Leadership Style and Capability on the Formulation of Business Strategy in the State-Owned Enterprises in Indonesia

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Abstract. The performance of the state-owned enterprises (SOE) in Indonesia seen from the total assets, income, and net income for the period of 2012 to 2016, is still not optimal. Such conditions are related to the formulation of business strategy that are based on capability and leadership style. So this study aims to examine the effect of leadership style and capability on business strategy. This study uses quantitative methods with verification analysis. The unit of analysis is SOEs in Indonesia with the observation unit is the management of the company. Data and information are collected in a cross section / one shoot time horizon. The design of the analysis used to test hypotheses is Partial Least Square (PLS). The results of the study show that leadership style and capability play a role in the formulation of business strategy. Capability has a greater role than leadership style in the formulation of the right business strategy. This results have implications for SOE’s management that the formulation of the right strategy is built by superior capabilities and driven by appropriate leadership styles

1. Introduction
The performance of SOE can be seen from the total assets, income, and net income for the period of 2012 to 2016. In the period 2012-2016, there was an increase in total assets as a whole from the 13 existing sectors, namely from IDR 469,409 billion in 2012 to IDR 1,018,334 Billion in 2016, however, there are still several sectors that have experienced fluctuations in total asset ownership such as the Trade and Retail sector that have declined in 2014. With regard to total revenue, there were fluctuations of the 13 SOE sectors in the 2012-2016 period. Total SOE’s Net Profit for the Year 2012-2016 (in billion rupiah) from 13 sectors as a whole shows a fluctuations. Total SOE Net Profit for the Period of 2012-2016 (in billion rupiah) from 13 sectors as a whole shows fluctuations.

Some authors point out company performance indicators including: profitability and market share [1]; and Investment (ROI), Return on Equity (ROE), Profit Margin, Market Share, Debt to Equity, Earnings per share, Sales growth, Assets growth [2]. So based on the data above, it shows that the performance of SOEs in Indonesia cannot be said to be optimal.

The results of the literature review reveal that there are several variables related to the achievement of company performance. Phongpetra and Johri (2009) found that business strategies had a positive effect on the financial performance and marketing performance of the organization [3]. Nevertheless, the phenomenon of business strategy implemented by SOE management in Indonesia has not been
precise, such as not giving serious attention to cooperative strategies, while according to the theory it is explained that business strategies do not only include competitive strategy but also need to pay attention to cooperative strategy with other parties related. In addition, business strategy tend not to be fully appropriate because the conditions and business culture are bureaucratic, so that it seems less market-oriented. Previous research shows that business strategy are influenced by capability [4]; [6]; [5], and leadership style, [6]. According to Pearce and Robinson (2015), basically every company is different because it has a unique set of resources which include tangible assets, intangible assets, and organizational capabilities to utilize these assets [7]. Meanwhile, there were problems in capability, such as in the ownership of tangible assets and intangible assets. In terms of reputation, SOE companies also tend to be weak compared to private companies. In addition, the work culture of existing employees has not been able to pursue market demands.

Then there is another aspect that is thought to have an impact on the formulation of business strategy, namely leadership style. According to Hersey (2004), leadership style is a pattern of behavior (words and actions) of a leader perceived by others [9]. On the other hand, phenomena related in SOEs in Indonesia are found, such as leadership that is applied is sometimes still bureaucratic, so it does not pay attention to the aspirations of employees.

SOEs have an important role in economic development in Indonesia so that it requires the formulation of the right business strategy to reach a superior business performance. The problems in leadership style and capabilities can hinder the formulation of the right business strategy, so that based on the research background, this study aims to examine the effect of leadership style and capability on the formulation of business strategy in the State-Owned Enterprises in Indonesia.

2. Literature Review

2.1. Leadership Style

According to Hughes, Ginnet, and Curphy (2015), leadership can be analyzed through three aspects, namely leader, follower, and situation. In the aspect of leader, leadership is influenced by personality, leader position, or expertise, and so on [8]. While in the follower aspect, leadership is influenced by the extent of the values, norms, and cohesiveness of followers. Another aspect that can influence leadership is the situation, which is related to the task, the level of work pressure, the environment, and others. Hersey (2004) assumes that leadership style is a pattern of behavior (words and actions) of a leader perceived by others [9]. Nanjundeswaraswamy and Swamy (2014) analyze two leadership styles namely transformational leadership and transactional leadership [11]. Transformational leadership concentrates on developing followers and their needs. Managers with transformational leadership styles concentrate on the growth and development of employee value systems, the level of inspiration and morality of employees based on their abilities. Transactional leadership relies more on "trade" between leaders and followers where followers are compensated for finding specific goals or performance criteria. Based on the study of several concepts and dimensions of the leadership style, and adjusted to the unit of analysis of this research, namely SOE in Indonesia, the the dimensions of this study refer to the opinions of Nanjundeswaraswamy and Swamy (2014) which examine two leadership styles namely transformational leadership and transactional leadership [11].

2.2. Capability

Wheelen and Hunger (2015) argue that capability is the ability of a company to utilize its resources which consist of routines and business processes that regulate interactions between resources in converting inputs into output [1]. According to Pearce and Robinson (2015), basically every company is different because it has a unique set of resources which include tangible assets, intangible assets, and organizational capabilities in utilizing these assets [8]. Hitt, Ireland, and Hoskisson (2015) stated that each organization is a unique collection of resources and capabilities [12]. Capability is a combination of tangible individual resources and intangible resources used to complete tasks in producing, distributing, and providing services for products and services produced by the company for its customers.
in the framework of value creation. Similar opinions were expressed by Thompson et al. (2014) that capability is developed from and carried out by company resources [13]. Based on the study of various concepts and dimensions of the company's capabilities, and by considering the condition of the unit of analysis of this research, then the variable of capability is measured using the dimensions of tangible assets and intangible assets.

2.3. Business Strategy

The concept of business strategy according to Hubbard and Beamish (2011) is how organization positions itself relative to competitors to create competitive advantage in the industry [15]. According to Pearce and Robinson (2015), business will be successful if the company has several advantages relative to its competitors [8]. Whereas according to Wheelen and Hunger (2015), business strategy is in the form of competitive strategies (competing against all competitors in excellence) and / or cooperative strategies (cooperation with one or more companies to achieve excellence over competitors) [1]. Parnell (2010) examines business strategies based on three dimensions, namely cost leadership, differentiation, and focus [16]. While in Gupta's (2012) study, the dimensions of business strategy include customer orientation, unique company capabilities, imitation barriers, internal marketing, employee empowerment, and visionary leadership that are found to be related to marketing experience. Based on the comparative dimensions conveyed by the previous author, and adjusted to the empirical conditions of the unit of research analysis, in this study, the business strategy variable measured by dimensions refers to Wheelen and Hunger (2015) which include competitive strategies and cooperative strategies [1].

Previous research shows that business strategy are influenced by capability and leadership style, according to Dogan's findings, Özdemirci, Güngör (2014), the selection of differentiation strategy and the application of participatory, proactive and generous HR policies is far more effective in improving performance [4]. Kim (2014) found mutually beneficial conditions between network resources of the company and its partners, compatibility of underlying resources, including physical and R & D resources, strategies, status, and complementary technologies - have a positive relationship with economic performance company in a portfolio alliance [5]. Hassab Elnaby, Hwang, & Vonderembse (2012) found that search business strategy increases a company's ability to achieve organizational capabilities and enables companies to achieve higher levels of financial performance [5]. Meanwhile, according to Denver Mapetere et al. (2012), leadership must be able to create a vision for each strategic program, design effective communication strategies and role models of behavior change that are consistent with new strategies [7].

Based on the description above, the hypothesis is proposed:

H : Leadership style and capability affect the formulation of business strategy both simultaneously and partially.

3. Methodology

This study uses quantitative methods with verification analysis, namely research to determine the relationship between variables through a hypothesis testing based on data in the field [14]. The unit of analysis in this study is SOEs in Indonesia with the observation unit is the management of the company. Data and information is collected directly empirically at one specific time, namely in 2019, so that the observations in this study is conducted in a time horizon that is cross section / one shoot. The design of the analysis used to test hypotheses is Partial Least Square (PLS). PLS is a powerful analytical method because it can be applied to all data scales, does not require many assumptions and sample size does not have to be large. PLS besides being used as confirmation theory can also be used to recommend relationships that exist or not and also propose further testing propositions.

4. Findings and discussion

4.1. Measurement Model Analysis (Outer Model)
Measurement model explained the relationship model between indicators and latent variables, with the purpose is to analyse the validity of dimensions and indicators which were used to measure research variables those are spatially construct. Table 1 below is showing square root of Average Variance Extracted (AVE) and composite reliability. Suggested value of AVE score is > 0.5. Composite Reliability is used to view reliability or dimension reliability level in measuring research variables. When value of Construct Reliability is greater than 0.70.

| Tabel 1. Score of AVE and Composite Reliability. |
|-----------------------------------------------|
| Variables  | AVE  | Composite Reliability |
| Business strategy  | 0.595 | 0.880 |
| Capability  | 0.558 | 0.910 |
| Leadership Style  | 0.510 | 0.860 |

Source : Primary data processed by Smart PLS (2019)

Based on the value of AVE and Construct Reliability in Table 1, then dimension of variable could be declared reliable in measuring research variables.

Besides, measurement model analysis can also provide dimensions that are related most closely to the research variables by looking at dimension which has the biggest loading factor. Based on the above information, then we can find out which one is the most dominant indicator reflecting the research variables. Tabel 2 below is displaying measurement model analysis regarding the validity of each variable and its indicators.

| Tabel 2. Measurement model analysis (outer model) |
|-----------------------------------------------|
| Dimensions  | Loading Factor | Deviance | t-count | Explanation |
| BS1 <- Competitive  | 0.843 | 0.025 | 34.357 | Valid |
| BS2 <- Competitive  | 0.767 | 0.036 | 21.126 | Valid |
| BS3 <- Competitive  | 0.858 | 0.027 | 32.245 | Valid |
| BS4 <- Cooperative  | 0.842 | 0.022 | 37.621 | Valid |
| BS5 <- Cooperative  | 0.830 | 0.025 | 32.611 | Valid |
| CAP1 <- Tangible Asset  | 0.843 | 0.026 | 32.822 | Valid |
| CAP2 <- Tangible Asset  | 0.773 | 0.034 | 23.017 | Valid |
| CAP3 <- Tangible Asset  | 0.747 | 0.048 | 15.638 | Valid |
| CAP4 <- Tangible Asset  | 0.814 | 0.028 | 29.081 | Valid |
| CAP5 <- Intangible Asset  | 0.860 | 0.022 | 39.335 | Valid |
| CAP6 <- Intangible Asset  | 0.826 | 0.030 | 27.489 | Valid |
| CAP7 <- Intangible Asset  | 0.608 | 0.052 | 11.725 | Valid |
| CAP8 <- Intangible Asset  | 0.843 | 0.027 | 31.304 | Valid |
| TS1 <- Transformational  | 0.865 | 0.023 | 37.016 | Valid |
| TS2 <- Transformational  | 0.605 | 0.096 | 6.280 | Valid |
| TS3 <- Transformational  | 0.882 | 0.024 | 36.860 | Valid |
| TS4 <- Transactional  | 0.725 | 0.050 | 14.441 | Valid |
| TS5 <- Transactional  | 0.798 | 0.039 | 20.600 | Valid |
| TS6 <- Transactional  | 0.785 | 0.054 | 14.490 | Valid |

Source : Primary data processed by Smart PLS (2019)
Chin (2000) stated that if loading factor>0.50 or if the value of tcount>ttable, then dimension of variable could be declared valid in measuring variables. So that, the value of loading factor in Table 2 show that dimension of variable could be declared valid in measuring variables.

4.2. Structural model analysis (inner model)

Inner model analysis (structural model) is the analysis that indicates the link between latent variables. In detail, inner model analysis associated with the hypothesis proposed. Prior to prove whether the research hypothesis is supported by empirical facts or not, the first stage is to test the overall model fit. To indicate the overall model acceptable or not, we do “goodness of fit test” or GOF. Goodness of fit test is to prove a hypothesis, that theory has been used in accordance with the empirical data or those theory has been supported with data (Model fit with data). Inner model to be evaluated using goodness of fit model (GoF), namely shows the difference between the observed values and the values predicted by model. In addition, testing conformity also indicated by the value of Q², where the value over 80% are considered good. Following is the value of GoF and Q-square on construct:

| Variable         | R Square | Communality | GoF  |
|------------------|----------|-------------|------|
| Business strategy| 0.660    | 0.795       | 0.706|
| Capability       |          |             |      |
| Leadership Style | 0.758    |             |      |
| Source: primary data processed by Smart PLS (2019).

The table above gives the critical value to test the model. Both GoF value and Q-square value indicates the value greater than 0.70, which means that the research model has been supported by the empirical conditions or fit model.

Figure 1 below displays the result of model testing using Smart PLS 2.0

![Figure 1. Result of Research model](image-url)
4.3. Hypothesis Testing

The following section will explain the results of hypothesis testing from the structural model based on the proposed hypothesis.

| Table 4. Simultaneous Testing from Leadership Style and Capability to Business Strategy. |
|-----------------------------------------------|---|---|---|---|
| R²  | F count  | F Table  | Conclusion                                      |
| 0.660  | 45.657*  | 3.195  | There is simultaneous influence from Leadership Style and Capability to Business Strategy |

Based on the test table 4 above it is known that with a 95% confidence level (α=0.05), there is a simultaneous influence from Leadership Style and Capability to Business Strategy, where the simultaneous influence is 66% while the remaining 34% is influenced by other factors not examined.

Next will be discussion about partial testing as follow.

| Table 5. Partial Testing. |
|---------------------------|-----------------|-------|------|---|
| Structural Model         | γ               | SE(γ) | T count | R² |
| Leadership Style -> Business strategy | 0.274 | 0.127 | 2.153* | 0.196 |
| Capability -> Business strategy | 0.586 | 0.123 | 4.777* | 0.464 |

* significant at α=0.05 ( t table =2.01)

The test results in table 5 show that Capability has a greater influence (46.4%) than Leadership on Business Strategy (19.6%).

Based on the results of the hypothesis test, the following findings can be obtained:

Figure 2. Result of ‘t’ test research model.
The research findings show the support for the hypothesis that leadership style and capability have an effect on the formulation of business strategy with shared influence of 66%. Capability has a greater role (46.4%) compared to leadership style (19.6%) in the formulation of appropriate business strategy of SOE. SOE Capability is more dominantly formed by tangible assets compared to intangible assets, with coefficients of 0.948 and 0.942 respectively. While in leadership style variable, transformational leadership has a greater role than transactional leadership with coefficients of 0.919 and 0.910 respectively.

This result illustrates that in SOEs, the formulation of business strategy rests on tangible assets owned, which are supported by the implementation of transformational leadership. Intangible assets that play a role in the formulation of business strategies are representative offices, quantity of experts, adequate supporting technology, funding sources, and facilities and infrastructure owned. These aspects provide the greatest support in terms of capability in formulating the right business strategy. Transformational leadership means that leaders are able to concentrate on the growth and development of employee value systems, able to encourage the development of inspiration and morality of employees based on their abilities, and able to enlarge vision, insight and clarify the reasons for employees behaving. These aspects provide the most support in terms of leadership style in formulating the right business strategy.

The findings of this study provide support for the finding of [4],[5],[6] that organizational capabilities affect performance. This study also support the finding of [7], that leadership affect performance.

5. Conclusion and Recommendation
The research findings show that leadership style and capability affect the formulation of business strategies. Capability has a bigger role than leadership style in formulating the right business strategy of SOE.

Based on the findings of this study it is recommended to SOE management to strengthen the ownership of capability in the form of tangible assets and intangible assets and encourage the implementation of leadership styles, especially transformational leadership and transactional leadership in order to obtain the right business strategy.

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