







# “The effect of social capital and transformational leadership on the performance of rural enterprises”

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# THE EFFECT OF SOCIAL CAPITAL AND TRANSFORMATIONAL LEADERSHIP ON THE PERFORMANCE OF RURAL ENTERPRISES

## Abstract

The existence and performance of enterprises in rural areas become an interesting phenomenon as a solution for community welfare. The purpose of this study is to examine social capital and transformational leadership as factors that influence village-owned enterprises' performance and the ability to innovate as a mediator. The research population consists of 216 village-owned enterprises. Riau Province in Indonesia is the place of research focus. This study used probability sampling with area sampling or cluster sampling. Respondents were managers, secretaries, treasury, or heads of business units of each village-owned enterprises. A total of 120 respondents participated in this analysis. The research hypotheses were tested using the partial least squares-structural equation modeling. The outcomes demonstrate that social capital and transformational leadership significantly positively affect enterprises' performance with a p-value < 0.05, and the ability to innovate is proven to be a mediator with a p-value < 0.05. This study is relevant to the government program related to community welfare and offers implications for rural enterprises to improve social capital, leadership capabilities, and innovation.

## Keywords

performance, social capital, transformational leadership, welfare, innovation, village enterprises

## JEL Classification

M13, M21, O15, O18

## INTRODUCTION

Inequality in economic development has received serious attention. It is related to the problem of regional equity and the distribution of spatial resources. To overcome the problem of equal distribution of development, various European countries have established enterprises in the suburbs. In China, the government has even established firms created and owned by villages that significantly impact people's well-being.

In Indonesia, the government has formed village-owned enterprises (VOEs). Their aim is to boost this community welfare and overcome economic inequality. As a social and commercial institution, they provide various facilities and infrastructure and create community development projects.

Number of village-owned enterprises in Indonesia has reached 57.2730. Unfortunately, records suggest that most village-owned enterprises are only standing and require more productive operations. Nonetheless, they remain largely stagnant (Basri et al., 2023). It is impossible to isolate Indonesia's village-owned enterprise problems from its human resource capacity. Social capital, leadership, and innovation are important factors behind this analysis.

## 1. LITERATURE REVIEW AND HYPOTHESES

Various studies have been conducted to improve the efficacy of rural enterprises. This is because such companies contribute to improving the economic advancement of rural regions. The resource-based view (RBV) (Wernerfelt, 1984) hypothesis posits that evaluating a company's performance depends upon a confluence of internal and external organizational elements. Wernerfelt (1984) argues that internal and external resources determine organizational success. Many research results state that competitive advantage is the basis of the heterogeneity of valuable resources, whereas company resources drive sustainable competitive advantage (Uddin et al., 2023). Numerous studies have provided an approach to intangible assets as a resource to produce the organization's internal strength (Trequattrini et al., 2022).

Social capital is one of the organization's external strengths that contributes to the company's value. Social capital is trust and social networks owned by the company (Itani et al., 2023). Trust creates an environment that encourages involvement in exchanging knowledge and information. At the same time, a network facilitates the development and sharing of intellectual assets through the sharing of knowledge and information (Zhang et al., 2022). Community trust and extensive social networks will impact increasing sales by leveraging networks and trust.

Lyu et al. (2022) show that social capital can improve business performance. According to Tajpour et al. (2022), social capital might influence success because the entrepreneur's perception of the company they are running might be enhanced by information from business associates. Numerous research has proved a favorable relationship between social capital and organizational performance (Jamil & Rasheed, 2023; Paşamehmetoğlu et al., 2022). However, Akintimehin et al. (2019) have shown that social capital does not impact business results.

Social capital also encourages collaboration and innovative interaction and facilitates learning. Social interactions and networks that shape how people interact constitute structural capital

(Sentini et al., 2020). Social capital entrepreneurs possess, such as trust, social networks, and attitudes, will influence their behavior at work with innovative behavior. According to the RBV hypothesis, social capital and innovative capacities can mutually influence one another for the better (Karadag et al., 2023). If human resources can develop the capabilities of their social capital, they will bring up new ideas that can give birth to an innovation that benefits the company (Sentini et al., 2020; Konno & Schillaci, 2021). Basri, Yasni, et al. (2021) and ul zia et al. (2023) proved that social capital affects increasing innovation capability.

Apart from social capital, organizational success often hinges on the quality of its leadership. Robbins and Judge (2015) state that the approach known as transformational leadership is the strategy used by leaders to inspire employees to go beyond self-interest and has a profound and extraordinary impact on employees. Saleem et al. (2019) and Goestjahjanti et al. (2022) found that servant leadership style contributes to business continuity and is positively related to performance. Backed by Naderi et al. (2019), transformational leadership influences social values and the conduct of social organizations. Although the literature indicates that transformational leadership influences the behavior of subordinates, research still offers mixed results (Ghadi et al., 2013). However, Osborn and Marion (2009) and Basri et al. (2022) showed a direct relationship that is not significant. For village-owned enterprises, transformational leadership is also needed to make the organization more successful.

The role of leaders is also vital in developing an innovative corporate culture. Leaders who have charisma, inspire their followers, and stimulate their minds are more likely to foster open lines of communication and share new ideas within the firm (Becker et al., 2022). Transformational leadership encourages employees to discuss and try creations (H. Yang & J. Yang, 2019). By fostering an innovative culture and surrounding employees with creative thinkers, transformational leaders pave the way for breakthrough ideas to flourish (Dhir et al., 2023). They improve businesses' capacity for creativity by encouraging workers to think outside the box and take the initiative to get things done (Cui et al., 2022). Gui et al. (2022) also prove that

the capacity for innovation is favorably correlated with transformational leadership.

Innovation can also affect performance. Research shows that innovation is essential in improving organizational performance (Alosani et al., 2020). Migdadi (2022) shows that transformational leadership can create innovation. Wang et al. (2021) also stated that social capital is essential in creating innovation. The higher ability of innovation owned by the organization can improve performance with new products or businesses needed by the community (Wongsansukcharoen & Thaweepaiboonwong, 2023; Zhou et al., 2023). Increasing social capital through investments and relational assets leads to increasing corporate innovation.

The literature review highlights the need for more excellent uniformity in treating various elements influencing the link between social capital and transformational leadership on performance. Thus, the research goal is to fill the void by investigating whether innovation capability intervenes in the connection between social capital, transformational leadership, and business success. The following hypotheses are proposed:

- H1: Social capital has a favorable impact on organizational performance.*
- H2: Social capital has a favorable impact on innovation capability.*
- H3: Transformational leadership has a favorable impact on organizational performance.*
- H4: Transformational leadership has a favorable impact on innovation capability.*
- H5: Innovation capability has a favorable impact on organizational performance.*
- H6: The relation between social capital and organizational performance is influenced by the intervening factor of innovation capability.*
- H7: The relation between transformational leadership and organizational performance is influenced by the intervening factor of innovation capability.*

## 2. METHODOLOGY

The subjects involved in this study are organizations located in Indonesia's rural areas known as village-owned enterprises. A total of 216 village-owned enterprises in Riau Province make up the population. This study used a cluster sampling strategy to collect samples. Respondents were directors, secretaries, treasurers, or heads of business units. The information was gathered by utilizing a questionnaire distributed to the respondents by mail.

Social capital is measured using indicators of social capability, social networking, trust, and cohesion (Basri, Br Pinem, et al., 2021). The abilities of decision-making, motivation, communication, subordinate control, responsibility, and emotional regulation are all used in transformational leadership (Kim & Aldrich, 2005). Innovation capability is measured by developing new products, using relevant technologies, refining processes, and reacting to rivals. The scale was adapted from Basri, Yasni, et al. (2021). Indicators of performance include things like revenue growth, sales returns, customer satisfaction, and competitiveness. This scale was adopted from Basri et al. (2022). The survey items were graded using a five-point Likert scale, where 1 means totally disagree and 5 means totally agree.

Structural equation modeling (SEM) using partial least squares (PLS) was utilized to evaluate the research hypotheses. Partial least square analyzes the connections between model variables, indicators, and constructs, as well as the connections between the constructs (Ghozali & Latan, 2015). The PLS approach was used for analysis; this method entails two phases. The first step is to ensure each indicator's construct reliability and validity by testing the measurement model. Second, using the t-test provided by the PLS, the study examines the structural model to see whether there is an impact between variables/correlation between constructs.

There are two phases to validating the measurement model (outer model): the convergent validity and discriminant validity tests and the reliability test. The paper uses management accounting literature tools to evaluate the research model's robustness, including the coefficient of determination (R<sup>2</sup>), path coefficients, and hypotheses testing.

### 3. RESULTS

The data were obtained via a questionnaire regarding social capital, transformational leadership, innovation capabilities, and organizational performance distributed to managers. There were 300 questionnaires distributed to 126 village-owned enterprises, and 120 were responded in a format usable for analysis (response rate 40%). Table 1 displays the demographics of the respondents.

**Table 1.** Characteristics of respondents

Characteristics	Amount (n)	Percentage (%)
<b>Gender</b>		
Male	73	60.8
Female	47	39.2
<b>Age</b>		
21-30 years	60	50.0
31-40 years	43	35.8
41-50 years	14	11.7
>50 years	3	2.5
<b>Education</b>		
Junior high school	3	2.5
Senior high school	55	45.8
Bachelor	60	50
Master	2	1.7
<b>Length of work</b>		
<1 year	58	48.3
1-5 years	49	40.8
6-10 years	13	10.8
Total	120	100.0

Table 1 shows that males comprise the vast majority of responders, namely 73 respondents (60.8%); 60 respondents are 21-30 years old (50%), and respondents with bachelor's degrees constitute 50%. The average time the respondents worked, namely less than one year, amounted to 58 (48.3%).

**Table 2.** External load value

Variable	Items	Outer Loading	AVE	Cronbach's Alpha	Composite Reliability
Social Capital (X1)	X1_1	0.764	0.564	0.914	0.928
	X1_2	0.733			
	X1_3	0.725			
	X1_4	0.756			
	X1_5	0.761			
	X1_6	0.706			
	X1_7	0.785			
	X1_8	0.736			
	X1_9	0.751			
	X1_10	0.790			

Evaluation of the outer model is the next test. The two main parameters established in the external model test are internal consistency, which pertains to reliability testing and construct validity, encompassing both convergent and discriminant validity. Table 2 displays the study's external measurement model.

The SmartPLS program can be employed for the analysis of reflexive indicators by assessing the anticipated correlation between item scores or component scores to ascertain the credibility of the size model and verify the reliability of measurements using a load factor of at least 0.6 and an AVE (average variance extracted) of 0.5. Most indicators for each variable in this study have loading values, and the average extracted variance (AVE) value exceeds 0.6; therefore, the data processing results with PLS satisfy convergent validity (Hair et al., 2010).

The dependability of the instruments with valid items is also evaluated. The assessment of the construct's dependability was conducted through the utilization of Cronbach's alpha and composite reliability measures; an indicator is considered consistent in assessing latent variables if its Cronbach's alpha value surpasses 0.60 and the combined dependability value surpasses 0.70 (Hair et al., 2010). Cronbach's alpha values exceeding 0.60 and composite dependability values surpassing 0.7 successfully satisfy the construct validity reliability tests, as outlined in Table 2.

The study then checks the strength of the relationship between constructs by calculating R<sup>2</sup> and examining the path coefficients ( $\beta$ ) in the



**Table 2 (cont.).** External load value

Variable	Items	Outer Loading	AVE	Cronbach's Alpha	Composite Reliability
Transformational Leadership (X2)	X2_1	0.791	0.564	0.914	0.928
	X2_2	0.704			
	X2_3	0.724			
	X2_4	0.769			
	X2_5	0.772			
	X2_6	0.743			
	X2_7	0.762			
	X2_8	0.752			
	X2_9	0.764			
	X2_10	0.723			
Innovation Capability (Z)	Z1	0.750	0.562	0.913	0.928
	Z2	0.728			
	Z3	0.745			
	Z4	0.742			
	Z5	0.725			
	Z6	0.761			
	Z7	0.795			
	Z8	0.766			
	Z9	0.760			
	Z10	0.722			
Organizational Performance (Y)	Y1	0.717	0.544	0.907	0.923
	Y2	0.705			
	Y3	0.731			
	Y4	0.735			
	Y5	0.743			
	Y6	0.721			
	Y7	0.799			
	Y8	0.738			
	Y9	0.720			
	Y10	0.763			

structural model. One measure of the moderating effect of an independent variable on a dependent variable is the coefficient of determination (R<sup>2</sup>).

**Table 3.** Value of coefficients of determination (R<sup>2</sup>)

Variables	R square	R Square Customized
Innovation Capability (Z)	0.546	0.538
Organizational Performance (Y)	0.753	0.747

Table 3 shows that the innovation capability (Z) variable has an R-Square value of 0.546. This result shows that 54.6% of the variance in innovative prowess (Z) may be accounted for by differences in social capital (X1) and transformational leadership (X2). The R-squared value for the organizational performance (Y) variable is 0.753. This percentage (75.3%) demonstrates how the interplay of innovation capability (Z), social capital (X1), and transformational leader-

ship (X2) might explain organizational performance (Y). The reliability of the link between the two constructs was then checked using a path coefficient analysis. A significant association between two constructs can be considered when the path coefficient value exceeds 0.100 (Ghozali, 2014).

Hypotheses testing uses a significance test of the p-value and the correlation coefficient, as presented in Table 4.

Table 4 shows that all seven hypotheses in this study have p-values below 0.05; hence, they can be accepted. Therefore, the influence of the independent variable greatly benefits the dependent variable. The direct effect path coefficient in the displayed research model can be calculated using the information in Table 4, which describes the research model and is generated using Smart PLS.

**Table 4.** Hypotheses testing results

Hypothesis testing	Original Sample (O)	Sample Average (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P value	Results
Social Capital → Performance	0.376	0.375	0.063	5.946	0.000	Accepted
Leadership → Performance	0.346	0.347	0.066	5.233	0.000	Accepted
Social Capital → Innovation Capability	0.238	0.238	0.087	2.732	0.007	Accepted
Leadership → Innovation Capability	0.579	0.583	0.074	7.792	0.001	Accepted
Innovation Capability → Performance	0.289	0.287	0.082	3.502	0.001	Accepted
Social Capital → Innovation Capability → Performance	0.069	0.070	0.035	1.978	0.048	Accepted
Leadership → Innovation Capability → Performance	0.167	0.168	0.054	3.122	0.002	Accepted

The hypotheses analysis outcomes demonstrate that social capital significantly affects organizational performance, with a p-value of  $0.000 < 0.05$  and a T-statistic value of 5.946 ( $> 1.64$ ), respectively. With an original sample estimate of 0.376 in a positive direction, the study can infer that social capital and organizational performance are positively correlated. Therefore, H1 is accepted: social capital has a favorable impact on organizational performance.

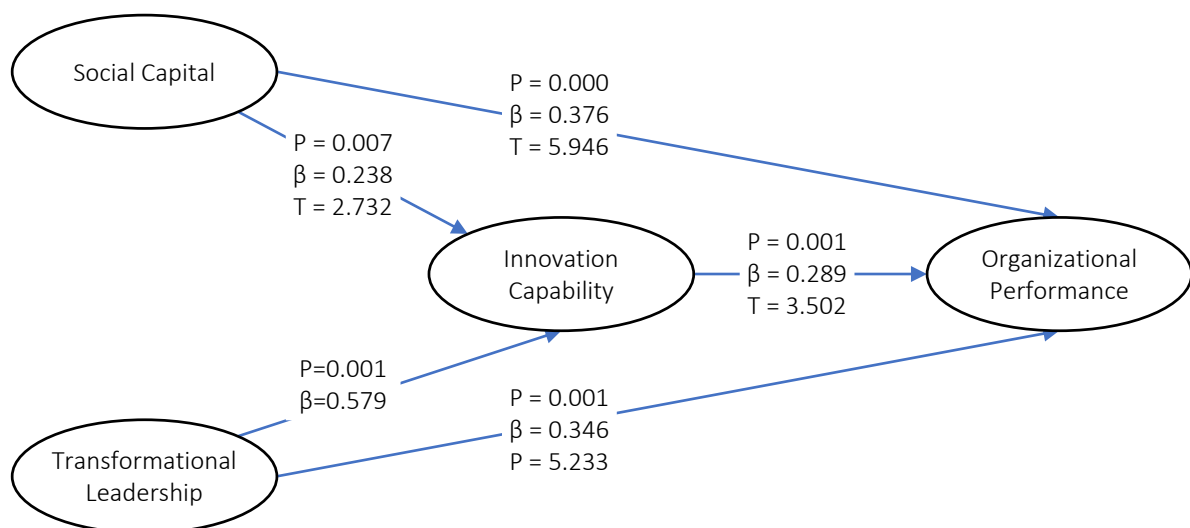
Testing H2 reveals the importance of social capital and innovation capability. It is evident from the fact that the T-statistic is 2.732 ( $> 1.64$ ), and the p-value is  $0.007 < 0.05$ . A positive value of the original sample estimate of 0.238 indicates a favorable relation between social capital and innovation capability. Therefore, H2 is accepted: social capital does, in fact, positively affect one's capability to innovate.

The study's results demonstrate a robust connection between transformational leadership and organizational performance. It is evident from the direct ef-

fect path coefficient, namely a p-value ( $0.001 < 0.05$ ) and the T-statistic value 5.233 ( $> 1.64$ ). The positive value of the original sample estimate shows a favorable association between transformational leadership and organizational performance, which is equal to 0.346. H3 is accepted: transformational leadership positively affects organizational performance.

The results demonstrate a substantial association between transformational leadership and innovation capability, with a T-statistic of 7.792 ( $> 1.64$ ) and a p-value of  $0.000 < 0.05$ . The direction of the association between transformational leadership and innovation capability is favorable, as indicated by the positive value of the original sample estimate, which is equal to 0.579. Therefore, it can be acknowledged that H4 is accepted: transformational leadership favorably affects innovation capability.

As can be observed from a p-value of  $0.001 < 0.05$  and the T-statistic value of 3.502 ( $> 1.64$ ), a sta-

**Figure 1.** Structural equation model test results

tistically significant association has been observed between innovation capability and organizational performance. The positive value of 0.289 for the original sample estimate suggests a positive direction of causality between innovation capability and organizational performance. Hence, H5 is accepted.

Test findings indicate that innovation capability plays a considerable moderating influence in the association between social capital and organizational performance, with a p-value of  $0.001 < 0.05$  and a T-statistic of 1.978 ( $> 1.64$ ). With an original sample estimate of 0.069, innovation capability has the potential to boost social capital and organizational performance. This study supports H6.

Additionally, findings prove that transformational leadership and organizational performance are mediated by innovation capability. A p-value of  $0.002 < 0.05$  and a t-statistic value of 3.112 ( $> 1.64$ ) signify a non-direct connection between transformational leadership and organizational performance. The original sample estimate value for the connection between innovation capability and transformational leadership and organizational performance is positive, at 0.167, suggesting a positive effect of innovation capability on both variables. The capability to innovate thus intervenes in the relationship between transformational leadership and organizational performance, indicating that H7 is accepted.

## 4. DISCUSSION

This study proves that social capital positively affects organizational performance. The greater the social capital, the better the organizational performance. In line with Ganson et al. (2022), establishing reciprocal confidence ensures that the company will not damage the neighborhood or the surroundings through the participation of business actors in the area. Success in the workplace may be boosted by a growing sense of confidence in society (Akintimehin et al., 2019). Akintimehin et al. (2019) and Lyu et al. (2022) also explained that social networks facilitate the development and sharing of intellectual assets, which improves organizational performance. The existence of public trust and extensive social networks can increase sales. Solid social capital makes it easier to understand the sur-

rounding environment. Organizations that already have sizeable social capital have extensive information networks. Village-owned enterprises are more successful when they have more networks. They are proven to do more service to the community (Rahayu et al., 2023; Akbar et al., 2023).

This study also supports the RBV theory (Wernerfelt, 1984) that the external and internal strength of the organization can support the success of the organization. One of a company's competitive advantages is its ability to cultivate and maintain strong relationships with its target audience.

The presence of social capital has also been shown to boost innovation capability. In line with Lyu et al. (2022) and Ince et al. (2023), social capital can encourage organizations to innovate. Social capital owned by the organization through public trust and social networks can give birth to creative ideas. This capital directs managers to work together to complete tasks to achieve innovation capabilities (Ince et al., 2023; Chung & Kim, 2017; Xue et al., 2022), which explains that having more social capital will encourage people to act more creatively. In village-owned enterprises, many innovations are also carried, which have an advanced category (Syahza et al., 2021). Social capital, such as trust, social networks, and attitudes, can influence work behavior. The study's result corroborates the RBV hypothesis, which holds that an organization's human resources can generate innovations by drawing on their social capital (Collins & Clark, 2003).

This study also proves that transformational leadership positively affects organizational performance. Village-owned enterprises with transformational leaders are more advanced than other companies (Andarista & Kriswibowo, 2023). Supporting Bass and Riggio (2005), the company's innovation, creativity, and communication will all benefit from a leader with transformational traits like charisma, the ability to inspire others, and a focus on intellectual stimulation. These findings also support Sari et al. (2021) that transformational leaders can lead village-owned enterprises to success, and Muhammed and Zaim (2020) and Siyal et al. (2021), who state that creative, innovative, and motivating leaders can direct subordinates to achieve organizational goals.



Transformational leadership has also proven to affect innovation capabilities positively. Transformational leadership encourages employees to discuss and try innovations (H. Yang & J. Yang, 2019) freely. Following Dhir et al. (2023), leaders should inspire their followers and foster a culture where new ideas are encouraged. These results support the leadership theory (Fiedler, 1964) that leaders' performance is determined by their understanding of the situation in which they lead. As one of the most important variables affecting innovation, leadership significantly impacts organizational traits, including culture, structure, strategy, and rewards and inspiring the innovation of those who follow them (Gumusluoglu & Ilsev, 2009). The study also supports Gui et al. (2022) and Karimi et al. (2023) that innovation capability is correlated favorably with transformational leadership.

The findings demonstrate that an innovative culture directly contributes to the organization's success. The study's discoveries indicate that the more innovative the ability possessed by corporate managers, the more organizational performance increases (via working conditions and workforce skills) (Azmi et al., 2023). The ability to innovate is one part of the RBV theory that can create a positive direction toward improving organizational performance. If human resources can take advantage of the innovation capabilities developed, new ideas will emerge to create new products that benefit the company. This study supports Kamal et al. (2023) and Migdadi (2022), who found that innovation capability affects firm performance.

The discovery of the mediation analysis confirms that the capability to innovate intervenes in the connection between social capital and organizational performance. Innovations sparked by social capital can lead to greater organizational performance. This outcome supports Chung and Kim (2017), who state that entrepreneurs' social capital, like trust, social connections, and attitudes, will influence innova-

tive behavior. The stronger the innovation potential of the company, the more advanced the performance of new products or businesses that society needs (Anning-Dorson, 2018). Previous studies have shown that the ability to innovate drives increased company performance (Khin & Ho, 2020).

One of the most critical ways village-owned enterprises have improved their performance is through adopting creative techniques, which are the fruition of the original ideas of managers. Therefore, the greater a company's capacity for innovation, the more it will benefit from improved purchase decisions and overall business performance.

Innovation capability was also discovered to play a significant mediating factor between transformational leadership and organizational performance. Village-owned enterprises with innovative managers will inspire their employees to think beyond the box. It is also backed by the contingency hypothesis that transformational leaders create the right conditions for innovation by collecting innovative teams and imparting a stronger incentive to innovate (Dhir et al., 2023). Leaders influence creative ideas to create something new (Mutonyi et al., 2020). Creative, innovative, and motivating leaders can direct subordinates to attain organizational objectives. This study is consistent with Wongsansukcharoen and Thaweepaiboonwong (2023), who showed that leadership influences innovation and will benefit the organization it leads.

Even though this study validated all hypotheses, it can only be generalized to a small area. This analysis allows further development, not just in Riau Province. Furthermore, according to the RBV theory, many other internal and external factors influence organizational success. As an outcome, additional research can be carried out to investigate other internal and external elements that influence organizational success.

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## CONCLUSION

The goal of this study is to ascertain how social capital and transformational leadership affect organizational performance, specifically in Indonesian village-owned enterprises, and to examine how innovation ability functions as an intermediary factor. According to the investigation results, social capital and transformational leadership affect organizational performance and innovation capability. Innovation capability moderates the association among social capital, transformative leadership, and organizational performance.

This study possesses various constraints: several village-owned enterprises are located in scattered rural locations, and some are difficult to reach, making it challenging to collect data. This study also has yet to cover a wider area. Further studies are suggested to use Google Forms to facilitate data collection.

This paper contributes to improving organizational performance in rural areas. Enhanced organizational performance in rural areas can reduce development disparities in rural and urban areas. To increase the success of villages' enterprises, expanding the network and improving transformational leadership for organizational managers is necessary. The government needs to hold leadership training to train village-owned enterprise managers. Increasing social networks and transformational leadership will likely increase the success of village-owned enterprises.

## AUTHOR CONTRIBUTIONS

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Writing – review & editing: Hariadi Yasni, Yuni Rianti.

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