

Leadership and Organisational Performance in Malaysian SMEs: The mediating role of Entrepreneurial Orientation

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ABSTRACT

Whether and to what extent entrepreneurs' leadership could influence entrepreneurial orientation (EO) and organisational performance was a major question of the current study. More specifically, the study tested a casual modelling, examining the various relationships among leadership behaviours, EO and organisational performance in Malaysian SMEs. Based on a response of 397 Malaysian entrepreneurs and a test of Structural Equation Modelling (SEM), the results revealed that transformational and transactional leadership had different impact on the organisational performance variables. In addition, EO seemed to mediate the relationship between the leadership behaviours and one of the organisational performance variables (Growth). Implication was also discussed.

Keywords

Leadership, Entrepreneurial Orientation, Organisational Performance, SMEs, Malaysia

INTRODUCTION

Previous studies have demonstrated that there are links between leadership and performance (As-Sadeq & Khoury 2006; Ling et al. 2008; Lo et al. 2010) and others have looked at entrepreneurial orientation and performance (Moreno & Casillas 2008; Rauch et al. 2009; Wiklund 1999), but there are very few studies that have been conducted to examine the relationships between these three variables simultaneously (Todorovic & Schlosser 2007; Yang 2008). Abdul Razak (2010) proposed that effective leadership behaviours and entrepreneurial attitudes are among the key factors for the success of Small and Medium Enterprises.

Leadership refers to the process of how to influence people and guide them to achieve organisational goals (Northouse 2007; Robbins & Coulter 2005). Effective leaders are important because they are one of the factors determining the success or failure of a group, organisation or even a whole country (Fiedler 1996). Previous studies also have shown that a good leader can enhance organisational performance (Bass 1985; Ogbanna & Harris 2000; Tarabishy et al. 2005; Yang 2008), increase employees' satisfaction (Papalexandris & Galanaki 2009) and improve employees' motivation (Papalexandris & Galanaki 2009).

Entrepreneurial orientation (EO) on the other hand can be described as entrepreneurship at the firm level (Lee, Lee & Pennings 2001). According to Morris & Paul (1987), EO can be

defined as the company's top management inclination to take calculated risks, to be innovative, and to display proactiveness in their approach to strategic decision making. SMEs are expected to be entrepreneurially orientated in order to be competitive and an EO contributes to the success of a firm. It also means that the EO is not something that can be bought by a firm (Lee, Lee & Pennings 2001). EO is something that the entrepreneurs or owners of SMEs need to build, instil, foster and maintain. It has also been shown previously that a high level of EO improves the performance of the organizations (Smart & Conant 1994; Wang 2008; Wiklund 1999).

The purpose of this paper is to analyse the relationship between transformational and transactional leadership behaviours towards EO and organisational performance of SMEs in Malaysia. EO is important since it represents a firm's strategic orientation to achieve organisational success (Wiklund & Shepherd 2005). Moreover, entrepreneurial SMEs can be an engine growth for the economic development of the country.

LITERATURE REVIEW

Leadership and Organisational Performance

The transactional and transformational theory of leadership was first developed by Burns in 1978. Bass (1985) has further refined Burns (1978) model with a proposed theory of transformational leadership. Unlike Burns, Bass contended and suggested that transformational and transactional leaders were not different ends of a leadership continuum (Muenjohn 2010). But that these leadership behaviours might be displayed at the same time by the same leader but to differing degrees (Bass 1985).

In small medium enterprises (SMEs), the leadership behaviours of the top management can have a strong impact on the innovativeness and the performance of the firm (Matzler et al. 2008). As the business becomes globally competitive, SMEs development requires a new vision and set of directions to help them to become more competitive and have the ability to sustain their businesses. In order to be able to do this, the leadership behaviours of the CEO/owner would play a major role in ensuring the directions and a clear vision to be shared among employees in their establishments.

In regards to the studies on leadership behaviours and performance of SMEs, transformational leadership is found to have a positive impact on the performance of SMEs and this relationship is significant (Matzler et al. 2008; Pedraja-Rejas et al. 2006; Yang 2008). However, in regards to transactional leadership, contradicting findings are found between these studies. Transactional leadership is found to have a small, significant positive relationship towards the performance of SMEs in study conducted by Yang (2008) but there is a negative and significant relationship between transactional leadership and the performance of organization in study conducted by Pedraja –Rejas et al. (2006).

Leadership and Entrepreneurial Orientation

The type of leadership behaviour displayed by the owner or manager could help to foster entrepreneurial behaviours within SMEs (Arham, Muenjohn & Boucher 2011). Eyal & Kark (2004) postulated that transformational leadership is one of the main processes for influencing followers and improving their devotion, loyalty, excitement and enthusiasm and it is acknowledged as a basic condition required for the development of radical entrepreneurial

approaches. Previous literature has also shown that transformational leadership contributes significantly to the dimensions of EO (Eyal & Kark 2004; Yang 2008).

Transactional leadership on the hand involves an exchange process between leaders and followers (Bass 1985; Daft 2008). Transactional leaders use monitoring behaviours and these leaders seek to control others to ensure that the workplace is stable and procedures are followed (Bass 1985). There here are contradictory findings in relation to the relationship between transactional leadership behaviour and EO. Yang (2008) found that transactional leadership has a small, positive relationship towards EO but in a study conducted by Eyal & Kark (2004), there is no significant relationship between transactional leadership and the development of EO. They claimed that managers who employ transactional leadership behaviour are less inclined to be proactive in any systematic manner or to foster innovation within the organization. An enterprise requires entrepreneurship but what is required to maintain the ongoing operation of an SME and guide an enterprise to success is the effective leadership that exists within the organisation (Arham, Muenjohn & Boucher, 2011).

Entrepreneurial Orientation and Organisational Performance

According to Aloulou & Fayolle (2005), an innovative firm is not considered entrepreneurial if it does not take risks or does not display proactiveness when dealing with competitors and the environment. Covin & Slevin (1989) described the ability of a firm to display excellent performance in the three dimensions of EO consisting of innovativeness, proactiveness and risk-taking can be considered to be entrepreneurial. They proposed that entrepreneurial style measured the degree to which top managers favour innovative activities, are inclined to take considerable business related risks and proactively compete with other firms.

There are much existing literatures that has shown that there is a link between EO and organisational performance (Ahmad & Ghani 2010; Smart & Conant 1994; Yang 2008; Zahra 1991). However, the nature and extent of the relationship seems to be different between different types of organizations. Lee, Lee & Pennings (2001) have found that EO is only weakly linked to the performance of start-up companies whereas in other studies, there was a moderate, positive significant relationship between EO and overall business performance (Fairoz, Hirobumi & Tanaka 2010; Smart & Conant 1994; Yang 2008). Fairoz, Hirobumi & Tanaka (2010) also reported that the sales growth, profit and market share were higher for firms that adopted higher EO as compared to those with lower EO. Smart & Conant (1994) concluded that firms with higher EO have better performance outcomes than firms with lower and medium EO. By utilizing the initial dimensions of EO, this paper assesses the individual EO of owner/top managers of SME establishments.

Organisational Performance

Organizational performance is one of the most important dependent variable of interests for researchers concerned with just about any area of management (Richard et al. 2008). According to Madrid-Guijarro et al. (2007) high performing firms are able to generate a variety of company and society benefits like attracting resources, wealth creation and jobs generation. These authors also claimed that an accurate measure of performance can provide reliable insight into what affects performance and how firms can develop good strategies, arrange resources, meet consumer expectations and compete. Inappropriate measures of performance will mislead the results that lead to a poor competitive position (Madrid-Guijarro et al. 2007). Murphy et al. (1996) confirm that growth, profitability and efficiency are the

most commonly form of performance factors in the entrepreneurship literature. This is similar to what has been outlined by Covin & Slevin (1991) that growth and profitability represent the dimensions of a firm's economic performance. Markman & Gartner (2002) postulated that growth positively influences profitability

RESEARCH PROPOSITIONS

Due to the mixed results from previous research on the variables discussed above, the following propositions were made:

Proposition 1: Transformational leadership has a greater and positive impact on the Organisational performance variables (Growth and Profitability) than transactional leadership.

Proposition 2: Transformational leadership has a greater and positive influence on Entrepreneurial Orientation than transactional leadership.

Proposition 3: Entrepreneurial orientation mediates the relationship between the leadership behaviours and organisational performance.

RESEARCH METHOD

To examine the relationships between leadership behaviours, entrepreneurial orientation and organisational performance of SMEs in Malaysia, a quantitative research method was used. There were two approaches used to collect the data. First, a list of enterprises was obtained from the SME Corp Malaysia. From this list, 1100 firms were selected in equal proportion from the Manufacturing and Services industries. These two industries were chosen because they are the main industries where SMEs contribute significantly to the development of economy in Malaysia (SME Annual Report, 2009/10). The second approach to data collection adopted was distributing the questionnaires through several agencies like the SME Corp. Malaysia and Malaysian Institute of Management that conduct training and seminars for the SMEs in Malaysia.

The subjects were either the owner or the top level manager of small and medium enterprises. They were selected because of their knowledge and expertise with regards to their own establishment, operation and their knowledge of the direction of the firm. They were also the most informed individuals about the firms' overall operational activities (Yang 2008). Small and medium sized enterprises tend to have a relatively limited number of core products and technologies and therefore the owners or managers of SMEs are likely to have a clear understanding of their business operation, consequently enhancing the accuracy of the responses (Isobe, Makino & Montgomery 2004),

Research Instrument

A self-reporting instrument was developed for this research containing a total of 60 items representing 5 different sections that included leadership behaviours, EO, organisational performance, background of business/participant and also participant's willingness to participate in a future interview with the researcher. The measurements for the leadership behaviours were adopted from the Multifactor Leadership Questionnaire (MLQ) by Avolio & Bass (2004). They were measured on a five-point Likert scales that ranged from 0=Not at all

to 4=*Frequently, if not Always*. The EO measure used in this study was comprised of the initial dimensions developed by Miller (1983) (innovativeness, proactiveness and risk taking). The measurement of these dimensions was adopted from Covin & Slevin (1989) and Wang (2008). Organisational performance in this study was measured through growth and profitability. The measurements of these dimensions were adopted from Matzler et al. (2008). To standardize the scaling format of the research instruments, all items for EO and organisational performance were also measured on five-point Likert scales ranged from 0=*Strongly Disagree* to 4=*Strongly Agree*.

Research Procedure

A web-based survey was developed and emailed to the selected sample. Three follow-up reminders were sent together with follow-up telephone calls to increase the response rate among the respondents. It was anticipated that there would be a low response rate through the web-based survey, therefore a second strategy of distributing the questionnaire directly to participants in SME training courses and seminars was initiated. Several agencies that conduct and organise such training and seminars were contacted and some of them agreed to assist with the distribution and collection of the survey questionnaire. All together there were 1800 questionnaires distributed. Of these, 473 questionnaires were returned but 68 were removed due to being incomplete or the respondent did not represent the target sample for this study. This gave a total of 405 usable questionnaires for this research. Ten surveys were removed due to outliers; therefore only 395 surveys without missing data remained for analysis, representing approximately 22% response rate.

Participants

395 participants responded on a designed questionnaire. 52.1% of respondents came from the Manufacturing industry and 47.9% came from the Services industry. 45.8% of the respondents were the owners of the firms and the rest were the Top Managers represented 54.2% of the sample. Majority of the respondents were relatively young ages between 31-40 years old representing 45.1% whereas 26.4% represented by those between the ages of 41-50 years old. In terms of gender, male respondents represented 62.7% while females represented 37.3%. Majority of respondents are Malay (84.4%) and 45.6% of the respondents have at least a Degree (Bachelor). Finally, the small-size enterprise represented 68.8% of the sample and the rest of 31.2% were the medium-size enterprise.

RESULTS

Cronbach's alpha coefficients were conducted for all research variables. Leadership behaviours earned a high coefficient of 0.859 while the Cronbach's alpha coefficient for EO was 0.724 and overall Cronbach's alpha coefficient for organisational performance was 0.803. All variables achieved 0.70 or above indicating an acceptable statistic testing level (Nunnally, 1967).

To test our propositions, A Structural Equation Model was employed. According to Fornell (1982), SEM is suited to confront a priori knowledge and hypotheses with empirical data and indicators of the overall model quality inform the researcher to what degree his model fits with the empirical data.

Figure 1 shows the results of the structural coefficients and the variances of the endogenous constructs. The overall chi-square of the model as statistically significant ($\chi^2 = 1428.02$; $df = 359$; $p < .01$). The ratio of the chi-square to the degree of freedom (χ^2/df) was 3.98 and the

root mean square error of approximation (RMSEA) was 0.087. The goodness of fit index (GFI) was 0.82 and the adjusted goodness of fit index (AGFI) was 0.78. While the fit indices showed slightly below a good fit level (see for example Hair et al. 2004), it indicated a reasonable fit between the data and the proposed model.

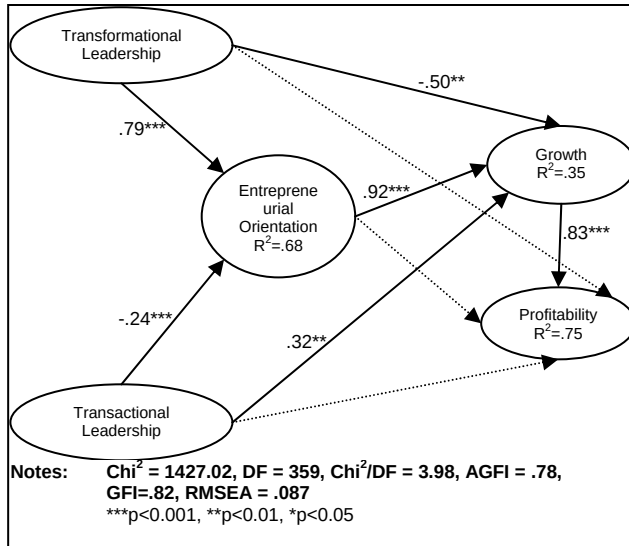


Figure 1. Results: Leadership, EO, Growth and Profitability

Local fit indices are reported in Table 1. All indicator loadings are ranging from 0.44-0.95. The average variance extracted (AVE) and composite reliability for each of the construct are also reported. The AVE should be at least 0.5 and the composite reliability should be greater than 0.6 (Bagozzi & Yi, 1988). Based from the table, only Idealised Influence and Growth have poor AVE values which were 0.36 and 0.38 respectively. The rest of the constructs have at least 0.46 and above. However, the composite reliability exceeded the suggested value of 0.6 for all constructs. Hence the measurement model seems to possess adequate convergent validity.

For Proposition 1 which stated transformational leadership has a greater and positive impact on the Organisational performance variables (Growth and Profitability) than transactional leadership the results showed that transformational leadership had less and negative impact on Growth than transactional leadership (TL: $\beta = -.50$, $p < .01$ and TA: $\beta = .32$, $p < .01$). However, there was no significant relationship found between the two leadership behaviours and Profitability and therefore Proposition 1 was rejected.

Proposition 2 stated that transformational leadership has a greater and positive influence on Entrepreneurial Orientation than transactional leadership. The test showed that transformational leadership had a stronger influence on EO than transactional leadership (TL: $\beta = .79$, $p < .001$ and TA: $\beta = -.24$, $p < .001$). Proposition 2 was, therefore, fully supported.

Proposition 3 was partially supported. Figure 1 showed that while EO doesn't mediate the relationship between the leadership behaviours and Profitability at the significant level, the relationship between the leadership behaviours and Growth could be mediated by EO. According to Baron and Kenny (1986), a variable mediates a relationship if it reduces the path coefficient of a direct relationship once the mediator is computed into the model. In this study the direct relationship between TF and growth was $\beta = 0.15$, $p < 0.05$ and TF to profitability

was $\beta = -.26$, $p < 0.001$. These path coefficients are reduced to $\beta = -.50$ and $\beta = -.29$ respectively once EO is introduced as a mediator. As a consequence, EO can be considered a partial mediator between TF and organisational performance. However, EO was found not to mediate the relationship between TA and growth and profitability since the path coefficient between TA and growth was not reduced once the mediator is introduced.

Table 1 Reliability and Validity of Scales

Constructs		Items	Loadings	AVE	CR
Trans- formational Leadership	Idealised Influence	II_2	0.68	0.36	0.69
		II_3	0.59		
		II_4	0.64		
		II_6	0.47		
	Intellectual Stimulation	IS2	0.62	0.48	0.73
		IS3	0.67		
		IS4	0.77		
	Individualised Consideration	IC1	0.69	0.67	0.8
		IC2	0.93		
	Inspirational Motivation	IC3	0.65	0.46	0.71
IC4		0.64			
IC5		0.73			
Tran- sactional Leadership	Contingent Reward	IC6	0.65	0.52	0.68
		IC7	0.78		
	Management- by- Exception Active	IC8	0.73	0.47	0.64
		IC9	0.64		
	Management- by- Exception Passive	IC10	0.85	0.53	0.77
		IC11	0.55		
IC12		0.76			
EO	Innovativeness	INN1	0.63	0.5	0.67
		INN3	0.79		
	Proactiveness	PA3	0.62	0.51	0.67
		PA4	0.8		
	Risk-taking	RT1	0.51	0.58	0.72
		RT2	0.95		
Growth		GR1	0.62	0.38	0.63
		GR3	0.45		
		GR4	0.73		
Profitability		PROF1	0.44	0.48	0.62
		PROF4	0.87		

CONCLUSION AND IMPLICATION

Previous studies of leadership have shown that a good leader can enhance organisational performance (Bass 1985; Ogbanna & Harris 2000; Tarabishy et al. 2005; Yang 2008),

increase employees' satisfaction (Papalexandris & Galanaki 2009) and improve employees' motivation (Papalexandris & Galanaki 2009). Studies on entrepreneurial orientation focused on relationship among entrepreneurial orientation, market orientation and performance (Todorovic & Ma 2008). Very rare investigation has been carried out to look into the relationship between leadership behaviors, entrepreneurial orientation and organisational performance, especially in the context of Malaysian SMEs.

The results of the current study draw several implications. Firstly, the behaviours that associated with transactional leadership seem to have more impact on organisational performance than transformational leadership. Within the context of Malaysian SMEs, transactional leadership which focuses on providing direction and motivate employees in the way of instituting goals by clarifying and task requirements is still significant leadership behaviour to promote organisational growth. In addition, due to relatively small firm size, a close monitoring style of leadership (Management-by-exception Active) and a focus on the exchange of rewards for efforts (Contingent reward) might still be more relevant in the context of Malaysian SMEs.

Secondly, when comes to Entrepreneurial Orientation, transformational leadership seems to play more important role than transactional leadership. Perhaps, the entrepreneurs who displayed transformational leadership tended to be more proactive in their entrepreneurial practices such as they are willing to take more calculated risks and be more innovative in their strategic approach than the entrepreneurs who practised transactional leadership. Not surprisingly, transformational leadership, according to Eyal & Kark (2004), is acknowledged to set the basic conditions for radical entrepreneurial approaches. In addition, previous literatures also have shown that transformational leadership contributes significantly to the dimensions of EO (Eyal & Kark 2004; Yang 2008).

Third, EO positively influence growth. Since EO represents a firm strategic orientation (Wiklund & Shepherd 2005), firms that are willing to take reasonable amount of risk, being innovative and proactive in their approach would be able to accelerate growth. EO also plays an effective mediating role between transformational leadership and growth. Thus, transformational leadership can enhance the performance of entrepreneurial firms through EO.

Finally, this study raises some issues that need to be addressed by future research. For future research, it would be useful to include the environmental factors that will affect the performance of the entrepreneurial ventures. The use of self-reported measures also might encourage common response biases (Moers 2005). It is also suggested that in the future a longitudinal study would be carried out to investigate the detail process of how the leadership behaviours might affect the performance and EO. Despite the weaknesses and limitations, we hope that the findings produced from our study would incite debates for research direction.

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