



Enhancing the Performance of Village-Owned Enterprises: The Role of Transformational Leadership and Organizational Capabilities

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ABSTRACT

Objective - This study aims to investigate the extent to which transformational leadership could enhance financial and social performance of village-owned enterprises through organizational capabilities.

Methodology/Technique – This study conducted a survey involving village-owned enterprises in Siak Regency, Indonesia. 121 questionnaires were distributed directly to the directors of village-owned enterprises and 89 completed and usable responses were received. Data was analyzed using WarpPLS 5.0 to determine that transformational leadership, directly and indirectly through organizational capabilities can enhance financial and social performance of village-owned enterprises.

Finding - This study demonstrates that transformational leadership has a positive direct effect on organizational performance. Transformational leadership also has a positive effect on organizational performance through organizational capabilities. This study proves that organizational capabilities act as a partial mediator on the relationship between transformational leadership and organizational performance. **Novelty** - The results of this study demonstrate that transformational leaders are important in improving the performance of village owned enterprises. Therefore, this study suggests that village consultative bodies need to consider the behavioural characteristics of transformational leadership in recruiting village-owned enterprise directors.

Type of Paper: Empirical.

Keywords: Transformational Leadership; Organizational Capabilities; Financial Performance; Social Performance; Village-owned Enterprises.

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1. Introduction

As a business entity owned by the village, Village-Owned Enterprise has a very important role for all elements in the village in Indonesia.

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Village-Owned Enterprise is expected to improve the economy of the community and the village, by doing business that suits the potential of the village. Therefore, to achieve its mission, this organization has to demonstrate financial success and welfare for the village community.

The success of an organization cannot be separated from the ability of organizational leaders to optimize the resources of the organization. One of the abilities that organizational leaders need to have is the ability to make changes, which is known as transformational leadership. Transformational leadership is a type of leadership where the leader has the ability to motivate employees to do their work beyond the minimum limit of their job description. Transformational leadership theory shows that transformational leadership is not only related to individual employee performance but also performance at the group and organizational level (Bass, 1985; Chen et. al., 2019).

Leaders who have the ability to influence subordinates in certain ways to make a change can enable the organization to exist in a dynamic environment. For organizations to continue to survive in a dynamic environment, organizations must develop capabilities to enhance core business processes and sustainable learning (Zoot, 2003). The capability referred to here is the ability of the organization to carry out its tasks or activities in a coordinated manner so as to achieve organizational goals (O'Regan et. al., 2006). Thus, the organization will be able to improve its performance. Several studies have found that the capabilities of a company have a positive impact on organizational performance (Henri, 2006; Krasnikov & Jayachandran, 2008; Lekatompessy, 2012; López-Cabarcos, et. al., 2019; López-Cabarcos, et. al., 2015; Spanos & Lioukas, 2001).

Village-owned enterprises are expected to improve the economy of the community and the village. They are able to choose a type of business that is suited to the potential of the village. These types of businesses include: social businesses, rentals, broking, production, trade and financial services. Of the various types of businesses, most Village-Owned Enterprise chose to operate in the savings and loan businesses. With the condition of savings and loan businesses that have little income and high risk, many Village-Owned Enterprise experience non-performing loans (krjogja.com). In addition, Village-Owned Enterprises engaged in small and medium scale financial services have certain competitors, namely the Rural Bank (in Indonesian term is BPR) and Cooperatives. With a high level of competition and change, Village-Owned Enterprises must have the capability to be able to show good performance and be able to compete with dynamic competition.

This study aims to investigate the effect of transformational leadership on organizational capabilities and its effect on the financial and social performance of village-owned enterprises. Village-owned enterprises have an important role in improving village welfare, therefore village-owned enterprises must be able to achieve the financial and social goals of the village-owned enterprise itself. Like any other enterprises, the leaders of village-owned enterprises have an important role in planning and utilizing the organization's resources and achieving organizational goals.

Based on the discussion above, this study aims to investigate to what extent leaders that are categorized as transformational leaders are able to enhance the capabilities of an organization, particular of a village-owned enterprise facing a dynamic environment, and therefore will have an impact in leveraging the performance of the organization itself. Past studies on transformational leadership have focused on profit organizations (Chen et. al., 2019; Hamidizadeh, Oboudi & Ramezani, 2017; Lekatompessy, 2012; López-Cabarcos, et. al., 2019; López-Cabarcos, et. al., 2015; Song et. al., 2007). Therefore, this study contributes to the existing literature by providing evidence of the importance of the role of transformational leadership and organizational capabilities to enhance the financial and social performance of village-owned enterprises. Therefore, this study suggests that village consultative bodies need to consider the characteristics of directors who have a transformational leadership style in recruiting village-owned enterprise directors.

The rest of this paper is organised as follows. Section 2 presents the literature review and hypothesis development. A discussion of the research methodology is provided in Section. 3. Section 4 reports the results and explanation of the study. Finally, section 5 present concludes the study.

1. Literature Review and Hypotheses Development

We developed a conceptual framework for this study based on previous literature relating to leadership, organizational capability, organizational performance, resource-based view theory (RBV) and dynamic capability theory. The RBV believes that competitive advantage and performance of organizations depends on how organizations utilize their available resources, which are scarce and difficult to emulate by competitors in the market (Barney, 1991). Organizations will achieve superior performance and a sustainable competitive advantage if competitors find it difficult to imitate company resources with other alternatives and require high costs to replicate them (Amit & Schoemaker, 1993).

The rapidly changing environment is encouraging companies to pay more attention to dynamic capability. Dynamic capability is the development of RBV theory. Dynamic capability is defined as the ability to perceive opportunities, make investments to seize opportunities and reconfigure the resource base and the ability to adopt change (Teece, 2007). This dynamic capability will then become a source of significant and sustainable competitive advantage (Wu, 2010).

RBV and dynamic capability have been the basis for important empirical studies related to intangible resources (Newbert, 2008); technological, marketing, or regulatory capabilities and their effect on performance measures (De Carolis, 2003), or the importance of resources and the ability to gain a competitive advantage in public organizations (Symaniec-Micka, 2014).

2.1 Transformational Leadership

Transformational leadership was first introduced by James MacGregor in 1978 and, according to Burns (1978), transformational leadership is a process of mutual assistance between leaders and subordinates to advance to a higher level of moral and motivation than ever before. Transformational leadership is also defined as the ability of leaders to motivate employees to exceed the minimum limit of their job descriptions, so as to produce contextual performance that is higher than before (Podsakoff, MacKenzie & Bommer, 1996). Transformational leaders communicate organizational vision and motivate employees to work towards that vision (Bass, 1985). Transformational leaders also instill pride, communicate privately, facilitate creative thinking, and inspire employees (Lievens et. al., 1997). Transformational leadership will create conditions of mutual care and mutual inspiration between employees which in turn produces high performance (Bass, 1999).

Transformational leadership focuses on what the leader wants to achieve while taking into account the personal characteristics of the leader to their subordinates (DuBrin, 2010). Transformational leadership has four dimensions (Bass & Avolio, 2003). First, idealized influences, which are charismatic elements of transformational leadership where leaders will be role models who are admired, respected, and imitated by others. Second, inspirational motivation, meaning the leader inspires and motivates by giving meaning and challenge to the work of his subordinates. Third, intellectual stimulation, by gathering new ideas and problem solutions from his subordinates. Finally, individualized consideration, in which leaders' channel personal attention to others based on individual needs for achievement and growth.

A leader with a transformational leadership style is characterized by six behaviors. These are: identifying and articulating a vision, providing an appropriate model, encouraging acceptance of group goals, high performance expectations, providing individual support to staff and intellectual stimulation (Podsakoff, McKenzie, Moorman, & Fetter, 1990). The understanding of the behavioral characteristics of transformational leaders was extended by Charles, Wearing and Mann (2000) to include seven behaviors, which are developed based on Podsakoff, McKenzie, Moorman, and Fetter (1990). The seven behaviors are: (1) communicates a vision, (2) develops staff, (3) provides support, (4) empowers staff, (5) is innovative, (6) leads by example, and (7) is charismatic.

Past empirical studies have been conducted to examine the effect of transformational leadership on individual performance (Buil et. al., 2018; Dvir, Eden, Avolio, & Shamir, 2002; Wang, Law, Hackett, Wang,

& Chen, 2005) and the effect of transformational leadership on organizational performance (Aragon-Correa et. al., 2007; Choudhary et. al., 2013; Peterson, Walumbwa, Byron, & Myrowitz, 2009; Rowe et. al., 2005). Previous research has also shown that transformational leadership has an indirect effect on organizational performance through culture (Ogbonna & Harris, 2000), knowledge management (Birasnav, 2014; Gowen et. al., 2009), entrepreneurship (Morales et. al., 2006), human resource management (Zhu et. al., 2005), and competitive strategies (Menguc et. al., 2007). The indirect relationship between transformational leadership and organizational performance can also be seen through organizational capabilities. Previous studies have examined the effect of transformational leadership on organizational performance through organizational capability elements such as through innovation (Arago'n-Correa et. al., 2007; Farr & Ford, 1990; Morales et. al., 2012; Kanter, 1983; Para-González, 2018) and organizational learning (Arago'n-Correa et. al., 2007; Morales et. al., 2012; Para-González, 2018). This study seeks to investigate empirically whether transformational leadership influences organizational performance through organizational capabilities, where organizational capabilities are seen from marketing capabilities, technical capabilities and organizational capabilities as a whole (López-Cabarcos et. al., 2015; López-Cabarcos et. al., 2019; Ali et. al., 2019).

2.2 Organizational Capabilities

Organizational capability is a strategy that can bring the organization a competitive advantage so that it has an impact on performance (Henri, 2006). Organizational capability refers to an organization's capacity to maintain combined resources in an organizational process to influence the final outcome (Amit & Schoemaker, 1993). Barney (1991), Peteraf (1993), and Prahalad and Hamel (1990) argue that an organization can survive in a highly competitive environment due to its ability to create new resources, form a good capability program, and make capabilities more unique so that it cannot be imitated by other organizations.

Teece et. al. (1997) and Jones et. al. (2005) argue that the concept of organizational capability has a foundation in competitive advantage. The resource-based view (RBV) theory also considers that organizational capability can be used to maintain competitive advantage (Lekatompessy, 2012; Singh, et. al., 2019). Whereas dynamic capability theory posits that to maintain a sustainable competitive advantage, organizations must have capabilities that involve sensing and forming opportunities and threats, seizing opportunities, managing threats and reconstructing organizations (Teece, 2007). This theory also posits that in a non-static environment, companies must change the way they create and capturing value through future vision, business model innovation and future strategies to obtain and maintain sustainable competitive advantage (Eisenhardt et. al., 2010; Teece, 2007).

Most previous studies examine organizational capabilities and tested them partially. Organizational capability is seen as innovation (Miller & Friesen, 1982), or market orientation (Subramanian & Gopalakrishna, 2001). Baker and Sinkula (1999) and Arago'n-Correa (2007) conducted a study of organizational capabilities in terms of market orientation and learning orientation. Bhuian et. al., (2005) studied organizational capabilities as entrepreneurship and market orientation. Organizational capability is seen by Deshpande and Farley (2004) as market orientation and innovation. Hurley and Hult (1998) looked at organizational capabilities with innovation, market orientation, and organizational learning. Henri (2006) conducted a study about organizational capabilities and in his research Henri (2006) examined the organizational capabilities of four elements namely: market orientation, innovative, organizational learning, and entrepreneurship. In general, previous research has looked at organizational capabilities through market orientation, innovation, organizational learning, and entrepreneurship.

Meanwhile, Spanos and Lioukas (2001) and López-Cabarcos et. al. (2015) view capability as a concept consisting of organizational capability, marketing capability and technical capability. Some researchers studied organizational capabilities partially, such as marketing capabilities (Hooley et. al., 1999; Kamboj & Rahman, 2015; Takahashi et. al., 2017) and technological capabilities that have the same view as technical capabilities (Vitorino Filho & Moori, 2018; Wang et. al., 2006).

2.3 Organizational Performance

Organizational performance is a reflection of organizational success in achieving its objectives from various activities undertaken (Ventrakaman & Ramanujam, 1986). Waterhaouse and Svendsen (1998:59) define performance as measurable actions or activities. Organizational performance is an indicator of the level of success in achieving organizational goals.

There are various indicators that can be used to measure organizational performance. Lee and Miller (1996) measure organizational performance using sales growth, revenue growth, market share growth, asset growth, new product development, employee morale and employee welfare as indicators. Agarwal et. al., (2003) measure organizational performance using two dimensions, namely objective and subjective performance. Objective performance is related to financial performance and marketing performance such as profitability and market share. Whereas subjective performance is based on measurements of customers and employees such as service quality, customer satisfaction and others.

Henri (2006) notes that performance measures began to develop in the early 1990s and culminated in 1996. Lynch and Cross (1991) in Henri (2006) introduced a performance pyramid linking strategy and operations by translating strategic objectives from top-down measures and bottom-up size. In 1992 and 1996, Kaplan and Norton proposed a form of performance measurement called the balance scorecard. Kaplan and Norton assumed that financial perspectives alone did not adequately describe organizational performance. Therefore, the concept of performance measurement of the resulting balance scorecard is not only seen from a financial perspective, but also from a non-financial perspective consisting of a customer perspective, internal process perspective and organizational capacity.

Along with the development of various types of businesses, a type of businesses which main purpose is to create value for society is gaining popularity (Certo & Miller 2008). This type of business combines profit seeking and social goals (Peredo & McLean 2006; Neck et. al., 2009). This kind of business has two elements in measuring its success; financial and social performance. Financial performance measures the ability of an organization to generate profits to support its social goals. Social performance can be measured by evaluating the sustainability of resources and production methods, the number of activities carried out to achieve the established social mission, the positive effects of social activities carried out and the long-term impact of social activities carried out on the wider community (Bagnoli & Megali, 2011). In this study, the performance of village-owned enterprises is measured by looking at their financial performance and social performance since the village-owned business enterprises in carrying out its business has two functions, namely financial functions and social functions. The two functions are interrelated, where the financial function encourages village-owned enterprises to continue to improve their social performance for the community.

2.4 Transformational Leadership and Organizational Capabilities

Leadership is a process in which a leader influences subordinates in seeking subordinate voluntary participation to achieve organizational goals (Arshad et. al., 2016). Therefore, a leader can be defined as a person who delegates or influences others to act in carrying out goals (Morales et. al, 2012). Significantly increased business competition with a changing business environment forces organization to keep abreast of these changes in order to survive. For this reason, organizations need leaders who have the ability to understand the complexities of a rapidly changing and dynamic global environments. Different leadership styles will have different impacts within the organization (Buil et. al., 2018).

Transformational leadership style is a leadership style that increases awareness of collective interests among members of the organization and helps them to achieve their collective goals (Morales et. al., 2012). Transformational leadership seeks to create emotional connections with subordinates and inspire them to higher values. Transformational leadership is committed to organizational goal. Therefore, transformational leadership will strive to encourage all employees to commit to the results they achieve (Bass, 2000).

Transformational leaders try to make changes to organizations with the aim of shaping them into something different (Arshad et. al., 2016). This is done to prepare the organization for challenges, such as dealing with new technology or new competitors. These changes can be made by developing capabilities that are in improving core business processes and sustainable learning (Senge, 1990; Zott, 2003).

Capability is the ability of an organization to carry out its tasks or activities in a coordinated manner so as to achieve organizational goals (Eikelenboom, 2005; O'Regan et. al., 2006). The capability must focus on three important elements (a) managing an efficient and effective production department that is open to product and process innovation, (b) developing technical knowledge and expertise by exploring economies of scale, and (c) investing in equipment and technological capabilities (López-Cabarcos et. al., 2015). López-Cabarcos et. al. (2015) divides organizational level capabilities into 3 elements namely: organizational capabilities, marketing capabilities and technical capabilities. Leaders who are able to make changes will be able to recognize and analyze the capabilities possessed by the organization. With these abilities, the resources owned by the organization be utilized properly in accordance with organizational goals. Based on the above discussion, the following hypothesis is proposed:

H1 Transformational leadership has a positive effect on organizational capabilities.

2.5 Transformational Leadership and Financial Performance

Transformational leadership describes how leaders can encourage, develop, and implement significant changes in the company, by empowering employees to direct them to change, to achieve greater quality and efficiency of all organizational business processes (Bass, 1999; Lievens et. al., 1997). To achieve positive change, leaders must have certain characteristics and skills, be role models for subordinates (charisma), have a set of moral values that are highly developed, must be competent, reliable, have a vision and be able to motivate others to accept that vision and implement it.

Transformational leadership theory states that leaders exhibit certain behaviors that accelerate the level of employee innovation so as to improve employee performance, organizational innovation, and organizational performance (Colbert, Kristof-Brown, Bradley, & Barrick, 2008). By implementing transformational leadership, leaders will easily direct their subordinates to achieve organizational goals. With the proper implementation of business processes, the company's financial performance can be improved. Previous research provides evidence that transformational leadership influences financial performance (Avolio et. al., 1988; Barling, Weber & Kelloway, 1996; Howell & Avolio, 1993; Koene, Vogelaar & Soeters, 2002; Strukan, Nikolic & Sefic, 2017). Thus, the proposed hypothesis is:

H2 Transformational leadership has a positive effect on financial performance.

2.6 Transformational Leadership and Social Performance

As mentioned above, village-owned enterprises not only have the aim of generating profit but also have social goals. Organizational social goals can be achieved if all members of the organization understand the social value of the organization and leaders have an important role in transmitting values (Abu Tineh et. al., 2008). Transforming values, attitudes, and motives of employees from a low level to a higher level of passion and maturity will enable the achievement of high performance (Bass, 1985).

Burns (1978) suggests that transformational leadership occurs when leaders and subordinates increase each other's higher values and motivations and produce a transformation effect on leaders and subordinates. Employees under transformational leaders have full confidence in the leader's vision and mission. So that leaders who have transformational leadership will be able to instil the values and social goals to be achieved by the organization and transform it to employees. The process of transforming the values and objectives will result in a transformation in the activities and performance of employees. That way leaders and employees

together will provide an influence on improving social performance. Transformational leadership can improve organizational performance (Singh et. al., 2015). In addition, transformational leadership contributes significantly to effective organizational policy and performance (Bass, 1998). Transformational leadership is also predicted to improve an organization's social performance. Based on above discussion, the following hypothesis is proposed:

H3 Transformational leadership has a positive effect on social performance.

2.7 Organizational Capabilities and Financial Performance

A dynamic business environment forces organization to be able to maintain business sustainability by creating a competitive advantage. An organization's competitive advantage depends on its capabilities to acquire, integrate, and reconfigure resources in responding to a changing business environment (López-Cabarcos et. al., 2015). The main theory of dynamic capability (Eisenhardt & Martin, 2000; Teece et. al., 1997) supports the idea that performance and competitive advantage results from reconfiguring resources that are appropriate to their environment.

Organizational capability is a strategy that can bring an organization a competitive advantage (Henri, 2006). Organizational capability is important to assist organizations in relation to management and organizational processes, leader competencies, employee knowledge and skills, efficient organizational structure, organizational culture, existing coordination mechanisms, strategic planning procedures, and the ability to attract employee creativity (Galbreath, 2005; Teece et. al., 1997). Organizations with capabilities will be able to manage operational activities more effectively and efficiently and make management and employees more productive. This will improve financial performance, as seen by an increase in organizational income. The resulting profit illustrates the increase in financial performance achieved by the organization.

Based on the RBV theory, dynamic capability theory and empirical findings, capabilities have been considered as antecedents to performance (Wernerfelt, 1984). Several studies have shown a positive relationship between capability and performance (Richey, Tokman, & Dalela, 2010; Lekatompessy, 2012). López-Cabarcos et. al., (2015) have also proven that capability and profitability have a positive relationship. Based on the above discussion, the following hypothesis is proposed:

H4 Organizational capabilities have a positive effect on financial performance.

2.8 Organizational Capabilities and Social Performance

The creation of social value is the main goal of village-owned enterprises, while the creation of economic value is needed in order to encourage the organization to improve its social performance (Mair & Martí, 2006). Social value refers to the supply of goods and services needed for an organization's social purposes such as community service, community development, community economic improvement, or dealing with various other social problems (Austin, Stevenson & Wei Skillern, 2006; Sud, Van Sandt, & Baugous, 2009).

To be able to achieve the organization's social goals, the organization must have the ability to manage its resources (Bagnoli & Megali, 2011). Several studies have focused on resource theory and capabilities in assessing the achievement of organizational goals. This approach stresses the importance of analysing the organization's resources and capabilities, their use, characteristics, or new capabilities that result in organizations from existing and complementary interactions (Barney, 2002; Grant, 1996). With the abilities and capabilities of the organization in managing and analysing its resources, this will support the organization in achieving its goals. Village-owned enterprises that prioritize social goals will be able to achieve higher social performance so that the benefits will be felt by the community. The study of the effect

of organizational capability on social performance is still limited. This study aims to identify the focus of capability relationships on social performance. Therefore, the following hypothesis is proposed:

H5 Organizational capabilities have a positive effect on social performance.

2.9 Transformational Leadership, Organizational Capabilities and Financial Performance

Several studies have been conducted to determine the direct effect of transformational leadership on financial performance, profitability and other financial measures (Purvee & Enkhtuvshin, 2015; Wongyanon et. al., 2015). Several previous studies have also examined the relationship of organizational capabilities to financial performance. In this study, organizational capability is positioned as a mediating variable that mediates the relationship between transformational leadership and financial performance. This is based on the argument that transformational leadership is the ability of leaders to align employee goals and organizational goals. This will cause the employee to fully trust the leader, resulting in higher motivation in the employee. That way, employees make greater contributions to produce creativity that is beneficial to the organization. The process of production and management of the organization will also be more effective and efficient, all of which are capabilities possessed by the organization. Through this organizational capability that can be optimized, the organization will be able to experience an increase in revenue which will impact its financial performance. Based on above discussion, the following hypothesis is proposed:

H6 Organizational capabilities mediate the relationship between transformational leadership and financial performance.

2.10 Transformational Leadership, Organizational Capabilities and Social Performance

Transformational leadership can affect social performance if the leader is able to empower the capabilities of the organization. Transformational leaders are able to maximize the utilization of capabilities owned by the organization. Leaders will also be able to explain the company's social goals to employees and direct them towards these goals (Bass, 1985; Bass, 1999; Lievens et. al., 1997). That way, employees will align their goals towards the organization's social goals, and ultimately have an impact on improving the organization's social performance. Therefore, the proposed hypothesis is:

H7 Organizational capabilities mediate the relationship between transformational leadership and social performance.

3. Research Methodology

This is a quantitative study which uses a questionnaire to obtain data. The data in this study was analyzed using Structural Equation Modelling-Partial Least Square (SEM-PLS) using WarpPLS 5.0. The population in this study is 121 Village-Owned Enterprise in Siak Regency, Riau Province, Indonesia. All of the member of the population were taken as a sample. The respondents in this study were the directors of Village-Owned Enterprises. The questionnaires were handed over directly to the directors. The respondents were asked to rate their perception of the statements given using a 1-10 scale from strongly disagree (1) to strongly agree (10).

This study investigates three constructs namely: transformational leadership, organizational capability and organizational performance. Transformational Leadership was measured using 7 items adopted from Carless, Wearing and Mann (2000). Organizational capability in this study is defined as the ability of the organization to carry out its tasks or activities in a coordinated manner so as to achieve organizational goals. This is measured using instruments developed by López-Cabarcos et. al., (2015) and Spanos and Lioukas (2001).

There are 14 items to measure capabilities; 7 items to measure organizational capability, 4 items to measure marketing capability and 3 items to measure technical capability. Organizational performance consists of financial performance and social performance. Organizational performance is measured by 5 items consisting of 3 items of financial performance and 2 items of social performance. The instrument used was adopted from Widener (2007) and Bagnoli and Megali (2011).

4. Results

From the 121 questionnaires distributed, 94 questionnaires were returned. 5 questionnaires were dropped due to incomplete responses. Therefore, only 87 responses (73.55% response rate) can be further analysed.

4.1 Assessment of the Model

An evaluation of the model was conducted by testing the validity and reliability of the model. Validity is evaluated through a confirmatory factor analysis by examining convergent validity and discriminant validity (Latan & Ghozali, 2012). Convergent validity is assessed using the loading indicator. This research model has a loading between 0.614-0.907 and greater than 0.50. AVEs are in the range of 0.530-0.744 and greater than 0.50. This indicates that the indicators used in this study can explain each variable (Chin, 1998; Hair et. al., 2014). Discriminant validity is performed by comparing R² of average variance extracted (AVE) of each construct with correlation or construct with other constructs in the model. Correlations among latent variables. With R² of AVEs shows that the R² of AVE of each construct is greater than the correlation between constructs and other constructs in the model, so this research model has good discriminant validity (Fornell & Larcker, 1981 in Ghozali 2014: 40).

The reliability of data can be assessed through Cronbach's alpha and Composite reliability. In this study Cronbach's alpha has a value between 0.657-0.931. Composite reliability has a value between 0.854-0.927 and is greater than 0.70. This shows that all instruments used are error free and consistent in every construct with high reliability.

4.2 Assessment of Inner (Structural) Model

Figure 1 below shows the R² on the organizational capability is 0.506, while R² of financial performance and social performance are 0.472 and 0.547 respectively.

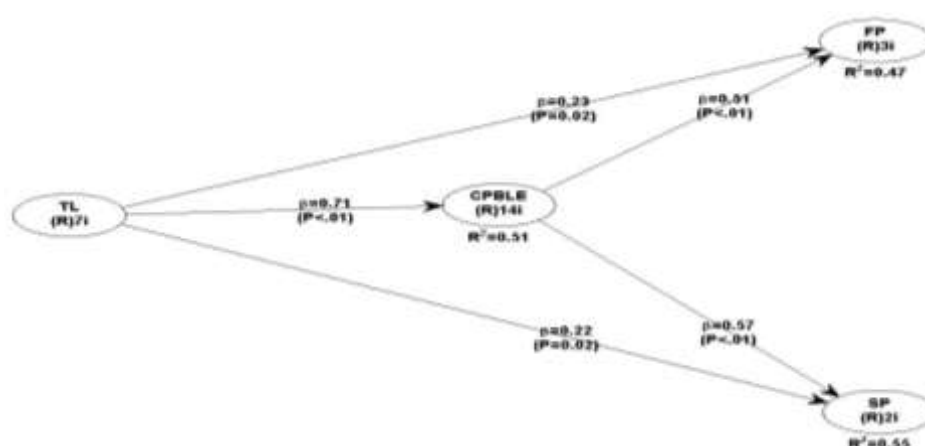


Figure 1. Full Structural Equation Model

4.3 Direct Effect

Based on Figure 1 above, transformational leadership has a positive effect on organizational capability ($\beta = 0.711$, $PV < 0.001$). Transformational leadership has a positive effect on organizational performance, both on financial performance ($\beta = 0.229$, $PV = 0.019$) and social performance ($\beta = 0.221$, $PV = 0.024$). Organizational capability has a positive influence on organizational performance, which has a positive effect on financial performance ($\beta = 0.506$, $PV < 0.001$) and a positive effect on social performance ($\beta = 0.566$, $PV < 0.001$). Therefore H1, H2, H3, H4 and H5 are accepted.

4.4 Indirect Effect

Based on Table 2 below, it was found that organizational capabilities are able to act as a mediator that relates transformational leadership to financial performance (VAF= 37.94%) and a mediator for the relationship between transformational leadership and social performance (VAF= 39.18%). In this study organizational capabilities act as a partial mediator. Therefore H6 and H7 are accepted.

Table 2. Result of the PLS for Indirect Effect

Path	axb (1)	axb+c (2)	VAF=(1)/(2)x100%	Decision
TL→OC→FP	0.711x0.506=0.360	0.360+0.588=0.948	20%<37.94%<80%	Partial mediation
TL→OC→SP	0.711x0.566=0.402	0.402+0.624=1.026	20%<39.18%<80%	Partial mediation

Notes:

a = path coefficient value of predictor variable to mediator, with the significance of $p < 0.05$

b = path coefficient value of mediator variable to criterion, with the significance of $p < 0.05$

c = path coefficient value of the predictor variable on criterion before the mediator variable included in the model, with a significance of $p < 0.05$ ($\beta = 0.588$; $\beta = 0.624$; $p < 0.01$)

5. Discussion

This study has 7 hypotheses that were tested using data obtained from the directors of Village-Owned Enterprises in Siak Regency, Riau Province, Indonesia. The results of this study indicate that the impact of transformational leadership on financial performance and social performance can be enhanced through the utilization of capabilities (organizational, marketing, and technical capabilities) owned by the organization. This research has proven that transformational leadership has impact to organizational capability. This research is in line with Hamidizadeh, Oboudi and Ramezani (2017).

Organizational capabilities which include marketing and technical capabilities are very important capabilities for the organization to have in order to survive in a dynamic business environment. These capabilities will be able to be owned and developed if the organization's leaders have transformational leadership, so they can motivate employees to explore their capabilities (Bass, 1985). As a consequence, in order to improve organizational performance, Village-Owned Enterprises or other businesses organizations need to pay attention to transformational leadership in determining organizational leaders. This result is consistent with López-Cabarcos, et. al., (2015). Organizations need to consider the characteristics of transformational leaders in determining leaders. Thus, organizations that have leaders who are able to understand the capabilities of the organization and then empower it will be able to compete in a dynamic business environment.

6. Conclusion

This research aims to analyse the extent to which transformational leadership enhances village-owned enterprise performance through organizational capabilities. All hypotheses proposed are accepted. Although this research has succeeded in achieving its objectives, generalization of the results must be carried out with caution. This research is only conducted in village-owned enterprises in one district in Indonesia. Therefore, this will limit the generalization of this study. This study only considers transformational leadership and organizational capabilities as variables that will improve the performance of village-owned enterprises. Future research can expand populations and add other variables to broaden the understanding of how the performance of village-owned enterprises can be improved.

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