

## The Relationship between Transactional Leadership Style and SMEs Growth in the Top 100 SMEs in Kenya

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### Abstract

*The general objective of this study was to investigate the relationship between transactional leadership style and Small and Medium Enterprise growth in the top 100 SMEs in Kenya. This was a mixed method study targeting the KPMG top 100 SMEs of 2013. A causal research design was employed to investigate the relationship between the independent variable transactional leadership style with key constructs being contingent reward, Active management by- exception, and cohesion and team performance which all together had 16 items and the dependent variable SMEs growth whose constructs were workforce growth, sales growth, and return on assets with 15 items. Stratified proportionate random sampling and purposive sampling techniques were used to obtain a sample of 227 out of a target population of 553 CEOs and Managers. Data was collected using a closed ended questionnaire and a structured interview guide. Pearson's correlation, multiple regression and Pearson's chi-square techniques were used to analyse the data. The analysis indicated that transactional leadership style and SMEs growth had a strong positive and significant correlation ( $r = 0.702$ ,  $p = 0.007$ ), and a positive and significant relationship ( $\beta_1 = 0.128$ ,  $t = 1.470$ ,  $p > 0.023$ ). The study concluded that the effectiveness of transactional leadership style is dependent on the nature of the enterprise and recommended that where employees are hired on short term contracts to deliver on specific assignments, small and Medium enterprise leaders should adopt a transactional leadership style, in order to facilitate growth of their enterprises..*

**Keywords:** Leadership, Transactional leadership style, SMEs Growth.

### 1. Introduction

According to Penrose (1995) firm growth is the increase in certain parameters of the firm (e.g. employment, revenues, profits and assets). In any business venture, business growth is commonly used as a measure of success. Business growth is also a precondition for the achievement of other financial goals of business (Brush & Vanderwerf, 1992; Delmar, Davidson & Gartner, 2003). Phillips and Kirchoff (1989) argued that young firms that grow have twice the probability of survival than young non-growing firms; moreover, strong growth may reduce firm's profitability in the short run but profitability rises in the long run. This analogy is supported by Churchill and Lewis (1983) who developed a five stage model of growth of a business.

These stages are; existence, survival, success, and take-off and resource maturity. In each stage of development, a different set of factors is critical to the firm's survival and success. The business survival could be equated with a firm that has fully completed the transaction to stage-two organization in the five stages of small business growth. There is empirical evidence that not all SMEs complete the five stages of business growth since some collapse while in the first stage.

For instance, most of the SMEs in Kenya do not move from the first stage (existence) to other stages such as survival, success, take off and resource maturity (Olawale & Garwe, 2010). Leadership has been described as a trait as well as a process (Northouse, 2015; Daft, 2011; Achua and Lussier, 2013).

Northouse (2015) citing Jago (1982) observes that the trait viewpoint conceptualizes leadership as a property or a set of properties possessed in varying degrees by different people while the process viewpoint suggests that leadership is a phenomenon that reside in the context of the interactions between leaders and followers and makes leadership available to everyone and can, therefore, be observed in leaders behaviours' and as such can be learnt. Leadership has been defined in terms of emergence (exerting influence or attaining high status in social systems), effectiveness (evaluation of Managers or how managers affect employee satisfaction, motivation and unit results) or as a process (aligning group members to focus on group goals). Uchenwamgbe (2013) citing Stoner and Gilbert (2001) stressed that an understanding of leadership is important to small and medium scale enterprises.

Leadership style is the relatively consistent pattern of behaviour that characterises a leader (Dubrin, 2001). Harper (2012) observes that theoretical examination of successful leadership practices that have influenced the world have revealed leadership style as an indicator of organisational success as it relates to follower influence. More so, several scholars have alluded that leadership styles vary according to the character of the leader and the situation of the firm or enterprise. And therefore, leadership style can be described as the kind of behaviour and ability that the manager has, which enables him to interact with the employees to achieve goals (Hesham, 2010). Transactional leadership style involves an exchange process between leader and follower, and uses rewards and punishment to motivate the team or employees (Northouse, 2015).

## **2.0 Literature Review**

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 (Lo, Ramayah, & Min, 2010); accordingly, the leader-member exchange is dependent upon rewards. The leaders will offer the rewards based on what was discussed in the employee's 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 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, Schrieshem and Williams (1999) define transactional leadership as an exchange process in which the leader provides rewards in return for the subordinate's effort and performance.

Transactional leadership, present in many businesses, may help clarify everyone's roles and responsibilities, and because team members are judged on performance, ambitious people motivated by external rewards often thrive (Samaitan, 2014). Some of its measures can, however, also de-motivate employees. For example, it doesn't offer much in terms of inspiration, to motivate people to go beyond the basics; therefore employees might get complacent and develop a tendency to achieve minimal expectations that only would help them avoid penalties (Schein, 2010).

Transactional leaders are seen as those who guide or motivate their followers in the direction of established goals by clarifying role and task requirement's (Robbins, 2003). Guardia (2007) found that transactional leadership is the elementary factor to organizational success at both team and individual level and that transactional leadership behaviour has vital relation with the group and individual performance factors. In accordance with Boedker et al. (2011), transactional leadership is considered to be an elementary factor to organizational success at both team and individual level. The efficient achievement of organizational objectives is by linking job performance to valued rewards and by ensuring that employees have the resources they need to get the job done (Obiwuru, Okwu, Akpa, and Nwankwere, 2011).

Howell and Hall-Merenda (1999) concluded that transactional leadership positively predicts employees' performance. In Russia, Elenkov (2002) initiated a study to investigate the impact of leadership on organizational performance and found that Russian managers who practice transactional leadership behaviour have positive impact on organizational performance as well as innovation. In a military setting, which is characterized as an organization operating in an unstable environment, Bass, Avolio, Jung and Berson (2003) concluded that platoon leaders who demonstrate transactional leadership characteristics increase the performance of the platoon members. Yang (2008) also reported a positive relationship between transactional leadership and business performance in SMEs in Taiwan.

However, this study utilized DEMANTEL approach in testing the association between leadership style and business performance by measuring employee engagement, however, our study will rely on regression analysis. Further, the study was conducted in a developed country therefore; the results may not be significant in a developing economy. Guest (2010) in a study on the relationship between transactional leadership and employee engagement noted that relations between managers and employees have a significant effect on productivity. Bad relations often lead to violations of psychological contract, low levels of fulfillment of perceived promises and commitments made by the organization. Quality supervision requires one to have good leadership qualities. Bosses are expected to be in tune with their people; on the contrary being in tune with the personnel is not a guarantee of their productivity levels as indicated in the study by Bass et al, (2003); the above study by Guest (2010) however, did not investigate the relationship between the contingent reward systems and enterprise growth.

Barrow (2006) studied the influence of leadership on the subordinate behavior and found that subordinate's performance was a strong causal force in the determination of the behavior a leader utilized. He indicated that low-performing subordinates caused the leader to behave much more punitively, more autocratically, less considerably and to push for more production, whereas high performance from the subordinates resulted in the leader being more considerate towards the workers, less punitive, less autocratic, and somewhat less task emphasis oriented. The results of the above study indicated that the complexity of the task significantly influenced leader's task emphasis orientation. The high complexity tasks caused the leader to utilize more supportive and considerate styles. It was also found that when a worker's performance changed from low to high, the leader became increasingly supportive and considerate of his style, much more so than when performance was declining.

However, a study undertaken by Aziz, Abdullah, and Tajudin (2013) on the effect of Leadership styles on the business performance of SMEs in Malaysia revealed that both transactional and transformational leadership were positively and significantly related to performance though transactional was highly related compared to transformational. This study however, relied on secondary data to derive the association between the leadership styles and the performance of SME's in Malaysia. Similarly, findings by a study conducted by Koech and Namusonge (2012) in Kenya among state-owned corporations showed that both transformational and transactional leadership styles were positively related to performance, though transactional had a higher correlation. This study however, was conducted among government owned companies thus the study findings may not be applicable to SME's operating in a more complex market. This, however, was not the case in Nigeria where a study conducted within small businesses revealed that transactional leadership had a significant positive effect on performance while transformational had a positive but insignificant relationship to performance (Obiwuru *et al*, 2011); however, this study relied on qualitative data to measure business performance, while this current study utilized both qualitative and quantitative data to investigate the relationship between the research variables.

Valdiserri and Wilson (2010), who examined the impact of leadership behaviour on the profitability and organizational success of 48 small businesses in West Virginia and Pennsylvania, concluded that transformational and transactional leadership behaviour contributes to the profitability and success of small businesses. There was a strong correlation between transformational and transactional leadership and profitability and a moderate correlation between transformational and transactional leadership and organizational performance. They concluded that transformational and transactional leaders are able to produce a positive atmosphere, and inspire and motivate their employees to perform at a higher level. Leaders with transformational and transactional leadership attribute contribute to good performance of the firm by demonstrating respect, integrity and direction to all individuals in the firm. This study relied on a case study review of the companies; however, the current study employed a causal research design. An earlier study by Hernez-Broome and Hughes (2004) suggested that leaders of small businesses need to develop a good understanding of forms of leadership behaviours in order to improve organizational performance. This study however was not able to investigate the relationship between other leadership behaviors and the performance of organizations.

Amirul and Daud (2012) investigated the relationship between transactional leadership and leadership outcomes in 325 companies in Malaysia. The results indicated that transactional leadership is positively related to performance outcomes. This study however, measured performance of the firm using extra effort, effectiveness and satisfaction as indicators for firm performance; the current study however, measured firm growth using sales growth, return on assets and workforce growth as the dependent variable dimensions.

Aziz, Mahmood, Abdullah, & Tajudin (2013) found a positive significant relationship between transactional leadership and performance in a study on SMEs in the services sector. However, the current study targeted firms in all sectors of the economy as long as they fall within the Top 100 SME's in Kenya. In a study, on the influence of the leadership style and Entrepreneurship Orientation (EO) of top-level managers of SMEs on business performance Hayat and Riaz (2011) posited that effective leaders are needed in the rapidly changing global environment that increases the intensities of business. Therefore, it is important for the leaders of SMEs to fully understand the rapidly changing business environment and to adopt the appropriate leadership styles to improve business performance. The study confirmed that there is a positive relationship between the transformational and transactional leadership styles of the leaders of SMEs and their performance. However, this study targeted only top-level managers within the firm and did not distinguish the extent of the relationship between the leadership style and performance of firms independent of the entrepreneurship orientation. This study therefore, sought to analyze the relationship between laissez-faire leadership style and SMEs growth.

### **3.0 Methodology**

This study adopted a mixed methodology where both quantitative and qualitative research methods were used. Stratified random sampling was applied to obtain a sample size of 227 respondents from a population of 553 CEOs and Managers. Purposive sampling was used to select a sample size of 25 respondents for the qualitative study. A structured questionnaire was used to collect the quantitative data while an interview guide was used to collect the qualitative data. The dependent variable was measured with 15 items while the independent variable was measured with 16 items. The measures involved likert scale type of questions with responses ranging from 1=strongly disagree to 5=strongly agree. Data was analyzed using descriptive statistics and inferential statistics for the quantitative data and thematic analysis for the qualitative data.

### **4.0 Findings**

#### **Transactional Leadership and SMEs Growth**

Under transactional leadership style, the specific constructs measured were contingent reward, active management – by- exception; group cohesion and team performance. Each construct measured the extent to which this leadership style is practiced in the SMEs and as such leading to firm growth. These findings are presented in Table 4.1As illustrated in table 4.1 findings reveal that the management (leaders) always explains to the employees how to attain and maintain rewards for the success of the organization as shown by the mean score of 4.3883 and a standard deviation of 0.93264. The managers also agreed that employees are punished for poor performance as shown by the mean score of 3.9947 and a standard deviation of 1.18591. Further, employees are judged on their personal results (mean = 4.2660, STD dev. = 1.09618). The managers also provide the direction to the employees in regard to what needs to be done if they are to be rewarded as indicated by the mean score of 4.4309 with a standard deviation of 1.03444.

Findings also illustrate that the managers provide the employees with new ways of solving organization problems as shown by the mean score of 4.3511 which is in the interval of a strong extent of agreement and a standard deviation of 0.98336. The management as well explains to the employees which behaviors will lead to rewards.

This is according to the score obtained of 4.3138 and a standard deviation of 1.14342. The respondents as well strongly agreed that the company leaders monitor follower performance, provide instructions, and clarify procedures, monitor closely the employees for efficiency as well as address problems and concerns that arise at the workplace. This aspects obtained mean scores all in the interval of 4.1 – 5 for a strong extent of agreement.

According to the findings also, the management of the top 100 SMEs express satisfaction when the employee meets their performance expectations. This had a mean score of 4.0372 and a standard deviation of 0.89185. The respondents also agreed that the management of the top 100 SMEs is proud to be committed to loyal employees, as well that they care less much what others do unless the work is absolutely essential. Leaders also indicated that they must assist employees in accomplishing their tasks with a mean score of 3.6915 and a standard deviation of 1.47729. However, the respondents neither agreed nor disagreed that the management of the organizations provide employees with assistance in exchange for their efforts or that they met the employees often for feedback and discussions. These aspects had mean scores of 2.90961 (0.22248) and 2.9362 (1.57391) which were all under the neutral range.

### **Correlation between Transactional Leadership and SMEs Growth**

Results on the correlation between transactional leadership style and organization SMEs growth are as presented in Table 4.2. The table gives the correlation coefficient and the significance value (p-value) where the test was conducted at the 5% level of significance.

### **Hypothesis Testing**

Testing the significance of the relationship between transactional leadership style and SMEs growth, chi-square test was conducted at the 5% level of significant and 95 confidence interval. The hypothesized relationship between transformational leadership and SMEs growth was as follows;

**H<sub>0</sub>:** There is no significant relationship between the transactional leadership style and SMEs growth in the top 100 SMEs in Kenya.

The study findings in table 4.3 indicate the chi-square test results for the relationship between transactional leadership and SMEs growth. These results give evidence of existence of a significant relationship between transactional leadership and SMEs growth ( $\chi^2=43.432$ ; d. f. = 47; P= 0.023 (P<0.05). Based on this, the study rejected the null hypothesis and accepted the alternative hypothesis since the p-value was less than 0.025 testing at 5% significance level two tailed test. Therefore, the study concludes that there is a statistically significant relationship between the transactional leadership style and SMEs growth in Kenya.

### **Interview Responses on Transactional Leadership style and SMEs Growth**

As simply put by the respondents, a transactional leader (manager) will always instruct (command) employees on what to do. These leaders will never allow the employees to give views on how a given job should be done regardless of their ability to execute the assignment. The study showed that leaders use transactional leadership style with the aim of achieving organizational goals. Under transactional leadership, the policies and procedures give clear guide lines to subordinates.

The managers felt that transactional type of leadership style is suitable for organizations with routine tasks that require less training and experience. One of the managers who participated in the interview gave the following information concerning transactional leadership and growth;

*“In an organization where transactional leaders are the managers, employees and staffs in the lower level of management follow a given and clear chain of operational process and commands. The employees are required to do exactly what their manager instructs them to do to complete their daily tasks.”* He added that; *“If an employee has signed a contract with the company, the rules and policies stipulate the penalties for not following the regulations that are set by the company guiding their contact and operation. In cases where employees have to negotiate for a position in the company where this leadership style is adopted, they have to acknowledge that their managers have the full authority over their work and output.”*

The responses showed that transactional leadership style is very effective in improving an organization's performance in case of an uncertain environment and to achieve competitive advantage in the organizations. In this kind of leadership, the leaders exhibit certain behaviors that accelerate the employees' level of innovative thinking. Through this employees' performance level is improved as well as giving more organizational innovation, and consequently organizational performance and growth.

To improve performance, transactional leaders empower employees by providing sufficient autonomy to decide the way to perform job activities, promote organizational learning, and support employees to utilize all the available resources required to improve creativity.

A discussion with one of the managers had the following;

*“A transactional leadership style from my point of view is one of the leadership styles that positively generates favorable changes and builds value in each of the employees”.*

Transactional leadership style was seen to not only give rewards and benefits to the employees but also reducing the pressure in the work as well as increasing the employees' moral and ethical behavior. Through this, employees are more satisfied with their work and this could also improve the employee productivity. With better productivity of employees, organizations are better placed to harness growth capabilities.

## **5.0 Discussions and Recommendations**

### **Transactional leadership style and SMEs growth**

The study findings supported the assumption that transactional leadership style, through the contingent reward based on a bargaining exchange system in which the subordinates and the leader agreed together to accomplish the organizational goals while the leader's task was to provide rewards for what has been accomplished. Leaders articulate their expectations and offer recognition when goals are achieved. Through the contingent reward aspect, the employees are able to create more sales and work harder to achieve even higher sales; these findings support the findings of Guest (2010) whose study noted that relations between managers and employees have a significant effect on productivity of an organization.

Findings as well indicated that, transactional leadership style implies closely monitoring employees for mistakes and errors and then take corrective action as quickly as needed. This may influence growth of sales since employees are rewarded for exceeding expectation. The transactional leader and the employee are in a transactional contract or agreement therefore, the leader and the employee get to focus on similar goals for the organization thereby ensuring that they drive for profitability and there is a possibility for growth. The leader also closely monitors work in general and each individual's performance. From the findings also, there is a positive and significant correlation between transactional leadership and growth. This proves that the transactional leadership style maybe instrumental and important in the organization as there is a positive relationship between the mode of leadership and the return to assets. These findings were similar to the findings of Chaudhry and Javed, (2012) in their study that showed a significant impact of transactional leadership on performance of employees.

According to the findings on the relationship between transactional leadership and the growth of SMEs in terms of the factors that are instrumental in measuring the company's growth, transactional leadership style has a significant correlation SMEs growth at the 5% level of significance. These findings prove the point that, the constructs contingent reward, active management by exception, and group cohesion and team performance are vital for growth of an organization. These results are similar to the findings of Valdiserri and Wilson (2010) whose study found that transactional leaders are able to produce a positive atmosphere, and inspire and motivate their employees to perform at a higher level.

These findings strongly resonate with other findings that sought to ascertain that the management (leaders) in SMEs always explains to the employees how to attain and maintain rewards for the success of the organization. The study findings also established that employees are punished for poor performance as well as judged on their personal results. The managers also provide the direction to the employees of what needs to be done if they are to be rewarded. These behaviors lead to increased productivity and performance of the organization as shown from the findings. These findings are in agreement with a study done by Barrow (2006) whose findings showed that subordinate's performance was determined by the behavior a leader utilized.

Transactional leadership maybe beneficial in contract based jobs where employees are hired on short contracts to deliver on specific assignments. However, where employees are engaged on a long term basis and the enterprise requires that employees are innovative and creative transactional leadership style may not facilitate growth as this type of leadership does not avail employees that kind of space. This style of leadership also assumes that employees are motivated by reward yet employees may also join an enterprise to acquire personal growth and skill development, therefore, this style of leadership may lead to employee turnover and resultantly lead to the need to continuously employ which is an expensive venture. However, the study findings did not agree with the findings by Yanney (2014) who found that transactional leadership style did not have a significant effect on organizational performance in small scale manufacturing enterprises in Ghana, similarly Hayat and Riaz (2011) found that transactional leadership style was not a good predictor of firm performance in a study carried out in 100 SMEs in Punjab, Pakistan.

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## Appendix

**Table 4.1 Transactional Leadership Style and SMEs Growth**

	Mean	Std. Deviation
I explain to the employees how to attain and maintain rewards for the success of the organization.	4.3883	.93264
I punish employees for poor performance.	3.9947	1.18591
I judge the employees on their personal results.	4.2660	1.09618
I provide the direction to the employees of what needs to be done to do if they are to be rewarded.	4.4309	1.03444
I provide the employees with new ways of solving organization problems.	4.3511	.98336
I explain to the employees which behaviors will lead to rewards.	4.3138	1.14342
I monitor follower performance.	4.3617	1.02744
I provide instructions and clarify procedures	4.3777	1.11908
I closely monitor the employees for efficiency.	4.5372	1.07161
I address problems and concerns that arise at the workplace.	4.5213	.86808
I express satisfaction when the employee meets their performance expectations.	4.0372	.89185
I am proud to be committed with loyal employees.	3.4574	1.77122
I care less much what others do unless the work is absolutely essential.	3.6755	1.60415
Leaders must assist employees in accomplishing their tasks.	3.6915	1.47729
I provide employees with assistance in exchange for their efforts	2.9096	1.22248
I meet the employees often for feedback and discussions.	2.9362	1.57391

**Table 4.2 Correlation analysis between Transactional leadership Style and SMEs Growth**

		Transactional Leadership	SMEs growth
Transactional leadership	Pearson Correlation	1	
	Sig. (2-tailed)		
SMEs growth	Pearson Correlation	.702**	1
	Sig. (2-tailed)	.007	

\*\* . Correlation is significant at the 0.01 level (2-tailed).

**Table 4.3 Chi-Square Tests between Transactional Leadership and SMEs growth**

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	43.432 <sup>a</sup>	47	.023
Likelihood Ratio	40.419	47	.019
Linear-by-Linear Association	.501	1	.042
N of Valid Cases	188		

a. 50 cells (78.1%) have expected count less than 5. The minimum expected count is .02.