

**THE IMPACTS OF TRANSFORMATIONAL LEADERSHIP ON ORGANIZATIONAL
OUTCOME:
STUDY IN SMEs**

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ABSTRACT

Transformational leaders inspire followers to accomplish more by concentrating on the follower's values and helping the follower align these values with the values of the organization. The purpose of this literature review is to investigate the impact of the transformational leadership style on organizational outcomes. This review examines the following organizational outcomes: organizational citizenship behavior/performance, organizational culture, and organizational vision. By understanding the impact of transformational leadership on these outcomes, transformational leaders can influence employee behavior so that the behavior has a positive impact on the organization.

One hundred and sixty eight respondents who working in small medium enterprises (SMEs) in different type of sectors participated in this study. A correlation test was used to investigate the relationship between transformational leadership style and organizational outcomes (organizational outcomes: organizational citizenship behavior/performance, organizational culture, and organizational vision). Regression analysis was carried out to examine the hypothesis and relationship between transformational leadership style and organizational outcomes.

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DEDICATION

This project is dedicated to my Husband and my Parents who have never failed to give me financial and moral support, for giving all my need during the time I developed the system and for teaching me that even the largest task can be accomplished if it is done one step at a time.

DECLARATION

I declare that this thesis entitle “title of the thesis” is the result of my own reaesrch except as cited in the references. The thesis has not been accepted for any degree and is not concurrently submitted in candidature of any other degree.

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Date : 9 JANUARI 2012

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CHAPTER 1:

INTRODUCTION

1.0 Introduction

Contributions of Small and Medium Enterprises (SMEs) sector are widely recognized towards enhancing the nation's economic growth. It can be seen from various aspects such as in terms of business units, employment opportunities as well as economic output, (Hashim, 2005). According to SME Corporation (2009/2010), SMEs comprise 99.2% of the overall business establishment in Malaysia and they contribute 8 – 8.5% in 2010 based on expectations of over 6% growth in overall GDP. Furthermore, SMEs employ about 56% of the country's workforce and the value added products are expected to be worth RM120 billion in the manufacturing sector in 2020. Realizing the important roles of SMEs, government has allocated RM605.3 million to SME Corporation for various development programs and financial assistance.

Although SMEs roles towards enhancing economic growth and increasing employment opportunities are well known, there are barriers and challenges faced by this sector which undermine their performance. It can be categorized to internal and external causes of challenges. The challenges are arising from globalization, liberalization and extensive organizational, institutional and technological change (Saleh & Ndubisi, 2006). These challenges will cause to low productivity, poor management, lack of managerial capabilities, and shortage of skills for new business environment and etc. Besides, business nowadays is characterized by ever changing environment and therefore firms have to adapt with the changes for their survival. One approach that has been widely implemented for firms' competitive advantage is to innovate.

In SME's context, the contingency approach to management is most relevant on the basis there is no one best way to manage. To be effective, planning, organizing, leading, and controlling must be tailored to the particular circumstances faced by the SME. Business owners have always asked questions such as "What is the right thing to do? Should we hire more people or train existing ones to grow? Should we use task or people oriented leadership styles? What motivational approaches and incentive programs should we use?"

The contingency approach to management (also called the situational approach) assumes that there is no universal answer to such questions because organizations, people, and situations vary and change over time - it all depends on a complex variety of critical environmental and internal contingencies. The contingency approach to leadership entails the need for leaders to be flexible in their choice of leadership style based on the situation. When attempting to influence a group or individual is unsuccessful, one suggested course of action available to the leader is to adopt an alternative style of leadership more compatible with elements of the situation. The leader must have the skills to predict the likelihood with certainty that the present leadership style "is not working" that warrants the leader's changing his or her style.

For the SMEs, this approach is best combined with transformational-type of leadership. Transformational leaders motivate followers to achieve exceptional outcomes through setting and communicating visions for outcomes that extend beyond individual self-interest and Transformational leadership is defined as a leadership approach that causes change in individuals and social systems. In its ideal form, it creates valuable and positive change in the followers with the end goal of developing followers into leaders. The concept of transformational leadership was initially introduced by leadership expert and presidential biographer James MacGregor Burns. According to Burns (1978), transformational leadership

can be seen when “leaders and followers make each other to advance to a higher level of moral and motivation.” Through the strength of their vision and personality, transformational leaders are able to inspire followers to change expectations, perceptions and motivations to work towards common goals. Transformational leadership has four components: idealized influence, inspirational motivation, intellectual stimulation and individualized consideration.

Bernard M. Bass (1985), extended the work of Burns (1978) by explaining the psychological mechanisms that underlie transforming leadership; Bass also used the term "transformational" instead of "transforming." Bass added to the initial concepts of Burns (1978) to help explain how transformational leadership could be measured, as well as how it impacts follower motivation and performance. The extent to which a leader is transformational is measured first, in terms of his influence on the followers. The followers of such a leader feel trust, admiration, loyalty and respect for the leader and because of the qualities of the transformational leader are willing to work harder than originally expected.

These outcomes occur because the transformational leader offers followers something more than just working for self gain; they provide followers with an inspiring mission and vision and give them an identity. The leader transforms and motivates followers through his or her idealized influence, intellectual stimulation and individual consideration. In addition, this leader encourages followers to come up with new and unique ways to challenge the status quo and to alter the environment to support being successful.

1.1 Purpose of this study

This study aims to investigate the impact of the transformational leadership style on organizational outcomes in SMEs. This research examines the following organizational outcomes: organizational citizenship behavior/performance, organizational culture, and organizational vision.

By understanding the impact of transformational leadership on these outcomes, transformational leaders can influence employee behavior so that the behavior has a positive impact on the organization.

1.2 Problem statement

Leadership has a direct cause and effect relationship upon organizations and their success. Leaders determine values, culture, change tolerance and employee motivation. They shape institutional strategies including their execution and effectiveness. Leaders can appear at any level of an institution and are not exclusive to management. Successful leaders do, however, have one thing in common. They influence those around them in order to reap maximum benefit from the organization's resources, including its most vital and expensive: its people. In fact, the influence of leaders and their effectiveness in moving people to a shared vision can directly shape the organization.

Past research has shown that transformational leadership will give impacts on employee commitment to organizational change and organizational condition. Due to this impact, transformational leadership is needed in all organization. Purpose Personal behaviour related to leadership styles which may have positive or negative impact on this relationship.

1.3 Objective

The aim of this study is to investigate the transformational leadership theory and its relationship to, or influence on organizational outcome in SMEs. The following specific objective will be addressed:

1. To study the impact of the transformational leadership style on organizational outcomes.

1.4 Definition of terms

1.4.1 Small Medium Enterprise (SMEs)

In general, SMEs definition is based on annual sales turnover, shareholders' funds and number of employees. SMEs in Malaysia are heterogeneous in nature. It involves various industries which indicate the differences in manpower, operations, cost, sales and etc. Therefore, it is quite difficult to provide a definition that will fulfil different characteristics of each industry. However, a standard definition of SMEs in Malaysia has been approved for adoption by National SME Development Council (NSDC) for wider coverage and applicability. The definition is based on two criteria i.e. number of employees or annual turnover. It is use for primary agriculture, manufacturing, manufacturing related services and services sectors (National SME Development Council, 2005).

Table 1: Definition of SME based on the number of full time employees

Sector Size	Primary agriculture	Manufacturing (including agro-based) & Manufacturing Related Service	Services sector (including ICT)
Micro	less than 5 employees	less than 5 employees	less than 5 employees
Small	between 5 & 19 employees	Between 5 & 50 employees	between 5 & 19 employees
Medium	between 20 & 50 employees	between 51 & 150 employees	between 20 & 50 employees

Source: National SME Development Council (NSDC), (2005)

Table 2: Definition of SME based on annual sales turnover

Sector Size	Primary agriculture	Manufacturing (including agro-based) & Manufacturing Related Service	Services sector (including ICT)
Micro	less than RM200 000	less than RM250 000	less than RM200 000
Small	between RM200 000 & less than RM1 million	between RM250 000 & less than RM10 million	between RM200 000 & less than RM1 million
Medium	between RM1 million & RM5 million	between RM10 million & RM25million	between RM1million & RM5million

Source: National SME Development Council (NSDC), (2005)

1.4.2 Transformational Leadership

Transformational Leadership is a style of leading people in an inspirational way rather than driven by transactional numbers alone. Considerable research has been done into the concept of Transformational Leadership, particularly since first introduced to a wider audience, by James MacGregor Burns in 1978.

Whilst much of this research focuses on leadership concepts in the political arena and in organizational psychology, there is conclusive and consistent evidence to prove that Transformational Leadership does create significant positive change in an organization. In

addition, the resultant redesign of organizational culture creates an environment where the followers give more than either they, or the organization, likely anticipated.

1.4.3 Organizational Outcomes

According to Boundary Management (2000), outcomes are the purpose or the reason for the existence of the organization, unit, or work group. Outcomes have a unique definition, and are somewhat synonymous with the way that the word “mission” is used. For organizations, outcomes need to be thought of as subsets, attached to each other, which then forms a greater system or process. The ultimate outcomes are defined at the highest levels of the organization; with everyone being held accountable that has some impact or influence on those results. Past research has shown that transformational leaders has direct affect organizational outcomes such as organizational citizenship behaviour/performance, organizational culture and organizational vision.

i. **Organizational citizenship behaviour/performance:**

"Organizational Citizenship Behaviors (OCBs) are a special type of work behavior that is defined as individual behaviors that are beneficial to the organization and are discretionary, not directly or explicitly recognized by the formal reward system (Organ, 1988). These behaviors are rather a matter of personal choice, such that their omission is not generally understood as punishable. OCBs are thought to have an important impact on the effectiveness and efficiency of work teams and organizations, therefore contributing to the overall productivity of the organization.

ii. Organizational Culture:

A pattern of shared basic assumptions that the group learned as it solved its problems of external adaptation and internal integration, which has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems.

iii. Organizational Vision:

The way an organization or enterprise will look in the future. Vision is a long-term view, sometimes describing how the organization would like the world to be in which it operates.

CHAPTER 2:

LITERATURE REVIEW

2.0 Small and Medium Enterprises (SMEs) in Malaysia

SMEs play an important role in the development of Malaysian economy. SMEs are important traders and service providers to primary industries. Furthermore, a large number of SMEs are also producers of finished goods and services. Collectively, these SMEs contribute to the growth of manufacturing, services and agriculture sectors, as well as ICT services, in terms of output, value-added, employment and exports (SME Annual Report, 2006). Their contributions resulted in big impacts to the economy as a whole. In year 2005, SMEs contributed to 32 percent of gross domestic products, 56.4 percent to employment opportunities and 19 percent to exports (SMIDEC, 2008). However, SMEs in Malaysia only contribute 32 percent GDP over 99.2 percent of total establishment compared to 40 percent GDP in other regional economies such as Thailand, Taiwan and Korea, this suggests that there is a big room for Malaysian SMEs to expand their role (SME Annual Report 2006).

Since SMEs' contribution to the national economy is still relatively small, the Government has made the development of SMEs a high priority area. The Government aims by 2010 to increase SMEs' contribution to GDP from 32 percent to 37 percent and their total exports to increase from 19 percent to 22 percent and to employ over 6.2 million workers by prioritizing SMEs development (BNM Press Statement, 2007 and SME Annual Report 2006). This is reflected in the national development agendas, namely the Ninth Malaysia Plan (9MP) and the Third Industrial Master Plan (IMP3), in which the key strategies for SMEs development are outlined for the period of 2006-2010 and 2006-2015 respectively (SME Annual Report,

2006). from 9MP, a number of training programs for SMEs were implemented to improve their resource planning, management capability, financial management and human resource development as well as upgrading their marketing and technical skills.

The challenges and obstacles faced are highly related to the developmental stage of the companies and it includes lack of managerial capabilities, shortage in financing and human resources. Factors involved include low access in borrowing and small capital investment, low access of needed infrastructure, low level of expert abilities and raw materials, low expertise in management and technical knowledge. This increases the need for value creation among SMEs to ensure business sustainability which coexists within an environment of good corporate governance. The lack of human resources in SMEs pushes them to outsource to improve their organisation

2.1 Transformational Leadership

Transformational leadership theory was developed in the late 20th century by Burns (1978) in his analysis of political leaders. Prior to this time much attention had been given to the examination of the approaches of leaders who successfully transformed organizations. Burns characterized transformational leadership as that which “occurs when one or more persons engage with others in such a way that leaders and followers raise one another to higher levels of motivation and morality”. He believed that transformational leadership could raise followers from a lower level to a higher level of needs which agrees with Maslow’s (1954) hierarchy of needs.

Another researcher, Bernard M. Bass (1985), extended the work of Burns (1978) by explaining the psychological mechanisms that underlie transforming leadership; Bass also used the term "transformational" instead of "transforming." Bass added to the initial concepts of Burns (1978) to help explain how transformational leadership could be measured, as well

as how it impacts follower motivation and performance. The extent to which a leader is transformational is measured first, in terms of his influence on the followers. The followers of such a leader feel trust, admiration, loyalty and respect for the leader and because of the qualities of the transformational leader are willing to work harder than originally expected. These outcomes occur because the transformational leader offers followers something more than just working for self gain; they provide followers with an inspiring mission and vision and give them an identity. The leader transforms and motivates followers through his or her idealized influence, intellectual stimulation and individual consideration. In addition, this leader encourages followers to come up with new and unique ways to challenge the status quo and to alter the environment to support being successful

Bass (1985) refined and expanded Burns' leadership theory. Bass said that a leader is "one who motivates us to do more than we originally expected to do". He said that this motivation could be achieved by raising the awareness level about the importance of outcomes and ways to reach them. Bass also said that leaders encourage followers to go beyond self-interest for the good of the team or the organization. In organizations since the 1980s (Bass, 1985; Bass, Waldman, Avolio, & Bebb, 1987; Tichy & Devanna, 1986). The use of this theory concentrated on exchanges between leaders and followers inside the organization. Transformational leadership serves as a means to "create and sustain a context for building human capacity by identifying and developing core values and unifying purpose, liberating human potential and generating increased capacity, developing leadership and effective followership, utilizing interaction-focused organizational design, and building interconnectedness" (Hickman, 1997). According to Aarons (2006), "Leadership is associated with organizational and staff performance". Personal and organizational behavior related to leadership demands a more candid look at the leadership styles which may have a

positive or negative impact on these two variables. The purpose of this literature review is to investigate the impact of the transformational leadership style on organizational outcomes.

2.2 Organizational outcomes

Several studies have documented important connections between transformational leadership and organizational operation. Transformational leadership has been linked to an array of outcomes, such as employee commitment to the organization (Barling, Weber, & Kelloway, 1996) and job satisfaction and satisfaction with a leader (Koh, Steers, & Terborg, 1995). Transformational leadership is positively related to a number of important organizational outcomes including perceived extra effort, organizational citizenship behaviors, and job satisfaction. According to Trice and Beyer (1993) leadership can change and sustain the culture of the organization by generating new or reinforcing established sets of beliefs, shared values, practices, and norms within organizations.

Transformational leaders influence subordinates by motivating and inspiring them to achieve organizational goals (Bass & Avolio, 1995). Transformational leaders also try to help subordinates imagine appealing future outcomes (Bass & Avolio) related to the organization. Research has shown that transformational leaders affect organizational outcomes such as organizational citizenship behavior, organizational commitment, job satisfaction, effort, and in-role performance.

This review of literature will specifically examine the influence of transformational leadership on the following organizational outcomes: organizational citizenship behavior/performance, organizational culture, and organizational vision.

2.3.1 Organizational Citizenship Behavior/Performance

Past research has demonstrated that transformational leadership has a direct influence on organizational citizenship behavior/performance (MacKenzie, Podsakoff, & Rich, 2001).

Organizational citizenship behavior/performance is described as non-obligatory, voluntary behavior by an employee, which exceeds the employee's normal work duties and is not associated with any type of organizational reward system (Organ, 1990). Research has shown that organizational citizenship behavior/performance has a positive effect on employee performance (Podsakoff, MacKenzie, Paine, & Bachrach, 2000) and produces positive benefits for organizations and organizational personnel. According to Schlechter and Engelbrecht (2006), "Organizational citizenship behavior is by its very nature an extremely positive and desirable behavioral phenomenon. It is behavior that the organization would want to promote and encourage". Moreover, organizational citizenship behavior/performance is positive, selfless behavior for organizations because it involves employees giving help to each other without the expectation that those receiving the help will have to give anything back in return.

Bass (1990) theorized that transformational leadership creates employees who are unselfish, faithful, and connected to the organization. These types of employees often perform beyond what is expected of them (Bass, 1985) in relation to their job descriptions. Several studies have shown a direct connection between transformational leadership and the following organizational citizenship behaviors: virtue, helping, sportsmanship, courtesy, and altruism (MacKenzie et al., 2001).