

Non-Market Capability: Improve Performance Banking Industry

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Abstract: Companies should have the capability and Non-Market Capabilities (NMC). Both allow to reduce the negative impacts of policies that can be realized through communication. Hence, the NMC can improve the performance of the company if the conditions are not optimal. This weakness is due to the operating pressure of the environment that are controlled by government regulation related products and services related to public needs. Thus, the capability to be dynamic and able to integrate internal and external competence in responding to rapidly changing business environment. The objective of this research is to develop a model MNC role in simplifying government regulations on the performance and role in mediating resource diversification strategy is complex and build relationships NMC, resources, complexity of the environment, diversification strategy and performance. This research has resulted in a model that is able to simplify the NMC role of government regulations on the performance and role in mediating resource strategy of diversification within the complex environment. NMC is the ability of effective communication with stakeholders that allows banks to benefit from the government's involvement.

Key words: Non-market capabilities, regulations, diversification, complex environment, mediating resource, complexity

INTRODUCTION

The issue of diversification has been well documented in the literature of corporate finance, although the general consensus is still not achieved yet (Berger *et al.*, 2010). Meanwhile, many studies provide evidence that the conglomerates have a lower performance compared to firms specialization (Lang and Stulz, 1994) in function. The bank's business activities tend to be fee-based income and able to improve performance the support of government and central bank are strong, it will encourage banks to pay more attention to its primary function as an intermediary institution. The case in the Indonesian banking change due to continuous government regulations. Bank performance will increase due to the regulation (Barth *et al.*, 2001). However, the government policy often intervenes company which will give a negative impact on bank performance (Apatachioae, 2013; Sabihaini and Mintarti, 2012).

The success of the banking business is determined by internal business environment and the honest human factor. Next, to achieve optimum performance and superior company requires a number of specialized resources with variety of operating capabilities, marketing dynamic marketing capability and marketing survival (Sukdej and Ussahawanitchakit, 2015) and operations, marketing and environmental capabilities (Yu *et al.*, 2014). The company must not only has high capability but also advised to

have a Non-Market Capability (NMC). NMC is the capability that allows a company to reduce the negative impacts of policies that can be realized through communication. Thus, the NMC is important for the company if the company's performance is not optimal for an operating pressure environment that is controlled by government regulation where products and services related to public needs (Schiemenn, 2011); Capabilities must be dynamic, so that, it can integrate internal and external competences to respond rapidly changing business environments (Sukdej and Ussahawanitchakit, 2015; Zahra *et al.*, 2006).

The purpose of this research is to develop the relationships NMC, resources, complexity of the environment, diversification strategy and performance. This research will be developed in the NMC's role models by simplifying government regulations on the performance and role in mediating resource diversification strategy, the complexity of the environment and government regulations.

Literature review:

Non-market capability: To support the company's strategy, NMC is needed to describe internal processes, resources, companies' knowledge related to activities that are not evenly distributed among companies (Bonardi *et al.*, 2006; Wan, 2005). Elements and attributes of NMC that is a set of resources such as physical

facilities, employee skills and special abilities and special skills possessed by the top management. Therefore, NMC can create high competence (higher-order competencies). Bonardi *et al.* (2006) stated that there is a positive correlation between the company's strategic decision to engage in a review of the existing regulations with the performance (Rate Of Return/ROR).

Resources: Widener (2006) stated strategic resources has an impact on the performance of non-manufacturing companies. Humans have a positive influence on the performance, physical capital that did not correlate with performance while structural capital (the facilities that is required new technologies and other assets such as patents) are negatively correlated to company performance. However, structural capital in the company manufactures has a negative correlation to the performance and the relationship between the human capital strategic (strategic human capital) is not significant to the performance.

Environmental complexity: Environmental complexity reflects the degree of heterogeneity or diversity factors, activity or situation faced by the company (Gonzalez-Benito *et al.*, 2010).

Diversification strategy: Rumelt (1984) relates the various categories of diversification and financial performance (profitability). The findings of this process with the sample 246 companies and found that the diversification strategy related (constrained and linked) the performance is within the average; Related constrained generate performance above average and unrelated resulting in performance below average. In this study does not explain why there are differences in performance. Bettis and Hall (1982) found that the relationship of diversification and return is positive while the relationship between the strategy and the return is negative. Research provides an explanation of the nature of the relationship between performance and diversification strategies using ROA as a measure of return (performance). Bettis and Hall (1982) stated that the diversification strategy negatively affect profitability (ROA) loan growth does not affect the profitability (ROA). Both of these findings may provide an explanation of the nature of the relationship between diversification strategy and performance. Some other results of empirical studies found that the diversification strategy has an impact on bank performance (Berger *et al.*, 2010). While, Lu and Yao (2006) found that the diversification strategy can improve the performance of companies in China when they adopt a higher level of

diversification. Meanwhile, Laeven and Levine (2007) found diversification strategies influence directly and negative toward the value of the bank.

Performance: Some previous studies measured bank performance using a health bank level indicators as a performance measure. The bank's performance is measured using five indicators covering aspects of Capital, Assets, Management, Earnings and Liquidity better known as CAMEL (Kasim, 2008). However, the researchers also agree that the use of one type of measurement is deemed not enough to explain the organizational effectiveness and need to include other operational measurements such as product quality and market share (operational performance).

Government regulation: The main element of the external or macro environment is the environment that is far from the organization but are very influential in the development of organizations such as changes in economic, political, regulatory (government policy) social environment, cultural and demographic, technological development, ecology and law (Pearce and Robinson, 2007; Wheelen and Hunger, 2004; Barth *et al.* (2001) found no relationship between government regulation, operational performance in the commercial banks. Chen and Zhu (2005) states that the higher government intervention to a company of Direct Government-Controlled Company (DGCC) the lower the level of achievement of company performance. Otherwise, the company's value is decreasing when government intervention in the form of ownership is small (Sun and Tong, 2003).

MATERIALS AND METHODS

Sample and data collection procedure: The study was conducted in commercial banks (BU) Indonesia that are included in the top big 10. These banks have a good performance, since, 2015. The sample used was 296 banks. Analysis unit bank organization observed at the level of branch offices. Data collection was conducted by using surveys and interviews. Each branch is represented by the leadership of the head branch as respondents.

Variable and measurement: Resources variable is a resource owned by the company: as the physical resources, human resources, financial resources and managerial expertise (managerial skills). Indicators of resources are six that were adopted from Kor and Mahoney (2005). Non-market capability variable is the perception of chairman to the commercial bank director in

interacting with government (BI) to present their views, ideas or refutation of any policy plan that will be implemented by the government and internal bank. There are 5 indicators developed from (Wan, 2005; Bonardi *et al.*, 2006). Environmental complexity variable is the level of diversity and heterogeneity of the elements in the external environment faced by banks that influence strategic decisions. Indicators of environmental complexity developed by the concept of competitiveness power from (Gonzalez-Benito *et al.*, 2010) were using a 4 indicators, namely: changes in consumer tastes, the level of competition, changes in the behavior of suppliers and technological developments. Rate diversification variable is level of diversification undertaken by the bank at the bank's main function (intermediation) as strategic response to changes in the external environment. The level of diversification is measured using a Concentric Rate (CR) or Specialization Rate (SR). CR is the ratio between the income of primary income (core business) and total income. This study is to measure CR based on Rumelt (1984) where the main income is proxied by interest income is the main income of the bank. The formula is as follows:

$$CR = \frac{\text{Total } Y_i}{Y \text{ total}} \quad (1)$$

Where:

- CR = Concentric Rate
- Total Y_i = Total interest income
- Y total = Total income

The level of diversification based on the CR can be explained as follows: if the value of CR is higher (95% > CR > 70%) then the lower the level of diversification. It means that the bank's business activities leads (concentrated) to core business activities.

If the number CR is getting low (below 70%) then the higher level of diversification. It means the bank's business activities further away from core business activities or tend to business activities that generate fee-based income. The research instrument is an open question in the form of interest income and total revenues in range the last 3 years.

Performance variabel is the level of performance or achievements of the company at a specific time period. Performance measurement in this study refers to the analysis of CAMEL. The performance indicators that is used: asset quality aspects (NPL), earning (ROA, ROA) and aspekliquidity (LDR). Measurement of these indicators is using a ratio scale. After an assessment of each indicator, the scale ratio of each indicator is converted into a scale interval of 5 levels based on the following criteria: (unhealthy), (less healthy), (healthy

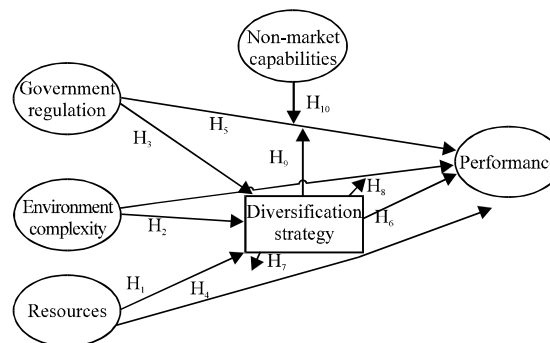


Fig. 1: Conceptual model and hypothesized relationships

enough), (healthy) and (very healthy). Government regulation variable is how far the government and BI policies to encourage the mainly functions as a collector and distributor of funds perceived by the bank as a good opportunity or as inhibitors of banking performance. Government regulation in this study are the rules and policies issued by the government and BI such as: API policy, the packages policy: GWM and interest rate BI.

Research model: The analysis used in this research is Structural Equation Modelling (SEM). Multilevel model can be estimated by using a structural equation model (Oberski, 2014). The relationship model of causality in this study is the result of the theoretical justification from various sources that are supported by the results of empirical studies, thus, forming a research model. Tests on a model developed by Hair *et al.* with the goodness of fit criteria, i.e., CMIN/DF, CFI, RMSEA, GFI and TLI (Fig. 1).

Hypothesis: Based on literature study, the hypothesis are as follows:

- H₁: the better the resources, the higher the level of diversification (diversification strategy)
- H₂: the higher the environmental complexity, the lower the level of diversification (diversification strategy)
- H₃: the greater the government support (government regulation) the higher the level of diversification (diversification strategy)
- H₄: the better the resources, the higher the performance
- H₅: the greater the government support (government regulation) the higher the performance
- H₆: the higher the level of diversification, the higher the performance
- H₇: diversification strategy role mediating influence on the performance of resources

- H₈: diversification strategy role mediating influence on the performance of environmental complexity
- H₉: diversification strategy role mediating the effect of government regulation of performance
- H₁₀: non-market capability role moderating influence on the performance of government regulation

RESULTS AND DISCUSSION

To test the hypothesized links in our conceptual framework, Structural Equation Modeling (SEM) was used in this study. Results of the overall goodness of fit models testing suggest that all measurement results at an acceptable level, so that, it can be stated quite fit estimasian models (Table 1). Testing the model results were pretty good confirmation with CFI and TLI well above the recommended threshold of 0.90, the RMSEA <0.08 (Hu and Bentler,1999).

Results of hypothesis test:

- H₁: the better resources, the higher the level of diversification (diversification strategies) have positive significant ($\beta = .045, p < 0.05$)
- H₂: the higher the complexity of the environment, the lower the level of diversification have significant negative ($\beta = -0.25, p < 0.05$)
- H₃: the greater the support for the government (government regulation) the higher the level of diversification (diversification strategies) have significant positive ($\beta = 0.23, p = 0.009$).
- H₄: the better resources, the higher the performance have positive significant ($\beta = 0.30, p = 0.001$)
- H₅: the greater the support for the government (government regulation) the higher the performance have a significant negative ($\beta = -0.64, p = 0.000$)
- H₆: the higher the level of diversification, the higher the performance of BU ($\beta = 0.16, p > 0.05$). Thus, H_{1,2,3,4} and H5 are supported but H6 is not supported.
- H₇: the diversification strategy role mediating influence on the performance of resources have significant positive ($\beta = 0.037, p = 0.000$)
- H₈: the diversification strategy role mediating influence on the performance of BU environmental complexity have significant negative ($\beta = -0.040, p = 0.000$)
- H₉: the diversification strategy role mediating the effect of government regulation of performance have positive significant ($\beta = 0.037, p = 0.000$)
- H₁₀: NMC role moderating influence on the performance of government regulation have significant positive ($\beta = 0.0505, p = 0.000$). Thus, H_{7,8,9} and H₁₀ are supported

Table 1: Measurement model's goodness of fit index

Goodness of fit index	CMIN/DF	CFI	TLI	NFI	GFI	AGFI	RMSEA values
Calculated	1.316	0.968	0.963	0.848	0.826	0.778	0.051

Primer data in 2015

Structural model is very support the hypothesis H₇-H₉. Thus, resources and government regulations have a significant influence on the diversification strategy which is getting closer to its core business. While the higher environment complexit, the further banking diversification from the bank's main function. The bank's business activities tend to be fee-based income and able to increase performance. However, when the diversification strategy included in the structural model, the effect of government regulation and the performance is stronger when the banking strategy approaching core business diversification. Strong government regulation of banks will encourage banks to pay more attention to its primary function as an intermediary institution. These results indicate that the diversification strategy plays a mediating role in the environmental complexity, government regulation and bank performance and fully mediate these relationships.

These results are consistent with existing studies of Sabihaini and Mintarti (2012). The result of the diversification strategy plays a role in mediating the resources and banking performance and fully mediate the relationship. These results are consistent with (Widener, 2006; Schiemenn, 2011) that is found that people equity would increase if triggered by good human resources system then able to have high performance. The resources and capabilities of the company also has a major role to the improvement of company performances (Pearce and Robinson, 2007). Meanwhile, when the NMC as a mediator, it is introduced in the model regulation on performance and the effect on performance is becoming stronger. These results indicate that the NMC is able to strengthen the influence of government support on bank performance. In other words that government involvement will be able to improve bank's performance if they are supported by the NMC. For optimal banking in the use of the NMC can be a source of excellence for banking. This is because the bank is engaged in the service industry, so that, more priority to non-market capabilities that could be used as a source of excellence for banking. Type moderation is perfect moderation (Pure moderation) (Fig. 2).

Theoretical contribution: First, based on the theory of RBV, a conceptual framework helps to examine the relationship among the abilities (resources and non market) the diversification strategy and the regulation of

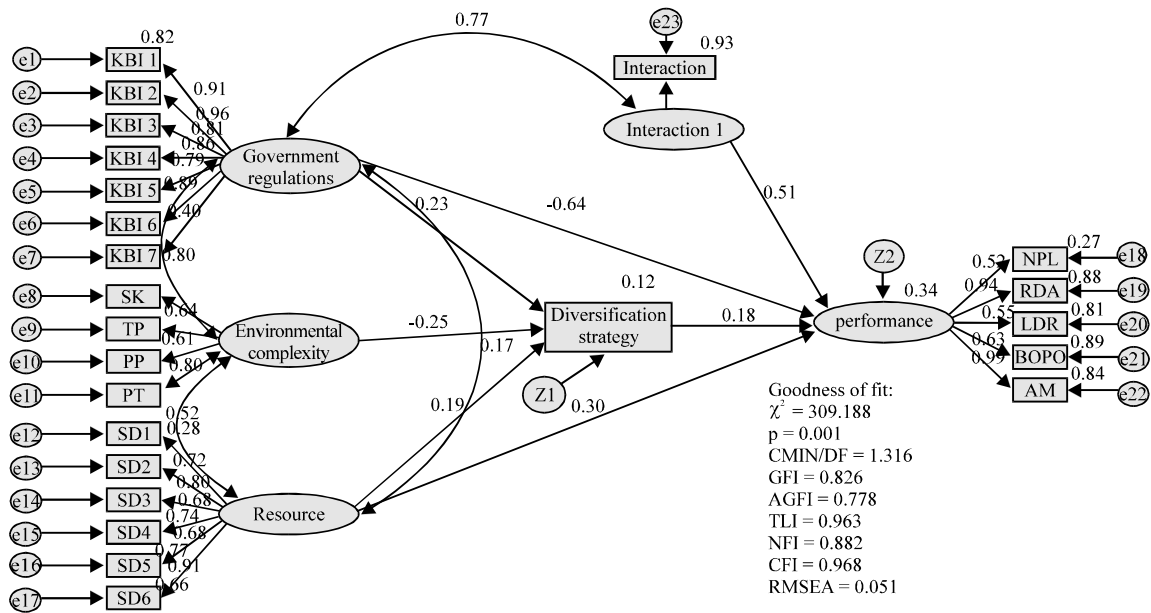


Fig. 2: Result of structural model

the effect on performance. Therefore, this research empirically study the relationship among five constructions holistically also clarify the contribution of diversification strategy as mediation and NMC as a mediator. Second, the findings of this study further strengthens the presence or truth of E-S-P paradigm, especially in the banking industry.

Managerial contribution: This study provides important implications regarding the NMC in the context of the banking industry. It will support the branch leaders to consider and implement it to achieve the performance and beware in learning about the environment (more attention to the environmental conditions, especially in conditions of environmental complexity that is getting higher, banking is more appropriate to use a strategy that is increasingly diversified or strategy that leads to activity fee-based income which resulted in increased performance of the banking system. However, the bank should be aware that its main function is as an intermediary institution, namely, collecting and distributing funds in the form of credit). It means banks should also encourage revive the real sector by granting credit. Learning the business environment is very helpful to analyze environmental effects which can help companies to improve the performance and efficiency of government regulation.

CONCLUSION

This study presents the relationship of NMC, resources, environmental complexity, the strategy of

diversification on performance. In addition, this research had developed a role model of NMC that is able to simplify the government regulations on the performance and plays role in mediating resource diversification strategy, the complexity of the environment and government regulations. NMC is the ability of effective communication with stakeholders that allows banks to give benefit from the government’s involvement. But in reality, the NMC is not easy to be realized by leaders at the branch and bank management.

Data were analyzed by SEM. The results showed that the resources, government regulation have influence positively on the diversification strategy but the environmental complexity has a negative effect on the strategy of diversification. Resources has positive effect on performance while it has the negative effect of government regulation. Diversification strategy has negative effect on performance. Diversification strategy has negative effect on the role mediating that is influence of resources, government regulations and environmental complexity of the performance. NMC plays role to moderate the effect of government regulation on performance.

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