



## Financial Performance of Village Owned Enterprises (VOEs)

Yuni Purwita Sari \*

Local Government of Blitar Regency, Indonesia

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### ABSTRACT

*To accommodate village potentials and fulfillment of villagers' needs, through Law No. 32 of 2004 concerning Local Government, the government provides great support so that the village has a business entity which is able to develop and drive the local economy. Law No. 32 of 2004 states that the village can establish a village-owned enterprises (VOEs), village businesses formed / established by the village government whose capital ownership and management are carried out by the village government and the community, in accordance with the needs and potential of the village. In its development, VOEs were encouraged as economic institutions at the village level supported by the government in order to handle economic activities at the village level because their shares were dominated by the village government. In the framework of this achievement, the financial performance assessment is needed to give feedback for VOEs manager in making the right decision for VOEs development. This study aims to search a proper measurement that appropriate to measure the financial performance of Village Owned Enterprises (VOEs). The result of the study found that several financial ratios can be utilized to measure the financial performance of Village Owned Enterprises (VOEs). Those financial ratios can be classified into capital, asset, management, earning and liquidity assessment, which is known as CAMEL model: 1) Ratio of Asset Development is used to measure the Capital Adequacy; 2) Ratio of Productive Asset Quality is used to measure the Asset Quality; 3) BoPo Ratio (Operational Cost of Operating Income) is used to measure the Management Efficiency; 4) Ratio on Asset (ROA) is used to measure the Earnings Quality; and 5) Loan to Deposit Ratio to measure the Liquidity.*

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### 1. Introduction

Many countries in the world concern on local development as a choice to enhance their economic and social growth by empowering the local resources. Local development focuses upon a region's local population as its ultimate source of economic development and growth (Coffey and Polesse, 2007). The difficulties in administering and managing development programs efficiently and effectively under centralized planning caused many developing countries to decentralize responsibility for socioeconomic development planning and management to the local agencies and local government beginning in the 1970s (Firman, 2009).

Decentralization is not intended to weaken the role of central government, but to make local governments empowered and more responsive to local needs. It opts to diminish dependence on a central government; to improve accountability; to institutionalize change; and

to encourage economic development (Grindle, 2007, pp. 178–183). It is believed that wider local autonomy could trigger local development, as it could encourage the local government and communities to take initiatives for necessary action and regulation for their own benefits (Firman, 2009).

Decentralization, as a form of administrative reform, brought support for the local government to improve their local development by optimizing their potentials. It also gave benefits to villages, where previously they have less priority in socioeconomic development.

A village is the smallest unit of the country closest to the community and in real terms directly touches the community's need for prosperity. As representatives of the state, the village is obliged to develop both physical development and human resource development, as an effort to improve the quality of life for the greatest welfare of the village community. If the village is

\* Corresponding author. Tel.: +62-8563549167; e-mail: [yunipurwitasari@gmail.com](mailto:yunipurwitasari@gmail.com)

capable in providing the needs of its community independently, the village will be able to prosper the community and at the same time make income for itself.

In order to accommodate village potentials and fulfillment of villagers' needs, through Law No. 32 of 2004 concerning Local Government, the government provides great support so that the village has a business entity which is able to develop and drive the local economy. Article 213 of Law No. 32 Of 2004 states that the village can establish a village-owned enterprises in accordance with the needs and potential of the village. Village-owned enterprises are guided by laws and regulations, and it also can make loans in accordance with laws and regulations.

In accordance with the mandate of Law Number 6 of 2014, the village gets a big chance to enhance its role in rural community economic development. Village Owned Enterprise (VOE) can become an instrument and optimize its role as a local economic institution that is legal at the village level for improve community welfare and village income. Village Owned Enterprises (VOEs) become the container for village government and its citizens to carry out proportionally economic empowerment programs at the village level. The existence of VOEs is expected to be able stimulate and move the economy of the village.

Village Owned Enterprises (VOEs), as the local enterprise servicing local society founded by local village government, enables economic growth, job creation, the building of local vital infrastructure and sustainable development. Any lapse or failure in the governance of an important local village organization erodes public trust and confidence. This is not only affects the reputation of the organization but also impacts negatively on the economy. Therefore, VOEs must be managed professionally and independently, so that they need people who have the competence to manage them. In recording employees or managers and others must be adjusted to the standards set out in the Articles of Association (AD/ART) of the VOEs.

In its development, VOEs were encouraged as economic institutions at the village level supported by the government in order to handle economic activities at the village level because their shares were dominated by the village government. In the framework of this achievement, the financial performance assessment is needed to give feedback for VOEs manager in making the right decision for VOEs development.

In the public sector the nature of financial performance is a function of what the public sector entity is held accountable for accomplishing in financial terms in the identified period. Assessment of financial performance is one way that can be done by the management in order to fulfill its obligations to funders and also to achieve the goals set by the organization.

The financial performance measurement in Village Owned Enterprises (VOEs) has not been done so much, so that in theory there is no agreement regarding the name and rules of measurement. However, in the

context of government organization's transparent and accountable financial management, financial performance measurement needs to be carried out, even though the accounting rules in public sector financial statements differ from those of private organizations.

This study aims to search a proper measurement that appropriate to measure the financial performance of Village Owned Enterprises (VOEs). The result of this study is important, as Wang and Huynh said (2013), financial performance measurement offers managers with inputs to enhance the organization's performance, in this case VOEs performance. It will give better understanding, suggestion and input for VOE managers. Consequently, they make better decisions and strategies, so that they can achieve the more improved VOE performance. Furthermore, the success of VOE means that it will improve community welfare and village income.

## 2. Discussion

### 2.1. Village Owned Enterprises in Indonesia

The issuance of Law No. 32 of 2004 concerning Regional Government signals that the village has the right to establish Village Owned Enterprises (VOEs). Since that time, VOEs began to flourish and the local governments respond it by involving VOEs in the economic development activities. However, the establishment of VOEs must be supported by efforts to strengthen capacity and also supporting regional policies that facilitate and protect this business from the threat of competition from large investors.

The birth of Law No. 6 of 2014 concerning Village is expected to be a source of new spirit of VOEs. It reaffirmed that the village can establish VOE, a business entity that all or most of its capital is owned by the village through direct investment from village assets which are separated in order to manage assets, services, and other businesses for the greatest welfare of the village community.

The requirements needed for establishment of Village-Owned Enterprise are (Regulation of the Minister of Internal Affairs Number 39 of 2010 article 5 clause (1)):

1. There is an initiative from the village government and/or the community based on the villagers' deliberations;
2. There is potential community economic business;
3. It is formed according to community needs, especially in meeting basic needs;
4. There are availability of village resources that have not been used optimally, especially village wealth;
5. There are availability of human resources who are capable in managing business entities as assets that drive the economy of rural communities;
6. There are existence of community business units which are community economic activities managed partially and are not accommodated; and
7. It is built to increase community income and village original income.

The principles of managing VOEs are important to be elaborated or described so that they are understood and perceived in the same way by village governments, members (capital partners), Village Consultative Bodies (BPD), Regional Governments, and communities. In the Book of Guide to the Establishment and Management of Village-Owned Enterprises (2007: 13) there are 6 (six) principles in managing VOEs:

1. *Cooperative*. All components involved in VOEs must be able to do good cooperation for the sake of the development and survival of their business.
2. *Participatory*. All components involved in VOEs must be willing to volunteer or be asked to support contributions that can drive business progress.
3. *Emancipative*. All components involved in VOEs must be treated equally regardless of class, ethnicity and religion.
4. *Transparent*. Activities that affect the interests of the general public must be known to all levels of society easily and openly.
5. *Accountable*. All business activities must be technically and administratively accountable.
6. *Sustainable*. Business activities must be developed and preserved by the community in the container of VOEs.

Herry Kamaroesid (2016) divided VOEs business types into several classifications, as follows:

1. **Banking VOEs**  
VOEs that are banking types or some kind of microfinance institutions actually present the earliest before other types of VOEs are present, even before the term VOEs itself was born. Village Credit Institutions (LPD) present in traditional villages in Bali are examples of prominent village banking. Later a number of districts formed the microfinance institutions' VOEs easily, simply and simultaneously in all villages, with a uniform goal: reducing the entanglement of community members from moneylenders while at the same time facilitating access to credit for residents, especially the poor. This premature Microfinance Institution is similar to the various revolving fund projects run by the government such as the PNPM Mandiri SPP.
2. **Serving VOEs**  
In addition to Banking VOEs, the Serving VOEs began to grow incrementally in many villages. The limitations of clean water and the inability of most residents to access clean water encourage many villages to manage and service the needs of clean water residents with containers of VOEs or Village Water Supply Companies.
3. **Brokering and Renting VOEs**  
Before VOEs actually there were already many villages running village businesses in the form of services or intermediary services, such as payment services, tractor rentals, and also village markets. This is a simple business, it can even do a monopoly, with a clear captive market even though it only operates within the village itself. But in many cases many cases of tractor rentals are also a form of village protection against farmers. The village is present, renting tractors to farmers at very

affordable prices, and can even be paid after harvest.

#### 4. Trading VOEs

VOEs that trade basic needs and means of agricultural production began to grow in many villages. This is a simple business, local scale, and has an internal village scope, which serves the needs of local residents.

#### 2.2. Financial Performance

Financial performance is an analysis conducted to see the extent to which an organization has carried out operational activities using the rules of financial implementation properly and correctly (Fahmi, 2012: 2). Khan and Jain (2006) argue that financial performance is the process of selection, relation and evaluation focusing on the financial statement and significant relationship that exists between them, in order to obtain a better understanding of the organization's position and performance. While according to Aktan and Bulut (2008), financial performance refers as a firm's ability to generate new resources from day to day operations over a given period.

Financial performance is a subjective measure of the accountability of an entity for the results of its policies, operations and activities quantified for an identified period in financial terms (PSAB Conceptual Framework Task Force, 2012). In the public sector, the nature of financial performance is a function of what the public sector entity held accountable for accomplishing in financial terms in the identified period. Multiple perspectives of financial performance considered together provide a comprehensive picture of a public sector entity's achievement in relation to the multiple accountabilities expected of it. The public sector refers to the central, provincial and local governments, and government organizations.

Borrowing the business term, the benefits of evaluating performance of organization are as follows (Ermayanti, 2009):

1. To measure the achievement of organization in a certain period that reflects the level of success of the implementation of its activities.
2. To assess the contribution of a part in achieving overall corporate goals.
3. It can be utilized as a basis to determine the future organization's strategy.
4. It gives input in making organizational decisions and activities in general and divisions or parts of the organization in particular.
5. As a basis for determining investment policies in order to increase efficiency and productivity of the company.

#### 2.3. Measuring Financial Performance of Village Owned Enterprises (VOEs)

The financial performance measurement in Village Owned Enterprises (VOEs) has not been done so much, so that in theory there is no agreement regarding the name and rules of measurement. However, in the context of government organization's transparent and

accountable financial management, financial performance measurement needs to be carried out, even though the accounting rules in public sector financial statements differ from those of private organizations.

For evaluating the financial performance, financial ratios are used. These ratios help in evaluating whether the organization is performing well or not. The pivotal instruments for providing most of such economic information are the financial statements prepared at regular intervals by the public enterprises.

Financial statements, as a vehicle of communication, intend to convey information about how the unit works over a period of time and its condition at a point in time. This financial report aims to communicate the economic message from the results of business decisions and events that can be expressed in terms of data that can be measured in such a way as to achieve maximum understanding with the user. Economic messages that the various users draw from these financial statements get facilitated when the individual variables are transformed into financial ratios. This transformation allows direct comparison of economic units of different sizes and provides a better picture of a firm's financial position and the interrelationships of the data. Financial ratios, the derivatives of financial statements, therefore, are widely applied to reach certain judgments about the firm under study. They are expected to provide the economic and objective justification for the decisions.

Misra and Aspal (2013), Kaur et al., (2015), Karri et al., (2015), Naeem (2016) used the CAMEL model to evaluate the financial performance of public banks. While to examine the financial performance of other public sector, several financial ratios such as liquidity ratio, solvability ratio, profitability ratio, activity ratio, and solvency ratio are used (Alhabsyi, 2015; Afrijal and Ramadhani, 2016; Hajar, 2016; Sari, 2016).

In term of financial performance assessment of Village Owned Enterprises, Hartini et al., (2015) conduct a research aims to analyze how Healthy Financial Performance BUMDes Pagar Mayang Sumber Makmur sub-district North Tambusai. She used CAMEL model, based on Bank Indonesia Regulations No.6 / 10 / PBI / 2004 dated April 12, 2004 concerning Bank Soundness Rating System and Bank Indonesia Circular No. 6/23 / DPNP dated May 31, 2004 concerning how to evaluate the health level of public banks.

We can adopt the financial ratios to measure the financial performance of Village Owned Enterprises (VOEs). Based on several previous research regarding the measurement of public sector's financial performance, there are several financial ratios that appropriate to measure the financial performance of VOEs. Those financial ratios can be classified into capital, asset, management, earning and liquidity assessment, which is known as CAMEL model. In the CAMEL model, the organizations are rated on the basis of CAMEL where 'C' means Capital Adequacy, 'A' is for Assets Quality, 'M' for Management Efficiency, 'E' is for Earnings Quality and 'L' for Liquidity. This

method aims to know and explain about financial performance of organizations that can be categorized into healthy, healthy enough, less healthy or unhealthy.

#### 1. Capital Assessment

The asset development ratio against initial capital is used to see the development of assets of VOEs, which is by comparing changes in assets with initial capital (the Collaboration between the Department of Village and Community Empowerment of Blitar Regency and the Faculty of Agriculture of Brawijaya University, 2017).

#### 2. Asset Assessment

Productive Asset Quality Ratio is used to measure the quality of assets of VOEs. Assessment of this ratio is intended to measure problem loans with total loans provided. The smaller the ratio, the more VOE is productive (the Collaboration between the Department of Village and Community Empowerment of Blitar Regency and the Faculty of Agriculture of Brawijaya University, 2017).

#### 3. Management Assessment

Operational Cost of Operating Income, in Indonesia abbreviated BOPO explains the ratio of the ratio between the operational costs and the operating income of a VOE. The smaller the value, the more efficient VOE is (the Collaboration between the Department of Village and Community Empowerment of Blitar Regency and the Faculty of Agriculture of Brawijaya University, 2017).

#### 4. Earning Assessment

Kasmir (2012) describes the ratio of Return on Assets (ROA) is a ratio that shows the level of return of the amount of assets owned by a bank that operationalized. This assessment is intended to measure VOE's ability to obtain Remaining Operating Results (SHU), or in other word earning after tax, from the total assets used (the Collaboration between the Department of Village and Community Empowerment of Blitar Regency and the Faculty of Agriculture of Brawijaya University, 2017).

#### 5. Liquidity Assessment

Liquidity ratios measure the ability of the firm to meet its current obligations. The size of VOEs liquidity can be measured by LDR (Loan to Deposit Ratio), by comparing the amount of cash and VOE money in the bank with the initial amount of capital. This ratio is used to see the level of distribution of funds. The smaller the ratio, the better the distribution (the Collaboration between the Department of Village and Community Empowerment of Blitar Regency and the Faculty of Agriculture of Brawijaya University, 2017).

### 3. Conclusion

Village-Owned Enterprises (VOEs), village businesses established by the village government whose capital ownership and management carried out by the village government and the community, were encouraged as economic institutions at the village level supported by the government in order to handle

economic activities at the village level. In the framework of this achievement, the financial performance assessment is needed to give feedback for VOE's manager in making the right decision for VOE's development.

There are several financial ratios that appropriate to measure the financial performance of VOE's. Those financial ratios can be classified into capital adequacy, asset quality, management efficiency, earning quality and liquidity, which is known as CAMEL model. Ratio of Asset Development is used to measure the Capital Adequacy, Ratio of Productive Asset Quality is used to measure the Asset Quality, BoPo Ratio (Operational Cost of Operating Income) is used to measure the Management Efficiency, Ratio on Asset (ROA) is used to measure the Earnings Quality, and the Loan to Deposit Ratio to measure the Liquidity.

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