



## **The Effect of Leadership Styles on the Business Performance of SMEs in Malaysia**

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### **Abstract**

This paper investigates the effect of leadership styles 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 Business Performance BP questionnaire and the demographic questionnaire. The findings revealed that there were significant positive relationships between transactional leadership and business performance and transformational leadership 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 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; 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 & Gallear, 1996; Ladzani & 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 et al., 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 conducted in 2005 by Malaysian Department of Statistics, revealed that 99.2 percent or 518,996 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 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 (2005) 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 et al. (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) stated 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. The objective of this study is therefore to investigate the relationship between leadership styles and 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 et al. (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. Based on these discussions, the following hypothesis is formulated.

H<sub>1</sub>: 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 et al., 1974). The employees are empowered and feel compelled and dedicated to assist in accomplishing the goals and objectives of the organization (Somers & Birnbaum, 1998). Feinberg et al. (2005) stated 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. Gillespie 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 et al., 1987), promotion (Waldman et al., 1990), innovation (Keller, 1992), and achievement (Howell & Avolio, 1993). Barling et al. (1996) found that the effects of transformational leadership on financial result are positive. Dvir et al. (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) agreed with Ramey (2002) and support that transformational leadership positively influenced job satisfaction. Following the analysis of the relationship between leadership and physical distance unit performance, Howell et al. (2005) find that transformational leadership positively predicted unit performance. Transformational leadership was positively linked to organizational performances (Zhu et al., 2005) and the chief executive officers hold a vital role in the firm's success. Based on these discussions, the following hypothesis is formulated:

H<sub>2</sub>: 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:

H<sub>3</sub>: There is significant negative relationship between passive-avoidant leadership and performance.

## **3. Method**

### *3.1 Sampling and data collection procedures*

This study used a random sample of SMEs registered in Malaysia. Sekaran (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*

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 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. Results

### 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 and BP. As can be seen in Table 1, the Cronbach Alpha achieved for leadership styles (transactional, transformational and passive-avoidant) 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 profile of the respondents is illustrated in Table 2. 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.

### 4.3 Testing of hypotheses

Regression analysis was used to test the relationships between transactional, leadership and performance ( $H_1$ ), transformational leadership and performance ( $H_2$ ) and passive-avoidant and performance ( $H_3$ ). The regression analysis results in Table 3 indicate that transactional leadership is positively and significantly related to performance. This finding supports  $H_1$ . The results also indicate that transformational leadership is also positively and significantly related to performance. This finding also supports  $H_2$ . However, the regression analysis result of passive-avoidant leadership indicates that relationship is negatively related to performance and this support  $H_3$ .

## 5. Discussion and conclusion

This study examines how leadership styles 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 et al., 2003; Lowe & Galen, 1996).

Leadership is important for SMEs to survive, and a future research study could examine a leader's personal construct. A study on leadership development could provide owner/managers with knowledge as to what type of development is necessary to enhance leadership skills and attributes to maintain business performances. Although this research confirmed the role of leadership styles as an 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 model. Researchers can conduct research from other aspects of leadership 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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**Table**

Table 1: Reliability scores for variables

Variable	No. of items	Cronbach Alpha Value
<i>Transactional</i>	8	0.866
<i>Transformational</i>	20	0.900
<i>Passive-Avoidant</i>	8	0.923
Business Performance	7	0.902

Table 2: Profile of respondents

<i>Characteristics</i>	<i>Frequency</i>	<i>Percentage</i>
<i>Gender</i>		
Male	276	73.6
Female	99	26.4
<i>Age</i>		
Below 30	145	38.7
31-40	151	40.3
41-50	51	13.6
51-60	28	7.4
<i>Marital status</i>		
Married	208	55.5
Single (Bachelor)	167	44.5
<i>Education level</i>		
Doctorate/Master	50	13.3
Bachelor	186	49.6
HSC/MCE	135	36.0
LCE and below	4	1.1
<i>Lengthy of company established</i>		
Less than 5 years	171	45.6
5-10 years	107	28.5
11-15 years	64	17.1
16-20 years	33	8.8
Above 20 years	0	0.0
<i>Number of employees</i>		
Fewer than 5	101	26.9
6-20	215	57.3
21-50	33	8.8
51-100	26	6.9
100-200	0	0.0

<i>Company's type</i>		
ICT services	152	40.5
Transportation services	67	17.8
Food supplies	101	26.9
Tourism	16	4.2
Finance etc	39	10.4
<i>Number of years worked</i>		
Less than 5 years	226	60.3
6-10 years	99	26.4
11-15 years	4	1.1
16-20 years	34	9.1
21 and above	12	3.2

Table 3: 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

Sig p<0.001