

1-1-2009

Leadership styles and company performance: the experience of owner-managers of SMEs

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Recommended Citation

Chandrakumara, Palli Mulla K A; De Zoysa, Anura; and Manawaduge, Athula S.: Leadership styles and company performance: the experience of owner-managers of SMEs 2009, 391-401.
<https://ro.uow.edu.au/commpapers/1561>

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Abstract

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Keywords

Leadership, styles, company, performance, experience, owner, managers, SMEs

Disciplines

Business | Social and Behavioral Sciences

Publication Details

Chandrakumara, A., De Zoysa, A. & Manawaduge, A. S. (2009). Leadership styles and company performance: the experience of owner-managers of SMEs. 4th international Asian academy of applied business conference (pp. 391-401). Makati City, The Philippines: Asian Academy of Applied Business.

LEADERSHIP STYLES AND COMPANY PERFORMANCE: THE EXPERIENCE OF OWNER-MANAGERS OF SMEs.

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ABSTRACT

Leadership styles of owner-managers were explored in the context of a developing country in South Asia with a view to examining their impact on financial performance of SMEs. It was justified that the study has both theoretical and contextual significance. Data were collected from 204 companies in Sri Lanka by adopting mixed methodologies that consisted of both qualitative and quantitative approaches. Descriptive statistics and correlation coefficient were used in the analysis. The findings revealed that the existence of three main leadership styles in the sample, namely; entrepreneurial, managerial, and mix of both entrepreneurial and managerial leaderships. The analysis indicated that 60 percent of firms had increased financial performance, while 35 percent firms had decreased financial performance. The impact analysis showed that entrepreneurial leadership style is more effective than managerial leadership styles and the mixed style of leadership in terms of increasing financial performance. Overall, the study contributes to the theory of leadership styles and performance in the context of developing countries. It also has practical implications for business leaders and owner managers of SMEs.

Key Words: Entrepreneurial leadership, Managerial leadership, Financial Performance, SMEs, Developing Countries

INTRODUCTION

The success or failure of a group, an organisation, or even an entire country rests on leadership (Fiedler, 1996; Idris et al., 2008). However, most of the leadership research during the past half-century was conducted in the United States, Western Europe Latin American and Asian nations (Dofman and House, 2004; Yukl, 2002, Hofstade, 1993) and less is known about leadership and their entrepreneurial orientations in South Asian, African, Arab, and Eastern European countries (Dofman and House, 2004; Kropp, Lindsay, and Shoham, 2008). This requires research studies in number of different context that includes specific industries and cultures (Valliere, 2008; Idris et al., 2008; McPherson, 2008; Smith 2007). The aim of this study is to explore leadership styles of owner managers of SMEs in a context of a developing country in South Asia—Sri Lanka in particular and examine their impact on financial performance of companies.

RESEARCH CONTEXT AND ISSUE

The empirical part of this study is carried out in Sri Lanka. Sri Lanka was known as Ceylon until 1971, and is a well known outlier among developing nations. It has a labour force of about 7.5 million out of a total population of over 20 million. Sri Lanka was the first country in South Asia to adopt an open market economy back in 1977, and is today known as ‘the Gateway to South Asia’ by many investors. Sri Lanka is perhaps South Asia’s most opened economy today (Chandrakumara and Budhwar, 2005). This has enabled the private sector (both local and foreign) to make their investment in all the sectors of the economy. It has enjoyed healthy economic growth since the early 1990s and has a relatively well developed capital market infrastructure. Its per capita income (US\$ 1,500) remains the highest in the region, after the Maldives. Despite the civil conflict prevailed in last two and half decades, macro stability was maintained and considerable reforms have been implemented, most prominently in trade,

taxation, privatization, and enhancing the flexibility of the labour market. As a result, Sri Lankan economy has been very resilient to both internal and external shocks over the last two decades (Chandrakumara and Budhwar, 2005). With the end of the civil war in 2009, Sri Lanka now has an opportunity for greater economic growth and to recapitalize its development potential. Referring to Sri Lanka's potential for higher economic growth, Microsoft founder Bill Gates states that Sri Lanka is now poised for greater economic growth and development and much of that will be fuelled by the use of software and the power of IT. Sri Lanka's high literacy rate, at over 90%, and its high standards of education, English language speaking skills and healthcare give it a strong economic foundation. The country's IT literacy rate is nearing 20%, which represents a significant jump from 8% only a few years ago. According to Dell Global Business Centre in South Asia, Sri Lanka is emerging as one of the top two countries in South Asia promoting the use and development of IT. The consulting giant, A.T. Kearney's Global Services Location Index (GSLI) has ranked Sri Lanka among top 20 countries for outsourcing globally in 2009. Sri Lanka is ranked number 16 in the index in 2009 compared to the number 29 position held in 2007, and is taking off as a global outsourcing destination steadily since 2005. With regard to customer satisfaction, Grey Group Asia Pacific's study on consumer attitudes survey (2009) ranked Sri Lanka topped the Asian list with 93 per cent on the satisfaction scale out of 16 countries surveyed, while Taiwan took the last spot with 28 percent.

Sri Lanka was one of the first developing countries to understand the importance of investing in human resources and promoting gender equality. As a result, Sri Lanka has achieved human development outcomes more consistent with those of high income countries (The World Bank, 2000). In 1999, Sri Lanka was ranked the highest in South Asia in economic governance by the Human Development Centre (New York). Sri Lankans exhibit many Asian traits in their family and other social interactions, but in business management they tend to mix Asian traits with Western management philosophies and practices. Many Sri Lankan managers maintain a distance from their subordinates, and there is a reward system based on individual performance, reflecting an individualistic cultural trait (Nanayakkara, 1993; 1984). Several studies carried out in the country reveal that many Sri Lankan managers believe that many employees fall into the X type category of people described by McGregor, who see work as a way to live rather than as a way of life, and have negative attitudes towards sharing responsibility, challenging the status quo, and pioneering innovation (Nanayakkara, 1992). Chandrakumara and Sparrow (2004) also found that Sri Lankan employees are oriented towards organizations and positions oriented work ethics. Accordingly, they believe that work is good in itself but meaningful only if it relates to an organization and a job position rather than believing and depending on entrepreneurship. The decision-making system in a typical Sri Lankan family is hierarchical, in which major decisions are made by the father or the mother or by both. As the desire to be independent is curtailed from childhood, the individual develops a tendency to look for approval from the hierarchy. The attribution of values to a particular job as of high or low status seems to begin in the family. Parents who are desirous of determining the future of their children direct their children to jobs which are considered of high status. As such, Sri Lankan employees are also oriented towards maintaining status and security oriented upwards striving (Chandrakumara and Sparrow, 2004).

All this evidence suggests that Sri Lankan employees and managers are oriented towards projecting more managerial and administrative styles than entrepreneurial styles of leadership (e.g. depending on jobs in others' organisations, low risk taking, negative attitudes towards challenging the status quo etc.). However, there is no evidence to indicate whether Sri Lankan business leaders or owner managers are also oriented towards either managers or entrepreneurs and the impact of any of such orientation has on company performance. Thus, the main objective of this study is to investigate managerial and entrepreneurial leadership styles of Sri Lanka business leaders in the SMEs (owner-managers) and examine their impact on company performance.

LITERATURE REVIEW

Entrepreneurs and Managers

Managers are constantly asked to behave like entrepreneurs. The other way round, entrepreneurs are often asked to behave like managers. The manager is supposed to develop the drive and opportunism of the entrepreneur, and the entrepreneur is expected to learn the methodical disciplines of the manager

(Heller, 2006). In the management literature, entrepreneurship seems to be associated with leadership and sometimes used as synonymous. Some researchers have tried to combine the two concepts to explore both leadership and entrepreneurship (Gupta et al., 2004; Tarabishy et al., 2005). However, management and leadership are not necessarily synonymous, but they may be related (Davidson and Griffin, 2000). Nevertheless, differences can also be found between managers and entrepreneurs. Entrepreneurs emerged out of people while managers are appointed. Entrepreneurs have helpers while managers have colleagues. Entrepreneurs tend to use their natural powers of wisdom, charisma, and intuition, while managers depend more on positional power. Although the influencing power of a manager is founded upon authority, entrepreneurs influencing power goes beyond the formal authority. Building on non-rational decision-making models from behavioural decision theory, Busenitz and Barney (1997) asserted that entrepreneurs are more susceptible to the use of decision-making biases and heuristics than are managers. Thus, 'entrepreneurs are the people who notice opportunities and take risk and responsibility for mobilising the resources necessary to produce new and improved good and services' (Jones and George, 2007). In contrast, managers are the people who are responsible for supervising the use of human and other resources to achieve organisational goals effectively and efficiently (Jones and George, 2007). Davidson and Griffin (2000) however, argue that when it comes to performing roles, the differences between roles are often the differences of degree rather than of kind. As life cycle theory of organisational leadership (Baliga and Hunt, 1987) highlights organisations need both managers and entrepreneurs or leaders. To achieve optimum results, the two skill sets need to overlap or complement each other (Davidson and Griffin, 2000). Accordingly, when an organisation is at the beginning stage, entrepreneurial leadership (transformational) is instrumental in creating a vision allowing the organisation to be born and take a few steps. At the Collectivity and Formalisation stages, managerial or transactional leadership becomes important to handle accelerating growth. A heavy emphasis on entrepreneurial leadership is needed again at the Elaboration of structure stage. In the context of rising competition for critical resources in a complex and volatile environment, recent literature observes that the escalating ineffectiveness of more traditional approaches to strategy necessitates an entrepreneurial approach to enhance company performance (Gupta et al., 2004). Entrepreneurial orientation, the presence of organisational level entrepreneurship, is commonly used measure in the literature (Wen Yang, 2008; Busenitz and Barney, 1997; Wiklund and Shepherd, 2005; Morris and Kuratko, 2002).

The demand for differential placed on leaders may vary according to demographic composition of organisations, national or regional political systems, or the strategic requirements of the leader's organisations (Bass, 1990). Preferences for certain leader behaviours have also been shown to be associated with dominant norms of cultural entities (Stening and Wong, 1983) and religious or ideological values such as Confucianism (Hofstede and Bond, 1988). For example, organisational management practices in China, India, and Hong Kong are often based on kinship relationships-that is, hiring relatives is often the norm, rather than exception (Dofman and House, 2004). Thus, the importance of strong family ties and paternalistic management practices are emphasized in these countries (De Lema and Durendez, 2007; Dofman et al., 1997). Similar management practices have been adopted by entrepreneurs or business leaders in Sri Lankan context too (e.g Nanayakkara, 1992). According to management literature, these orientations are not essentially managerial or professional. At the same time, literature indicates that the role of lead entrepreneur is important to new start-ups or to smaller dynamic entrepreneurial business ventures (Kropp, Lindsay, and Shoham, 2008; Lumpkin and Dess, 1996; Covin and Slevin, 1989). In addition, the life cycle theory of organisational leadership (Baliga and Hunt, 1987) also highlights need of entrepreneurial leadership at different stages of life the life cycle. When such lead entrepreneurs or owner managers manage organisations, it can be argued that the leadership orientation is entrepreneurial than managerial.

Leadership Style/Orientations and Performance

Different leadership behavioural approaches or orientations have been used to examine the impact of leadership styles on performance. While Lumpkin and Dess (1996) viewed entrepreneurship as autonomous pursuit of innovative opportunities, Thornberry (2006) asserts that entrepreneurial leadership is more like transformational leadership than it is like transactional leadership, yet it differs in some fundamental ways. Thus, in this study, we use leadership approaches, behaviours and styles to explore entrepreneurial and managerial orientations of leadership. The most commonly studied

behavioural aspects of leaderships are task oriented and relationship-oriented leadership dimensions (e.g. Bond and Hwang, 1986). Participatory and charismatic leadership styles have also been studied in cross cultural contexts, with former showing major differences among cultures and the later having more universally positive effects (Dofman and House, 2004). Some researchers have developed prediction of participation based on Hofstade's power distance scores and results were generally supportive for the prediction that participation tends to produce good results for lower power distance cultures (e.g., Jago et al., 1993). Bass (1990) notes confirming cross-cultural evidence for the proposition that there is a hierarchy of leadership effectiveness among various leadership styles. For example, transformational leaders are more effective than those practicing transactional leadership. Thornberry (2006) note that entrepreneurial leadership is more like transformational leadership than it is like transactional leadership. Wen Yang (2008) also found that transformational leadership with higher entrepreneurial orientation can produce higher business performance. In their study of comparison between entrepreneurs and managers of small business firms in the US, Begley and Boyd (1987) found that entrepreneurial firms showed higher growth rates than managerial firms. Strategic management literature also indicates that firms must have strong entrepreneurial orientations to yield high performance (Lumpkin and Dess, 1996; Covin and Slevin, 1991; Peters and Waterman, 1982; Zahra, 1993).

Research carried out in non-Western context also suggests some approaches to leadership and performance. Misumi's performance-maintenance (PM) theory of leadership (1985) focuses on Performance and Maintenance functions in Japanese context. These leadership functions are similar to the 'Task centered' and "support oriented" leadership functions previously addressed in Western theories of leadership (Dorfman and House, 2004). Misumi's results suggest that for effective leadership, supervisors must emphasize both orientations together. As pointed out by Smith (1997), specific behaviours associated with each function will vary according to context. Research carried out in Indian context also support the view that managers and workers often voice a preference for paternalistic and nurturing leaders who are also authoritarian and assertive (Sinha, 1994; Kakar, 1971). Base on these mixed research findings Sinha (1984) developed a Nurturant-task oriented model (NT) that incorporated a combination of leadership styles. Simply the model suggests that an ideal leader is both nurturant and task oriented. The importance of both the Misumi and Sinha research programs is that they emphasize the importance of context as determining which processes of leadership are considered effective and which are not (Smith, 1997). In a study of managerial behaviour of SMEs, De Lema and Durendez (2007) found that managers of family firms use some managerial tools such as management accounting systems and cash budget. On the other hand, entrepreneurship literature suggests that organisations must be more entrepreneurial to enhance their performance (Lumpkin and Dess, 1996; Begley and Bond, 1987; Gupta et al., 2004). In addition, the life cycle theory of organisational leadership (Baliga and Hunt, 1987) also highlights organisations need both managers and entrepreneurs or leaders and, the two approaches need to overlap or complement each other in order to achieve optimum results (Davidson and Griffin, 2000). Further, Gupta et al., (2004) also emphasize the need for a balance approach of entrepreneurship and management for effective leadership. For example, while pursuing innovation and proactive behaviour, a collaborative orientation may be required to contain risk and speedy commercialisation of innovation.

METHODOLOGY

Measures of Leadership Styles and Performance

The literature review seems to suggest that entrepreneurial leadership is more like transformational leadership than it is like transactional leadership (e.g. Thornberry, 2006). It is also reveal that entrepreneurial orientation of leadership consists of both leadership approaches and styles which are associated with elements of transformational leadership approach (Bass, 1985) and autocratic styles (Dofman, Hangers & Brodbeck, 2004). Similarly, it was found that managerial orientations are associated with transactional leadership approach and participative leadership styles (Dofman, Hangers & Brodbeck, 2004; House and Dessler, 1974). In the GLOBE culture and leadership scale, Dofman, Hangers & Brodbeck(2004) also considered reversed score of Autocratic style as participative. Accordingly, we developed 20 alternative statements to represent entrepreneurial (10) and managerial (10) leadership styles. Respondents are expected to select any alternative approach as a solution to a

given scenario. The scenarios were selected based on the information gathered through a pilot study of 18 owner-managers. They were relevant to common issues and decision making situations faced by the respondents of the pilot survey.

An example scenario question reads as follows; “In deciding on a new business project, which of the following would you consider more important to you”. The two alternatives relevant to the above statement were; “My own vision and strategy” and “The cost analysis and market forecasts prepared by my staff”. In the analysis we considered first alternative as “entrepreneurial orientation” and the second alternative as “managerial orientation”. Altogether, there were ten such business scenarios in the scale. In this way we attempt to incorporate both conceptual and contextual knowledge in developing measures as the Bass (1990) review of leadership literature reveals that one of the shortcomings of leadership research is the use of existing standardised U.S instruments that may not fully capture non-U.S. or non-western conceptualisation of leadership.

With regard to measure of company performance, previous studies have often used self-reports to gather business performance data, and these results have proven to be reliable (Knight, 2000). Furthermore, public information is unreliable because most SMEs are privately held and have no legal obligation to disclose information (Wen Yang, 2008).

In addition, respondents may be reluctant to provide actual financial data (Tse et al., (2004). Hence, this study used subjective, self reported measures of business performance. Specifically, respondents were asked to select one of five business performance situations that described the changes in sales revenue over the last three operating years. The five situations given were: (1). Substantial increase, (2). Slight increase, (3). No significant change, (4). Slight decrease, (5). Substantial decrease.

This method is assumed to be more reliable in a socio cultural context in which many business people in the country do not have positive attitudes towards income tax system and therefore tend to avoid revealing actual sales or profits amounts. Similar methods have been used by previous researchers in the context of Japanese SMEs as well (for example, De Zoysa and Herath, 2007).

EMPIRICAL DATA AND RESULTS

A questionnaire survey was conducted among a sample of 500 manufacturing firms in Sri Lanka. The analysis was based on usable 204 responses, providing a response rate of 41 percent. Given the context of a developing country and a mail questionnaire survey, this responses rate can be considered as satisfactory.

Characteristics of the sample

A profile of the sample firm is presented in Table 1. The responses indicate rather a fair representation of many firms in the manufacturing sector, while chemical, petroleum, rubber, and plastic product category represents a 21 percent of all firms. The other two dominant industry categories are textiles and apparels (17.6 per cent) and paper, printing, and allied products (16.7 per cent) respectively.

TABLE 1
Profile of the Sample Firms

Type of Industry	Firms	%
Chemical, petroleum, rubber and plastics products	43	21.1
Electronic and electric equipment	7	3.4
Fabricated metal products	13	6.4
Food, beverages and tobacco	11	5.4
Furniture, fixtures and lumber and wood	13	6.4
Machinery, computer and transportation equipment	8	3.9
Paper, printing and allied products	34	16.7
Stone, clay, glass, concrete products	14	6.9
Textile and wearing apparel	36	17.6
Miscellaneous	25	12.3
Total	204	100.0

Age	Firms	%	Employees	Firms	%
0-5 years	12	5.9	1 – 15	22	10.8
6-15 years	75	36.8	16 – 100	40	19.6
16-25 years	60	29.4	101-250	78	38.2
26-50 years	44	21.6	251 – 500	37	18.1
Over 50 years	13	6.4	Over 500	20	9.8
Total	204	100.0	Total	197	100.0

Table 1 also shows that many firms (57 percent) in the sample have over 15 years of business experience. Among notable feature of the sample is the dominant representation of small and medium scale firm as it reveals that about 90 percent of firms have less than 500 employees.

Profiles of Respondents/Owner managers

Table 2 indicates the profiles of responders who are the owner managers of the sampling firms. It shows that male dominant (about 76 per cent) representation of owner managers in the sample, while majority of them (55 per cent) belongs to the age category of 30-50 years. Among the interesting and notable features of the respondents' profiles are the qualifications and the years of experience. According to Table 2, almost 50 percent of the owner managers have either a professional qualification or a bachelor, or masters' degree qualification and about 60 per cent of them have over 15 years of experience. This feature seems to be more reliable response when we compare it with the age of the business, which also indicates as 57 percent of firms over 15 years of experience (Table 1.)

TABLE 2
Profile of the Owner/Managers

Sex	Total		Age	Total	
	Total	%		Total	%
Male	156	76.4	Below 30 years	13	6.4
Female	48	23.6	30-50 years	110	53.9
Total	204	100.0	Above 50 years	81	39.7
			Total	204	100.0

Qualification	Total		Experience	Total	
	Total	%		Total	%
GCE OL/AL/ Diploma	98	48.0	Less than 5 years	20	9.8
Bachelor's Degree	42	20.6	5-10 years	25	12.3
Postgraduate Degree	28	13.7	11-15 years	40	19.6
Professional qualification	36	17.7	Over 15 years	119	58.3
Total	204	100.0	Total	204	100.0

Leadership Styles of Owner-Managers

In order to identify leadership styles of respondents, we allocate one mark for each of the entrepreneurial orientation statement. Accordingly, total number of point applicable for 100 percent entrepreneurial leadership styles was 10. The leadership orientation of owner managers was measured by the total score they receive. A score of 1 to 4 was identified as more oriented towards managerial style (less oriented towards entrepreneurial), while a score of 7 to 10 was identified as entrepreneurial. A score of 5 or 6 was identified as mix of both managerial and entrepreneurial styles. Accordingly, Table 3 shows the distribution of respondents based to their respective leadership styles.

TABLE 3
Leadership Styles of Owner- Managers

Leadership Style	Number of Owner-Managers	Percentage
Entrepreneurial	71	35
Managerial	79	39
Both Entrepreneurial and Managerial	54	26
Total	204	100

Table 3 shows rather equal distribution of leadership styles among two major categories of leadership style. Although it is not necessarily the majority of the sample, managerial leadership is the dominant group among the three leadership styles that represents 39 percent of the owner- managers. There are about 35 percent owner managers who are oriented towards entrepreneurial leadership styles. The sample also consists of 26 percent of owner- managers who are having both entrepreneurial and managerial leadership styles.

Financial Performance of Firms

Table 4 present financial performances of firms according to the degree of change in sales occurred during past three years. Accordingly, about 60 percent of firms have a substantial or slight increase in sales. Of the total number of firms, about 11 percent reported a stable position, while about 29 percent having substantial or slight decrease in their sales performance.

TABLE 4
Financial Performance of Firms

Degree of change	Change in Sales during last 3 years	
	Number of companies	Percentage
Substantial increase	57	27.9
Slight Increase	67	32.0
Stable	21	10.7
Slight decrease	16	8.1
Substantial decrease	42	21.3
Total	204	100.0

Relationship between Leadership Styles and Financial Performance

In order to examine the relationship between leadership styles and financial performance, we identified three main performance categories from the above table and named as 'Increased sales', 'decreased sales', and 'stables sale' categories. Table 5 indicates correlation between leadership styles and financial performance.

Table 5 clearly shows that there is a statistically significant positive relationship between entrepreneurial leadership style and increased financial performance ($r = 0.25, P > 0.01$). The reliability of the positive impact of entrepreneurial leadership on financial performance is further justified by the significant negative relationship between entrepreneurial leadership styles and decreased financial performance ($r = 0.22, p > 0.01$). Similarly, the relationship between managerial leadership styles and sales performance is negative ($r = 0.28, P > 0.01$). The reliability of the negative relationship between managerial styles and company performance is also justified by the significant positive relationship ($r = 0.25, P > 0.01$) between managerial leadership styles and decreased financial performance. Another interesting finding of the study is that financial performance is not influenced by owner managers who are oriented towards both managerial and entrepreneurial leadership styles.

TABLE 5
Leadership Styles and Financial Performance

Leadership Style	Financial Performance		
	Increased	Decreased	Stable
Entrepreneurial	0.25**	-0.22**	-0.07
Managerial	-0.28**	0.25**	0.08
Both Entrepreneurial and Managerial	0.04	-0.04	-0.01

** Significant at 0.01 level, * significant at 0.05 level

Overall findings of this study revealed that when owner- managers become more entrepreneurial oriented in their leadership style, they can increase financial performance of their companies. In other words, it seems to suggest that entrepreneurial leadership style is more effective than managerial leadership styles and a combined form of managerial and entrepreneurial leadership styles in terms of increasing financial performance.

CONCLUSIONS

The main objective of this study was to explore leadership styles of owner managers of SMEs in a context of a developing country in South Asia and examine their impact on financial performance of companies. Literature review indicates that less is known about leadership and their impact on company performance in the context of developing countries in the South Asian region and in particular leadership styles of Sri Lanka business leaders (owner-managers). Conceptually, it was intended to identify entrepreneurial and managerial leadership styles of owner managers. The existing literature supported the argument that entrepreneurial leadership style is relatively more important than managerial leadership styles. Research carried out in non-Western context also suggested the importance of pursuing both managerial and entrepreneurial leadership styles. Data were collected from a sample of 204 companies in Sri Lanka by adopting mix methodologies of quantitative and qualitative methods. The findings indicated that the sample consisted of owner-managers with three main leadership orientations, namely; managerial (39 percent), entrepreneurial (35 percent), and mix leadership styles (26 percent). Financial performance of selected companies showed that about 60 percent of firms have a substantial or slight increase in sales, while about 29 percent of firms reported having substantial or slight decreased in their sales performance. The rest of the 11 percent of firms reported a stable position of financial performance. The examination of the relationship between leadership styles and financial performance revealed that entrepreneurial leadership style is more

effective than managerial leadership styles and the mixed leadership style of managerial and entrepreneurial in terms of increasing financial performance. Overall, this study contributes to the theory of leadership styles and performance in the context developing countries. The study also has practical implications for business leaders and owner managers of small and medium scales companies in particular.

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