

Relationship between Entrepreneurial Orientation and Firm Performance: Moderation of Transformational Leadership in the Context of Pakistani SMEs

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Abstract

The current research investigated the relationship between entrepreneurial orientation and firm performance through moderation of transformational leadership in the context of Pakistani SMEs. For this purpose, 193 SMEs were selected from Khyber Pakhtunkhwa. The data was collected through a structured questionnaire from the selected respondents. The study found that entrepreneurial orientation is positively and significantly related with firm performance ($t=13.39$, $p<.05$). The study also found that transformational leadership moderates the significant relationship between entrepreneurial orientation and firm performance. Limitations, managerial implications and direction for future research are also highlighted.

Keywords: Entrepreneurial Orientation, Transformational Leadership, Firm Performance, SMEs

Introduction

SMEs performance is the topic of discussion among educators, researchers, practitioners and policy makers all over the world. The determinants and attributes of SMEs performance have been remained a focus of debate and interest among researchers and practitioners (McKelvie & Wiklund, 2010). SMEs faced different types of problems, such as having unskilled employees, lack of experience and educational background, limited financial resources, lack of technology, limited numbers of employees and managerial expertise (Khalique *et al.*, 2011; Mahmood, 2008; Saleh & Ndubisi, 2006; Aris, 2007). Hard works are frequently undertaken by SMEs to realize how to develop and further enhanced their performance. These efforts of SMEs are essential, because this sector of the economy is considered as one of the essential engine for economic growth of the country (Ahmadani & Shaikh, 2012). The main focus of this current research study is to study the impact of EO on SMEs performance in Pakistan on entrepreneurial Orientation

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(EO) perspective, leadership behavior, environmental factors and access to financial resources in the organizations. For this purpose, the analysis will be done through collection of quantitative data. Entrepreneurial orientations, leadership behavior, access to financial capital and environmental factors are recognized as important factors for success of the organization (Hafeez *et al.*, 2012; Hannay, 2009; Zhang *et al.*, 2008; Wang, 2008; Fiedler, 1996).

Entrepreneurial orientation (EO) is considered a cause of competitive advantage. The EO is very important for entrepreneurial success and it is necessary for SMEs in Pakistan to possess and exercise EO in their organization. However, the role of entrepreneurship and EO and firm's performance relationship are not clear in developing countries (Fairozet *et al.*, 2010). Every organization needs good leadership in their organization to enhance firm's performance. According to Tsai (2008) most leadership study has been focused on the behavior of leader on one's performance, satisfaction and motivation, rather than examining the moderating role on the relationship between EO and SMEs firm's performance (Mason *et al.*, 2015). Wang and Poutziouris (2010) determined and stated that leadership is not clearly understandable in SMEs. Access to financial capital is also essential for firm to influence the EO and firm's performance relationship. Wikuland and Shepherd (2005) asserted that most successful entrepreneurial firm are more innovative, risk taking and proactive in dynamic, hostile and complex environment.

Problem Statement

Many researchers investigated and suggested that SMEs are considered as an essential component of growth in several countries (Shahbaz *et al.*, 2014; Savlovschi & Robu, 2011). The contribution of Pakistani SMEs towards the economy is still low as compared to other developed and developing countries. The contribution of SMEs towards GDP in Sarilanka is 53%, in Japan is 55%, in UK is 55% and 60% in China. The contribution of SMEs in Pakistan towards GDP is 40% which can be further improved (SMEDA, 2014). This shows an important opportunity for SMEs to refine and enhance their performance to improve economic growth of the nation (SMEDA, 2014). Economic growth and development is very essential for decreasing unemployment and enhance productivity as well as firm's performance and also encouraging the process of expansion and internalization (Subhan, Mehmood & Sattar, 2013).

SMEs are always being in pressure due to intense competition internally and globally. SMEs should adopt and enforce changes such as

entrepreneurial and effective leadership in order to continue productivity and to compete globally (Hashim, 2012). Hashim (2012) stated that effective leadership is needed for organization to sustain growth and profitability, and also to motivate employees to accept new challenges and to get outstanding business results. Previous studies also highlight the link of EO with FP in developed economy, and few studies were conducted in developing economy as well. Researchers suggested a moderating role of variables like access to financial capital, environmental factors, and leadership behavior on the EO and firm performance relationship (Mason *et al.*, 2015; Muchiri & McMurray, 2015). Thus, the focus of the current study is to find out the moderating effect of TL on EO and FP relationship in Pakistani context.

The following research question need to be answered:

1. Does entrepreneurial orientation affect SMEs performance?
2. Does transformational leadership moderate the relationship between EO and SMEs performance?

The study wants to achieve the following objectives

1. To investigate the association between EO and SMEs performance in Pakistan.
2. To examine whether TL moderates the relationship between EO and SMEs performance.

Significance of Study

The findings of the study in hand give valuable insights to entrepreneurship and leadership literature. In this area of research, a lot of studies mainly focused on Western culture or other industrialized countries, therefore the current study states that the concepts of EO and firm's performance relationship and influence of leadership behavior and other resources and capabilities are applicable in the developing country like Pakistan. The impact of EO on firm's performance and also moderating role of TL. This research study also provides a good understanding of leadership behaviors that would be considered more suitable for SMEs in Pakistan. There are some factors or variables that may be essential in Western or developed countries, but are not in the perspective of Pakistani SMEs. Modification in the Western or developed concepts of entrepreneurship and leadership might make them better and appropriated for entrepreneurs in Pakistan.

Literature Review

Entrepreneurial attitude and good leadership as considered the main basis that drive SMEs success (Arham *et al.*, 2013). Evidence suggests that poor management skills and inadequate leadership are considered the

primary factors for SMEs failure (Davies *et al.*, 2002). It has been noticed that a company needs entrepreneurship but to good leadership is mandatory to maintain operation and to guide the enterprise (Arham *et al.*, 2011). Khattak *et al.*, (2017) concluded that innovation and creativity is essential for organization survival. Transformational leaders encourage and motivate innovation and creativity that positively effect firm performance (Saleem *et al.*, 2017; Akhtat *et al.*, 2014).

Thus, entrepreneur needs to be a good leader or to develop leadership behavior to run the enterprise in both good and bad times. At the time of crisis, the enterprise need appropriate leadership to keep their employees focused and motivated. To prevent organizational failure and to achieve good organizational performance one may introduce right leadership. Strong leadership is required to successfully implement lean production in SMEs (Achanga *et al.*, 2006). The behavior of perfect leader of the organization may structures all the components of the firms that may improve organizational performance.

Valdiserri and Wilson (2010) investigated leadership impact on FP in West Virginia. They found that transactional and transformational leadership mainly contribute to organization success. They found a moderate correlation between transactional and TL and FP and a strong correlation between transactional and TL and profitability. They also stated that both transactional and TL can produce a positive atmosphere, encourage followers to perform their best. Leaders who possess the attributes of TL and TRL have contributed to the organizational performance. To improve firm performance, the leaders of small businesses develop and sustain a good leadership behavior in their respective organizations (Hernez-Broome & Hughes, 2004).

Chen (2004) also studied the effect of leadership and culture on firm performance in Taiwan by taking a sample of 749 respondents from SMEs. The study found that top management commitment and good leadership is essential for organizational success. He further concluded that transformational leadership is important for organizational performance because such leader promote innovation and creativity in the organization.

Yang (2008) argued that various leadership behaviors may affect firm performance differently. In line with the above statement, the same results were found in Chile SMEs (Pedraja-rejas *et al.*, 2006). They concluded that TL is the most dominant style of leadership.

Ling *et al.*, (2008) studied the impact of TL behavior on FP by taking 121 CEOs from small and medium enterprises. They argued that SMES play significant role in providing a setting which is advantageous to all and particularly for CEOs which possess transformational

leadership style. These CEOs play vital role in enhancing firm performance. The reason they argued that the CEO of SMEs is more powerful than those of large organizations and thus they can empower their followers. The CEOs of SMEs have the potential for establishing high expectations and instilling individual commitment. Hence, the most significant and vital role of transformational leadership is evident in potential and task oriented environment of the SMEs. The above arguments were supported by the study finding as well as they found a positive and significant relationship between CEO TL and FP. Ling *et al.*, (2008) argued that transformational CEOs influenced accounting and traditional measures of performance by encouraging novel thinking in their subordinates and closely observe to implement firm's strategy.

Behery (2008) investigated the impact of knowledge sharing behavior and transactional and TL behavior on firm performance in UAE business environment. To measure leadership a questionnaire developed by Bass and Avolio (1985) called MLQ was used for the study. The study found that both transactional and TL style have significant association with FP. The study also found that knowledge sharing behavior is significantly related with firm performance. Geyer and Steyrer (1998) also studied the impact of leadership styles and bank performance. They found that transformational and transactional leadership is correlated with firm objective performance. They also found that individualized consideration dimension of transformational leadership has insignificant relation with long term performance of Australian banks.

Ihua (2009) conducted a comparative study for the purpose to find out key failure factors of UK and Nigeria SMEs. The study found that lack of leadership and poor management are the main factors of failure for SMEs operating in UK. While in case of Nigeria the main factors for failure of SMEs are inadequate infrastructure and poor economic conditions. Due to a small sample size of only 45 questionnaires and two interviews, from both countries were selected. Based on such a small sample size one may not generalize the results of their study. UK policy makers give more attention to these internal factors to improve SMEs performance. They suggested Nigerian government to improve infrastructure and address difficult economic conditions which create the main cause for SMEs growth.

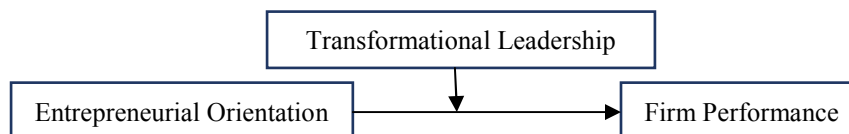


Figure 1: Theoretical Framework

Hypotheses of the Study

H₁: EO is significantly related with firm performance

H₂: Transformational leadership moderates the significant relationship between EO and firm performance

Research Method

To answer the research questions and to achieve the objectives of the study and to test and check hypothesis of the current research study, the data were collected through structured questionnaires. The population of this study is all the top managers and owners of the SMEs, which operating in KPK, Pakistan. There are total of 2800 SMEs operating in KPK. But it is difficult for the researcher to collect data from the whole population, thus the sampling frame of the current study consists only three districts namely Nowshera, Peshawar and Charsadda districts of KPK. There are 739 SMEs operating in these three districts of KPK. The study used convenience sampling technique. The study selected a sample size of 254 employees of the selected SMEs. The employees are either top managers or owners of the firms. The purpose of this research is hypothesis testing. The nature of this research is cross-sectional, and descriptive.

A total of 254 questionnaires were distributed among the study respondents. Out of which 212 questionnaires were received back with a response rate of 84.46%. However, some questionnaires were found incomplete or incorrect and thus discarded from the study. Final analysis was carried on 193 questionnaires.

Table 1 Questionnaire Particulars

	No. of Questionnaires	Percentage
Total Distributed Questionnaires	254	100%
Received Back Questionnaires	212	83.46%
Incomplete Questionnaires	19	8.96%
Total Correct Questionnaires	193	75.98%

The study collected the data from top level managers and owners of SMEs operated in KPK, Pakistan. The most important and primary source of data was individual top managers / owners of SMEs. A structured close ended instrument was selected and used having a five point Likert scale ranging from 1 “strongly disagree” to 5 “strongly agree”. Entrepreneurial orientation has 18 questions in which 7 belong to innovativeness, 5 belong to risk attitudes and 6 belong to pro activeness. Firm performance has 8 questions from which 4 belong to growth and 4 belong to profitability. Transformational leadership has 12 questions,

access to financial capital has 7 questions and environmental factors have 10 questions. For entrepreneurial orientation questionnaire help is taken from Covin and Slevin (1989). For firm performance help is taken from Koe (2013). To develop transformational leadership questionnaire help is taken from Bass and Avolio (2004).

Results

This section reports the detail results of the study. The reliability of the research instrument was checked and found it satisfactory. The detail of the reliability analysis was reported in the below table.

Table 2: Alpha Reliability Coefficient

Scale	N	Alpha Coefficient
Firm Performance	8	.78
Transformational Leadership	12	.81
Entrepreneurial Orientation	18	.90

Table 2 illustrates result of Cronbach alpha coefficient value of firm performance, transformational leadership and entrepreneurial orientation. It was found that research instrument was reliable as its value is .78, .81, and .90 respectively which shows highly internal consistency among items of the research questionnaire. Thus, the instrument used by the current study is reliable. The study also checked the instrument validity by applying KMO and Bartlett's test and factor analysis. The details of these tests are given in the below tables.

Table 3: KMO and Bartlett's Test of EO

Kaiser-Meyer-Olkin Measure of Sampling Adequacy	.854
Approx. Chi-Square	760.376
Bartlett's Test of Sphericity	21
Sig.	.000

The results of Bartlett's and KMO tests of EO scale are reported in the above table. As shown, KMO value is .854 which is well above the required value of .6 as stated earlier. Thus, KMO test confirms that we should conduct factor analysis. Similarly, the value of Bartlett's test is significant ($p > .05$) which further confirms the phenomena. Bartlett's test tells about the association among the items of the instrument or variables. Significant Bartlett's test indicates that we accept the alternate hypothesis and reject the null hypothesis.

*Table 4: Component Matrix of Innovativeness***Component 1**

My company has introduced many new products and services in the market.	.840
I give due importance to Research & Development, technological leadership and innovations in my company.	.838
Our firm motivates employees for creative work and new experimentation.	.823
Our firm emphasizes on utilizing new technology.	.835
Our firm relay on designing new methods and procedures of production rather than adapting solution	.743
In my company changes in products is minor in nature	.821
Changes in the production or services usually not planned in our firm	.524
My organization take direct action to respond competitor	.826
My company seldom introduce new products or ideas in competition	.838
It's my hobby to conduct events related to my job	.780
Our firm have a strong tendency to 'follow the leader' in introducing new products or ideas.	.714
our organization seriously take actions against competitor actions	.721
We are always on the watch out for businesses that can be acquired	.513
My firm adopts a cautious "wait-and-see" strategy in uncertain situation	.658
My organization take risk to achieve high profit	.769
Sometime my organization take pro-active action to get opportunities	.818
Manager of our firm lead the team in introducing novel product or ideas	.811
Our organization encourage us to adopt new ideas with some calculated risk	.501

Component matrix or factor loadings of each statement of EO are reported in the above table. The instrument of EO contains 18 items. All items have a factor loading value greater than .4, and thus remain in the instrument. The acceptable factor loading value for each item is .4 as suggested by previous researchers (Field, 2009). As shown all the values are well above than the acceptable range. The value of factor loading near to 1 is highly acceptable and good one. Here, in this case accept one item having a factor loading value of .501, and all the remaining values are near to 1, thus, represent the good case.

Regression Analysis*Table 5 a: Entrepreneurial Orientation and Firm Performance*

Model	R	R ²	Adjusted R ²	SE	Durbin-Watson
1	.696	.484	.482	3.45	1.82

Predictor: (constant), Entrepreneurial Orientation

Dependent Variable: Firm Performance

Table 5a illustrates model summary result of entrepreneurial orientation and firm performance of regression analysis. *R* value is .696 and *R*² value is .484. This *R*² indicates that there is 48.4% variance in our dependent variable (Firm Performance) as a result of our independent variable

(Entrepreneurial Orientation). The DW value is lies in the acceptable range which is between 1.5 to 2.5. The DW value is 1.82, thus data have no problem of autocorrelation.

Table 5 b: ANOVA

		Sum of Square	df	Mean Square	F	p
1	Regression	2142.78	1			
	Residual	2282.49	191	2142.78		
	Total	4425.28	192	11.95	179.30	.00

Dependent Variable: Firm Performance

Predictor: (constant), Entrepreneurial Orientation

Table 5b describes ANOVA result of entrepreneurial orientation and firm performance. Total sum of square value is 4425.28 and value of degree of freedom (df) is 192. *F* value is 179.30. *P* value is also significant as $p < .05$. It also shows model fitness.

Table 5 c: Coefficient

Model	Unstandardized Coefficient		Standardized Coefficient		
	B	Std. Error	Beta	t	Sig
(Constant)	11.69	1.21		9.65	.00
EP	.267	.020	.696	13.39	.00

Table 5c indicates result of egression coefficient for entrepreneurial orientation and firm performance. It is evident from the table that *t*-value is 13.39. This *t*-value is significant at .05 level of confidence. The coefficient (B) value of entrepreneurial orientation is .267. This positive value means that if entrepreneurial orientation increases, it will positively and significantly increase firm performance. *P*-value is less than .05. It means that EO is significantly related with FP.

Moderation Results

Moderation Effect of Transformational Leadership on the Relationship between EO and Firm Performance

Table 6a: Model Summary

R	R ²	MSE	F	df1	df2	p
.7	.5	3.5	120.8	3.0	189.0	.00

Table 6a shows model summary of the moderating variable. Moderating variable enters in the relationship of independent variable and dependent variable and affecting it. Table shows that *R*-square value is .5. It means

that there is 50% variance in dependent variable because of independent variable. *F*-statistic value is 120.8.

Table 6b: Coefficient

Model	coeff	se	t	p	LLCI	ULCI
Constant	28.8	.2	157.6	.0	28.4	29.1
TL	.1	.0	2.3	.0	.0	.2
EO	.1	.0	7.4	.0	.2	.1
Int_1	.0	.0	3.1	.0	.0	.0

Table 6b illustrate result of moderation effect of transformational leadership style on the relationship between EO and firm performance. In the above table, last row shows the moderating result of the interaction term of transformational leadership style. Table shows that transformational leadership style is positively and significantly related to EO because *p* value is .00. The *p* value of interaction term is .0 which is less than .05. It shows that moderating variable significantly moderate relationship between EO and FP. Thus, this result confirms that TL significantly moderate relationship of EO with FP.

Discussion

The current study investigated the relationship of EO and FP through moderation TL in small and medium enterprises of Pakistan. The cause and effect relationship regression analysis was conducted between the study independent variable (s) and dependent variable (s). The study found that EO is positively and significantly related with FP. One possible explanation for such a result as that entrepreneur bring innovation in their products, add new features, tests, packaging, improve quality of the existing products, and shaped the products in new and attractive style that may attract the customers to purchase, thus, the overall sales of the firms increases which may improve their performance positively. Another plausible justification of such result is that entrepreneurial used state of the art technology which may improve product quality as well as reduce cost which ultimately improve firm performance via sales.

The results of the current study are in line with previous studies. Wang (2008) found that EO is significantly related with FP. The same results were found by Wiklund and Shepherd (2005); Lumpkin and Dess, (2001, 1996); Lyon *et al.*, (2000); Miller, (1993). However, some studies also found that there is no direct or significant relationship between EO and FP. Rauch *et al.*, (2009) concluded that there is no direct relationship between EO and FP. Similarly, Slater and Narver (2000) were failed to find out positive and significant association between EO and FP. Covin

et al., (1994) there is no significant relationship has been found between strategic orientation or EO and firm performance. Naldiet *al.*, (2007) concluded that EO dimensions may varies in different culture that may affect the overall results. Furthermore, entrepreneurial orientation (EO) did not improve the SMEs firm performance (Lee *et al.*, 2001).

The study in hand also check the moderating effect of TL style on the relationship between EO and FP. The study found that EO and FP relation was moderated by TL. The study findings are in line with previous studies like Hayat and Riaz (2011), Matzleret *al.*, (2008). Likewise, Matzleret *al.*, (2008), Ling *et al.*, (2008) also concluded that TL style is essential for SMEs performance. Engelenet *al.*, (2015) also found that TL play a moderating role on the relationship between EO and firm performance. Arhamet *al.*, (2011, 2013) concluded that TL is required for SMEs to perform best. The same results were also found by Chen (2004), Arnold *et al.*, (2001), Stewart (1989), Soriano and Martinez (2007), Wang and Poutziouris (2010), Kang *et al.*, (2010), Bhattacharyya (2006) and Todorovicand Schlosser, (2007). However, studies also found no relationship between TL and FP like Agleet *al.*, (2006); Ensley *et al.*, (2006); Waldman *et al.*, (2001).

Conclusion and Recommendations

The current study highlights the relationship of EO and firm performance in greater details. The study used TL as a possible moderator in order to further nourish the relationship between EO and FP. As stated earlier the study found positive and significant relationship between EO and FP. Thus, it is suggested that managers or owners of the SMEs must take initiatives to improve their organizations performance by motivating and encouraging entrepreneur activities. Owners and managers of SMEs should also encourage innovation and creativity in their respective organizations. They should create such environment that facilitate creativity because now a day's survival of organizations will depend on product innovation. Managers and owners of SMEs adopt state of the art technology and recruit skilled and creative employees to bring innovative products and services in the market. They should apply and encourage transformational leadership style because such leadership style may also effect individual as well as group or organizational creativity (Khattak *et al.*, 2017). The leaders, managers or the owners of SMEs develop strong links with financial institutions to finance their organizations.

Limitations and Future Research Directions

Although the gives important contributions to the field of entrepreneurial orientation and firm performance literature but it has some limitations as

well. First, the study used convenience sampling technique which may affect the generalizability of the results because of self-response biases. To generalize the results researchers may study the same phenomena by selecting the respondents through some probability techniques like simple random sampling, stratified random sampling etc.

Second, the sample size and sampling framework of the current study is comparatively small i.e. 193 from only three districts of KPK. In future researchers may replicate the same study by taking a large sample size and increase sampling framework to all over KPK or Pakistan.

Third, the current study based on self-reported data collecting from a single source. All measures of EO, firm performance, transformational leadership, access to financial capital and environmental factors were evaluated by the managers or the owners of the selected SMEs. In future researchers may use some other techniques to further clarify the relationship.

Fourth, the study evaluates firm performance on subjective measures. Such subjective measures may lead to performance evaluation bias (Moers, 2005). In future researchers may evaluate firm performance by using some objective measures like accounting performance or improvement in share prices.

Fifth, the study used cross-sectional research design by collecting the data on one time. So, we can't draw causal inferences from such research. In future researchers may avoid this limitation by using longitudinal research design by collecting the data of both dependent and independent variable in two or more points of time.

Finally, the study used Pakistani context. In future researchers also repeated the same findings in other different countries especially in other developing countries and industry.

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