

Therapeutic Governance and the Ladder of Institutional Capacity: A Multi-Aspect Framework for Transforming Village-Owned Enterprises in Developing Indonesia

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Abstract: *This study examines institutional governance challenges affecting Village-Owned Enterprises in Eastern Indonesia, where uneven performance reflects differences in legal integrity, social trust, and managerial capacity. Using a qualitative comparative case study of three enterprises representing collapsed, latent, and resilient trajectories, data were collected through 26 interviews, observation, and document analysis, and analysed using thematic cross-case synthesis. The findings show that economic interventions fail when legal accountability and community trust are absent. Transparent governance practices in post-failure settings function as mechanisms of institutional trust restoration, conceptualised as Therapeutic Governance. The study proposes the Institutional Triad typology and the Ladder of Institutional Capacity model, demonstrating that economic viability depends on prior consolidation of legal and social capacity. The integrated framework offers a maturity-sensitive approach to the design of rural enterprise policy. The results contribute to institutional governance theory and provide actionable guidance for differentiated development interventions in fragile governance contexts.*

Keywords: Therapeutic Governance; Institutional Capacity; BUMDes; Village-Owned Enterprise; Institutional Triad; Ladder of Institutional Capacity; New Institutionalism; Indonesia; Qualitative Comparative Study; Rural Governance; Institutional Transformation

1. Introduction

Village-Owned Enterprises (Badan Usaha Milik Desa, BUMDes), institutionalised under Indonesian Law No. 6 of 2014 and strengthened by Government Regulation No. 11 of 2021, constitute the largest state-sponsored rural enterprise network in Southeast Asia, with over 50,000 entities registered nationally. However, institutional performance remains alarmingly uneven. In Kupang Regency, East Nusa Tenggara, empirical data reveal that only a fraction of BUMDes operate actively, fewer hold legal entity status, and a significant proportion report negligible economic output (Kupang Regency DPMD, 2025). This underperformance reflects not resource scarcity but a fundamental failure of policy design: the persistent application of a one-size-fits-all (isomorphic) intervention model that assumes uniform institutional maturity across contexts differentiated by history, social capital, governance culture, and leadership integrity.

The conventional capacity-building paradigm, exemplified by UNDP (2009) and World Bank frameworks, treats institutional strengthening as a technocratic menu of training inputs and capital injections, ill-equipped to diagnose the psychosocial dimensions of dysfunction. This paper addresses this gap through a comparative qualitative study of three BUMDes, each representing a distinct institutional trajectory. The study develops three original, interrelated theoretical contributions: Therapeutic Governance, the Institutional Triad typology, and The Ladder of Institutional Capacity, synthesised into The Integrated Model of Institutional Transformation. The overarching research question is: how does the integration of multidimensional

institutional capacity approaches shape the transformation trajectories of BUMDes, and what strategic model best explains the observed asymmetric performance gaps?

2. Theoretical Framework

2.1 New Institutionalism and Institutional Capacity

This study is grounded in New Institutionalism (Hall & Taylor, 1996) and integrates three complementary analytical lenses. Historical Institutionalism (HI) directs attention to path dependence, showing how legacies of elite capture and patrimonial village leadership create institutional inertia that resists linear reform. Rational Choice Institutionalism (RCI) conceptualises institutions as rule systems for resolving collective action dilemmas and reducing transaction costs (North, 1990, in Logroño & Gallego-Bono, 2023), measuring BUMDes' capacity through the effectiveness of formal enforcement mechanisms such as AD/ART and accountability reporting. Sociological Institutionalism (SI) foregrounds legitimacy, arguing that BUMDes' capacity is fundamentally relational, contingent on community perceptions of ethical and social appropriateness (Meyer & Rowan, 1977). Institutional capacity is accordingly operationalised as multidimensional, encompassing structural integrity, procedural legitimacy, human capital, resource management, community participation, and multilevel network embeddedness (El-Taliawi & Van der Wal, 2019; Domorenok et al., 2021).

2.2 Institutional Work and Behavioral Public Administration

As the middle-range theoretical framework, this study draws on Institutional Work theory (Lawrence & Suddaby, 2006; Beunen & Patterson, 2019), which examines the purposive labour of creating, maintaining, and disrupting institutions. These three categories map directly onto the identified empirical trajectories. Behavioral Public Administration (Grimmelikhuijsen et al., 2017) complements this by incorporating psychological variables, including risk aversion, institutional trauma, and cognitive inertia, into the analysis of public organisational behaviour. This strand of theory is particularly relevant to the Latent trajectory, where high human capital coexists paradoxically with organisational stagnation.

2.3 Gaps in Existing Literature

Existing scholarship on BUMDes has documented governance deficits (Firmansyah, 2023; Samosir et al., 2025), capacity-performance linkages (Trinanda & Khoirunrofik, 2024; Ikram et al., 2025), and village fund governance (Adam et al., 2024). However, three persistent gaps remain: frameworks are predominantly technocratic, neglecting the psychosocial dimensions of dysfunction; typological schemes are insufficiently sensitive to the distinct mechanisms of failure, stagnation, and resilience; and no existing model articulates a theoretically grounded hierarchy of capacity prerequisites. This study directly addresses all three.

3. Research Methodology

This study employs a qualitative multiple-case study design (Yin, 2009) anchored in constructivist ontology and interpretivist epistemology. Three BUMDes in Kupang Regency were purposively selected to maximise variation in institutional maturity. Tesabela Village (BUMDes Talena Lai, officially classified as Perintis/early-stage) represents the collapsed trajectory. Noelbaki Village (BUMDes Tafena Tor, officially classified as Maju/advanced yet operationally paralysed) represents the latent trajectory. Kuanheum Village (BUMDes Tafena Hit Kuan, classified as Berkembang/developing yet demonstrating consistent growth) represents the resilient trajectory. The paradoxical selection, in which the government's most advanced site corresponds to the study's latent typology, is itself a central empirical finding that reveals the inadequacy of existing governmental classifications.

Primary data were collected through: (1) in-depth semi-structured interviews with 26 informants across all three sites, including village heads, BUMDes directors, supervisory board members, village council (BPD) representatives, community figures, and direct beneficiaries; (2) participant observation during village assembly meetings and community forums; and (3) documentation analysis covering AD/ART documents, financial records, village regulations, and government assessment reports. Sites were purposively selected to maximise variation in institutional maturity, guided by the criteria of legal status, operational activity, and community trust levels; theoretical saturation was determined when no new thematic categories emerged from successive

interviews. Analysis followed Miles, Huberman, and Saldaña's (2014) multi-cycle approach: open coding, focused and axial coding, cross-case synthesis, and member checking. Coding reliability was ensured through an audit trail maintained across all analytical phases, with peer debriefing conducted to validate thematic interpretations. Triangulation across data sources and theoretical frameworks strengthened robustness; negative case analysis further enhanced robustness. This study received ethical approval from the relevant institutional authority, and all informants provided informed consent prior to participation.

4. Empirical Findings: Three Institutional Trajectories

4.1 The Collapsed Trajectory: Tesabela Village (BUMDes Talena Lai)

4.1.1 Structural Collapse and Moral Hazard

BUMDes Talena Lai exemplifies total institutional collapse, driven by a complete loss of legitimacy through three converging dysfunctions: moral hazard at the leadership level, structural decoupling between formal rules and actual practice, and escalating destructive community responses that undermined institutional trust. The director's dual role as political authority and de facto BUMDes controller, without any accountability constraints, enabled systematic asset misappropriation, consistent with Arnall et al.'s (2013) analysis of elite capture in community-driven development. A village council member described the severity of the breakdown:

"Based on my observations as a BPD member at that time, the performance of the old BUMDes management was far from optimal. Various planned programs were not executed. Even the accountability report did not exist, making it very difficult to monitor BUMDes' development."

*Jimmy Ola, BPD Member and BUMDes Supervisor,
Noelbaki, December 2025*

Field monitoring was equally neglected, resulting in missing livestock, a tractor stored at the director's private residence, and service assets that were almost 100% damaged, illustrating the complete collapse of boundaries between personal and organisational resources, a severe instance of what Bromley and Powell (2012) term decoupling.

4.1.2 Pseudo-Structure and Intentional Exclusion

A particularly significant finding is what the study terms pseudo-structure: hierarchies formally established to satisfy fund-disbursement requirements but functionally inoperative. The head of the business unit testified:

"The organisational hierarchy exists, but only on paper. Throughout my appointment as head of the business unit, there was no actual task. After the funds were disbursed, I was not involved at all."

*Eduart Tokoh, Head of Business Unit, Tesabela,
December 2025*

A further testimony confirmed the complete absence of BPD oversight and the disappearance of Rp. 144.7 million in food

security funds managed entirely without the relevant unit head's knowledge. The primary theoretical finding is that moral integrity operated as a veto variable: without leadership integrity, all other institutional inputs became vectors for corruption amplification rather than development.

4.1.3 Social Consequences: Apathy and Destructive Participation

Repeated governance failures produced profound social consequences. Community members progressively withdrew from institutional engagement, producing what the study terms social scar tissue:

"The community has trusted and accepted, and many have become indifferent. It is better to focus on our own work. In terms of organisational culture, they usually just hold their own meetings; the community is rarely included."

Veni, Household Beneficiary, Tesabela, December 2025

4.2 The Latent Trajectory: Noelbaki Village (BUMDes Tafena Tor)

4.2.1 The Paradox of Competence Without Performance
BUMDes Tafena Tor presents the study's most analytically complex case: officially classified as the government's most advanced BUMDes yet exhibiting near-complete operational paralysis. The enterprise was revitalised through a legitimate village assembly process; management personnel hold relevant tertiary qualifications. However, financial reporting remains absent, and community engagement is minimal. The newly appointed director acknowledged the core challenge:

"In my opinion, training is needed to develop managerial potential in bookkeeping, given that I have just taken up the position and must be able to carry out the functions of developing the business to help the community."

Costa, BUMDes Director, Noelbaki, December 2025

4.2.2 Institutional Trauma and Psychosocial Inertia

The primary inhibitor is institutional trauma, the collective psychological residue of previous governance failures, manifesting as extreme risk aversion among new managers. The secretary described the resulting interpersonal dynamics:

"The new management does not yet know the challenges ahead. We still rarely meet, and even when we do, it is not for long. Our communication is still awkward, precisely because we still rarely meet."

Ratriani Danube, BUMDes Secretary, Noelbaki, December 2025

This "awkwardness" signals that institutional cohesion has not been established despite formal structural reconstitution. The institution is structurally alive but functionally dormant, a condition this study terms the Latent state, where path dependence is psychological rather than structural. The repeated phrase "not yet" (belum) across informant testimonies constitutes what the study identifies as deferred actualization: competent actors indefinitely postponing action pending certainty that never arrives.

4.3 The Resilient Trajectory: Kuanheum Village (BUMDes Tafena Hit Kuan)

4.3.1 Institutional Resilience Through Social Embeddedness

BUMDes Tafena Hit Kuan demonstrates consistent growth across net profit margin, ROA, ROE, and equity value for 2019–2024, maintained despite the COVID-19 pandemic, through three main business units: agricultural equipment rental, a community savings scheme, and commodity trading via a Bulog partnership. What distinguishes Kuanheum is not superior resources but a deliberate institutional ecology built around radical transparency. The director described the foundational practice:

"Every three months, we open the books to the community. We show them exactly what came in and what went out. This is not just reporting; it is our way of saying we trust them, so they trust us."

Ian Mareta Ndolu, BUMDes Director, Kuanheum, November 2025

This quarterly public accounting session transcends its administrative function to become what the study theorises as a Therapeutic Governance practice, a structured opportunity for the institution to demonstrate trustworthiness and for the community to exercise informed oversight.

4.3.2 Economic Embeddedness and Residual Challenges

The BUMDes commodity trading operation, which aggregates village agricultural produce for sale to Bulog, simultaneously generates revenue, ensures fair pricing, and reinforces the social bond between institution and community, exemplifying Granovetter's (1985) concept of economic embeddedness. Community members exercise proactive social control, providing direct feedback to management without waiting for formal reporting cycles, confirming that resilience is an actively maintained institutional achievement. However, field research also identified a significant coordination gap: the secretary acknowledged limited access to operational information, with the WhatsApp group serving as the primary, largely informational coordination medium. This centralisation of information, if unaddressed, could undermine sustainability if key personnel depart.

5. Discussion: Toward an Integrated Model of Institutional Transformation

5.1 Therapeutic Governance: Reconceptualising Transparency as Social Healing

The comparative analysis reveals a phenomenon absent from existing governance frameworks: in post-failure institutions, transparency and accountability mechanisms serve a different qualitative role, not merely as corruption-prevention instruments but as social healing mechanisms addressing the collective psychological wounds of institutional betrayal. Conventional Good Governance theory (UNDP, 2009) treats transparency instrumentally, as a tool for information symmetry and principal-agent alignment. This study argues that in post-failure contexts, transparency must be understood through an additional psychosocial dimension: as a ritual of

public truth-telling that acknowledges past harm and creates conditions for a renewed social contract.

Therapeutic Governance enriches Good Governance theory with a temporal and emotionally aware dimension: governance quality cannot be assessed solely by current structural compliance. However, it must also account for the institution's historical relationship with its community and the psychological work required to rebuild broken bonds. This contribution resonates with emerging scholarship on institutional trust (Estadieu et al., 2025). Practically, the sequencing of interventions matters as much as their content: capital and training applied before social trust is restored are absorbed by existing inertia, whereas transparency mechanisms transform institutional identity from betrayal to accountability.

5.2 The Institutional Triad and The Ladder of Institutional Capacity

The three trajectories constitute the Institutional Triad, a novel typological scheme that transcends Indonesia's financial performance-based governmental classifications. The Collapsed typology is characterised by a complete loss of legitimacy, structural decoupling, elite capture, and destructive participation, requiring legal restoration before any economic engagement. The Latent typology is characterised by high human capital paradoxically coexisting with organisational inertia, institutional scarring, and deferred actualization, requiring Therapeutic Governance before technical activation. The Resilient typology is characterised by an effective operational balance between procedural accountability and community participation, measured through consistent financial transparency, active community oversight, and sustained economic output, economic embeddedness, and active institutional maintenance, requiring scale-up support and market integration facilitation.

The cross-case analysis yields the study's major theoretical proposition: institutional capacity transformation is not a linear process of input accumulation but a sequential institutional process, The Ladder of Institutional Capacity, in which higher-order capacities are contingent on the prior fulfilment of lower-order prerequisites. Legal capacity (institutional integrity, rule compliance, freedom from moral hazard) is the non-negotiable foundation: capital investment in a collapsed institution amplifies corruption rather than development, as demonstrated in Tesabela. Social capacity (community trust, participatory legitimacy, psychosocial healing) can only be built once legal foundations are stable, activated through Therapeutic Governance, as illustrated by Noebaki's stagnation in its absence. Economic capacity (enterprise viability, market integration, network embeddedness) is achievable only when both prior tiers are securely established, as evidenced by Kuanheum. These findings resonate with Andrews et al.'s (2017) critique of isomorphic mimicry, extend it by identifying the specific psychosocial mechanisms through which conventional capacity building fails, and advance Grindle and Hilderbrand's (1995) framework by making the sequential dimension explicit.

5.3 The Integrated Model and Policy Implications

The three constructs synthesise into The Integrated Model of Institutional Transformation, providing both a diagnostic map through the Institutional Triad and a strategic roadmap through the Ladder of Institutional Capacity, with Therapeutic Governance as the pivotal transition mechanism between the Legal and Social tiers. The major theoretical proposition is:

"The transformation of BUMDes institutional capacity into rural economic development is not a linear function of capital and regulatory inputs, but an asymmetric evolutionary process requiring the fulfilment of The Ladder of Institutional Capacity; economic interventions are effective only if Legal Capacity has established legitimacy and Social Capacity has healed institutional trauma through Therapeutic Governance, necessitating a paradigm shift from isomorphic uniformity to asymmetric, maturity-based intervention."

For policymakers, this translates into four operationalised recommendations: (1) mandatory institutional maturity audit prior to any BUMDes intervention; (2) moratorium on capital grants to Collapsed institutions, replaced with legal restoration support; (3) conditional matching grant schemes for Latent institutions, tied to demonstrable transparency milestones; and (4) market access facilitation and scale-up incentives for Resilient institutions.

6. Conclusion

This study demonstrates that institutional performance differences among village enterprises are primarily rooted in variations in legal integrity and social trust rather than resource availability. Through comparative analysis, three institutional trajectories were identified, leading to the development of the Institutional Triad and the Ladder of Institutional Capacity model. The findings show that economic capacity emerges only after legal accountability and community legitimacy are established. Transparent governance practices play a critical role in restoring institutional trust in post-failure contexts. Although limited to three cases within one region, the study offers a theoretically grounded framework for maturity-sensitive policy design. Future research should test the proposed model across broader institutional contexts and incorporate quantitative validation approaches to strengthen generalisability.

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