










“Effect of governance practices on value co-creation and organizational performance: Evidence from village-owned enterprises in Riau, Indonesia”

AUTHORS	Ria Nelly Sari   Dewi Junita  Rita Anugerah   Satria Tri Nanda   Raisya Zenita 
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Ria Nelly Sari, Dr., Professor,
Department of Accounting, Faculty of
Economics and Business, Universitas
Riau, Indonesia. (Corresponding
author)

Dewi Junita, Research Assistant,
Department of Accounting, Faculty of
Economics and Business, Universitas
Riau, Indonesia.

Rita Anugerah, Dr., Professor,
Department of Accounting, Faculty of
Economics and Business, Universitas
Riau, Indonesia.

Satria Tri Nanda, Assistant Professor,
Department of Accounting, Faculty
of Economics, Universitas Lancang
Kuning, Indonesia.

Raisya Zenita, Lecturer, Department of
Accounting, Faculty of Economics and
Business, Universitas Riau, Indonesia.



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Ria Nelly Sari (Indonesia), Dewi Junita (Indonesia), Rita Anugerah (Indonesia),
Satria Tri Nanda (Indonesia), Raisya Zenita (Indonesia)

EFFECT OF GOVERNANCE PRACTICES ON VALUE CO-CREATION AND ORGANIZATIONAL PERFORMANCE: EVIDENCE FROM VILLAGE-OWNED ENTERPRISES IN RIAU, INDONESIA

Abstract

A broader community is currently paying a significant deal of attention to the existence of social enterprises. This is due to the belief that social enterprises can bring answers to community issues. Village-Owned Enterprises (VOEs), as one of the social enterprises that are expected to continue providing sustainable welfare for villages, must always strive for excellent organizational performance to fulfill their objectives. This study is based on the notion of participatory governance; it seeks to evaluate the effect of governance practices on value co-creation, as well as the effect these practices have on organizational performance. This paper collects data utilizing a structured questionnaire and a quantitative research approach. A cluster sampling methodology is used. The respondents are directors of VOEs in Riau Province, Indonesia. One hundred twenty-five data were analyzed using partial least squares (PLS) of the second order. The results reveal that good governance practices will boost value co-creation, enhancing organizational performance. The findings suggest that VOEs should pay particular attention to their process of managing, monitoring, and accountability to achieve value co-creation and fulfill their mission. The uniqueness of this study lies in its investigation of the governance practices of VOEs and the crucial role of value co-creation in enhancing their organizational performance.

Keywords

governance practices, partial least squares, performance, social enterprise, value co-creation, VOEs, quantitative study

JEL Classification

G34, L31, L32, M41

INTRODUCTION

Academics and the general public have become increasingly interested in social enterprises in recent decades due to their potential to offer solutions that would foster positive social changes. It is widely held that social enterprises may end poverty, improve the environment, provide access to opportunity, and expand public good (Defourny & Nyssens, 2008). The term "social enterprise" refers to a business that aims to achieve social and financial success (Pinheiro et al., 2021). One type of social company in Indonesia is a Village-Owned Enterprise (VOE). Indonesia Regulation No. 11 of 2021 stated that "VOEs are legal entities that can be established by a village on its own or in conjunction with other villages to manage businesses, utilize assets, develop investment and productivity, provide services, and/or offer other types of businesses for the benefit of the village community."

As a social enterprise, the role of VOEs in village communities is crucial. They serve a social function by addressing the village's social is-

sues, such as employment, garbage, drinking water, power, and the provision of inexpensive needs. These objectives are implemented to offer village residents public services, benefits, and welfare. According to Indonesian Regulation No. 3 of 2021, establishing VOs is an intended goal. The achievement of an organization's objectives is reflected in its own performance (Sari et al., 2019; Venkatraman & Ramanujam, 1986). Therefore, fully understanding how the performance and sustainability of VOs can be enhanced to act as the engine of the village economy and as a means to accomplish the community's well-being is crucial.

Good governance practices are one of the initiatives that organizations may employ to enhance their organizational performance. Governance has been investigated by Cornforth and Chambers (2010), Rezaee (2008), and Sari et al. (2021a, 2021b). Following the established definition, there are at least three essential aspects of governance. Specifically, some structures, methods, and processes provide an organization's overall direction, control, and accountability (Cornforth & Chambers, 2010). VOs represent social enterprises. Social enterprise is primarily motivated by a desire to fulfill a social goal while also conduct business utilizing market mechanisms (Santos, 2012). Based on these characteristics, one factor differentiates a social business from a commercial enterprise – the governance dimension – categorized as either participatory or non-participative. Participatory governance is social enterprise-aligned governance. It is a kind of governance that stresses democracy, mainly through deliberative activities. This governance includes parties or stakeholders affected by the organization's activities in democratic decision-making, not based on capital ownership or shareholders but on the principle of one member, one vote.

Value creation and the pursuit of positive social impact are essential to the success of any social enterprise (Duque-Zuluaga & Schneider, 2008). Value co-creation is a collaborative process between organizations and markets (in this example, stakeholders) in economic operations to develop new value from these interactions that can benefit both businesses and markets (stakeholders) (Payne et al., 2007, 2008). Value co-creation is not only a core concept in marketing and business management (Saarijärvi et al., 2013); this term is also used to describe the concept in which organizations are considered the determinants of value to a more participatory process that facilitates the joint production and development of meaning by individuals and organizations (Ind & Coates, 2013). Co-creation of value between the organization and its stakeholders will increase the organization's performance (Payne et al., 2008).

Governance is also related to value co-creation; it contributes to the organization's value production (Carlsson, 2007; Hamidi & Machold, 2020). In general, organizational objectives and economic operations are viewed as wealth-generating mechanisms for their stakeholders (Huse, 2007; Windsor, 2017). The responsibility of management is to protect the interests of all parties involved and return any profits to the shareholders (Shleifer & Vishny, 1997). Management's primary duty is to steer the organization toward continued value creation (Crow & Lockhart, 2016; Huse, 2007; Maseda et al., 2015).

1. LITERATURE REVIEW AND HYPOTHESES

VOs are organizations created by a village to drive the village economy and serve the community's needs. They are anticipated to provide jobs, improve a local's initial income, increase the usage of village resources in line with community demands, and serve as the cornerstone of rural economic growth and equity (Legislation Republic Indonesia, 2015). In contrast to conventional busi-

ness organizations, VOs have missions and social responsibilities that act as the organization's core foundation.

VO is a social enterprise; therefore, its success is determined not only by its financial performance but also by social performance (Ramos Vásquez & Ziga Dávila, 2008). Social performance is the attainment of the organization's success in carrying out its social goal as its primary mission. Furthermore, financial performance is crucial to

enabling VOEs to fulfill the organization's humanitarian objective (Bagnoli & Megali, 2011). Therefore, the financial and social performance of VOEs must reflect their performance.

Regarding governance, VOEs face particular issues, allowing for a distinct method of dealing with them. Governance relates to how the organization manages, monitors, and is accountable for the activities carried out by management to achieve organizational goals (Cornforth & Simpson, 2003). Corporate governance is the structure and process/technique used to guide and control an organization to assist the organization's effective attainment of its objectives. As a social enterprise, VOEs governance implementation differs somewhat from the organization. Purnomo (2016 cited in Widiastuti et al., 2019) suggested that VOEs implement six principles of governance: transparency, accountability, cooperation, participatory, emancipatory, and sustainability.

Transparency means that all operations, policies, and reports created by VOEs must be presented openly and transparently to all stakeholders, without exception. Accountability in this context implies that VOEs must be technically and administratively responsible for all activities. Cooperative implies that all individuals and stakeholders involved in managing VOEs must collaborate to support business growth and longevity. Participatory denotes that all participants in the village enterprise are willing to freely support and participate in decisions that can foster the enterprise's growth. In this context, emancipatory denotes that all participants in VOEs, regardless of social class, ethnicity, or religious affiliation, must be treated equally (Widiastuti et al., 2019). In order to survive, communities must create and manage the sustainable growth of VOEs.

The literature demonstrates that governance positively influences organizational performance (Ngatno et al., 2021; Nurjanah et al., 2020; Sofyani et al., 2020; Yasser et al., 2017). VOEs will have efficient and effective management if it applies the governance principles. Good governance is executed with structured control and oversight, including connected parties, such as internal and external partners of the organization, leading to effectiveness and efficiency inside the organiza-

tion. Then, effectiveness and efficiency will impact VOEs' organizational performance. Financial performance can be enhanced through efficiency and effectiveness. Because they will decide the failure or success of organizational governance, effectiveness and efficiency are of the utmost importance (Sari et al., 2006). VOEs' primary objective is to increase community and village welfare, shown in the achievement of social performance. According to Mair and Marti (2006), the achievement of the social mission of a social enterprise is inseparable from the achievement of its financial mission. Therefore, the primary mission to be achieved is its social mission. However, the achievement of this mission needs to be supported by the sound financial performance that comes from the business operations generated by VOEs.

Earlier studies have discovered the effect of governance implementation on firm performance (Malagila et al., 2021; Mohan & Chandramohan, 2018; Puni & Anlesinya, 2019). Mswaka and Aluko (2015) researched governance practices in social enterprise. They investigated the relationship between the design of governance structures and outcomes. The results show that the governance structure affects organizational outcomes. In addition, research has been conducted on the management of VOEs. A survey of VOE governance practices revealed that governance practices were still inadequate (Hafidh, 2017; Hayati, 2019). Sofyani et al. (2020) found, through qualitative exploratory research, that governance has an effect on the performance of VOEs.

Meanwhile, Nurjanah et al. (2020) found that governance principles simultaneously affect financial performance. However, research related to the governance of VOEs is still limited. Previous studies have only examined the financial performance of VOEs; the social performance of VOEs has not been studied. Consequently, current analysis is needed to fill in this gap.

Governance is essential in creating organizational value (Huse, 2007). According to Huse (2007), the critical role of governance in creating organizational value can be viewed from two perspectives. First, based on a stakeholder perspective, corporate governance describes the relationship between several actors involved in the deci-

sion-making process and oversight of corporate resources (Huse, 2007). The board's responsibility as a stakeholder representative is to balance the interests of various stakeholders. Apart from that, another important thing is ensuring that the distribution of resources and wealth is carried out fairly and equitably. Second, based on the corporate perspective, governance is seen more broadly, channeling wealth to stakeholders and creating wealth for the organization itself. Both the stakeholder and corporate perspectives only emphasize one party, namely the creation of value for stakeholders or the company itself. Therefore, Lusch et al. (2016) noted the need to align the interests of stakeholders and the organization by creating value co-creation.

Value co-creation refers to social and economic values. It occurs through the collaboration of actors involved in integrating resources and exchanging services for the stability and survival of both organizations and stakeholders (Lusch et al., 2016). Grönroos (2012) revealed that value co-creation is a process in which organizations, customers, and suppliers (market) interact to produce a material and symbolic value that benefits the organization and market. For this reason, governance is needed to facilitate collaboration and collective processes to increase corporate wealth creation (Huse, 2007). Thus, implementing governance will affect the exchange of services/values that contribute to both parties, namely, organizations and stakeholders (Hamidi & Machold, 2020). Hamidi and Machold (2020) examined the role of governance practices in creating value co-creation. They found that governance practices would encourage value co-creation.

The governance of VOEs is guided by six pillars, as mentioned above. The implementation of these governance principles allows the active participation of management and external stakeholders in the operation of the organization, resulting in the active collaboration of both parties in value co-creation.

Successful management of value co-creation and service/value exchange between organizations and their stakeholders will help organizations improve their performance (Payne et al., 2008).

This condition is reflected in the organization's ability to generate revenue, maximize profits, and fulfill its social mission. A "value network" facilitates the exchange of goods/services and co-creation, influencing organizational performance. Therefore, value co-creation will enhance organizational performance (Restuccia & Ouellet, 2009). Some experts revealed that value co-creation would improve organizational performance (Chuang & Lin, 2015; Hamidi & Gharneh, 2017; Leclercq et al., 2017; Ren & Li, 2015; Restuccia & Ouellet, 2009).

The role of governance is to foster collaboration and collective processes to make it easy for organizational value co-creation (Huse, 2007). The governance practices allow for collaborative interactions between organizations and stakeholders to produce a value that benefits both (Hamidi & Machold, 2020). The characteristic of governance of social enterprises, namely, participatory governance, opens ample space for all stakeholders to be actively involved in organizational management decisions and policies. Furthermore, the shared process of service/value between organizations and stakeholders will generate new values that are useful and have consequences for improving performance (Chuang & Lin, 2015; Leclercq et al., 2017; Restuccia & Ouellet, 2009).

Based on the the discussion above, this study aims to enrich the limited empirical studies that relate governance practices and value co-creation to firm performance, especially governance practices in hybrid social enterprises, particularly in VOEs in Indonesia, which remains largely unexplored. Therefore, this study proposes the following hypotheses:

H1: Governance practices have a positive effect on organizational performance.

H2: Governance practices have a positive effect on value co-creation.

H3: Value co-creation has a positive effect on organizational performance.

H4: The effect of governance practices on organizational performance is indirect through value co-creation.

2. METHODOLOGY

This study was carried out among VOEs in Riau Province, Indonesia. Using the cluster sampling method, respondents were selected based on clusters of coastal and inland areas. A total of 319 VOEs from four districts were chosen. The respondents were directors of VOEs. Data were collected from March to July 2022. Among the 319 questionnaires sent directly to the directors of VOEs, 125 (39.18%) questionnaires were returned and could be processed further.

Table 1 displays the demographic data. The proportion of male respondents (82.4%) is greater than that of female respondents (17.6%). Almost 50% of participants were between the ages of 31 and 40 (43.2%), and 82 had a high school diploma or its equivalent (65.6%). In addition, 60% of respondents have worked for at least two to five years.

Table 1. Descriptive statistics of the respondents

Variables	Frequency	Percentage
Gender		
Male	103	82.4
Female	22	17.6
Age		
Less than 30 years	18	14.4
31-40	54	43.2
41-50	37	29.6
51 years and over	16	12.8
Education background		
High school	82	65.6
Diploma's degree	11	8.8
Bachelor's degree	32	25.6
Job tenure		
Less than two years	20	16
2-5 years	75	60
Six years and over	30	24

Note: $N = 125$.

The constructs studied were measured by instruments developed and used in previous studies. All of the constructs are measured by a 5-point Likert scale. Respondents were asked to agree with the statements provided by choosing from strongly disagree (1) to strongly agree (5).

Eighteen items from Widiastuti et al. (2019) are used to measure governance practices. Based on the six VOEs governance principles, governance

practice indicators were derived from Purnomo (2016). The measurement items used include "Our VOE has a system and mechanism for selection/recruitment of employees" and "The public/community can access VOE financial reports."

Value co-creation was assessed through four items applied by Liu and Huang (2020). Examples of measurement items are "Our VOE always interacts with customers to serve them better" and "Our VOE always works with beneficiaries to improve the economy of the community."

Organizational performance is measured using five items adapted from Bagnoli and Megali (2011) and modified by Sari et al. (2021a, 2021b). Organizational performance is comprised of both financial and social performance. Sample of measurement items are "Profits generated by our VOE during the last two years have increased" and "The growth in the number of residents served by our VOE over the past two years has increased".

The structural equation modeling-partial least squares (PLS-SEM) tested the hypotheses. PLS-SEM produces fewer biased estimates for small sample sizes than covariance-based SEM (Chin, 1998). PLS-SEM is advised when studying complicated models (Hair et al., 2017). This study contains a somewhat sophisticated model due to the presence of second-order constructs (for governance practices). In addition to a mediating variable, PLS-SEM might be a more appropriate analysis method for this investigation. PLS-SEM trumps regression analysis for evaluating the mediation effects (Hair et al., 2019). Therefore, using PLS-SEM analysis in this investigation is justifiable.

3. RESULTS

Before the measurement and structural models are evaluated, the fit model and quality indices are assessed. According to Weerawardena et al. (2015), the calculation of APC, ARS, and AVIF must be done to determine whether the model fit the data. Based on Table 2, p-values for APC and ARS are less than 0.01, and AVIF values are less than 3.30 (Kock, 2011). Thus, the model fits the data. Additionally, the assessment of GoF evaluates the performance of the PLS model in relation to the

measurement and structural models (Tenenhaus et al., 2005). Table 2 demonstrates that the computed GoF value exceeds the 0.36 criterion value for a large effect size.

Table 2. The fit model quality indices

Criteria	Values
APC	0.517***
ARS	0.562***
AVIF	2.203
GoF	0.645

Note: *** $P < 0.00$.

To assess the causality in the research model (path direction among constructs), the paper assesses SPR, RSCR, SSR, and NLBCDR (Kock, 2015). According to Kock (2015), the ideal value of SPR, SSR, and NLBCDR is one (1), but the minimum value of SPR, SSR, and NLBCDR is 0.7, while the minimum value of SSCR is 0.9. Based on the calculation, all the values of the four indices are one (1), meeting the acceptable value limits. This indicates that the proposed direction of the hypotheses in the research model is accurate.

Before testing the hypotheses, it is necessary to analyze the research model. There are two steps to analyzing the research model. First is assessing the measurement model (external model), and second is assessing the structural model (Anderson & Gerbing, 1988). The measurement model (outer model) is evaluated by assessing the validity and reliability of each variable and instrument item (Hair et al., 2014, 2019). The validity of the research instrument was checked using discriminant and convergent validity. Based on the square root of AVE compared with the correlation between latent variables, discriminant validity was determined (Hair et al., 2014). Table 3 shows that the AVE of all constructs is greater than the correlation. These results indicate that the instrument used in this study has sufficient discriminant validity.

Table 3. Reliability, validity, and correlation values

Variable construct	Cronbach alpha	Composite reliability	AVE	VAVE	Correlations (significant at $P < 0.01$)		
					Governance practices	Value co-creation	Organizational performance
Governance practices	0.959	0.967	0.830	0.911	–	–	–
Value co-creation	0.884	0.921	0.744	0.863	0.739	–	–
Organizational performance	0.858	0.899	0.644	0.802	0.679	0.732	–

AVE method was used to evaluate the convergent validity. Table 3 demonstrates that the AVE value for all three constructs (governance practices, value co-creation, and organizational performance) exceeds 0.50. Convergent validity can also be evaluated using the loading indicator of the construct item. Table 4 demonstrates that the indicator loading values of items for all constructs are greater than 0.5 and fall within the range of 0.664-0.932. These outcomes indicate that the instrument's items have adequate convergent validity (Chin, 1998; Ghozali & Latan, 2014).

Cronbach's alpha and composite reliability are used to assess the reliability of data. Cronbach's alpha and composite reliability values for all constructs are greater than 0.7 (Table 3). Therefore, all constructs are reliable (Hulland, 1999; Hair et al., 2014).

Table 4. Outer model

Variable construct	Item	Loading
Governance practices (Second-order construct)	Transparency	0.932
	Accountability	0.902
	Cooperation	0.922
	Participatory	0.892
	Emancipative	0.888
	Sustainability	0.930
Value co-creation (First-order construct)	VC1	0.783
	VC2	0.912
	VC3	0.881
	VC4	0.870
Organizational performance (First-order construct)	OP1	0.839
	OP2	0.731
	OP3	0.888
	OP4	0.664
	OP5	0.866

Furthermore, after accessing the measurement model, an assessment of the structural model is carried out. Figure 1 illustrates the path analysis results. Value co-creation and organizational performance have respective R2 values of 0.546 and 0.578. 54.6% of the variations that occur in value

Table 5. Path analysis result

Path	Expected signs	Path coefficients	Standard errors	P values
Governance practices → Organizational performance	+	0.304	0.083	< 0.001
Governance practices → Value co-creation	+	0.739	0.075	< 0.001
Value co-creation → Organizational performance	+	0.508	0.079	< 0.001

co-creation are influenced by governance practices, and 57.8% of the variations in organizational performance are influenced by governance practices and value co-creation. There are, however, additional variables that affect organizational performance that were not investigated in this study.

The focus of this study is to explore the effect of governance practices on value co-creation and organizational performance. Table 5 displays the statistical results of hypotheses testing. The statistical findings indicate that governance practices have a statistically significant positive effect on organizational performance ($\beta = 0.304$, P -value 0.001), supporting *H1*. In addition, governance practices have a statistically significant positive effect on value co-creation ($\beta = 0.739$, P -value 0.001). Therefore, *H2* is accepted. In addition, statistical analysis demonstrates that value co-creation has a significant positive effect on organizational performance ($\beta = 0.508$, P -value 0.001), accepting *H3*.

This study reveals that the effect of governance practices (GP) on organizational performance (OP) is indirect because it is mediated by value co-creation (VC). This indirect effect was tested using the Variance Accounted For (VAF) method. Based on the VAF method, calculations are carried out in three stages (shown in Table 6). First is to calculate

the indirect effect (GP→VC · VC →OP), $0.739 \cdot 0.508 = 0.375$. Next is to calculate the total effect by adding up the value of the indirect effect and the direct effect of GP on OP without including the VC variable, $0.375 + 0.679 = 1.054$. Finally, dividing the value of the indirect effect on the total effect value, $0.375 \div 1.054 = 0.3558$. Therefore, the VAF value obtained is 0.3558 or 35.58%. Based on Hair et al. (2014), the VC variable acts as a partial mediating variable because the VAF value (35.58%) is between 20%-80%. These findings support *H4*, which asserts that governance practices have a significant positive effect on organizational performance through value co-creation.

Table 6. VAF calculation

Description	Value
Indirect effect = $0.739 \cdot 0.508$, GP → VC = 0.739; VC → OP = 0.508	0.375
Direct effect GP → OP; without including VC as a mediator = 0.679	0.679
Total effect = $0.375 + 0.679$	1.054
VAF = indirect effect/total effect = $0.375/1.054$	0.3558

4. DISCUSSION

These findings provide evidence regarding the effect of governance practices on value co-creation and organizational performance. The relationship

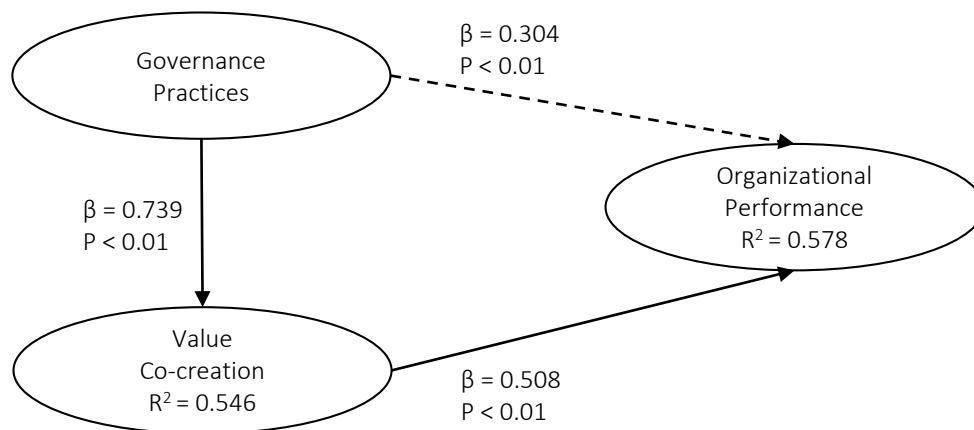


Figure 1. Path analysis model

between governance and performance through value co-creation has not been studied, especially for social enterprises such as VOEs. In addition, research on governance, especially the governance of VOEs, remains limited. The findings reveal that governance practices positively affect organizational performance (*H1*). This demonstrates that governance is crucial to enhance the organizational performance of VOEs. This finding strengthens Sofyani et al. (2020) by providing empirical evidence that supports the existing effect of governance on the organizational performance of VOEs. The finding also extends Nurjannah et al. (2020) and Sari et al. (2021a, 2021b). Furthermore, this study has also measured performance with an additional dimension, namely, social performance. Thus, the measurement of VOE performance is in line with organizational characteristics and mission. Organizations that implement good governance practices have an orderly system and run their organization following their management principles, thereby allowing for extra focus on its mission. Then, it will certainly have consequences for enhancing organizational performance.

Moreover, the results indicate that governance practices significantly affect value co-creation (*H2*). Governance seems to be more crucial to the creation of organizational value (Huse, 2007). The results of this study support Huse (2007) and Hamidi and Machold (2020), who argue that the implementation of governance facilitates collaboration and collective interaction between organizations and stakeholders, which then allows the exchange of services/values that are beneficial to the organization and stakeholders. Moreover,

VOE with participatory governance allows the involvement and participation of the community as stakeholders, consequently leading to collaborative interactions. If managed properly, it will produce new values beneficial for both.

Furthermore, the findings show that value co-creation significantly affects organizational performance (*H3*). This finding is consistent with Chuang and Lin (2015), Lim and Hong (2016), Ren and Li (2015), and Hamidi and Gharneh (2017). Thus, organizations capable of creating value co-creation with their stakeholders will facilitate organizations in achieving better organizational performance. Organizations and stakeholders work together to achieve a common value to support each other for the organization's success.

In addition, the results show that value creation plays a significant role in the indirect effect of governance practices on organizational performance as a mediator between governance practices and organizational performance (*H4*). This finding shows that value co-creation is formed because of the influence of governance practices and, then onwards, affects organizational performance. Value co-creation acts as a result of stakeholder involvement in the organization. VOEs, as social enterprises that implement participatory governance, are believed to require good collaboration with the community to create value that is in accordance with the organization and stakeholders. This exemplary collaboration then has an impact on the organization in improving its performance (Killa, 2014; Payne et al., 2008).

CONCLUSION

This paper investigates the extent to which the governance practices of VOEs can enhance their performance through value co-creation. According to the statistical result, governance practices significantly positively affect value co-creation and organizational performance. In addition, value co-creation partially mediates the effect of governance practices on organizational performance.

This study presents evidence regarding the significance of implementing governance practices on VOEs consistent with established governance principles. The principles of VOE governance are ideal to allow the involvement/participation of stakeholders (government, customers, and the community) to be active together for the advancement of VOEs and the community. Therefore, the application of appropriate guidance requires proper execution. The results can improve organizational performance and achieve the organization's mission. Furthermore, for the government as a key stakeholder, providing

education to the village community is necessary to promote its active involvement and participation in the progress of the VOs and the community itself.

Lastly, there are opportunities for future investigations. First, future research can replicate this analysis for different social enterprises and countries by adjusting the concept of governance in each organization. Second, future studies may use mixed methods to study the influence of governance practices on organizational performance to conduct a more in-depth analysis. Because this study relies solely on quantitative data from closed questions, it provides limited insight into respondents' perceptions. Third, future research should consider innovation (Khan et al., 2019) and social enterprise capabilities (Rehman et al., 2019), among other mediating variables.

AUTHOR CONTRIBUTIONS

Conceptualization: Ria Nelly Sari, Dewi Junita, Rita Anugerah.

Data curation: Dewi Junita, Satria Tri Nanda.

Formal analysis: Rita Anugerah, Satria Tri Nanda, Raisya Zenita.

Funding Acquisition: Ria Nelly Sari.

Investigation: Ria Nelly Sari, Raisya Zenita.

Methodology: Ria Nelly Sari, Dewi Junita, Rita Anugerah.

Project administration: Satria Tri Nanda.

Resources: Dewi Junita, Satria Tri Nanda.

Software: Dewi Junita.

Supervision: Ria Nelly Sari, Rita Anugerah.

Validation: Satria Tri Nanda, Raisya Zenita.

Visualization: Satria Tri Nanda, Raisya Zenita.

Writing – original draft: Ria Nelly Sari, Dewi Junita.

Writing – review & editing: Ria Nelly Sari, Rita Anugerah.

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