

The strategy of the banking industry in Indonesia: following institutional theory or resource-based view?

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Abstract

This study addresses the ongoing debate about the tension faced by firms –either using different strategy or similar strategy compared to other firms to achieve good performance. Using the institutional theory and a resource-based view as the framework, this study answers the question and proves which strategy really affects the performance of the firms. Using data from the Indonesian banking industry, the results of the analysis show that being different enhances the firm's performance (ROA).

Keywords: *Institutional Theory, Resource-based View, Isomorphism, Strategy, Firm Performance, Banking Industry, Indonesia.*

Abstrak

Studi ini membahas perdebatan yang terus dialami oleh perusahaan – apakah perusahaan lebih baik menggunakan strategi yang berbeda atau strategi serupa dibandingkan dengan perusahaan lain untuk mencapai kinerja yang baik. Dengan menggunakan teori institusional dan pandangan berbasis sumberdaya sebagai kerangka kerja, penelitian ini menjawab pertanyaan dan membuktikan strategi mana yang benar-benar mempengaruhi kinerja perusahaan. Dengan menggunakan data dari industri perbankan Indonesia, hasil analisis menunjukkan bahwa menggunakan strategi yang berbeda meningkatkan kinerja perusahaan (ROA).

Kata Kunci: *Teori Institusional, Resource-based View, Isomorfisma, Strategi, Kinerja Perusahaan, Industri Perbankan, Indonesia.*

JEL: G20, G21, L10, L19

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Introduction

In strategic management literature, there is an ongoing debate about how firms can survive and achieve good performance. The debate focuses on the question of whether the firms should be different, or be the same as the other firms in the industry. Similarities or differences in the firms can be manifested by many attributes, such as strategy elements, product attributes, competitive capabilities, or intangible assets (Gamble, et al., 2015), but following Deephouse (1999), this study sees their strategic attributes as the subject of the research. A company's strategy spells out why the company matters in the market place by defining its approach to creating superior value, and for customers, and represents a managerial commitment to pursuing an array of choices about how to compete (Thompson, et al., 2016). The strategy of a firm, among many conceptual definitions, reflects the position of the firm vis a vis the competition in the market (Mintzberg, 1987). On one side there is a basic argument stating that firms gain competitive advantage by having different strategies (Porter, 1991; Barney, 1991). On the other hand, being similar in their strategies can help the firms to obtain legitimacy and increased performance (DiMaggio and Powell, 1983; Deephouse, 1996).

From the perspective of the institutional theory (DiMaggio and Powell, 1983), the firm should be the same as the others, or at least resemble the industry trends in order to achieve superior performance. A firm's propensity to imitate another firm in its industry environment called as isomorphism. The institutional theory's perspective also states that strategic activities are defined as social and normative things. The motivation to do this action comes from the tendency of the actors in companies to gain legitimacy from constituents/stakeholders. Thus, by equating with the strategic choice, as deemed by the constituents, this will help the organization to achieve the average or even above average performance in the industry. Specifically Deephouse (1996) called the resemblance of strategies as strategic isomorphism, a term that can be interpreted as the extent to which an organization's strategy resembles the conventional or normal strategy in an industry.

By contrast, strategy scholars have argued that a firm with a distinct position achieves better performance (Carpenter, 2000; Porter, 1991) and the perspective of the Resource Based View (RBV) argues that a firm's performance is determined by the resources it owns (Barney, 1991). The resources of a firm are more important than the existing structure of the industry in achieving a competitive advantage (Barney, 1991). The RBV focuses on the concept of the difficult-to-imitate attributes of the firm as the sources of superior performance and competitive advantage (Barney, 1986; Hamel and Prahalad, 1996). In this view, valuable organizational resources can enhance organizational capabilities and eventually lead to higher performance. So, by owning unique and rare resources the firm will achieve a competitive advantage and have a distinct position relative to its counterparts, which ultimately enhances the performance of the firm. The ability of the firm to perform better, as compared to its competitors, is also made possible by having a unique organizational structure, proven systems and processes that align well with the resources it owns (Collis & Montgomery, 2005).

This paper addresses the tension between two perspectives, namely institutional theory (DiMaggio and Powell, 1983) and resource-based view (Barney, 1991), by examining it in the context of the strategy of the firm. In addition, this study examines which strategy actually does enhance the performance of the firm, especially its financial performance. For several reasons this research was conducted in the banking industry of Indonesia. Firstly, the banking industry is a highly regulated industry where all activities in the industry are supervised and regulated by the government and its agencies, such as the central bank. The Indonesian banking industry is supervised and regulated by government agencies such as the Bank of Indonesia (BI) as the central bank and the Financial Services Authority (Otoritas Jasa Keuangan- OJK). The unique characteristics of the industry often makes the firms face the dilemma of being similar with each other to be legitimized by their constituents and achieve good performance or of being different to achieve a competitive advantage with a distinct position and improve the firm's performance. Secondly, taking into account that most banks consider the selection of assets and liabilities is a fundamental strategic decision (Santomero, 1984), it is therefore an appropriate context to see how the mechanism for similarity and differences in strategy affect performance. Thirdly, while there were studies relating to the bank industry in Indonesia, such as Mulyaningsih and Daly (2011), Setiawati and Naim (2001), and Hidayat et al., (2012), to name the few, none of them investigated the perspective of institutional theory and resource-based view. Lastly, this kind of study has been empirically tested in several previous studies in western countries (Deephouse, 1999; Garcia and Sabate, 2010), but evidence from developing countries, such as Indonesia, where the banking industry is remarkably competitive (as there are large numbers of banks), is rarely investigated.

Literature Review

Institutional Theory

Introduced by DiMaggio and Powell (1983), this theory states that an organization will tend to resemble other organizations in its environment to gain legitimacy. The institutions are created by the man to organize and form the interaction of political, social and economic transactions, they are

structure that provide stability in life by considering rules, norms, cultural benefits, roles and resources (Scott, 2001; Shi et. al., 2008). Once the rules, norms, cultural benefits, roles and resources internalized, that is encoded into actors through a socialization process, institutions transform to a pattern of attitudes and behaviors, which will shape actors' (or organizations') future attitudes and behaviors and provide stability and meaning to social life.

From this view, institutional theory is quite different from the rational economic perspective, which emphasizes individual self-interest, conscious decision making, and economic optimization, rather it suggests firm to being similar to other firms. Motivation for this action came from the tendency of actors to gain legitimacy from constituents.

Formulating a strategy is about thinking of the future of the business organization, which involves forward thinking and planning. As such, the uncertainty is inherently unavoidable, making the strategic thinking aspects of the job of top managers complex and difficult. To lessen the nature of their job, mimicking other managers' strategies is a possible solution, especially when the strategies proven successful. This propensity is called as isomorphism. The successful strategy then becomes an "industry recipe" (Spender, 1989), resembling what the institutional theory called governance structure, institutional logic, and an institutional template. From this perspective, the strategic activity is defined as a social and normative thing as more and more organizations mimic the recipes.

Resource Based View (RBV)

Proposed by Barney (1991), the RBV argues that the competitive advantage of an organization is determined by the key resources owned by the organization. The RBV takes an "inside out" view or a firm-specific perspective on why organizations succeed or fail in the market place (Dicksen, 1996). The RBV focuses on the concept of difficult-to-imitate attributes of the firms as sources of superior performance and competitive advantage (Barney, 1991; Hamel and Prahalad, 1996). Having different strategies means less competition from rivals, as the driver of that strategy is not similar. For instance, a company pursuing a low-cost strategy will seriously look at the costs for its input factors, emphasizing access for those factors is an important consideration, while its competitors who are pursuing different strategies tends to focus on the product attributes that help their firm to position its products objectively to obtain their proper value. Another example was company pursuing differentiation strategy as a way to compete – this company was looking the value driver such as product features and performance, technology and innovation, R&D, customer service, to position that the company's product was unique from the point of view of customers.

Thus, having similar strategies pushes firms to compete intensively with each other to access the driver of the strategies (e.g. input factor), which limits their performance, and increases the failure rate. Being different (Porter, 1980) reduces competition and increases performance.

To be different, or to be the same?

The perspective of strategic similarity

This perspective is derived from the resource dependence and institutional theories. Its view is that a firm should be same as others to achieve superior performance. Meyer and Rowan (1977) explain that a formal organization is known as a coordinated system with controlled activities that emerge when work is embedded in complex networks of technical relationships and boundary-spanning exchanges. However, in modern societies formal organizational structures emerge in highly institutionalized contexts (Wah et al., 2004). As such the existence of the positions, policies, programs and procedures of modern organizations are enforced by public opinion, by the view of important constituents, by knowledge legitimated through the educational system, by social prestige, by the laws and by the definitions of negligence and prudence used by the courts (Meyer & Rowan, 1997). Such elements of formal structure are manifestations of powerful institutional rules which function as highly rationalized myths that are binding on particular organizations (Wah et al., 2004).

Deephouse (1999) stated that a firm's strategy is legitimated normatively, socio-politically, or regulatively if it is endorsed by members of the organizational field. A range of normal strategies are institutionalized and legitimated by the organizational field through a repeated isomorphic process (Scott, 1995).

The strategy selection is inherently uncertain because it requires commitment to a certain method, and under such conditions mimetic behavior is possible (Cyert and March, 1963; Ghemawat, 1991; DiMaggio and Powell, 1983). So, the firm will prefer to select and imitate a successful strategy to achieve success (Haveman, 1993). The successful strategy is called an industry recipe (Spender, 1989). A firm which selects strategies outside of the "industry recipes" will face some risk and legitimacy challenges. Legitimacy challenges decrease the firm ability to gain resources from potential exchange partners in the organizational field, like customers, suppliers, and regulators (DiMaggio and Powell, 1983). Further, a legitimate firm will acquire higher quality resources at more favorable terms than a firm whose legitimacy is challenged, dissimilar firms who faced legitimacy challenges hinder resource acquisition and reduce performance (Deephouse, 1999).

Heugens and Lander (2009) explained there are several arguments that could explain the effect of isomorphic conformity to the performance of the firm. First, isomorphic organizations are more likely to attract higher quality resources than deviant counterparts. Resource providers prefer socially acceptable organizations that do not threaten their reputation for good judgment, have strategies the providers recognize as rational and are less likely to fail because of unanticipated risks (Baum & Oliver, 1991; Deephouse, 1999). Second, newly institutionalized templates for organizing may simply represent a better way of doing business than extant alternatives. Early adopters often pioneer templates because they improve efficiency and secure quality (Westphal *et al.*, 1997). Later adopters increasingly stand to gain symbolic benefits as a template itself becomes institutionalized, but this by no means implies that late conformers stop benefiting substantively (Kennedy & Fiss, 2008). Third, isomorphic strategies do allow for competitive differentiation. Organizational field members are usually indifferent to certain amounts of differentiation, allowing firms a range of acceptability (Deephouse, 1999) around the ordained template. Meaningful differentiation may result from different implementation patterns, as when organizations customize a template to enhance its contribution to quality and efficiency (Westphal *et al.*, 1997; Zbaracki, 1998).

Various empirical studies have supported the proposition that strategic conformity leads to higher performance because of increased legitimacy. By conforming, the firm less deviate to others, and thus the coefficient is negative between strategic deviation and performance. For example, a negative relationship between strategic deviation and performance was confirmed by Chen and Hambrick (1995); Miller and Chen (1995); Deephouse (1999); and Garcia and Sabate (2010). Deephouse's (1996) study of commercial banks in United States, investigated whether strategic deviation lead to performance, and found such relationship was supported by the data. In similar vein, Wah *et al.*, (2004) using sample commercial banks competing in Malaysia also found such negative relationship exist between strategic deviation and performance. In both studies, the strategic deviation was measured using standard deviation of asset strategy as recommended by Finkelstein and Hambrick (1990), and performance variable operationalized using Return on Assets. To further provide evidence, this study also utilized other performance measure, namely Net Operating Profit Margin, based on the reason that this variable was representing organization efficiency and effectiveness.

The negative relationship between strategic deviation and endorsements has also been reported by Deephouse (1996).

Hypothesis 1 (Conformity): Strategic deviation negatively relates to a firm's performance.

The perspective of strategic differentiation

This perspective views that the intensity of the competition among firms is directly related to the resources distribution and availability, so having a distinct position and different strategy will benefit

a firm because of the reduced competition for those resources. It is generated from well-known theories about strategic management like the competitive advantage theory (Porter, 1991) and the RBV (Barney, 1991). The RBV takes the approach that the resources of a company are more important than the existing structure of the industry to achieving competitive advantage (Barney, 1991). The RBV takes an inside out view or firm-specific perspective on why organizations succeed or fail in the market place (Dicksen, 1996; Madhani, 2009). The RBV focuses on the concept of the difficult-to-imitate attributes of the firm as sources of superior performance and competitive advantage (Barney, 1986; Hamel and Prahalad, 1996; Madhani, 2009).

From this view, the availability of resources in the market is limited. With limited resources, the competition will be intensified. Higher levels of rivalry usually lead to lower performance, because organizations must expend resources to compete more intensely. The increase in costs to acquire the needed resources will lead to a rational differentiation to reduce competition for similar resources, to the extent of their realized strategic position (Baum and Mezias, 1992). The conformity of strategies to other firms means the firm has many similar competitors that limit the firm's performance and increases the possibility of failure (Baum and Singh, 1994; Hannan *et al.*, 1990; Henderson, 1981).

Differentiation will reduce competition and enhance performance, so the firm must take a distinct position relative to its rivals. Imitation almost ensures a lack of competitive advantage and hence mediocre performance (Porter, 1991). The basis for the distinct position of a successful firm is that the firm has resources which are valuable, rare, inimitable, and non-substitutable (Barney, 1991). Resources that are valuable, rare, inimitable and non-substitutable make it possible for businesses to develop and maintain competitive advantage, to utilize these resources and competitive advantage for superior performance (Collis and Montgomery, 1995; Barney, 1991; Grant, 1991; Wernerfelt, 1984).

The relationship amongst strategic differentiation, competition, and performance has been demonstrated in various empirical researches. Research of Gimeno and Woo (1996) in airline industries in United States found that similarity in strategies was related to higher competition and ultimately decreased the revenue per passenger mile. Research by Banker *et al.* (2014) using non-financial firms and non-utility firms in United States also showed that differentiation is a source of sustainable performance. By differentiating, the firm more deviate to others, and thus the coefficient is positive between strategic deviation and performance.

Hypothesis 2 (Differentiation): Strategic deviation positively relates to a firm's performance.

Research Methodology

Sampling and Data Collection

Source of data was from 36 listed banks in the Indonesian banking industry. The information were collected from the information published in the annual report of each bank and the Indonesian banking directory released by the Bank of Indonesia. The purposive sampling method was utilized with the main criteria was the availability of the variables employed by this research. Since the latest available data for the research was year 2015, therefore this research used this data for analysis.

The Measurement

The selection of the measures for a firm's performance (the dependent variable) and strategic deviation (the independent variable) were based on the empirical study by Deephouse (1999).

Dependent variable

The performance measures for the firm were the common measures of a bank's performance, such as the Return on Assets (ROA) and Net Operating Profit Margin (NOPM) (Deephouse, 1999; Garcia and Sabate, 2010); the ROA is the standard return on total assets and NOPM is the ratio of the net income to the total assets. The utilization of ROA as a proxy of performance was based on the rea-

son that this variable was representing the performance of the bank regardless the capital structure of the bank. If the ROE instead of ROA was utilized, the capital structure decision will be influencing the performance of the bank, in which this research was not focusing on it. NOPM was considered as performance variable based on reason that this variable was representing organization efficiency and effectiveness.

Independent variable

To measure strategic deviation, the approach of Deephouse (1999; 1996) and Finkelstein and Hambrick (1990) was followed. Those authors claimed that specific strategy of the bank was represented by individual strategic variable. In this case, under regulated environment of banking sector, every bank has to make strategic decision to compete against each other, and autonomy to make decision regarding the variable was partly constrained by the regulation from regulator (e.g., interest rate from Bank of Indonesia). The measure of strategic deviation was based on the specific strategies used in the allocation of the banks' resources. In similar vein, Wahetal., (2004) utilized the same variables. It is measured through several strategic variables: 1) Cash. 2) Deposit in the central bank's reserve. 3) Securities. 4) Corporate loans. 5) Business loans. 6) Consumer loans. 7) Fixed assets. 8) Other assets.

These variables represent the asset categories reported in the balance statements and annual reports of Indonesian banks. Each asset strategy is measured as the proportion of a given asset type to the total assets. Each asset strategy was compared to the industry mean of the sample of bank for that strategy and calculated and expressed as a standard deviation. The measure of global strategic deviation was created by summing the absolute values of the standard deviations for all the asset strategies.

The following equation illustrates the calculation of the strategic deviation:

$$SDi = \left(\sum ABS \left[\frac{P_{ai} - M(P_a)}{SD(P_a)} \right] \right)$$

SDi = Strategic deviation for firm i

P_{ai} = Proportion of the assets in strategy a for firm i

$M(P_a)$ = Mean of assets strategy a for all firms in the sample

$SD(P_a)$ = Standard deviation of assets strategy a for all firms in the sample

Data Analysis Techniques

The SPSS computer software was used for the statistical analysis in this study. The data were analyzed using a simple regression method. The models shown below were used in the regression analysis to examine the relationship between the dependent variable and the independent variable:

$$\text{Model 1 : } ROAi = \alpha + \beta.SDi + \varepsilon$$

$$\text{Model 2 : } NOPMi = \alpha + \beta.SDi + \varepsilon$$

Where;

ROAi : Return On Assets for Bank-i

NOPMi : Net Operating Profit Margin for Bank-i

SDi : Strategic deviation for Bank-i

Model 1 was used to test the relationship between strategic deviation and the ROA as a performance indicator. Model 2 was used to test the relationship between strategic deviation and the NOPM as a performance indicator. If the result of the regression is negative and significant, it can be interpreted that strategic deviation enhances performance of the firm, meaning being similar to other firm, increase the performance (Deephouse, 1999). Thus supporting institutional theory. In contrary, if the regression coefficient is positive and significant, it can be interpreted that firms tend

to pursue differentiation strategy, meaning being different to other firm, increase the performance, and thus following resource-based view (Deephouse, 1999)

The statistical assumptions like normality and heteroscedasticity needed to be examined in order to achieve a best, linier and unbiased estimator. The fitness of each model was examined and the sign of each variable coefficient in each model was examined and tested statistically.

Research Results

A simple regression method was used to test the hypotheses. The classical assumption of the data was first tested. From the analysis, the data passed the statistical assumption test for the regression model. Table 1 presents the means, standard deviations, and correlations of the variables.

The correlation between the dependent variable – Strategic deviation and ROA was significant, while the correlation between Strategic deviation and NOPM was not significant.

Table 1. Descriptive Statistics and Correlations

	Mean	S.D.	Strategic deviation	ROA	NOPM
<i>Strategic deviation</i>	-5.623222	2.36796	1		
ROA	0.015136	0.01520	0.308*	1	
NOPM	0.009061	0.00985	0.150	0.871**	1

*. Correlation is significant at the 0.05 level (1-tailed).

**. Correlation is significant at the 0.01 level (1-tailed).

Discussion & Conclusions

The objective of this study is examine whether the firms should be different, or be the same as the other firms in the industry to increase performance. Similarities or differences in the firms can be manifested by many attributes, such as strategy elements, product attributes, competitive capabilities, or intangible assets (Gamble, et al., 2015). To symbolize variable representing similarities or differences, this study employed strategic deviation. Based on the statistical analysis (Table 2), the study concluded that the coefficient of strategic deviation was positive and significant ($p < 0.05$). Thus supporting hypothesis 2 over hypothesis 1, suggesting that differentiation was more profitable than conformity. However, if the performance variable was measured by Net Operating Profit Margin (NOPM) the coefficient of regression was not significant.

From ROA perspective, this result indicated that the more a firm’s strategies differed to the industry’s tendencies, the better the firm’s performance (ROA) was. These results did not support the previous research conducted by Deephouse (1999), Wah, et al., (2004), Chen and Hambrick (1995), Miller and Chen (1995) and Garcia and Sabate (2009) which confirmed the existence of a negative relationship between strategic deviation and a firm’s performance. Research conducted by Heugens and Lander (2009) also found that conformity to institutional norms simultaneously enhanced a firm’s performance.

Table 2. Regression Results

Independent Variable	Firm Performance	
	ROA	NOPM
<i>Strategic Isomorphism</i>	0.002*	0.001
F	3.569*	0.780*
R ²	0.095	0.022

*significant at 10% ($p < 0.10$)

Strategic differentiation is proved to enhance the performance of a firm, rather than conformity. The more the strategy of a firm differs to the industry trend, the better the performance of that firm is, compared to its deviant counterparts. This provides support for the statements of Barney (1991) and Porter (1980) who said that being different increase the possibility of winning competition and thus increasing performance, rather than mimicking other's firms strategy. So, if the question "To be different, or to be the same?" was asked in the context of the strategy employed in the banking industry of Indonesia, the answer is "Be different". Because if the firms try to be distinct from each other, they will be perceived of having something unique that offer something that other firms unable to provide, and thus satisfy the customers, and ultimately increase their performance.

The implications of our research are as follows, our evidence suggests that to achieve better performance, the firms who are in regulated industries such as the banking industry, especially in Indonesia, should choose to adopt the differentiation approach, compared to the trends in their industry. Conversely, if a firm made a strategic choice that was similar to the industry trends, this would potentially reduce the ability of the firm to offer products or services that uniquely attract the customer, and as a result reduced the performance of the firm.

There were some limitations in this empirical study that present opportunities for future research. First, the sample was limited to the local banking industry in Indonesia, our choice to focus on one industry limited the generalize ability of our conclusions. We therefore think it would be especially interesting to extend the analysis to other industries, especially to be studied in non-highly regulated industry. Second, the theory tested only one type of organization characteristics namely strategy. However, other organization characteristics maybe important, such as technology, organization structure, etc. Evidenced by low scored of R Square (0.095), incorporating these other characteristics, the results may provide a more general theory. Finally, the sample size was relatively small. However the total sample was appropriate for research of this nature (single industry and very regulated).

To conclude, this paper accommodated the question of whether a firm should be different from, or the same as, its competitors. It began by developing two competing perspectives, the institutional and resource dependence theories, and contributed the idea that legitimacy activates the flow of resources that energizes a firm. Competitive advantage and the RBV contributed the idea that firm differentiation, caused by owning unique resources, will reduce the competition and enhance the firm's performance. The discussion section suggested that it is better for the firm to be different to the others, or not to resemble the current industry trends to achieve good performance.

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