



The Effects of Leadership Styles and Entrepreneurial Orientation on The Business Performance of SMEs in Malaysia

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Abstract

This paper investigates the effect of leadership styles and entrepreneurial orientation on the business performance of SMEs in Malaysia. The owner/managers were sent a package of questionnaires which comprised the Multifactor Leadership Questionnaire MLQ 5X, the Entrepreneurial Orientation Questionnaire EOQ, the Business Performance BP questionnaire and the demographic questionnaire. The findings revealed that there were significant positive relationships between i) transactional leadership and business performance ii) transformational leadership and business performance and iii) entrepreneurial orientation and business performance. The findings also found that passive-avoidant leadership was negatively correlated with business performance. The findings can be generalized that transactional and transformational leadership styles were the dominant form of leaderships displayed by the owner/managers and entrepreneurial orientation helped improved the business performance of the SMEs in Malaysia. This study also provides an opportunity to expand the research on other industries such as manufacturing, constructions, agricultures and telecommunications.

Keywords: *Leadership styles, transformational, transactional, passive-avoidant, entrepreneurial orientation and business performance.*



1. INTRODUCTION

In the fast changing and increasingly competitive global market environment, small and medium enterprises (SMEs) are found to exert a strong influence on the economies of many countries (Ghobadian & Gallea, 1996; Ladzani & Van Vuuren, 2002). SMEs provide the economy with economic growth, employment and innovation. The SMEs have contributed significantly to job creation, social stability, and economic welfare of the countries. Studies have shown that SMEs have played major roles in fostering economic growth, generating employment opportunities and reducing poverty (Arinaitwe, 2006, Ayyagari, Beck & Demirguc-Kunt, 2005; Karides, 2005; O'Regan & Ghobadian, 2004; Audretsch, 2002). In Malaysia, SMEs have also played a critical role in the economic development of Malaysia. The Census of Establishments and Enterprises (Census) 2011 conducted by Malaysian Department of Statistics, revealed that 97.3 percent or 645,136 of business establishments in Malaysia were small and medium enterprises with the highest concentration in the services sector, especially in retail, restaurant and wholesale businesses.

While SMEs account for the majority of the business enterprises and boost employment figures, their contribution to the economy of Malaysia is only about 19 percent of the total export value and 32.5 percent of gross domestic product. Studies have revealed that the performance of organizations co-relate directly to the leadership styles of the leaders in the organizations. Traditional views have generally indicated that leaders can impact the performance of the organizations they lead (Thomas, 1988). According to Nave (2006) the success or failure of the business depends on the leadership styles employed by the leaders. Van Wart (2006) states that all organizations need leadership to guide organizational operations. Organizations require efficient leaders who are capable of steering people in the right direction to achieve its mission, vision, and to remain faithful to the philosophy and values of the organization. Plowman, Solansky, Beck, and Becker (2007) reiterate that leaders are the problem solvers who are able to guide the organization through challenges and achieve more through others. The ability to unite the organization to work towards the organization's goal is the role of an effective leader and it is critical to the organization's success and performance (Stahl, 2007). Great leaders can communicate the organization's future path to a certain group of people effectively and to get them to work as one towards common goals (Buckingham, 2005). Ireland and Hitt (2005) state that leadership is important to an organization's success and business performance especially in the competitive environment in which firms are presently operating.



The organization's success or performance is influenced by the difference in the leadership styles (Stahl, 2007; Ireland & Hitt, 2005). Bass (1985) introduces three types of leadership styles such as transactional leadership, transformational leadership, and passive-avoidant leadership. Transactional, transformational and passive-avoidant leaders are part of SMEs environment because they influence individual and organizational performance. According to Robbins (2003), transactional leaders are those who guide or motivate their followers in the direction of established goals by clarifying roles and tasks requirement. Transactional leaders are very focus of their task and are receptive to the performance of their followers (Johnson & Klee, 2007). In transformational leadership, the leader has the ability to identify the need for change, to set goals as well as to provide guidance towards the change while managing the transition effectively (Moorhead & Griffin, 1995). Transformational leaders are proactive and endeavor to maximize the individual, group, and organizational development beyond expectation and provide a sense of mission (Avolio & Bass, 2004). According to Avolio and Bass (2004), passive-avoidant leadership is comparable to "no leadership" while Gartner and Stough (2002) consider this leadership as a "do nothing" style leadership.

While leadership styles of leader are known to affect performances of the organization, it is also established that entrepreneurial orientation also has a positive impact on the business performance of the organization. Many researchers have found that entrepreneurial orientation is positively related to performance or outcomes of the organizations (Wiklund & Shepherd, 2003; Lumpkin & Dess, 1996; Naman & Slevin, 1993; Covin & Slevin, 1991; Peters & Waterman, 1982). Krauss, Frese, Friedrich, and Unger (2005) later found that entrepreneurial orientation is an important predictor for business. The entrepreneurial phenomenon is on the rise and ever growing (Gartner & Shane, 1995; Thornton, 1999). The world has grown into an entrepreneurial economy with new business being created and entrepreneurs are hailed as the new heroes of the economic development and competitive enterprises (Sathe, 2003). In the rapidly evolving environments of competition and change, incorporating an entrepreneurial approach as a foundation of strategic management is necessary (McGrath & MacMillan, 2000).

The objective of this study, therefore, to investigate the effects of leadership styles and entrepreneurial orientation on the business performance of SMEs in Malaysia.

2. LITERATURE REVIEW

2.1 Transactional Leadership and Performance



Transactional leaders are seen as those “who guide or motivate their followers in the direction of established goals by clarifying role and tasks requirements” (Robbins, 2003). Transactional leadership is created based on the basis of exchange between leaders and followers. Transactional leaders tend to stimulate their followers with rewards in an exchanged based relationship. Accordingly, the leader-member exchange is dependent upon rewards. The leaders will offer the rewards based on what was discussed in the employees’ formal contract. The relationship expires as stated in the terms of the contract or will be invalidated if promised rewards are delayed or not accomplished. Rewards may be seen as positive or negative and may not necessary be a financial. Kuhnert and Lewis, (1987) state that transactional leadership believed reward system is necessary between leaders and followers for the objective of advancing their personal goals. Pillai, Schriesheim and Williams (1999) define transactional leadership as "an exchange process in which the leader provides rewards in return for the subordinate's effort and performance". Guardia (2007) finds that transactional leadership is the elementary factor to organizational success at both team and individual level and that transactional leadership behavior has vital relation with group and individual performance factors. Roslan and Rosli (2012) tested the relationship between transactional leadership and performance of SMEs in Malaysia and found that there was a significant positive relationship between transactional leadership and performance. Based on these discussions, the following hypothesis is formulated.

H1: There is a significant positive relationship between transactional leadership and performance.

2.2 Transformational Leadership and Performance

Transformational leadership can lead to high-performing organization due to the supportive, delegative, participative, collaborative leader-follower relationship that evolves in an organization (Porter, Steers, Mowday, & Boulian, 1974).. The employees are empowered and feel compelled and dedicated to assist in accomplishing the goals and objectives of the organization (Sommers & Birnbaum, 1998). Feinberg, Ostroff and Burke (2005) state that transformational leaders promote and encourage cooperative decision making and problem solving. Likewise, Gillespie and Mann (2004) concur that in order for an organization to achieve the goals and objectives as well as gain the cooperation, its leaders encourage employees to grow and develop, set high goals for them, offer emotional support and direction, identify and work individually and as a team, to develop their abilities and capabilities. Gillispie and Mann (2004) find that the ability of transformational leaders to communicate, support, appreciate and develop



followers helps promote the trusting relationship between the members of the organization. Studies by previous researchers have shown that, there is strong correlation between transformational leadership with organizational performance. This strong correlation has been proven by Avolio (1999) and Bass (1998) with numerous different measures. Such researches have correlated the transformational leadership with supervisory assessments of managerial performance (Hater & Bass, 1988; Waldman, Bass, & Einstein, 1987), promotion (Waldman, Bass, & Yammarino, 1990), innovation (Keller, 1992), and achievement (Howel & Avolio, 1993). Barling, Weber, and Kelloway (1996) found that the effects of transformational leadership on financial result are positive. Dvir, Eden, Avolio and Shamir (2002) are able to show that followers achieved better results under transformational leaders than other types of leadership styles after measuring the effect of transformational leadership. A positive and moderate correlation was also found between transformational leadership and the job satisfaction (Ramey (2002). Stumpf (2003) agrees with Ramey and proves that transformational leadership positively influenced job satisfaction. Following the analysis of the relationship between leadership and physical distance unit performance, Howell, Neufield and Avolio (2005) find that transformational leadership positively predicted unit performance. Transformational leadership was positively linked to organizational performances (Zhu, Chew & Spangler, 2005) and the chief executive officers hold a vital role in the firm's success. Roslan and Rosli (2012) tested the relationship between transformational leadership and performance of SMEs in Malaysia and found that there was a significant positive relationship between transformational leadership and performance. Based on these discussions, the following hypothesis is formulated:

H2: There is significant positive relationship between transformational leadership and performance.

2.3 Passive-Avoidant Leadership and Performance

Passive avoidant leadership which is basically inactive and is often referred to as lack of leadership (Bass & Avolio, 1995). Passive-avoidant leadership is comparable to “no leadership” (Avolio & Bass, 2004) or a “do nothing” style leadership (Gartner & Stough, 2002). The leaders offer no further support or supervision for the tasks assign and decisions are left to others in the organization. Passive avoidant leaders will rapidly lose influence in the organization due to lack of action. Passive avoidant leadership has been established to be the least effective of the three leadership styles (Bass & Avolio, 1995). In passive-avoidant leadership, the leaders provide no further leadership support or management advice after handling out tasks. Avolio and Bass (1995) confirm that passive-



avoidant is the least effective of leadership styles. Thus, the following hypothesis is posited:

H3: There is significant negative relationship between passive-avoidant leadership and performance.

2.4 Entrepreneurial Orientation and Performance

Scholars tried to clarify performance using a firm's entrepreneurial orientation and that it was important to study the connection between entrepreneurial orientation and performance (Chakravarty, 1986) and to explore the nature of entrepreneurial strategy-making and its relationship with strategy, environment, and performance (Dess, Lumpkin, & Covin, 1997). Covin and Slevin (1989, 1991) invented a model which connects both entrepreneurial position to organizational performance. It is discovered that when the entrepreneurial orientation was positively related to performance and that an entrepreneurial posture definitely positively related to firm performance. Entrepreneurial orientation will have effect on overall firm performance, such as return on equity/assets/sales (Miller & Bromiley, 1990).

Zahra (1991) stated a positive relationship between entrepreneurial orientation and firm profitability and growth. Wiklund (1999) confirmed in his research that there was a positive relationship between entrepreneurial orientation and performance. Additional studies show a positive correlation between entrepreneurial orientation and firm performance (Smart & Conan, 1994; Zahra & Covin, 1995) and that entrepreneurial orientation is an important predictor for business (Krauss, Frese, Friedrich, & Unger, 2005). The research on entrepreneurial orientation confirms the relationship between entrepreneurial orientation and results or performance (Barringer & Bluedon, 1999; Covin & Slevin, 1989; Miller, 1983; Wiklund 1999; Wiklund & Shepherd, 2003; Zahra, 1991; Zahra & Covin, 1995).

Lumpkin and Dess (1996) held that entrepreneurial orientation reflects the firm's operational style, concentrating on decision-making, methods and practices. A few researchers confirmed that a positive relationship exists between entrepreneurial orientation and high performance (Lumpkin & Dess, 1996; Covin & Slevin, 1991; Peters & Waterman, 1982; and Naman & Slevin, 1993). Ibeh (2003) found that entrepreneurial orientation is connected to better export performance, especially for small firms. Frese, Brantjes, and Hoorn (2002), conducted a cross sectional, interview-based study of small businesses in Namibia and they found a positive relationship between entrepreneurial orientation and success in terms of firm size and economic growth. Tang, Tang, Zhang, and Li (2007) in their study in the emerging region of China found that entrepreneurial



orientation has a positive effect on firm performance. Gurbuz and Aykol (2009) tested the relationship between entrepreneurial orientation and Turkish small firm growth and confirm that entrepreneurial orientation affects firm growth. Chow (2006) conducted a study on the relationship between entrepreneurial orientation and firm performance in China and confirms that entrepreneurial orientation had a significant effect on firm profitability particularly for non-state firms.

The literature presented above leads to the development of the following hypothesis:-

H4: There will be a significant positive relationship between entrepreneurial orientation and business performance.

3. METHODOLOGY

3.1 Sampling and Data Collection Procedures

This study used a random sample of SMEs registered in Malaysia. Krecjie and Morgan (2005) recommended that the expected samples for this research should be between 357 and 361 samples considering the population of 5,138 SMEs in the services industry. The survey method was employed to collect data. Through postal services, 1000 questionnaires were sent to owner/managers of the SMEs throughout Malaysia. Out of 1000 questionnaires mailed to SME owner/managers throughout Malaysia, 391 answered questionnaires were collected, 16 questionnaires received via post mail were found to be incomplete where the respondents did not answer some of the questions. The incomplete questionnaires were rejected and only 375 questionnaires were accepted and used for further analysis.

3.2 Measures

3.2.1 Leadership Styles (Transactional, Transformational and Passive-Avoidant)

Multifactor Leadership Questionnaire (MLQ) which was developed by Avolio and Bass (2004) was used to measure the variables of leadership styles. This MLQ is under the proprietorship of Mind Garden and permission was obtained by the researcher to distribute 1000 questionnaires to the owner/managers of the SMEs. A five point Likert scale was used on which the owner/managers have to indicate the extent to which the items represent their leadership styles. According to Avolio and Bass (2004) the Multifactor Leadership Questionnaire (MLQ) is amongst the most widely used instruments to measure transformational, transactional and passive-avoidant leader behaviors as its internal reliability has been proven many times.



3.2.2 Entrepreneurial Orientation

The Entrepreneurial Orientation Questionnaire (EOQ) developed by Covin and Slevin (1991) was used to measure the variables of entrepreneurial orientation of the SME. The respondents were asked to select the response that is closest to the degree of agreement with the respective question. The respondent must choose a position based from 1 to 5 range on the Likert scale format. Many researchers have tested and proven the reliability of the scale (Covin & Slevin, 1991; Knight, 1997). Permission was requested from Covin and Slevin to use the EOQ for this study and Slevin confirmed that no permission was required to use the EOQ as the EOQ has been published in many journals

3.2.3 Performance

The performance of the firm was measured through a subjective approach. In this approach the performance of the firm is measured by the perception of the owner/managers providing responses to the Business Performance Questionnaire. The owner/managers were asked to state their firm's performance criteria such as sales growth, employment growth, market value growth, profitability and overall performance. This approach was chosen since there is no agreement among researchers on an appropriate measure of performance. Objective approach was not used in this study as collecting objective data is very difficult as the owner/managers are not willing to disclose the firm's information to outsiders.

4. ANALYSIS AND FINDINGS

4.1 Reliability

The instruments used in this study were developed from prior research and previously tested for reliability. Reliability tests were conducted to determine the internal consistency of the MLQ, EOQ and BP. As can be seen in Table 1, the Cronbach Alpha achieved for leadership styles (transactional, transformational and passive-avoidant), entrepreneurial orientation and performance are greater than 0.7 (Nunnally, 1978). This shows that the questions used in the survey instruments possess high stability and consistency.

4.2 Sample Characteristics



The respondents consisted of 73.6 percent male and 26.4 percent females, majority of which were in the age group of between 31-40 years (40.3 percent). Most of the respondents are married (55.5 percent). Majority of them had achieved a bachelor degree education (49.6 percent). Most of the respondents are in the ICT services sector and worked less than 5 years (60.3 percent). 45.6 percent of the firms have been established less than 5 years.

Table 1
Reliability scores for variables

Variable	No. of items	Cronbach Alpha Value
Transactional	8	0.866
Transformational	20	0.900
Passive-Avoidant	8	0.923
Entrepreneurial Orientation	9	0.795
Business Performance	7	0.902

4.3 Testing of Hypotheses

Regression analysis was used to test the relationships between transactional, leadership and performance (H1), transformational leadership and performance (H2), passive-avoidant and performance (H3) and entrepreneurial orientation and performance (H4). The regression analysis results in Table 3 indicate that transactional leadership is positively and significantly related to performance. This finding supports H1. The results also indicate that transformational leadership is also positively and significantly related to performance. This finding also supports H2. However, the regression analysis result of passive-avoidant leadership indicates that relationship is negatively related to performance and this supports H3. Entrepreneurial orientation is found to be positively and significantly related to performance and this supports H4.

Table 2
Regression of leadership styles

	Adjusted R-square	Beta	F-value	Sig.
Transactional	0.134	0.369	58.525	.000*
Transformational	0.164	0.408	73.616	.000*
Passive-Avoidant	0.024	-0.162	9.919	.002
Entrepreneurial Orientation	0.181	0.428	82.934	.000*

Sig p<0.001



5. DISCUSSION AND CONCLUSION

This study examines how leadership styles and entrepreneurial orientation can affect the business performance of small and medium enterprises in Malaysia. Significant conclusions from this study are that different leadership styles may affect business performance, and that transformational leadership has higher influence towards business performance than transactional leadership and passive-avoidant leadership. Based on the hypotheses tests, positive significant and strongly enough relationships are found between leadership styles (transformational and transactional) and business performance. It means that as leadership styles (transformational and transactional) level increases, the degree of business performance also increases. It can be concluded that leadership styles of SMEs owners/managers can influence the success and survival of the SMEs. Different leadership styles may affect performance. Transformational leadership is significantly more related to the business performance than transactional leadership and passive-avoidant leadership. Among the three leadership styles, transformational leadership is found to be the best predictor of the business performance. This study supports the position of Gartner and Stough (2002) that transformational leadership is more effective than transactional leadership. Transformational leadership has more influence than transactional leadership with higher productivity and performance (Bass, Avolio, Jung, & Berson, 2003; Lowe & Galen, 1996). This study also found that entrepreneurial orientation has a significant positive effect on business performance. It means that as the entrepreneurial orientation level increases, the degree of business performance also increases. It can be concluded that entrepreneurial orientation of SMEs owners/managers can influence the success and survival of the SMEs.

Leadership and entrepreneurial orientation are important for SMEs to survive. A study on leadership and entrepreneurial development could provide owner/managers with knowledge as to what type of development is necessary to enhance leadership skills and the entrepreneurial orientation attributes to maintain business performances. Although this research confirmed the role of leadership styles and entrepreneurial orientation as the important aspect of organizational strategy, additional research is needed to refine the understanding of this critical dimension. Future research is also needed to determine other measures of SMEs performance and integrate them in a leadership style and entrepreneurial orientation model. Researchers can conduct research from other aspects of leadership skills and entrepreneurship skills such as financial management, communication, motivation of others, vision, and self-motivation. With these, firms can make a more appropriate strategy in winning the competition with



other firms. For further research, researchers can extend this study on other industries such as manufacturing, constructions, agricultures and telecommunications.

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