



The Mediating Effects of Entrepreneurial Orientation on the Relationship Between Leadership Styles and Performance of SMEs in Malaysia

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Abstract

This paper investigates the mediating effects of entrepreneurial orientation on the relationship between leadership styles and business performance of SMEs. The owner/managers were sent a package of questionnaires which comprised the Multifactor Leadership Questionnaire, 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) transformational leadership and business performance, ii) transactional leadership and business performance, and iii) entrepreneurial orientation and business performance. This study also revealed that passive-avoidant leadership was negatively correlated with business performance. Although entrepreneurial orientation was supposed to be fully mediating the relationship between leadership styles and business performance, the results showed that the mediating effect was only partial. The findings can



be generalized as follows: (i) the study found that transformational and transactional leadership styles were the dominant form of leaderships displayed by the owner/managers of the SMEs and (ii) the direct effect relationships between leadership styles and business performance were more significant than the effect of using the entrepreneurial orientation as a mediator. This study also provides an opportunity to expand the research on other industries such as manufacturing, constructions, agricultures and telecommunications. Also, future researchers perhaps may want to investigate the effect of leadership styles and entrepreneurial orientation on Malaysian SMEs going abroad, as international expansion offers a potential way for these firms to increase growth and improve performance.

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

1. INTRODUCTION

Since 1970s, SMEs have played a critical role in the economic development of Malaysia. The Malaysian Government has been very focused in developing the Small and Medium Enterprises (SME). This has led to the birth of The New Economic Policy (NEP) which was announced in 1971 to bring about improvement in the nation's welfare and reduced the socioeconomic disparity. To support the growth of SMEs, the Malaysian Government under the 9th Malaysia Plan has provided financing assistance with RM3.9 billion being allocated to various Ministries to assist the SMEs. 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.

Despite the huge amount of money spent by the Malaysian Government to develop SMEs and although 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. It was also found that the productivity levels of the SMEs were lower than large enterprises (Census, 2005). Many studies have revealed that the performance of organizations co-relate directly to the leadership styles of the leaders in the organizations. Stahl (2007) and Ireland and Hitt (2005) stated that the performance of organizations depends on the leadership styles of the leader. Thomas (1998) has generally indicated that leaders can impact the performance of the organizations they lead. Nave (2006) found that the success or failure of the business depends on the leadership styles employed by the leaders. 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.

While many studies have found that 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 (Wiklund & Shepherd, 2003; Lumpkin & Dess, 1996; Naman & Slevin, 1993; Covin & Slevin, 1991; Peters & Waterman, 1982). Leadership and entrepreneurship are found to both intimately interconnected (Ireland & Hitt, 2005; Colbert, 2003; & McGrath & MacMillan, 2000). Krauss, Frese, Friedrich, and Unger (2005) later found that entrepreneurial orientation is an important predictor for business. The entrepreneurial orientation construct in entrepreneurship has received considerable attention from researchers (Lyon, Lumpkin & Dess, 2000; Aragon-Corea, 1998; Barringer & Bluedon, 1999; Zahra & Covin, 1995; Dess & Lumpkin, 1996). Studies on entrepreneurial orientation have been mostly focusing on the links between entrepreneurial orientation and performances (Lyon, Lumpkin, & Dess, 2000). Although there have been many studies on the direct relationship between leadership styles and business performance and the direct relationship between entrepreneurial orientation and business performance, not many studies have tried to focus on the mediating effect of entrepreneurial orientation on leadership styles and business performance relationships. Several research designs have concentrated on entrepreneurial orientation as a mediating variable (Wiklund & Shepherd, 2003 & Wolf & Pett, 2007). Lumpkin and Dess (1996) have called for additional research on the role of entrepreneurial orientation as a mediating variable.

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

2. LITERATURE REVIEW

2.1 *Transformational Leadership and Performance*

According to Burns (1978), transformational leaders form a vision that inspires and motivates the target audience. Transformational leaders attempt to elevate both followers and leaders to perform better with a higher level of consciousness. In transformational leadership, the employees are empowered and feel compelled and dedicated to assist in accomplishing the goals and objectives of the organization (Sommers & Birnbaum, 1998). 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. Elenkov (2002) who studied the relationship of transformational leadership on organizational performance in Russian companies found that transformational leadership directly and positively link to better 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, Rosli, Mohd Hussin and Anas (2013) 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:

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

2.2 Transactional Leadership and Performance

Robbins (2003) stated that transactional leaders are seen as those “who guide or motivate their followers in the direction of established goals by clarifying role and tasks requirements”. Transactional leadership is created based on the basis of exchange between leaders and followers. Followers are stimulated with rewards in an exchanged based relationship. 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. Kuhnert and Lewis, (1987) stated that transactional leadership believed reward system is necessary between leaders and followers for the objective of advancing their personal goals. 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 et al (2013) 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.



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

2.3 *Passive-Avoidant Leadership and Performance*

Passive avoidant leadership is often referred to as lack of leadership (Bass & Avolio, 1995), 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 established:

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

2.4 *Entrepreneurial Orientation and Performance*

According to Covin, Green and Slevin (2006), entrepreneurial orientation is a collection of preferences, beliefs, and attitudes associated with either individuals or firms. It has become a valuable construct in explaining the variances in individual and firm performances. More importantly, researchers in their studies have presented entrepreneurial orientation as a firm-level construct (Covin & Slevin, 1991; Lumpkin & Dess, 1996). In this particular context, entrepreneurial orientation describes organizational characteristics in terms of its propensity to be innovative, proactive, and risk taking. This is popularly supported with the used of questionnaire designed to measure the entrepreneurial orientation which was developed by Covin and Slevin (1991). Covin and Slevin (1989, 1991) invented a model which connects both entrepreneurial position to organizational performance. Entrepreneurial orientation will have effect on overall firm performance, such as return on equity/assets/sales (Miller & Bromiley, 1990).

Several 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. Roslan, Rosli and Mohd Hussin (2013) tested the relationship between entrepreneurial orientation and performance of SMEs in Malaysia and found that there was a significant positive relationship between entrepreneurial orientation and performance.

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.

2.5 Mediating effects of entrepreneurial orientation on the relationship between leadership styles and performance of SMEs.

Several research designs have concentrated on entrepreneurial orientation as a mediating variable. Lumpkin and Dess (1996) have called for additional research on the role of entrepreneurial orientation as a mediating variable. A study by Wiklund and Shepherd (2003) on 384 small and medium sized Swedish firms found that entrepreneurial orientation moderated the knowledge and performance relationship. Wolf and Pett (2007) in their studies on 700 small-sized manufacturing firms found that entrepreneurial orientation moderated the relationship between learning orientation and firm performance. This dissertation seeks to further examine entrepreneurial orientation as a mediating variable between leadership styles and performance of SMEs.

Based on the literatures of leadership styles, entrepreneurial orientation and business performance, most researchers have found that there exists strong relationship between (i) leadership styles (transformational/transactional) and performance and (ii) entrepreneurial orientation and performance. The researcher believes that there will be also a stronger relationship if entrepreneurial orientation acts as a mediator between leadership styles and business performance. In this study, the researcher believes that entrepreneurial orientation can mediate the relationship between leadership styles and business performance. With this concept in mind, the following hypothesis is developed:-



H5: Entrepreneurial orientation mediates the relationship between leadership styles and performance.

3. METHODOLOGY

3.1 Sampling and Data Collection Procedures

A random sample of SMEs registered in Malaysia was used in this study. Following the recommendation of Sekaran (2005), 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 data were collected using the survey method. 1000 questionnaires were sent to owner/managers of the SMEs throughout Malaysia via posted services. 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) was used to measure the variables of leadership styles (Avolio & Bass, 2004). 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. 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.

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. Many researchers have tested and proven the reliability of the scale (Covin & Slevin, 1991; Knight, 1997). 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. 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	Cronbachj 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 transformational, leadership and performance (H1), transactional leadership and performance (H2), passive-avoidant and performance (H3), entrepreneurial orientation and performance (H4) and the mediating effects of entrepreneurial orientation on the relationship between leadership styles and performance (H5). The mediator was tested according to the suggestion of Baron and Kenny (1986). The regression analysis results in Table 2 indicate that transformational leadership is positively and significantly related to performance. This finding supports H1. The results also indicate that transactional leadership is also positively and significantly related to performance. This finding also supports H2. 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. According to Baron and Kenny(1986), if leadership styles is no longer significant when entrepreneurial orientation is controlled, the finding supports full mediation. In this study, the researcher found that leadership styles is still significant after mediating with entrepreneurial orientation (figure 4.1), therefore the finding supports partial mediation.

Table 2 : Regression results of leadership styles(LS), entrepreneurial orientation(EO) and business performance(BP)

	Adjusted R-square	Beta (β)	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 $p < 0.001$

Figure 4.1 shows the standardized coefficient (β) after mediation for the tested variables (leadership styles, entrepreneurial orientation and business performance).

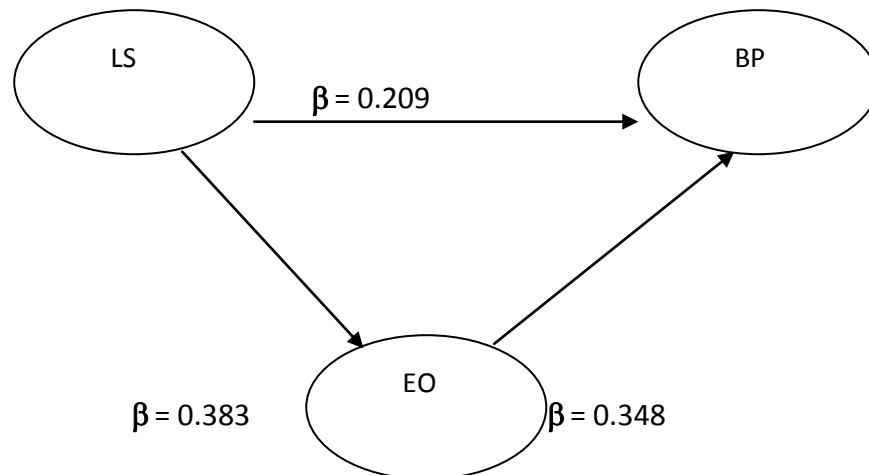


Fig. 4.1 : Relationship of tested variables (LS, EO and BP) after mediation.

5. DISCUSSION AND CONCLUSION

This study examines the mediating effects of entrepreneurial orientation on the relationship between leadership styles and performance of SMEs 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. However, when tested entrepreneurial orientation as a mediator of leadership styles and performance, the results demonstrate only partial relationship. The researchers believe that entrepreneurial orientation will fully mediating the relationship between leadership styles and business performance if there are efforts to upgrade the transactional and passive avoidant leaderships of SME owner/managers to transformational leadership. This study provides an opportunity to expand the research on other industries such as manufacturing, constructions, agricultures and telecommunications. Also, future researchers perhaps may want to investigate the effect of leadership styles and entrepreneurial orientation on Malaysian SMEs going abroad, as international expansion offers a potential way for these firms to increase growth and improve performance.

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