that the optimalization of organizational capabilities are important to ensure the existence of the organization in the business.

**Keywords:** Village owned enterprises, organizational level capabilities, sustainability performance

### **INTRODUCTION**

Village Owned Enterprise (in Indonesian term call Badan Usaha Milik Desa or BUMDes) is a business entity established with the aim of improving the economy and welfare of the village. At the beginning of its establishment, Village Owned Enterprises received financial support from local and village governments. In the course of its business, Village Owned Enterprises still continue to get injections of funds from villages and local governments ([Kemendes.go.id](http://Kemendes.go.id)). This condition cannot take place continuously. Village Owned Enterprises must be independent and not depend on injection of funds. For this reason, Village Owned Enterprises must not only increase their income so that they can provide additional income to the village, but also provide benefits to the community in order to carry out its social mission.

Sustainability performance shows the ability of an organization to exist over time, protect the organization, the environment and the social life of stakeholders and the community. To improve sustainability performance, Village Owned Enterprises must have a competitive advantage. Competitive advantage will arise because of the renewal and development of its capabilities [1].

Capability is the ability of an organization to carry out its tasks or activities in a coordinated manner so as to achieve organizational goals [2, 3, 4]. Capabilities can be seen from various points of view, including organizational level capabilities [5-9]. Organizational level capabilities focus on three important orientations (a) managing an efficient and effective production department that is open to product and process innovation, (b) developing technical knowledge and expertise with regard to economies of scale, and (c) investing in equipment and technological capabilities [10]. Several studies have provided evidence that organizational level capabilities have an influence on organizational performance [10-13].

This study aims to examine and analyze the effect of organizational level capability on sustainability performance. This research is expected to contribute to broaden insight for Village Owned Enterprises to achieve business sustainability and increase competitiveness. Furthermore, Village owned enterprise is also expected to be able to recognize and utilize its capabilities so that Village owned enterprise is able to adapt to the rapidly changing business environment.

This paper is organized as follows. Section 2 reviews the related literature and hypotheses development. Section 3 presents the research method. Section 4 summarizes the empirical results, and the final section provides conclusions from the paper and makes recommendations.

### **Literature review and hypotheses development**

#### *Organizational level capabilities*

Organizational level capability refers to dynamic capability theory which is the ability of an organization to intentionally adjust its organizational resource base. Organizational level capability is defined as a company's ability to integrate, build and reconfigure internal and external competencies to cope with a rapidly changing environment [14].

Teece [1], defines four categories of capabilities that an organization must have in a dynamic environment: perceiving opportunities and threats; shape market evolution and innovation; seize market and technological opportunities; and managing market and technological threats. In an unstable market, basic capabilities tend to wear out quickly. Therefore, every organization must be able to develop and renew its resources to maximize productivity which will have an impact on the sustainability of the organization itself [15].

López-Cabarcos et al [10] divides organizational level capabilities into three parts consisting of organizational capabilities, marketing capabilities and technical capabilities.

#### *Organizational capabilities and sustainability performance*

Sustainability performance of an organization shows its ability to protect the organization, the environment and the social life of stakeholders and the community. To create sustainability performance, one of the factors that must be owned by an organization is competitive advantage. An organization is said to have a competitive advantage if the organization has characteristics and resources that can create higher performance than other organizations in the same industry or market (16). Organizational competitive advantage arises because the organization continues to update and develop its organizational capabilities [1].

Organizational capability refers to organizational and managerial processes that include managerial competence, employee knowledge and skills, efficient organizational structure, organizational culture, efficient coordination mechanisms, strategic planning procedures, and the ability to attract employee creativity [14]. With the ability of organizations to update and develop organizational and managerial processes, organizations will be able to create competitive advantages which can then improve organizational performance. Organizational performance that increases continuously will bring the organization towards sustainability performance. Thus the organization can protect the organization, the environment, the lives of stakeholders and the community, thereby increasing the organization's performance. Several studies have shown the positive influence of organizational capability on performance [1, 10, 11] and sustainability performance [17]. Based on above discussion, the following hypothesis is proposed:

H1: Organizational capabilities have a positive effect on Sustainability Performance.

#### *Marketing capabilities and sustainability performance*

In achieving sustainability performance, Village Owned Enterprises and similar businesses must balance their social and commercial objectives. Commercial goals support the organization to continue to carry out the organization's social missions [18]. In carrying out commercial objectives, the organization must have something more than its competitors in attracting consumers and defending themselves against the strength of its competitors who are trying to suppress the organization. This ability came to be known as marketing capabilities.

Marketing capabilities are results-based competencies and are measured by items such as building special relationships with customers and suppliers, market knowledge, control over distribution channels, and placing a strong customer base [19]. Organizations that are able to develop marketing capabilities in accordance with the needs of the current business environment will be able to achieve commercial goals, which then make the organization will continue to emerge with social missions for stakeholders. The long-term existence of the organization aims to maintain the sustainability of the organization's performance [20]. Previous research shows that marketing capability has a positive influence on performance [21, 22]. Thus, the proposed hypothesis is:

H2: Marketing capabilities have a positive effect on sustainability performance.

#### *Technical capabilities and sustainability performance*

Leonard-Barton [23] defines technical capabilities as transformation-based competencies that refer to the competencies needed to convert inputs into outputs. Some other researchers give the technical term capabilities as technological capability [24]. Technical capability is measured by three items, namely, efficient production departments, technological and infrastructure capabilities, and economies of scale and technical experience.

Technical capabilities also involve the manufacturing process, technology, development of new products, production facilities, and forecasting technological changes in the industry. These skills are contained in organizations and are activated by markets, competitors, and external challenges and opportunities. By

increasing efficiency in the production process, it can reduce costs and increase consistency in shipping and, thereby increasing organizational competitiveness [24, 25].

By developing and updating technical capabilities, the organization will run more productively. This then causes the organization to have a competitive advantage that causes the organization to achieve its goals in a sustainable manner. So that, the sustainability performance of the organization can be improved. Previous studies have shown the influence of technical capabilities on performance [11]. Based on above discussion, the third hypothesis is proposed:

H3: Technical capabilities have a positive effect on Sustainability Performance.

## METHOD

### *Populations and sample*

The population of this study is 121 units of Village-Owned Enterprises in Siak Regency, Riau, Indonesia. Sampling is done by census method that is using the entire population as a sample. Respondents of this study were director of Village Owned Enterprises. The questionnaire was distributed directly to the Village owned enterprise's director.

### *Data collection*

The data in this study were obtained from a questionnaire sent in hardcopy to the Village-Owned Enterprises director in 121 Village-Owned Enterprises units. Research variables were measured using a ten-point scale, one for strongly disagree (1) and ten for the totally agree (10). Data were then analyzed using SEM-PLS with WarpPLS 5.0 software.

### *Measurement of variables*

Organizational level capabilities are capabilities owned by the organization consisting of organizational capabilities, marketing capabilities and technical capabilities. This variable was measured by using an instrument developed by López-Cabarcos et al [9] and Spanos dan Lioukas [10]. Organizational capability is measured using 7 items, marketing capability is measured by 4 items and technical capability is measured by 3 items.

Sustainability Performance in this study is seen from two sides. First, the organization has the ability to financial sustainability so that the organization is able to survive from time to time. Second, the organization also carries out social performance that will have a long-term impact on organizational sustainability. Sustainability performance variables are measured using 14 items adopted from Bagnoli and Megali [26].

## RESULT AND DISCUSSION

### **Results**

Of the 121 questionnaires distributed, the responses received were 89 (73.55%). This data is then processed further with the help of WarpPLS 5.0.

### *Assessment of outer model*

Evaluation of the outer model is done by looking at the validity and reliability. Validity is evaluated through confirmatory factor analysis by examining convergent validity and discriminant validity [27]. Convergent validity test results are performed by looking at the loading indicator. The results show that the loading value is between 0.649-0.928 > 0.50. AVE values are in the range of 0.561-0.784 > 0.50, this indicates that the indicators used in this study can explain each variable [28, 29]. Discriminant validity is performed by comparing the square root of average variance extracted (AVE) values of each construct with correlations or constructs with other constructs in the model. The table above shows that the square root of AVE for each construct is greater than the correlation value between constructs and other constructs in the model, so it is said to have good discriminant validity values [27].

Tabel 1. Validity and Reliability

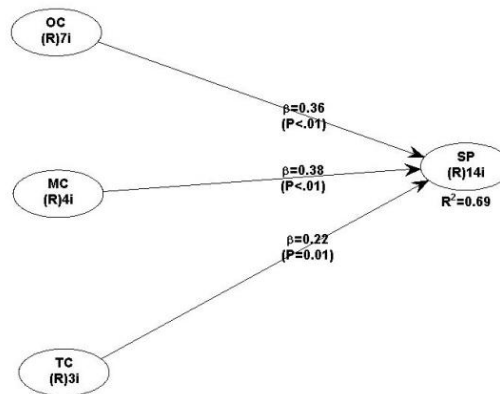
Variable	Cronbach's alpha	Composite Reliability	AVE	Correlations among l.vs. with sq. rts. of AVEs			
				OC	MC	TC	SP
OC	0.897	0.920	0.621	0.788			
MC	0.885	0.921	0.745	0.555	0.863		
TC	0.861	0.916	0.784	0.648	0.653	0.885	
STNP	0.939	0.947	0.561	0.719	0.727	0.705	0.749

Source: WarpPLS 5.0

*Assessment of inner model*

Figure 1 below show that the R-square value on the organizational level capability is 0.694, meaning that 69.4% of the organizational level capability is influenced by organizational capability, marketing capability and technical capability and the rest is influenced by variables outside the model.

Figure 1 displays the results of hypotheses testing. Organizational Capability (OC) has a positive effect on Sustainability Performance (SP) ( $\beta = 0.364$ ,  $PV < 0.001$ ), Marketing Capability (MC) has a positive effect on Sustainability Performance (SP) ( $\beta = 0.381$ ,  $PV < 0.001$ ), Technical Capability (TC) has a positive effect on Sustainability Performance (SP) ( $\beta = 0.220$ ,  $PV = 0.015$ ).

**Figure 1.** Full Structural Equation Model.**Discussion**

This study aims to examine and analyze 3 proposed hypotheses. Results from PLS support all hypotheses proposed. Organizational level capabilities have a positive effect on sustainability performance. In order for an organization to maintain its performance, the organization must renew and develop the capabilities of the organization in accordance with the business environment [14]. This research proves that the more managerial and employee competencies increase, the more efficient the organizational structure, the more conducive the organizational culture, the more efficient the coordination mechanism, the better the strategic planning and the more creative the employee's abilities, the more sustainable the performance of the organization.

This research also proves that the better the organization's relationships with customers and suppliers, the more the organization's knowledge of the market, the more organizational control of the distribution channel, the more precisely the organization places a strong customer base, the sustainability performance of the organization will increase. Finally, this research proves that the more efficient the operation of the production or service department, the more technological capability and infrastructure of the organization, the more technical organizational experience increases, the better the Village-Owned Enterprises sustainability performance. The results of this study support the dynamic capability approach. In a dynamic Village-Owned Enterprises environment, developing and updating organizational level capabilities is an important thing to do.

**CONCLUSION**

This research has succeeded in achieving its objectives. However, interpretation of the results of this study needs to be done carefully. This research was only conducted at Village-Owned Enterprises in 1 district, so the results of the study could not be generalized to Village-Owned Enterprises throughout Indonesia. In this study, sustainability performance is only influenced by one variable, namely organizational level capability. Previous research found that market orientation and corporate governance [30, 31] also play a role in improving sustainability performance. Future research can enlarge the sample to improve the generalization of research results and add other variables as variables that can affect sustainability performance, so that research results become more comprehensive.

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