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Will Transformational Leadership Style Increase Organizational Performance in MSMEs?

A Systematic Literature Review

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ABSTRACT

To achieve MSME innovation and performance, leadership is crucial. Burns's divided leadership into transformational and transactional styles is one of the key theories of leadership. The purpose of this essay is to pinpoint the best leadership philosophies for enhancing SME organizational performance. This study included a methodical review of the literature. According to the study's findings, transformational leadership is thought to enhance organizational performance in SMEs. Contrarily, there is little evidence that the transactional leadership style improves organizational performance in SMEs. In conclusion, transformational leadership is more crucial than transactional leadership for enhancing MSME performance. These findings help MSME executives develop transformational leadership, which is focused on the charisma of the leader.

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Introduction

One of the key factors influencing Indonesia's economic development is the presence of micro, small, and medium-sized enterprises (MSMEs). The following summarizes the

contribution of SMEs in 2017 as determined by information provided from the Ministry of Cooperatives and SMEs: 99.99% of business units, 97.02% of the workforce, 60% of the GDP, 14.17% of non-oil exports, and 58.18% of investment make up the country. This demonstrates how MSMEs can significantly boost economic growth. Instead, MSMEs continue to experience competitive constraints brought on by globalization; as a result, it is imperative to improve innovation and performance [1].

The necessity of leadership in attaining a competitive advantage over their rivals to enhance organizational performance is increased by the highly competitive and rapidly changing environment. The success or failure of an organization is largely determined by the effectiveness of its leadership [2]. In circumstances where the organization encounters numerous new difficulties and challenges, effective leadership can aid in improving organizational performance. Because they cannot recognize effective or ineffective leaders, SMEs experience issues with leadership styles that lower organizational performance, according to several studies [3].

The developing leadership paradigm has also drawn a lot of scholars and practitioners. According to Khanin [4], there are two different kinds of leadership: transformative and transactional. Its direct impact on MSME innovation and performance has also been the subject of numerous studies. Enough trust is built in followers by transactional leaders, who also assist them in finishing their assignments. They acknowledge the wants and needs of the followers, but they also explain how those wants and needs will be satisfied if the followers exhibit the anticipated behavior. Transactional leadership, meanwhile, can occasionally be rewarding and efficient. However, transactional leadership's impact is significantly increased by transformational leadership [5]. Transactional leadership is viewed as achieving the expected results with minimal likelihood due to inefficiency and a variety of other factors.

Even though there has been a lot of research on leadership, very few studies have examined the best leadership style for SME organizational performance. According to the theory known as the resource-based view (RBV), a company's performance is influenced by its strategic assets, such as an inventive organizational culture [6]. MSMEs must effectively utilize their potential while also exhibiting good leadership if they are to improve their performance and creativity. The SMEs examined in this study are from a variety of nations, including Vietnam, Malaysia, Indonesia, and Turkey. Consequently, the goal of this study is to determine which leadership style may best be applied to enhance organizational performance in SMEs.

Literature Review

A. Leadership

A leader is someone who has purposeful influence over the behavior of others [7]. Leadership is the practice of directing the behavior of others to make them want to follow instructions to accomplish specific objectives. Here, it can be said that leadership action has started if someone has started trying to affect the conduct of others. It becomes apparent how important a leader's influence and power are. Similarly, leaders' contributions to resolving conflict [8] are the capacity to persuade, make decisions, and persuade others to follow suit. As leaders, we have the responsibility to realize a higher vision of the future, not to prove ourselves superior to others.

B. Transformasional Leadership

Transformational leaders are leaders who try to motivate their subordinates to excel beyond previous expectations and estimates. The essence of leadership is to facilitate individual development to realize their potential [9], transformational leaders are those who have a clear vision for the direction of their company, act ethically, inspire workers, meet the needs of each employee through training, coaching, and mentoring activities, and place a strong emphasis on personal development and actualization [10]. The contemporary transformational leadership approach allows a leader to accomplish organizational objectives while also assisting staff members, particularly members of the millennial generation, who enjoy challenges in achieving their objectives.

C. Organizational Performance

Performance is the result of an individual's or an organization's level of success in completing a task within a specific time frame. Performance can also be seen as a success in providing services to the community over time. Without management, or without effective management that can support institutional attempts to improve performance, improved performance cannot be realized. Each effort at performance management is meant to be used to support performance at its greatest level inside each organization [11]. Organizational performance is the sum of all work outputs attained by an organization to meet organizational goals, so an organization's performance may be gauged by how well it can accomplish goals based on predefined goals [12]. Organizational performance, as defined by Sobandi [13], is the sum of what an organization has accomplished over a predetermined period in terms of input, output, outcome, benefit, and effect.

D. Micro, Small, and Medium Enterprises

Based on UU/20/2008 Chapter III Article 5, UMKM (Micro, Small and Medium Enterprises) is an institution that can create jobs, distribute income, lift people out of poverty, and play a role in economic growth. The criteria or characteristics of Micro, Small, and Medium Enterprises are as Table 1.

Table 1. Criteria for Micro, Small, and Medium Enterprises

No.	Business	Criteria	
		Asset	Omset
1	Micro Business	Maximum 50 million	Maximum 300 million
2	Small Business	>50 million – 500 million	>300 million – 2,5 billion
3	Medium Business	>500 million – 10 million	>2,5 billion – 50 billion

Source: Law no. 20 of 2008

Based on the Law on MSMEs Article 1 Paragraph 1 that Micro Enterprises are defined as individual business entities and/or productive businesses owned by individuals who meet the criteria as stipulated in the law. UMKM stands for Micro, Small, and Medium Enterprises, which is a group of businesses with the largest number. In addition, the MSME group has proven to be able to withstand shocks from the economic crisis. So, the strengthening of micro, small, and medium-sized business groups involving many of these groups is very necessary. In Indonesia, MSMEs have a proportion of more than 99% of the total business actors in this country, with a workforce that is absorbed reaching 51.7% to 97.2%. This shows that the contribution of MSMEs is so great to economic growth in Indonesia. Therefore, further development and research on MSMEs in Indonesia needs to be done.

E. Transformational Leadership on Organizational Performance

The definition of transformational leadership is "leadership that has a clear vision for the future of the organization, behaves well, inspires employees, meets the needs of each employee through activities such as education, coaching, and mentoring, and focuses on growth and actualization" [10]. Applying transformational leadership in organizations can boost productivity. Transformational leadership, which is focused on charisma, intellectual stimulation, and individual consideration, is thought to be able to enhance organizational performance in MSMEs [14].

Research Methods

This study employs the PRISMA (Preferred Reporting Items for Systematic Review and Meta-analysis) method, which is a systematic approach that adheres to the right procedures for conducting research. A systematic review is a research technique that tries to assess, pinpoint, and analyze every outcome of prior studies that are connected and pertinent to a certain subject, specific research, or current occurrence of interest. Because the pertinent study findings were synthesized using a systematic review, the information provided is thorough and impartial. The steps listed in Fig. 1 make up a systematic literature review [15].

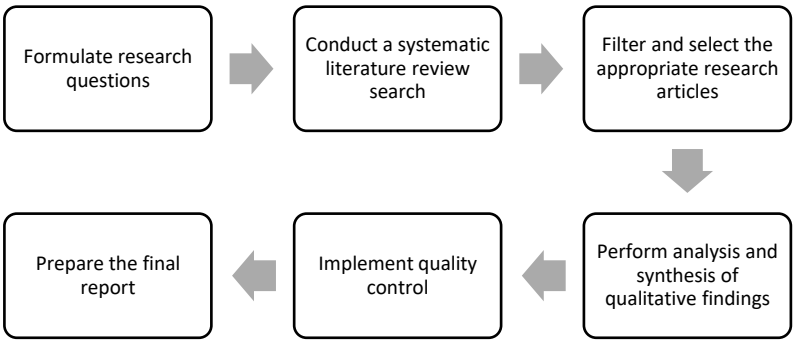


Fig. 1. Steps of the systematic literature review

To frame, examine, and deliver complete solutions in the form of a strategy model for MSMEs in enhancing organizational performance, a qualitative approach is used. Several articles were chosen as the major corpus after a thorough assessment of the literature. Based on several crucial points clarified by various authors, various scientific articles taken from specialized journals have assisted in developing the characterization of the most notable elements that characterize an effective leadership style in MSMEs [16]. This systematic review procedure consists of several steps: Compile Background and Objectives. Research Questions, Literature Search, Selection Criteria, Data Extraction Strategy, Assessing Quality of Primary Studies, and Data Synthesis [17].

Table 2. Research questions

ID	Research Questions	Motivation
RQ 1	Which journal is most significantly related to leadership style in SMEs?	Identification of the most significant journals on leadership styles in SMEs
RQ 2	What leadership style is most appropriate for SMEs?	Identification of the most appropriate leadership style applied to SMEs
RQ 3	Does innovation affect organizational performance?	Identify the effect of innovation on organizational performance
RQ 4	What research topics do leadership style researchers choose for SMEs?	Identification of research topics chosen by researchers on leadership styles for SMEs

This study was carried out between October 2022 and December 2022. With the help of the keywords leadership and SMEs, a search for research articles pertinent to the subject of this study was conducted. We use the databases Scopus, Google Scholar, Emerald Insight, Science Direct, and SAGE to choose papers. In order to preserve consistency in locating articles and prevent any bias, changes were made to the approach used to find them and the inclusion criteria were established.

Research in English (IC1), complete articles published in national and international journals for the 2015–2022 period, indexed in the database used, a focus on leadership style, transformational leadership, MSME, and publications between 2015–2022 are the inclusion

criteria used to direct the search and selection of articles (IC2). The sample is obtained, and the chosen articles are then examined to gather pertinent data. To gather knowledge emerging from the themes examined in the meta-synthesis, analysis and synthesis of data extracted from articles are made descriptively. As a result, meta-analysis can produce fresh ideas by synthesizing the information from various investigations, which can be used to repurpose certain qualitative research into new studies and advance scientific understanding [17].

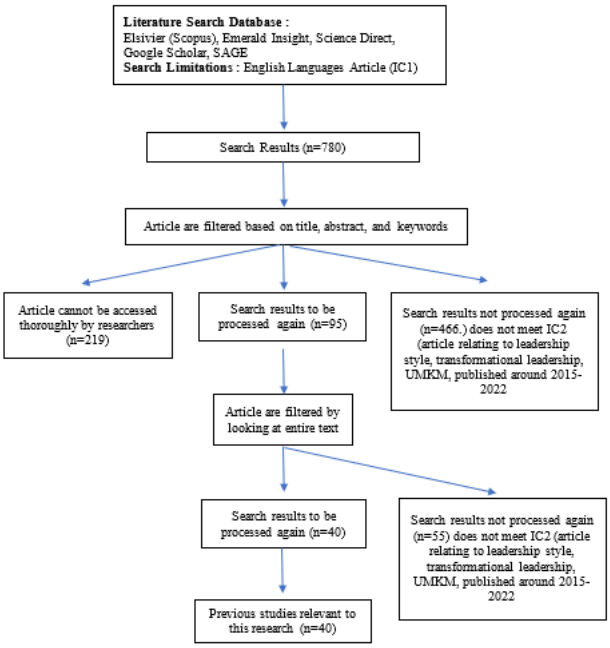


Fig. 2. Systematic Review of the Prism Flowchart

Results and Discussion

A. The Most Significant Journal of Leadership Style in SMEs

According to articles by Zainol et al. [18], transformational leadership both directly and indirectly has a favorable and considerable impact on SME innovation and performance. For SMEs in Indonesia to perform better, transformational leadership is more crucial than transactional leadership. These findings help SME leaders, who are focused on charm, intellectual stimulation, and individual concern, improve transformational leadership [14].

It is hypothesized that employee voice is a mediating mechanism through which transformational leadership influences process and product innovation in SMEs. This is based on the findings of research conducted by Rasheed et al. [19] aims to investigate the impact of transformational leadership on small and medium enterprise (SMEs) innovation through employee voice behavior.

The results of this study demonstrate that transformational leadership has a favorable impact on process and product innovation in SMEs, and that this relationship is mediated by

employees' voice behavior [19]. In contrast, the study by Ng & Kee [20] examined the effects of entrepreneurial skill, technical skill, and transformational leadership on business performance through innovation in owner-managed small and medium-sized firms (SMEs) [20].

According to Jardon & Martinez-Cobas [21], small enterprises play a crucial role in emerging nations. The study's findings support the notion that marketing prowess and transformative leadership are sources of competitive advantage in subsistence small businesses. Leaders specifically employ marketing skills to create a competitive advantage [21].

B. The Most Appropriate Leadership Style Applied To MSMEs

Based on the examination of various studies, it was determined that a transformational leadership style is the best one for MSMEs. A CEO with a transformational leadership style has a distinct vision for the direction of his company, acts morally, motivates staff [22], caters to their individual needs through activities like coaching and mentoring, and lays a heavy emphasis on development and actualization [10]. It has been scientifically demonstrated that this leadership style, which is characterized by charismatic, enthusiastic, and innovative leaders, can enhance organizational performance in SMEs. Additionally, it was claimed that MSMEs' failure was ultimately caused by ineffective leadership and management [23].

C. The Effect of Innovation on Organizational Performance

Vision, innovation, proactivity, and risk-taking are characteristics of entrepreneurial leadership that may be found in both leadership and entrepreneurship; their presence in organizational settings can have a favorable impact on the performance of SME businesses. In general, the two traits of entrepreneurial leadership that are most important for successful SME organizational performance are vision and creativity [18]. SME innovation and performance are positively and significantly impacted by transformational leadership, both directly and indirectly. These findings offer useful guidance for SME leaders to improve transformational leadership, which is focused on charisma, intellectual stimulation, and individual care [14].

D. Research Topics Selected by Researchers on Leadership Styles for SMEs

Based on the analysis of the articles that the researchers have done, the research topics chosen by the leadership style researchers for MSMEs are transformational leadership styles and transactional leadership styles. Previous research has studied many comparisons between the two. The traits of transformational leaders include having a distinct vision for the future of their business, acting morally, motivating staff, attending to each employee's needs through activities such as training, coaching, and mentoring, and placing a high emphasis on growth and actualization [10]. The current transformational leadership model enables a leader to achieve organizational goals while also helping members of millennial generation employees achieve their personal goals. This is because millennial generation employees are

individualistic and self-centered, and because they particularly enjoy challenges [24]. The core of transactional leadership is an agreement between a leader and their subordinates, where each side completes the transaction agreement to preserve their relationship through the bureaucratic system, rules, and regulations [25]. In the form of a system of acquired incentives, salaries, compensation commissions, and punishment if performance is subpar, transactional leadership emphasizes the reward and punishment system [10].

The study's findings demonstrate that both directly and indirectly, transformational leadership has a favorable and considerable impact on SME innovation and performance. The performance and innovation of SME's are positively and negligibly impacted by transactional leadership. However, it was discovered that transactional leadership had a favorable and considerable indirect impact on SME performance. In conclusion, transformational leadership is more crucial than transactional leadership for enhancing the performance of SMEs in Indonesia. These findings offer useful guidance for SME leaders to improve transformational leadership, which is focused on charisma, intellectual stimulation, and individual care [14].

Conclusion

For MSME performance to improve, transformational leadership is more crucial than transactional leadership. These results provide practical recommendations for enhancing transformational leadership, which emphasizes charisma and innovation for MSME leaders. According to the literature review that was conducted, transformational leadership is thought to enhance organizational performance in SMEs. Therefore, MSME executives must modify their leadership style to fit the organization they oversee to maximize organizational performance in line with expectations.

Conflict of Interest

The authors declare that there is no conflict of interest.

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