



Mediating Role of Entrepreneurial Orientation on Relationship between Transformational Leadership, Transactional Leadership and Performance of Small and Medium Enterprises

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ABSTRACT

The purpose of this study was to identify the transformational leadership, transactional leadership, entrepreneurial orientation and organisational performance of Small and Medium Enterprises (SMEs) in Malaysia. Four main constructs were selected namely transformational leadership, transactional leadership, entrepreneurial orientation and organisational performance based on Resource Based Theory (RBT) by Galbreath (2005) and Transformational Leadership Theory by Bass (1985). The research design used in this study was a survey method and data were collected using quantitative approaches. The respondents were 401 owner or manager of SMEs operating in manufacturing and service industries in Kuala Lumpur and Selangor. The respondents were selected using the Stratified Sampling Technique. The study instrument applied was questionnaires. The finding showed that transformational leadership has higher impact towards organisational performance ($\beta=0.257$, $S.E=0.055$) than transactional leadership ($\beta=0.220$, $S.E=0.054$). Entrepreneurial orientation also significantly contributed to organisational performance ($\beta=0.199$, $S.E=0.054$). Furthermore, this study found that entrepreneurial orientation acted as partial mediator between leadership behaviour and organisational performance ($\beta=0.284$, $S.E=0.256$). The key implications of this study revealed that transformational leadership proved to be more efficient than transactional leadership in term of leadership behaviour. Thus, the leader of SMEs need to practise and nurture the qualities of transformational leadership, and focus on entrepreneurial orientation in order to achieve better organisational performance. This study also acknowledges the leadership and entrepreneurial orientation as a resource and capability in organisation because the integration of these two elements are the yardstick for SMEs' success in Malaysia.

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KEYWORDS: Transformational leadership, transactional leadership, entrepreneurial orientation, organizational performance, SMEs

1. Introduction

Leadership play importance role in organization (Yang, 2008). Effective leader influences the followers in desired manner in achieving desired goal (Mohd Sam et al, 2012). Different leadership behavior may affect organizational effectiveness or firm's performance (Arif&Akram, 2018). Therefore, it is important for the leaders of SMEs to fully understand the rapid changing business environment and to adopt the appropriate leadership styles to improve business performance (Hayat and Riaz (2011).

Entrepreneurial orientation provides direction for organisations to pursue new opportunities, it is essential to

explore the role of organisational leader as they implement entrepreneurial orientation policies and procedures. Miller (2011,p.875) clarified that entrepreneurial orientation encompassed a process or a path how the entrepreneurs behave in creating their new entry, new product or technology and new market.

Small and Medium Industries are crucial pillar of Malaysia's economy, forming 98.5 % of the total establishments in the country. According to 11th Malaysia Plan 2016-2020, SMEs are expected to contribute up to 41% of the country's GDP by 2020, and approximately 32 initiatives will be intensified to develop resilient and sustainable SMEs (SMEs Annual Report 2017/2018). SMEs create employment opportunities,

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stimulate entrepreneurial capabilities and innovation, and contribute significantly to the Gross Domestic Product (GDP) (Abu Bakar et al., 2016). According to the SME Annual Report (NSDC,2018), SMEs contributed 37.1% of the Malaysia’s GDP. However, Aseancountry such as Thailand showed higher 40.2 % respectively. Therefore, the leaders have to face the challenge and equip the SMEs with a leadership skills and elements of entrepreneurial orientation to enhance the firm’s performance and alleviate the failure arise.

As a result, the main objective of this research is to explore the impact of leadership behaviour and entrepreneurial orientation (EO) towards performance of Malaysian SMEs in manufacturing sector and service sector. This two elements are recognized as important factor of firms achievement (Abdullah et al, 2018).The right leadership behaviour is important in entrepreneurial development since its creates the appropriate climate for the entrepreneurship and innovation within organisation. Even though the transformational leadership and transactional leadership is the most recent and commonly used by researcher in the current literature, there is still a need to diversify empirical evidence on its relationship with EO of SMEs in Malaysia. It is a hoped that this study can contribute to the leadership and EO not only to Small and Medium Enterprise but also to Micro Medium and Small Enterprise in Malaysia.

2. Literature Review and Hypotheses Development Transformational Leadership and Organisational Performance.

Transformational leaders uplift the morale, motivation, and morals of their followers (Bass, 1999).Transformative leaders are able to display a good directions to organisation (Givens, 2008).

Transformational leadership is more strongly correlated than transactional leadership with higher productivity and performance (Lowe et al 1996).Dzomonda et al 2017 revealed that transformational leadership suggested a better achievement from followers comes from transformational leaders than other types of leadership.

H1: Transformational leadership is significantly and positively related toorganisational performance.

Transformational Leadership and Entrepreneurial Orientation

According to Shahraki&Bhrain (2013), transformational leadership is perfectly suitable for organisational or firmsconsidering adopted EO. The researcher added that transformational leaders diligently market creativity and information through their charismatic behaviour. Eddleston (2008, p. 1055) postulated that a firm’s founder who practiced transformational leader behaviours would establish purpose, commitment and strategic flexibility. Studied done by Obeidant et al, 2018 on 330 employees in Jordonian commercial bank revealed that exit significant

effect of transformational leadership with the dimension inspirational motivation and intellectual stimulation on entrepreneurial orientation.

H2: Transformational leadership is significantly and positively related toentrepreneurial orientation.

Transactional Leadership and Organisational Performance

Transactional leaders cater to their followers’ immediate self-interests (Bass, 1999). Transactional leaders tend to stimulate their followers with rewards in an exchanged based relationship (Abdul Aziz et al, 2013). Kuhnert and Lewis (1987) stated that reward system is important between managers/ owners and employees in enhancing their personal goals. Lim (2016) displayed the positive relationship between transactional leadership and business performance in 62Malaysian managers in thewholesale subsector of the distributive trade sector.This is contrary with a study done by Naaem & Tayyeb(2011) in 100 SMEs in Punjab, Pakistan.

H3: Transactional leadership is significantly and positively related to organisational performance

Transactional Leadership and Entrepreneurial Orientation

Martin (2015) see transactional as the leadership style that incentives or punishments are priority in organisation and work requirements are set up to guide subordinates to gain organisational targets. Eyal and Kark (2004) found that no relationship exist between transactional leadership and entrepreneurial orientation. Islamet al.(2018) also claimed that the transactional leadership style has a negative impact on employee empowerment in the retail industry of Malaysia. Besides that, Öncer (2011) stated that transactional leadership has positive correlations with proactiveness factor. and no correlations with as innovativeness and risk taking. However, study conducted by Nahavandi (2006) indicate that a transactional leader generates an EO environment through the concept of exchange in the organisation.

H4: Transactional leadership is significantly and positively related to entrepreneurial orientation.

Entrepreneurial Orientation and Organisational Performance

Researchers and practitioners often associate the entrepreneurial orientation (EO) with the firm’s performance (Harry et al 2010). EO is demonstration of firm’s innovativeness, proactiveness and risk taking (Covin & Slevin, 1989; Miller, 1983).Innovativeness portrays organizational willingness and a tendency to achieve the desired innovation demonstrated in terms of behaviours, strategies, activities and processes. As a result, innovativeness usually result in new products/services or changes in service/product lines, developing new R&D processes, new methods of production, developing new

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systems/applications or introducing as well as implementing new procedure (Ismael & Sidnei, 2018).

The risk-taking element is attached to the firm’s tendency to capture in projects that have uncertain outcomes or high profits and losses (Lumpkin and Dess, 1996; Farzana Parveen, Jaafar, N.1; Sulaiman, A, (2016)). Proactiveness is an opportunity-seeking, forward-looking perspective involving introduction of new products or services ahead of the competition and acting in anticipation of future demand to create change and shape the environment (Lumpkin and Dess, 1996).

Hilmi et al. (2010) revealed that Malaysian SMEs show a high level of both product and process innovativeness but only process innovativeness is positively related to performance. Contrary with study done by Umar et al. (2018), claimed that both, product and process innovation have positive and significant impact on SMEs’ performance. Therefore, it is suggested that firms may gain benefit from adopting an EO.

H5: Entrepreneurial orientation is significantly and positively related to organisational performance

Entrepreneurial Orientation, Transformational Leadership and Organizational Performance

Transformational leaders change things by crafting the vision and by influencing followers to buy into the vision (Lussier & Achua, 2007). In addition, transformational leaders focus on the organization and direct follower commitment toward organizational goals.

Arif, S. & Akram. A. (2018) revealed that 110 respondents among employees of MIA group in Islamabad, Pakistan found that transformational leadership has a significant

relationship with EO. Yang (2008) also proposed that entrepreneurial orientation fully mediate relationship between transformational leadership and organizational performances through 449 respondents among managers and owners SMEs in Taiwan.

H6: Entrepreneurial orientation mediates the relationship between transformational leadership and organizational performance

Entrepreneurial Orientation, Transactional Leadership and Organizational Performance

Many studies have acknowledged the importance of entrepreneurial orientation and leadership behavior to the firm's performance (Abidemi et al.2018). Findings by a study conducted by Ebrahimi (2016) in 401 SMEs among manufacturing companies in Guilan Province showed transactional leadership were positively related to innovation and performance.

Meanwhile, Eyal and Kark (2004) that there is no significant relationship between transactional leadership and EO. In the context of SMEs in Malaysia, Hashim et al. (2018) demonstrated that transactional leadership has a significant relationship to EO and lead to positive relationship to performance.

H7: Entrepreneurial orientation mediates the relationship between transactional leadership and organizational performance.

3. Research Framework

Figure 1 illustrates the hypothesized model that links the transformational leadership, transactional leadership, entrepreneurial orientation and organisational performance

H1

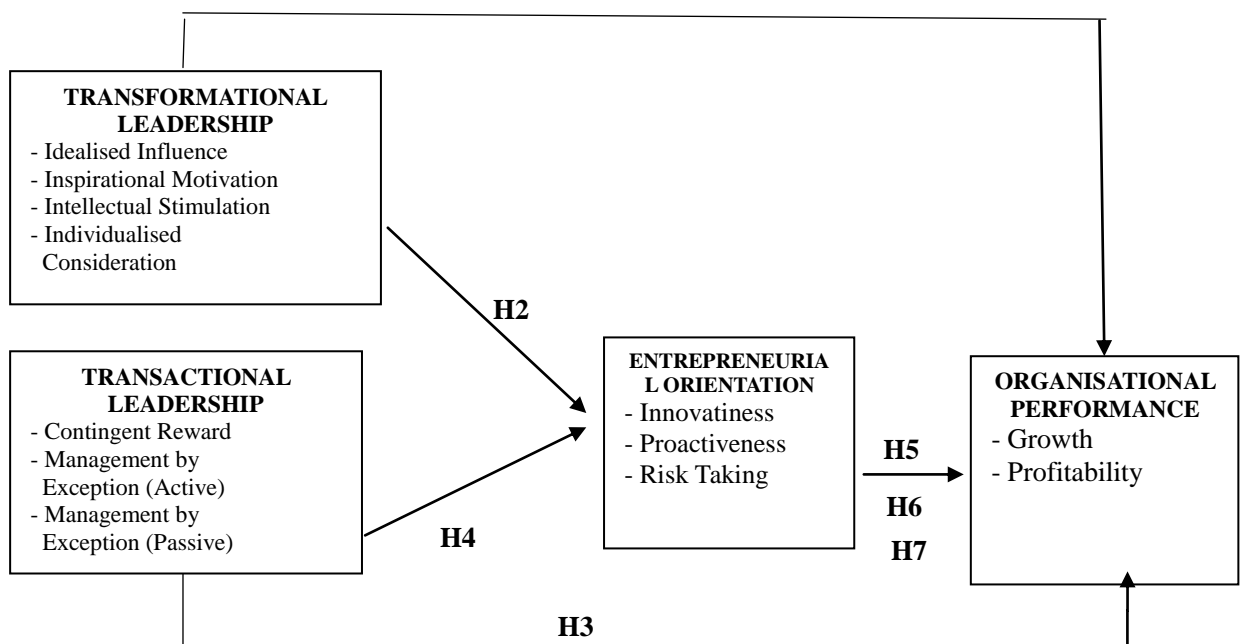


Figure 1: Conceptual Framework

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5. Research Methodology

Owners or managers from manufacturing and service sectors in Kuala Lumpur and Selangor in Malaysia were utilised as the population for this study. These two states were chosen due to their largest representation of SME establishments and significant contributions to the country’s economy (NSDC,2018). As shown in Table 1.1 there are currently 179,271 SMEs in Selangor and 133,703 in Kuala Lumpur. The questionnaire contained 61 items which covered 32 items in leadership behaviour, 11 items in entrepreneurial orientation,8 items in organisational performance and 10

items in demographic and back ground of respondents. All were measured using a ten-point Likert scale. The questionnaire was pre-tested before distributed among respondents.1700 questionnaires were distributed based on strata stratified sampling with closed-ended questions and 401 useable questionnaires were returned. For analyzing data, this study uses Structural Equation Modelling (SEM) though IBM-SEM-AMOS software as SEM is a second generation method of multivariate analysis technique(Hoque et al., 2018a; Hoque et al., 2018b).

Table 1. Number of SME Establishments by State

State	Total SME	Percentage (%)
Selangor	179,271	19.8
WP Kuala Lumpur	133,703	14.7
Johor	98,190	10.8
Perak	75,140	8.3
Pulau Pinang	66,921	7.4
Sarawak	61,036	6.7
Sabah	55,702	6.2
Kedah	48,894	5.4
Kelantan	46,618	5.1
Pahang	35,573	4.1
Negeri Sembilan	32,721	3.6
Melaka	31,361	3.5
Terengganu	29,324	3.2
Perlis	6,808	0.5
WP Labuan	2,567	0.3
WP Putrajaya	1,236	0.1
Total SMEs	907,065	100.0

Adoption from: *Economic Cencus 2016.Profile of SMEs (Reference Year 2015)*

5. Results

5.1 Descriptive Analysis of Demographic Characteristics of Respondents

The demographic profiles of the respondents have been outlined in Table 2.Fromthe questionnaire distributed, only

435 (25.58%) were received and 401 (23.58%). In this study, the statistical data of the respondents based on sectors, gender, education level position in company and firm location.

Table 2: Profiles of Respondent

		Frequency	Percent
Industry	Manufacturing	146	36.4
	Service & Other Sectors	224	55.9
Gender	Male	218	54.4
	Female	183	45.6
Education Level	Secondary Education	30	7.5
	Certificate/Diploma	37	9.2
	Degree	232	57.9
	Master	60	15.0
	PhD/Doctorate	39	9.7
Position in Company	Owners	264	65.8
Firm Location	Managers	137	34.2
	Selangor	207	51.6
	Kuala Lumpur	194	47.6

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5.2 Measurement Model

The measurement model of the study needs to achieve validity, reliability and unidimensionality (Hoque et al., 2018c; Hoque et al., 2017c; Awang 2015). If the factor loading value for all items are positive with a minimum

value of 0.6, then the unidimensionality will be achieved (Hoque et al., 2017b; Hoque & Awang, 2016a). Whereas, construct validity will be achieved when the fitness indexes for the measurement model gain three model fit types.

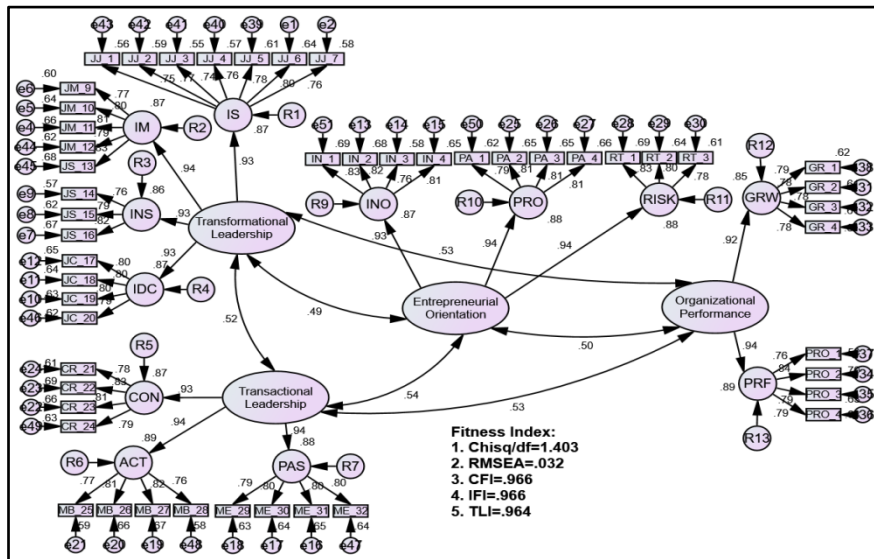


Figure 2. Pooled CFA Output

5.3 Structural Model

Figure 3 indicate the measurement model of Entrepreneurial Orientation, Transformational Leadership, Transactional Leadership and Organisational Performance latent constructs have met the requirement for unidimensionality as well as construct validity. Below illustrated seven hypotheses (H1, H2, H3, H4, H5, H6 & H7) are supported. The structural model explains 40% variance in SME performance. It is indicated that there are 60% elements or factors can contribute to established SMEs performance in the future research.

H1: Transformational Leadership has a significant direct effect on SME performance.

H2: Transactional Leadership has a significant direct effect on SMEs performance.

H3: Transformational Leadership has a significant direct effect on Entrepreneurial Orientation. H4: Transactional leadership has a significant direct effect on Entrepreneurial Orientation.

H5: Entrepreneurial Orientation has a significant direct effect on SMEs performance

H6: Entrepreneurial Orientation has mediates relationship between transformational leadership and SMEs performance
 H7: Entrepreneurial Orientation has mediates relationship between transformational leadership and SMEs performance.

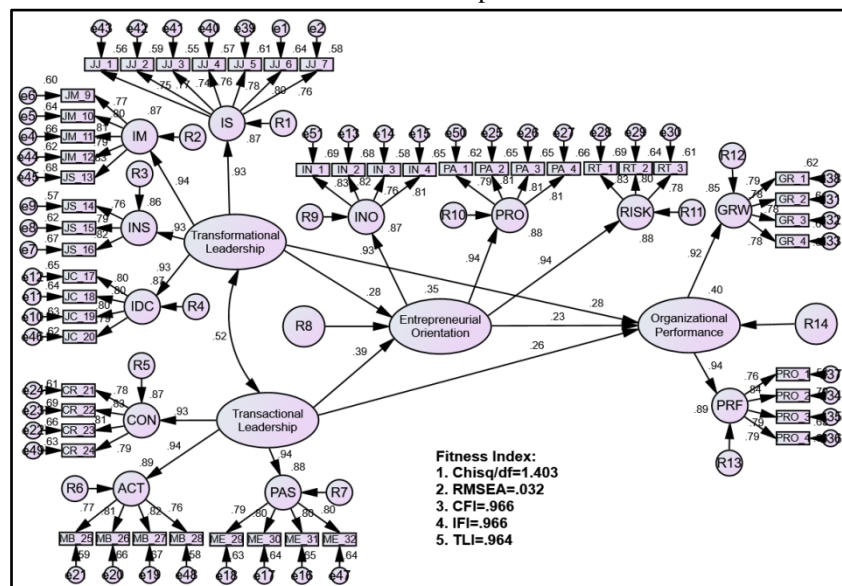


Figure3. Standardized Estimates

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5.4 Reliability and Validity

Table 3 shows value for every item of Composite Reliability (CR) and Average Variance Extracted (AVE) for construct EO, Transformational Leadership, Transactional Leadership

and Organisational Performance constructs have achieved when the value is that above 0.70 and 0.50 respectively (Lowry & Gaskin).

Table 3. Composite Reliability and Average Variance Extracted Results

	CR	AVE
Transformational Leadership	0.964	0.870
Transactional Leadership	0.955	0.877
Entrepreneurial Orientation	0.955	0.877
Organisational Performance	0.928	0.865

5.5 Discriminant Validity

According Awang et al. (2017b), and Awang et al (2015) Discriminant validity is achieved when correlation between independent variables must be less than 0.85. Since, the value in diagonal

is higher than any values in its row and column in Table 3, therefore this study has achieved the discriminant validity for the model.

Construct	Transformational Leadership	Transactional Leadership	Entrepreneurial Orientation	Organizational Performance
Transformational Leadership	0.933			
Transactional Leadership	0.52	0.936		
Entrepreneurial Orientation	0.49	0.54	0.936	
Organizational Performance	0.53	0.53	0.50	0.930

5.6 Relationship between Transformational Leadership and Organisational Performance

Table 4 below shows the path coefficient of transformational leadership on organizational performance is 0.257.The regression weight estimate of 0.257 has a standard error of 0.055. The critical ratio is shown as 4.686 standard errors

above zero. The probability of getting a critical ratio of 4.686 in an absolute value is 0.001.It showed that the hypothesis that transformational leadership has a positive and significant effect on organizational performance is duly supported.

Table 4: The Result of Hypothesis Testing for the Causal Effect of Transformational Leadership on Organisational Performance

		Estimate	S.E.	C.R.	P	Result
Organizational Performance	<-- Transformational Leadership	.257	.055	4.686	***	Significant

5.7 Relationship between Transformational Leadership and Entrepreneurial Orientation

Table 5 below shows the path coefficient of transformational leadership to entrepreneurial orientation is 0.228. This value indicates that for everyone unit increase in transformational leadership, its effect would contribute 0.228 unit increase in

entrepreneurial orientation. The regression weight estimate of 0.288 has a standard error of 0.059.The probability of getting a critical ratio of 4.864 in an absolute value is 0.001.Hence,the hypothesis that transformational leadership has a positive and significant effect on entrepreneurial orientation is duly supported.

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Table 5 : The Results of Hypothesis Testing for the Causal Effect of Transformational Leadership on Entrepreneurial Orientation

			Estimate	S.E.	C.R.	P	Result
Entrepreneurial Orientation	<---	Transformational Leadership	.288	.059	4.864	***	Significant

5.8 Relationship between Transactional Leadership and Organizational Performance

Table 6 below shows the path coefficient of transactional leadership on organizational performance is 0.220. This value indicates that for every one unit increase in Transactional Leadership, its effect would contribute 0.220

unit increase in organizational performance. The regression weight estimate of 0.220 has a standard error of 0.054. The probability of getting a critical ratio of 4.057 in an absolute value is 0.001. Hence, the hypothesis that transactional leadership has a positive and significant effect on organizational performance is duly supported.

Table 6: The Results of Hypothesis Testing for the Causal Effect of Transactional Leadership on Organizational Performance

			Estimate	S.E.	C.R.	P	Result
Organizational Performance	<---	Transactional Leadership	.220	.054	4.057	***	Significant

5.9 Relationship between Transactional Leadership and Entrepreneurial Orientation

Table 7 below shows the path coefficient of transactional leadership on entrepreneurial orientation is 0.376. This value indicates that for every one unit increase in transactional leadership, its effect would contribute 0.376 unit increase in

entrepreneurial orientation. The regression weight estimate of 0.376 has a standard error of 0.059. The critical ratio is shown as 6.430 standard errors above zero. Hence, the hypothesis that transactional leadership has a positive and significant effect on entrepreneurial orientation is duly supported.

Table 7: The Results of Hypothesis Testing for the Causal Effect of Transactional Leadership on Entrepreneurial Orientation

			Estimate	S.E.	C.R.	P	Result
Entrepreneurial Orientation	<---	Transactional Leadership	.376	.059	6.430	***	Significant

5.10 Relationship between Entrepreneurial Orientation and Organizational Performance

Table 8 below shows the path coefficient of entrepreneurial orientation on organizational performance is 0.199. This value indicates that for every one unit increase in entrepreneurial orientation, its effect would contribute 0.199

unit increase in organizational performance. The regression weight estimate of 0.199 has a standard error of 0.054. The critical ratio is shown as 3.678 standard errors above zero. Hence, the hypothesis that entrepreneurial orientation has a positive and significant effect on organizational performance is duly supported.

Table 8: The Results of Hypothesis Testing for the Causal Effect of Entrepreneurial Orientation on Organizational Performance

			Estimate	S.E.	C.R.	P	Result
Organisational Performance	<---	Entrepreneurial Orientation	.199	.054	3.678	***	Significant

5.11 Testing mediation

5.11.1 Baron & Kenny Approach (Transformational Leadership)

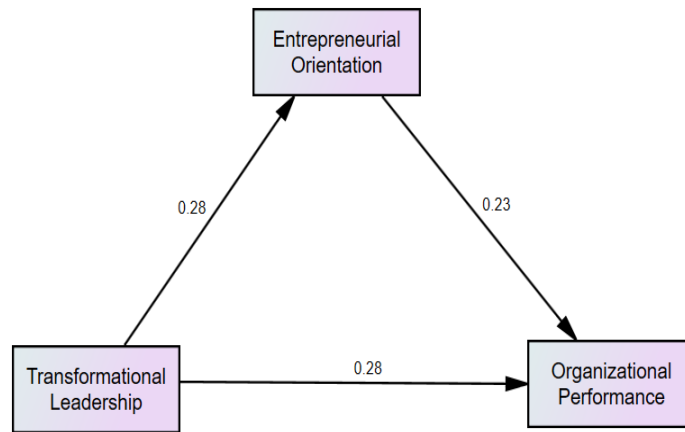


Figure 4: Baron & Kenny Approach for Transformational Leadership

INDIRECT EFFECT

a = Transformational Leadership on Entrepreneurial Orientation = 0.28***
 b = Entrepreneurial Orientation on Organizational Performance = 0.23***
 $a \times b = 0.28 \times 0.23 = 0.064$

DIRECT EFFECT

c' = Transformational Leadership on Organizational Performance = 0.28***

The mediator constructs for this study is Entrepreneurial Orientation. Figure. 1.1 shows that indirect effect for this model is $a \times b = 0.064 < 0.28$. It shows that the value of indirect effect is smaller than the value of direct effect

although the significant indirect are shown in the result. Hence, the **partial mediation** is said to exist when the direct effect increased after the model is estimated without the presence of mediation construct.

5.11.2 Baron & Kenny Approach (Transactional Leadership)

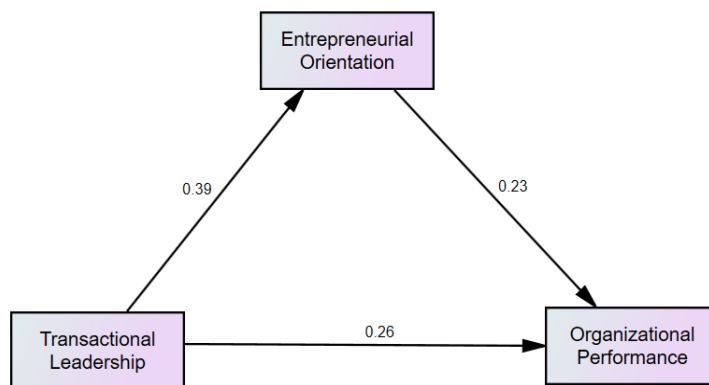


Figure 5: Baron & Kenny Approach (Transactional Leadership)

INDIRECT EFFECT

a = Transactional Leadership on Entrepreneurial Orientation = 0.39***
 b = Entrepreneurial Orientation on Organizational Performance = 0.23***
 $a \times b = 0.39 \times 0.23 = 0.0897$

DIRECT EFFECT

c' = Transactional Leadership on Organizational Performance = 0.26***

Figure 5 result showed that the mediation is occurred in the model due to significant indirect effect. In order to compute the z-test, the value of indirect effect ($a \times b$) should be significantly different from zero or must higher than the

direct effect (c'). For this indirect effect, $a \times b = 0.0897 < 0.26$. It shows that the value of indirect effect is smaller than the value of direct effect although the significant indirect are shown in the result. Hence, the **partial mediation** is said to

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exist when the direct effect increased after the model is estimated without the presence of mediation construct.

6. Discussion and Implications

The practice of transformational leadership, transactional leadership and entrepreneurial orientation are perceived to positively affect the outcomes of the firm. This study showed that transformational leadership has higher impact towards organisational performance than transactional leadership. This is in line with previous research by Arif & Akram (2018), Lim (2016), Arhamet al (2016) and Bass & Avolio (2004). On the other hand, Roa (2012) concluded that transactional leadership is more correlated to business performance than transformational leadership.

This study also acknowledges that entrepreneurial orientation also partially mediates the relationship between transformational leadership, transactional leadership and organizational performance and it proved that the integration of these elements are the yardstick for SMEs' success in Malaysia.

The results revealed that more male (54.4%) than female (45.6%) respondents. In 2015, women-owned SMEs accounted for 186,930 or 20.6 % of total SMEs in Malaysia with an annual growth rate of 8.0 percent (SME Annual Report 2016). From this study, it indicates that the increased of women entrepreneurs in Malaysia. There might be more female managers than female owners and thus this would have contributed to the higher percentage of women leaders in this study and perhaps more women than men hold these senior managerial positions. The majority of the respondents had degree education at 57.9%. 39 respondents had a Ph.D. or other doctorate (9.7%) of the sample. The result indicated that the higher education will lead manager or owners of SMEs to achieve or to direct a better business performance.

This study has extended the understanding of the possible linkages between transformational leadership, transactional leadership, entrepreneurial orientation and organisational performance as practiced in Resource Based Theory (RBT) by Galbreath (2005) and Transformational Leadership Theory by Bass (1985).

The main objectives of this study is to reveal the consequences which can be benefited SMEs in manufacturing and services sector in Malaysia. The effective owners and top managers and the elements of entrepreneurial orientation are essential factors in sustained growth and profitability of the firms. Leaders are stimulated to perceive the complexity of the interaction between their leadership behaviour and the level of entrepreneurial orientation executed in their firms.

7. Limitations and Future Research

Despite this study's theoretical and practical significance, it also has underlying limitations, which show avenues for further research in similar and different contexts. The

present study used cross-sectional data to investigate causal inferences (Harrison et al., 2016b). Future researchers are recommended to employ a longitudinal or experimental research design to overcome the concern for causality relationships (Cong et al., 2017).

This study contributes generalisations for both manufacturing and service industries. It does not cover the categorical difference between the two industries. There are several sub-categories of SMEs in each of these industries. A more detailed study looking at each of the two industries and the differences between the sub-categories within and between industries in respect to their leadership behaviour, entrepreneurial orientation, and organisational performance might provide direction for future research.

8. Conclusion

In summary, leadership plays an important role in organizational success. Transformational leadership style and transactional leadership style have been widely used in the organizations (Lo et al 2009). Malaysian SMEs also applied and utilised both leadership styles. This study showed that transformational leadership has higher impact towards organisational performance than transactional leadership. Entrepreneurial orientation also significantly contributed to organisational performance. Furthermore, this study found that entrepreneurial orientation acted as partial mediator between leadership behaviour and organisational performance. The key implications of this study revealed that transformational leadership proved to be more efficient than transactional leadership in term of leadership behaviour. Thus, the leader of SMEs need to practice and nurture the qualities of transformational leadership and focus on entrepreneurial orientation in order to achieve better organisational performance.

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