

# Leadership Styles and Performance of SMEs

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## Abstract

In this paper we raise a key question, “do leadership Styles affect performance levels of SMEs?” The objective of such a question is to examine the influence of different styles of leadership on the performance of small businesses. In a sample of small enterprise borrowers of a DFI we find that there exists a relationship between the style of leadership and performance.

**Keywords:** Affiliative, Authoritative, Coaching, Coercive, Continuum, Democratic, Pacesetter.

## 1.0 INTRODUCTION

This paper reviews and explores the different types of leadership styles and measures their effect on Performance of Small and Medium sized Enterprises (SMEs). In doing this we take a sample of SMEs that have borrowed from a named Development Finance Institution (DFI) and examine how the styles of these business leaders affects how well they do in business.

The meanings and interpretations of leadership can vary. According to Kanter (2004), “Leadership is not about the leader, it is about how he or she builds the confidence of everyone else”. “The very essence of all power to influence lies in getting the other person to participate”, (Overstreet, 2007). Thus, leaders are responsible for both the big structures that serve as the cornerstone of confidence, and for the human touches that shape a positive emotional climate to inspire and motivate people”, (Kanter, 2004). Explained in this manner, the essence of leadership then becomes followership. Another description of leadership is outlined thus, “effective leadership is the extent to which a leader constantly and progressively leads and directs his or her followers, towards organizational performance” (Uchenwamgbe, 2013). Then another, “leadership concerns the ability to influence the behavior of others to move according with the desire of the leader and in pursuit of goals (Low & Jiang, 2004)”. We see here then that there occurs the act of leading, and this leading is of fellow human beings. We also see that there is the intended goals which should produce results from this act of being followed or wanting to be followed. The results are to be desirable, better than the original state or good. This is the relationship we wish to explore in this paper. We want to do this by looking at leaders, on one side, and followers or the performance of these followers on the other side.

The performance of SMEs, for the purposes of this paper, shall be indicated by three financial parameters. These are; gross profits, return on investment (ROI), and the debt repayment progress. What follows, in the rest of this paper, is a review of literature on the relationship between leadership styles and performance of business firms, in particular SMEs, in section 2. In section 3 we outline the methodology we have employed to analyze this relationship between leadership styles and performance of SMEs. We bring out the results of our analysis in section 4 and in section 5, we conclude.

## 2.0 LITERATURE REVIEW

### 2.1 Factors Affecting Leadership Styles

Tannenbaum and Schmidt (1973) and Mullins (2007) as quoted in Uchenwamgbe (2013), have argued that attention to the manager's style of leadership has come about because of a greater understanding of the needs and expectations of people at work. It has also been influenced by such factors as:

- Increasing business competitiveness and recognition of efficient use of human resources;
- Changes in the value system of society,
- Broader standards of education and training,
- Advances in scientific and technical knowledge,
- Changes in the nature of work organization,
- Pressure for a greater social responsibility towards employees, for example through schemes of participation in decision-making and work/life balance; and
- Government legislation.

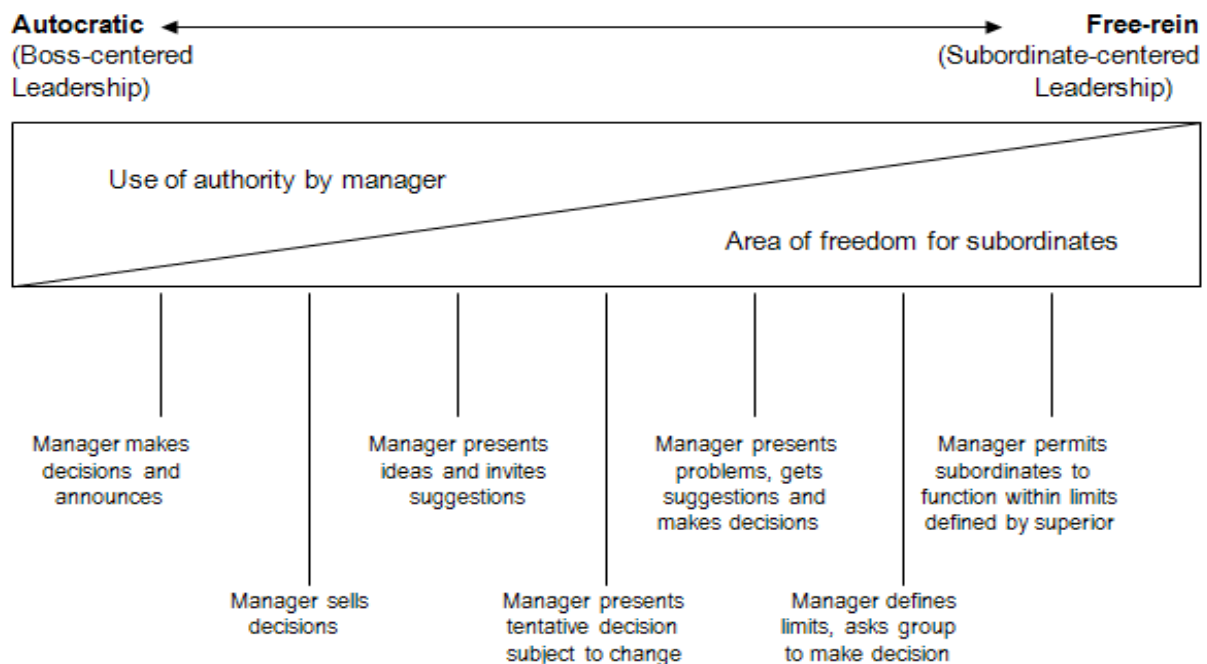
Other factors that have been cited to affect leadership styles elsewhere have included:

- Risk - decision making and change initiatives based on degree of risk involved,
- Type of business - creative business or supply driven,
- How important change is - change for change's sake,
- Organizational culture - may be long embedded and difficult to change.

All of these factors have combined to create resistance against purely autocratic styles of leadership. Tannenbaum and Schmidt use what they called a leadership continuum to explain the effect of leadership styles on the performance of employees and thus that of business firms (MSG Experts, 2015). The leadership continuum was originally written in 1958 by Tannenbaum and Schmidt and was later updated in the year 1973. Their work suggests a continuum of possible leadership behavior available to a manager and along which many leadership styles may be placed. The continuum presents a range of action related to the degree of authority used by the manager and to the area of freedom available to non-managers in arriving at decisions. A broad range of leadership styles have been depicted on the continuum between two extremes of autocratic and free rein types of leadership. In the figure below the left side of the continuum shows a style of leadership where control is maintained by a manager and the right side shows the release of control. However, neither extreme is absolute and authority and freedom are never without their limitations (MSG Experts, 2015).

The Tannenbaum and Schmidt continuum can be related to McGregor's supposition of Theory X and Theory Y. Boss-centered leadership is towards theory X and subordinate-centered leadership is towards theory Y (MSG Experts, 2015).

**Figure 2.1: Continuum Leadership Behavior.**



A manager is characterized according to degree of control that is maintained by him. According to this approach, four main styles of leadership have been identified:

**Tells:** The manager identifies a problem, chooses a decision, and announces this to subordinates. The subordinates are not a party to the decision making process and the manager expects them to implement his/her decisions as soon as possible.

**Sells:** The decision is selected by the manager only but he/she understands that there will be some amount of resistance from those faced with the decision. The Manager, therefore, makes efforts to persuade them to accept it.

**Consults:** Though the problem is identified by the manager, he/she does not take a final decision. The problem is presented to the subordinates and the solutions are suggested by the subordinates.

**Joins:** The manager defines the limits within which the decision can be taken by the subordinates and then makes the final decision along with the subordinates.

According to Tannenbaum and Schmidt, if one has to make a choice of the leadership style which is practicable and desirable, then that choice will depend upon the following three factors:

*Forces in the Manager:* The behavior of the leader is influenced by his personality, background, knowledge, and experience. These forces include:

- Value systems,
- Confidence in subordinates,
- Leadership inclinations,

- Feelings of security in an uncertain situation.

*Forces in the subordinate:* The personality of the subordinates and their expectations from the leader influences their behavior. The factors include:

- Readiness to assume responsibility in decision-making,
- Degree of tolerance for ambiguity,
- Interest in the problem and feelings as to its importance,
- Strength of the needs for independence,
- Knowledge and experience to deal with the problem,
- Understanding and identification with the goals of the organization.

If these factors are on a positive side, then more freedom can be allowed to the subordinate by the leader.

*Forces in the situation:* The environmental and general situations also affect the leader's behavior. These include factors like:

- Type of organization,
- Group effectiveness,
- Nature of the problem,
- Time pressure.

According to Tannenbaum and Schmidt, successful leaders know which behavior is the most appropriate at a particular time. They shape their behavior after a careful analysis of self, their subordinates, organization, and environmental factors.

## 2.2 STYLES OF LEADERSHIP

This is a situation where importance is given to which 'style' of leadership used. Therefore, "leadership style is the way in which the functions of leadership are carried out, the way in which the manager typically behaves towards members of the group" (Uchenwamgbe, 2013).

In this paper, we review six styles of leadership that this author looked at earlier in a paper entitled, "Leadership Styles and Loan Performance of Financial Institutions" (Lushinga, 2014). However, unlike in the 2014 paper where the author looked at the effects of the various forms of Leadership Styles on Loan Performance of a selected group of Financial Institutions, this paper is examining the influence of leadership styles on performance of SMEs. We present below the six styles of leadership whose influence on SMEs we want to examine.

In the context of this paper, we shall look at leadership styles as the manner and approach of providing direction, implementing plans, and motivating people. As seen by the employees, it includes the total pattern of explicit and implicit actions taken by their leader (Ojukuku et al, 2012).

This paper, therefore, outlines the following six basic leadership styles:

- The Coercive Style: Do what I tell you
- The Authoritative Style: Come with me
- The Affiliative Style: People come first
- The Democratic Style: What do you think?

- The Pacesetter Style: Do as I do now
- The Coaching Style: Try this

### 2.2.1 The Coercive Style

This leadership style typically involves leaders who are inexperienced with leadership thrust upon them in the form of a new position or assignment that has to do with people management. Coercive leaders retain for themselves the decision-making rights. They can damage an organization irreparably as they force their ‘followers’ to execute strategies and services in a very narrow way, based upon a subjective idea of what success looks like. There is no shared vision and little motivation beyond coercion. Coercive leadership typically eliminates commitment, creativity and innovation. In fact, most followers of coercive leaders can be described as biding their time, waiting for the removal of the leader that follows (Michael, 2010).

### 2.2.2 The Authoritative Style

The authoritative leader mobilizes the team toward a common vision and focuses on end goals, leaving the means up to each individual. If this style were summed up in one phrase, it would be “Come with me.” The authoritative style works best when the team needs a new vision because circumstances have changed, or when explicit guidance is not required. Authoritative leaders inspire an entrepreneurial spirit and vibrant enthusiasm for the mission. It is not the best fit when the leader is working with a team of experts who know more than him or her ( Benincasa , 2014) .

### 2.2.3 The Affiliative Style

The affiliative leader makes people connections and thus harmony within the organization. This works to create emotional bonds that bring a feeling of bonding and belonging to the organization. Here people come first. It is a very collaborative style, which focuses on emotional needs over work needs. When done badly, it avoids emotionally distressing situations such as negative feedback. Done well, it is often used alongside visionary leadership. It is best used for healing rifts and getting through stressful situations. Robyn Benincasa in his book on “How winning works”, describes the affiliative style as working best in times of stress, when teammates need to heal from a trauma, or when the team needs to rebuild trust. Beninsaca, however, emphasizes that this style should not be used exclusively, because a sole reliance on praise and nurturing can foster mediocre performance and a lack of direction (Beninsaca, 2014).

### 2.2.4 Democratic Style

The democratic leader builds consensus through participation. The democratic style is most effective when the leader needs the team to buy into or have ownership of a decision, plan, or goal, or if he or she is uncertain and needs fresh ideas from qualified teammates. It is not the best choice in an emergency situation, when time is of the essence for another reason or when teammates are not informed enough to offer sufficient guidance to the leader (Beninsaca, 2014).

### 2.2.5 The Pace Setter

The pace-setting leader builds challenging and exciting goals for people, expecting excellence and often exemplifying it themselves. They identify poor performers and demand more of them. If necessary, they will roll up their sleeves and rescue the situation themselves. They tend to be low on guidance, expecting people to know what to do. They get short-term results but over the long term this style can lead to

exhaustion and decline. Done badly, it lacks emotional intelligence, especially self-management. It is best used for results from an already motivated and competent team and the leader needs quick results. The pacesetter leader expects and models excellence and self-direction (Beninsaca, 2014).

### 2.2.6 The Coach

The coaching leader develops people for the future. The coaching style works best when the leader wants to help teammates build lasting personal strengths that make them more successful overall. It is least effective when teammates are defiant and unwilling to change or learn, or if the leader lacks proficiency (Benincasa, 2014).

The coaching leader connects wants to organizational goals, holding long conversations that reach beyond the workplace, helping people find strengths and weaknesses and tying these to career aspirations and actions. They are good at delegating challenging assignments, demonstrating faith that demands justification and which leads to high levels of loyalty. Done badly, this style looks like micromanaging. It is best used when individuals need to build long-term capabilities (Benincasa, 2014).

## 2.3 Leadership Styles and Performance of SMEs

In this section we take a look at literature on works that have already been done on the relationship between leadership styles and performance of SMEs. We firstly look at the work done by O'Regan, Nicholas; Ghobadian, Abby and Sims, Martin<sup>[1]</sup> in 2005 when they empirically examined the relationship between strategy, leadership and performance within a single study. They presented evidence from 194 firms, outlining the association between strategy characteristics and the dimensions of leadership in a ranked order according to their degree of importance. This analysis indicated that a balanced transformational and transactional leadership style is likely to lead to better performance. The study also found that firms strongly emphasizing any of the leadership styles performed better than firms with uncertain or weak leadership styles (O'Regan et al., 2005).

These findings provide practical guidelines to enable senior managers to consider leadership style in the formulation and deployment of their strategic plan. This analysis also indicated the need to consider and align leadership and strategy in order to achieve sustainable competitive performance (O'Regan et al., 2005). This work, unlike the current study, looked at firms of all sizes in general. In the current study, however, we confine our examination of the effect of leadership styles on SMEs.

In another study the quality of leadership and strategy was widely viewed as instrumental in maintaining and improving competitive performance. Ireland and Hitt (1999) in their study eloquently summarized this relationship by stating that "the formulation and deployment of strategic actions by effective leaders result in strategic competitiveness and above-average returns".

This relationship between strategy and performance has received much attention in the literature. For example, Schwenk & Shrader (1993) conducted a meta-analysis of existing studies and found that strategy was positively linked to growth. However, they asked the question, "what does this mean, and what drives the effectiveness of the strategy?" They argued that, success arises from approaching the strategy process in the right way, both from formulation and deployment perspectives. Accordingly, they went on to say, leadership has an important role to play in strategic effectiveness. It is, therefore, no great surprise that the literature on leadership and its impact on strategy and performance is extensive. Indeed, the literature contends that it is difficult to formulate and deploy any type of strategy without the active involvement of



the firm's leadership (Uchenwamgbe, 2013). Leadership can either be 'hands-on' or encompass a guiding role. Either approach depends on the impact of leadership characteristics on strategy and overall organizational performance (Schwenk & Shrader, 1993).

Interestingly, Mintzberg et al (1988), while acknowledging the role of leadership, contended that in the pursuit of strategic intent or performance, many leaders encountered significant difficulties in aligning organizational actions. In essence, this leads to one of the important questions often asked, "which type of leadership is likely to lead to better strategic direction and ultimately organizational performance?" Existing studies largely point to the existence of a dynamic and circular relationship between leadership, strategy, and performance (Uchenwamgbe, 2013).

The studies we have reviewed above point to the fact that a development of good leadership is amongst the main driving forces for the success of businesses. Evidence suggests that inadequate leadership and management skills as primary factors contribute towards the failure of SMEs (Uchenwamgbe, 2015).

In our present study, we wish to examine how leaders have exerted a positive or negative impact on SME performance. The aim in this study is to interrogate the strategic leadership in terms of different leadership styles and test their effect on performance of SMEs.

We shall, therefore, test the null hypothesis that *leadership styles do not affect performance of SMEs*. We shall define performance, as earlier indicated in this study, as significant change in the levels of the values of; debt repayment, gross profit, return on assets and return on investment of a randomly selected group of SMEs. This group of SMEs was randomly selected from the portfolio of borrowers of a DFI. We, thus, state our hypothesis as:

***Ho: Leadership Styles do not affect performance levels of SMEs***

If our null hypothesis is disproved then we shall seek an alternative hypothesis stated thus:

***Ha: Leadership Styles affect performance of SMEs***

### 3.0 METHODOLOGY

Firstly we collected data on 15 randomly selected SMEs from the database of the DFI. Secondly we administered a questionnaire to these SMEs as presented in Table 3.1 below. The questionnaires were administered by office visits to the concerned SMEs and followed through by phone conversations. In all the cases we explained the motive of the interviews ensuring that everyone understood that this was purely an academic exercise meant to draw lessons of the performance of the SMEs and nothing to do with the DFI's procedures. This was important to do as letting the SMEs Managers to guess the motive for the study would have alarmed the respondents into thinking this was to do with their obligations to the DFI and thus facing the danger of collecting false information. We also discussed the topic on leadership extensively with Chief Executive Officers of the SMEs.

#### QUESTION 1

How do you interact with your subordinates?

1	Directing them to do what you say	
2	Mobilizing them towards a commonly understood goal or vision	
3	Focusing on their emotional needs over their work needs?	
4	Letting them participate in all decision making and listening	

	to both the bad and the good news	
5	Building challenging and existing goals for them	
6	Connecting corporate goals whilst helping them find strengths and weaknesses and linking these to their career aspirations and actions	

**QUESTION 2**

When do you do this?

All the times	
In urgent situations only	
When there is a crisis	
A mix of 2 and 3 above	

We then matched the responses to the above question to the matrix below

QUESTION 1	COERCIVE STYLE
QUESTION 2	AUTHORITATIVE STYLE
QUESTION 3	AFFLIATIVE STYLE
QUESTION 4	DEMOCRATIC STYLE
QUESTION 5	PACE SETTER STYLE
QUESTION 6	COACHING STYLE

Having administered this questionnaire to the heads of SMEs, we repeated the same exercise on the employees of all the SMEs in our sample.

We then collected data on the performance of these SMEs from the DFI’s database. We also looked at the audited accounts of all the SMEs in our sample and recorded their performance on profitability. The data collected consisted of the names of the SME, the amount borrowed from the DFI, the status of the loan at the DFI, the SME’s gross profit and the return on investment (ROI). For the sake of the privacy of these firms, we shall use pseudo names, here, to protect the privacy of our respondents. We present this data in Table 3.1 below:

<b>TABLE 3.1</b>					
<b>STATUS REPORT ON SAMPLED BUSINESSES</b>					
	<b>ACCOUNT</b>	<b>AMOUNT (Zambian Kwacha)</b>	<b>DEBT STATUS</b>	<b>GROSS PROFIT</b>	<b>ROI</b>
1	Real Estate Properties	5,000,000	current	1,063,180	34.3%
2	Constuction Investments	14,140,261	current	(240,229)	-1.7%
3	Mining Equity	37,100,000	90 days arrears	1,883,560	-205.4%



4	Dry Cleaners	1,295,000	current	(12,000)	-1.3%
5	Fishing Limited	12,500,000		(7,960,799)	-97.3%
5	Aqua Farms Limited	8,375,000	current	(7,960,799)	-97.3%
6	Agro Farms	19,091,889	current	1,918,089	17.1%
7	Construction Enterprises	17,655,000	60 days arrears	129,211,050	7.0%
7	Transport Enterprises	13,000,000		129,211,050	7.0%
7	Trucks Enterprises	24,000,000		129,211,050	7.0%
8	Catering Services	5,000,000	grace period	(833,650)	-2.0%
9	Building Finance	35,000,000	current	(6,664,000)	-2.0%
10	Trading	31,500,000	60 days arrears	9,800,763	2.0%
11	Lodges Enterprises	3,000,000	60 days arrears	712,258	-7.0%
12	Farming Limited	1,300,000	current	(499,006)	-20.3%
13	Restaurants Limited	1,370,000	current	33,670	172.0%
14	Hospitality Limited	5,000,000	grace period	801,398	445.0%
15	Packaging Limited	8,708,597		(1,334)	-406.0%
15	Manufacturing Limited	6,200,000	Over 90 days arrears	(1,334)	-406.0%
15	Plastics Makers Limited	8,708,597	Over 90 days arrears	(1,334)	-406.0%

NOTE: Respondents bearing the same number are branches of the same SME

#### 4.0 RESULTS

Our exercise in section 3 above reviews that SME 1, SME 6, SME 13 and SME 14 not only made significant gross profit margins during our period of study but were also current with their loan repayments. They also had the largest value of the return on investment.

Our analysis of the leadership styles in these SMEs also reviewed that those SMEs (1, 6 and 14) with significantly high profit margins either had a democratic or a combination of democratic and coaching leadership styles. The rest of the SMEs either had an autocratic leadership style or it was impossible to determine their styles of leadership due to the conflicting and sometimes plainly confusing responses we received from such SMEs. Within the time available to write this paper we could only conduct one round of administering of the questionnaire. Our analysis was also confined to qualitative deduction of the type of leadership existing in these SMEs.

Our conclusion is consistent with results from the studies we looked at earlier in the section on literature review. These studies have already shown the relationship between styles of leadership and

their influence on business performance. Some of these studies go as far as pointing out the direction of this performance and how to get there. One such study helped us make the analysis and consequent conclusion in this paper. This is the work of John C Maxwell who when writing on “The Law of Influence” pointed out that, “The True Measure of Leadership Is Influence – nothing more, Nothing Less” (Maxwell, 2007).

## 5.0 CONCLUSIONS

The objective of this paper has been to examine the influence of different styles of leadership on the performance of small businesses. We took a sample of small and medium sized enterprises from amongst the borrowers of a DFI and found that there exists a relationship between the style of leadership and results of performance indicators in these businesses.

All the SMEs in our sample were corporative in their responses and did not feel nor indicate any form of intimidation that could have affected their response. Our findings, however, are consistent with the assertions in most of the literature we reviewed. This was that *leadership styles have a marked influence on the performance of businesses* and that in the case of SMEs this influence was always positive when the leadership style was democratic or that of a coaching type. Our sample though obtained from one source proves to be quite representative in the sense that it is composed of small businesses of varied specialization. They represent various economic sectors and their only common phenomenon is the fact that they are SMEs who have borrowed from one and the same DFI. This fact, actually, worked to give some kind of common ground as regards their performance as they all had the same source of capital with similar conditions. Therefore, their performance to a large extent depended on how they managed their resources. Their achievement of different financial results says a lot on how they organized themselves to utilize these resources.

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