



# The Relationship between Ethical Leadership, Leadership Effectiveness and Organizational Performance: A Review of Literature in SMEs Context

Mitra Madanchian<sup>1</sup>, Norashikin Hussein<sup>1</sup>, Fauziah Noordin<sup>1</sup>, Hamed Taherdoost<sup>2,3</sup>

<sup>1</sup>Faculty of Business and Management, Universiti Teknologi MARA (UiTM), Shah Alam, Malaysia

<sup>2</sup>Research and Development Department, Ahoora Ltd | Management Consultation Group, Kuala Lumpur, Malaysia

<sup>3</sup>Research and Development Department, Hamta Business Solution Sdn Bhd, Kuala Lumpur, Malaysia

## Email address:

Mitra.madanchian@gmail.com (M. Madanchian)

## To cite this article:

Mitra Madanchian, Norashikin Hussein, Fauziah Noordin, Hamed Taherdoost. The Relationship Between Ethical Leadership, Leadership Effectiveness and Organizational Performance: A Review of Literature in SMEs Context. *European Business & Management*. Vol. 2, No. 2, 2016, pp. 17-21. doi: 10.11648/j.ebm.20160202.11

**Received:** September 6, 2016; **Accepted:** October 20, 2016; **Published:** November 21, 2016

---

**Abstract:** Nowadays, the purpose of any organizations is to survive and maintain its entity by improving their performance. Organizations must always increase their performance to be highly competitive in markets. Nowadays, ethical leadership and leadership effectiveness are two of the significant motivations for improving an organizational performance. Therefore, understanding the relationships between ethical leadership, leadership effectiveness and organizational performance is vital. For that reason, this article presents some significant literature review of ethical leadership, leadership effectiveness and organizational performance. Towards the end, the author discussed the relationship between those mentioned three variables.

**Keywords:** Ethical Leadership, Leadership Effectiveness, Organizational Performance and SMEs

---

## 1. Introduction

Nowadays, the purpose of any organizations is to survive and maintain its entity by improving their performance [1]. Organizations must always increase their performance to be highly competitive in markets [2]. Understanding the ethical leadership and its impact on performance of an organization is also important because leadership is observed by some researchers [3, 4] as one of the significant motivation for improving an organization performance. On the other hand, leadership effectiveness has significant role for stakeholders and their organization to producing best services via efficient use of existing resources [5].

### 1.1. Leadership

As stated by [6], leadership is "... a relationship between those who aspire to lead and those who choose to follow.", and success in leadership "...is and will continue to be a function of how well people work and play together...." (Page: 58). Relationship appears to be a critical element when leadership is being defined [7]. [8] Summarized

leadership definitions that reflect concepts about what it means to be a leader, which included leadership as a trait, ability, skill, behaviour, and relationship.

In relation with [9], leadership becomes more essential when one has to develop and lead adaptive analysis to new or changing situations. [7, 10] pointed out that a successful leadership knowledge results from the key elements consist of changing attitudes, personnel development, and improved business and leadership skills.

### 1.2. Ethical Leadership

Ethics is a philosophical word rooted in the Greek term *ethos*, meaning custom, character, or behavior [11]. Ethical leadership is defined "...as the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships, and the promotion of such conduct to followers through two-way communication, reinforcement, and decision-making" ([12], p. 120). [13] mentioned that the personal beliefs of what is right or wrong

constitute ethics. Ethics can be referred to as a standard of conduct that demonstrates how an individual have to behave based on known virtues, values, and principles [14]. According to early researchers Confucius, Plato, Aristotle, and Socrates all had differing visions of the definition of ethics and how the understanding of ethics influenced people [15].

According to [16], ethical leadership has gradually become the focus of most researches nowadays. According to its name, ethical leadership offers more attention to the ethical basics of leadership. As stated by [17], good leadership except by ethics is characterized by effectiveness as well. He also added, leadership studies that pay no attention to values and ethical implications inherent in the leadership process always will be deficient. According to [18], the study of ethical leadership timely and worthwhile due to the ambiguity and immorality of the current business environment that contributes to a great demand among employees for ethical leaders.

### 1.3. Leadership Effectiveness

When examining the factors that lead to organizational success, researchers have argued that effective leadership is a key predictor of organizational success or failure [19]. However, others have argued that organizational performance cannot be significantly attributed or explained by the leadership of the organization [20, 21]. The compelling question is, do leaders and effective leadership matter and positively impact organizational outcomes. [22] argued that effective leadership is important and does impact organizational outcomes. According to [23], leadership effectiveness is the capability to influence the behavior of an individual or group in the direction of the achievement of a goal. The definition has developed from the idea of a leader being a born leader or just one who leads to a more multifaceted division of how a person applies power.

### 1.4. Organizational Performance

For researchers who are anxious with practically all areas of leadership, the most significant dependent variable is organizational performance [24], for that reason, it explains performances of an organization [25]. According to [26], organizational performance discusses the ability of an organization to reach objectives such as good quality products, high profits, a big market share, decent financial results, using relevant strategies for action. As stated by [27], there are various indicators to evaluate the performance of an organization, most of them are tangible; cost reduction, profits, sales volume, asset turnover, equity turnover, and inventory turnover. Otherwise, some intangible performance indicators such as customer satisfaction and product development are used rarely [28]. As said by [29], organization performance is a measure of an organization progress, that demonstrates how well an organization is achieving its goals.

In accordance with [30], to ensure organizational success,

the important step is analysis of organizational performance, but there is little agreement that due to the complexity of the construct there is still lack of valid set of criteria to measure organizational performance. Despite the fact, based on the literature in organizational performance, as a dependent variable it has been used widely and also many studies focused on recognizing the aspects that influence the inconsistency in performance outcomes. It is also still an unclear variable [1, 24, 28, and 31].

## 2. Ethical Leadership, Leadership Effectiveness and Organizational Performance

According to [32], leadership has an important role in the development and growth of any organization. The reason for this fact is that the leaders of the organization generally consider all the plans and business decisions, effective and timely decisions considering by the leadership of the organization can have a wide impression on the crucial business results.

[33] stated that a decent leadership behaviour have been recognized as the important factor that contributing to SMEs success. Furthermore, [34, 35] emphasized that insufficient leadership skills and poor management skills are major factors which drive the failure of SMEs. It is approved that an organization needs growth and profitability in their performance, but having an effective leadership assist organizations to preserve the operation and direct the employees to make organizational performance success [36]. Therefore, organizations require to develop comprehensive leadership behaviour such as ethical and effectiveness leadership to direct their organization through difficult times [33]. Suitable leadership behaviour in the organizations can keep employees motivated and focused.

A recent study conducted by [37], the authors examined the effects of leadership behaviour on the organizational success and profitability, the study has been done among 48 SMEs in Pennsylvania and West Virginia, the results showed that leadership behaviour has contribution to the organizational success and profitability. They concluded that regarding to existing strong correlation between organizational performance and leadership behaviour, a positive situation and motivate employees to have high level performance in the organization can be provided by an suitable leader.

Another study by [35] examined a multivariate model for predicting leader effectiveness that included both the assessment of the contribution of ethical leadership in predicting the effectiveness of a leader, as well as the effect of related variables that may moderate the relationship between a leader's ethical behaviors and leader effectiveness. The study concluded that leaders who are ethical is more effective, and this behavior can incrementally contribute to explaining and predicting the effectiveness of a leader. Furthermore in this study additional research is encouraged

that assists academics and practitioners in determining how ethical leadership quality may be further developed in leaders to add to their overall effectiveness.

Using data from two semiconductor companies in China, [38] examined the moral emotions (empathy and gratitude) as the ethical leadership's antecedents and hypothesized that leaders' moral emotions (empathy and gratitude) should predict ethical leadership behaviors. The study concluded that the leaders' moral emotions (empathy and gratitude) both have direct and positive effect on ethical leadership. Another recent conducted study by [1], provides evidence that supports that ethical leader behavior significantly help explain perceived organizational performance.

However some studies discussed that for the success of an organization the leadership role is very important, on the other hand others studies mentioned that poor leadership practices in small business contributes the failure of the firm [39, 40]. A conducted study by [41] observed the empirical evidences of success or failure of SMEs, and concluded that most of the reasons of SMEs' failure can be recognized to internal factors, which mostly had mainly are poor leadership and lack of managers skills. [42], in their study they examined of 200 bankrupt firms failure reasons, and exposed that poor management and lack of their knowledge are the main reason causes the failure of small firms. The mainstays of these firms eventually didn't have necessary talent and skills to excel in business. They suggested that, for organizations to be productive, innovative and competitive, they require to have mainstays with right leadership behaviour composed with sufficient support and training. Significantly, for those organizations to stay in business world for long-term, the leader of firm should have the ability to adjust to the changing business world. These elements are very significant to maintain a successful economy as well.

A research conducted by [39] in a comparative study to evaluate the factors of SMEs failure in the Nigeria and United Kingdom, exposed that poor leadership and lack of management are the most important factors that affect SMEs' failure in the United Kingdom on the other side, organizational insufficiency and poor economic are the most important factors in Nigeria. While the sample of the study include just two interviews and 45 questionnaires with respondents in Nigeria and United Kingdom, consequently would not be anticipated to be extended to the overall population, the result still supported that efforts are needed to improve management skills and decent leadership, while these factors are only applicable to United Kingdom not to Nigeria. The results show that leadership and management have been chosen by 77% respondents in United Kingdom compare to just 44% respondents in Nigeria. The study concluded that in order to improve the performance of SMEs in United Kingdom the policy makers must pay more attention to these internal factors. On the other side, the government of Nigeria must address the hard economic situations and improve the organizational insufficiency that causes slow growth of SMEs in Nigeria.

According to [43], the practice of the leadership behaviour forms by leaders has suggestions for all level of managers in an organization. [44] postulated that in SMEs, the performance of the organization can be positively influenced by the leadership behaviour of top management. While nowadays the business becomes internationally competitive, SMEs need a new sight and set of leading to assist them to sustain in the competitive business world and become more competitive. Thus, the leadership behaviour of the owner of CEO of the organization plays an important role in guaranteeing right leading and directions and also a clear sight to be shared with followers and employees. In a conducted study by [45], they explored the effects of leadership style of leaders of SMEs. They mentioned that in order to changing rapidly in the business world and increases the strengths of business, the effective leaders are needed. For that reason, it is very important for SMEs' leaders to understand the fast changing of business environment and to provide the suitable leadership to improve organization performance.

To understand the effects of leadership on organizational performance is also important because leadership is observed by some researchers (e.g. [46]) as one of the key to improving a firm's performance. On the other hand, effective leadership is observed as an effective source of management development and sustained competitive advantage for organizational performance improvement ([47]; [48]). [49], stressed that an understanding of leadership is important to small and medium scale enterprises (SMEs). Effective leadership provides the building block for organizational performance and it is absolutely essential to the survival and growth of every organization [50]. When examining the factors that lead to organizational success, researchers have argued that effective leadership is a key predictor of organizational success or failure [21, 51] and effective leadership can facilitate performance development [52]. In addition, to understand the effects of leadership on performance, it is important that leadership play a key role in developing the performance of the organization [25]. The improvement of organizational performance requires the development of effective leadership [53, 54]. Besides, [22] argued that effective leadership is important and does impact on organization's outcomes. As said by [21], effective leadership can result in enhanced organizational outcomes, particularly improved organizational profitability and growth.

### 3. Conclusion

In summary, leadership plays an important role in organizational success. Furthermore, having an ethical leadership within an organization has impact on organizational performance and for having successful performance the organizations require an effective leader to motivate and lead the followers. Finally, having an ethical leadership and effective leadership will help the organizations to sustain in their competitive worldwide business.

## References

- [1] Madanchian, M., et al., Effects of Leadership on Organizational Performance.
- [2] Arslan, A. and S. Staub, Theory X and Theory Y Type Leadership Behavior and its Impact on Organizational Performance: Small Business Owners in the Şişane Lighting and Chandelier District. *Procedia-Social and Behavioral Sciences*, 2013. 75: p. 102-111.
- [3] Zhu, W., I. K. H. Chew, and W. D. Spangler, CEO transformational leadership and organizational outcomes: The mediating role of human capital-enhancing human resource management. *The Leadership Quarterly*, 2005. 16(1): p. 39-52.
- [4] Lacerda, T. M. R. D. d. O. C. d., Understanding Leadership Effectiveness in Organizational Settings: An Integrative Approach, in *School of Economics and Management*. 2015, Universidade De Lisboa. p. 547.
- [5] Gul, S., et al. Leadership styles, turnover intentions and the mediating role of organizational commitment. In *Information and Knowledge Management*. 2012.
- [6] Kouzes, J. and B. Posner, The leadership practices inventory: Theory and evidence behind the five practices of exemplary leaders. Unpublished document. Retrieved February, 2002. 12: p. 2010.
- [7] Chen, Y.-T., Relationships among Emotional Intelligence, Cultural Intelligence, Job Performance, and Leader Effectiveness: A Study of County Extension Directors in Ohio. 2013, the Ohio State University. p. 288.
- [8] Northouse, P. G., *Leadership: Theory and practice*. 2015: Sage publications.
- [9] Mumford, M. D., et al., Leadership skills for a changing world: Solving complex social problems. *The Leadership Quarterly*, 2000. 11(1): p. 11-35.
- [10] Amagoh, F., Leadership development and leadership effectiveness. *Management Decision*, 2009. 47(6): p. 989-999.
- [11] Bell, J. R., R. R. Bell, and S. A. Elkins, Embedding ethical frameworks in the leadership system of not-for-profits: The special case of volunteers. *SAM Advanced Management Journal*, 2005. 70(4): p. 29.
- [12] Brown, M. E., L. K. Treviano, and D. A. Harrison, Ethical leadership: A social learning perspective for construct development and testing. *Organizational behavior and human decision processes*, 2005. 97(2): p. 117-134.
- [13] Griffin, R. W., *Management*, ed. t. ed. 2005, Boston: MA.: Houghton Mifflin Company.
- [14] Godfrey, R. K., *Effective Leadership: Factors That Influence Leaders' Ethical Behaviors in Decision Making – Case Study*. 2013, Capella University. p. 197.
- [15] Rich, P. B., The Impact of the Relationship between Ethical Leader Behavior, Transformational Leadership, and Organizational Performance Moderated By Organizational Hierarchy, in *School of Business and Technology*. 2014, Capella University. p. 100.
- [16] Li, C., Ethical Leadership in Firms: Antecedents and Consequences, in *Department of Management and Marketing* in the Graduate School of. 2013, University of Alabama. p. 108.
- [17] Ciulla, J. B., Leadership ethics: Mapping the territory. *Business Ethics Quarterly*, 1995. 5(01): p. 5-28.
- [18] Yukl, G., Leading organizational learning: Reflections on theory and research. *The Leadership Quarterly*, 2009. 20(1): p. 49-53.
- [19] Bennis, W. and B. Nanus, *Leadership: The strategies for taking charge*. New York, 1985.
- [20] Podolny, J., R. Khurana, and M. Hill-Popper, *How to put meaning back into leading*. HBS Working Knowledge, 2005.
- [21] Copeland, M. K., The Importance of Ethical Leadership in the Accounting Industry, in *School of Business & Leadership*. 2013, Regent University. p. 147.
- [22] Denison, D. R., R. Hooijberg, and R. E. Quinn, Paradox and performance: Toward a theory of behavioral complexity in managerial leadership. *Organization Science*, 1995. 6(5): p. 524-540.
- [23] Addison, L., *Leadership Skills among the Gifted and Talented*. 1985 Digest. 1985.
- [24] Richard, P. J., et al., Measuring organizational performance: Towards methodological best practice. *Journal of management*, 2009.
- [25] Obiwuru Timothy, C., et al., Effects of leadership style on organizational performance: A survey of selected small scale enterprises in Ikosi-Ketu council development area of Lagos State, Nigeria. *Australian Journal of Business and Management Research*, 2011. 1(7): p. 100-111.
- [26] Koontz, H. and C. Donnell, *Introduction to Management*. 1993, McGraw-Hill Inc., New York.
- [27] Choudhary, A. I., S. A. Akhtar, and A. Zaheer, Impact of transformational and servant leadership on organizational performance: A comparative analysis. *Journal of Business Ethics*, 2013. 116(2): p. 433-440.
- [28] Rhodes, J., et al., Factors influencing organizational knowledge transfer: implication for corporate performance. *Journal of knowledge management*, 2008. 12(3): p. 84-100.
- [29] Hamon, T., *Organizational effectiveness between transformational leadership and organizational performance in the largest public companies in Canada*. Unpublished doctoral dissertation, Capella University, Minneapolis, MN, 2003.
- [30] Lusthaus, C., *Organizational assessment: A framework for improving performance*. 2002: IDRC.
- [31] Rogers, E. W. and P. M. Wright, Measuring organizational performance in strategic human resource management: Problems, prospects and performance information markets. *Human resource management review*, 1998. 8(3): p. 311-331.
- [32] Avolio, B. J., et al., Leadership models, methods, and applications. *Handbook of psychology*, 2003.
- [33] Madanchian, M., et al., The Role of SMEs in Economic Development; Case Study of Malaysia.
- [34] Davis, D., *Business Research for Decision Making*. 6th ed. 2005, Australia: Thomson South-Western.

- [35] Copeland, M. K., The Importance of Ethical Leadership in the Accounting Industry: Regent University.
- [36] Arham, A. F., C. Boucher, and N. Muenjohn, Leadership and entrepreneurial success: A study of SMEs in Malaysia. *World*. 3(5).
- [37] Valdiserri, G. A. and J. L. Wilson, The study of leadership in small business organizations: Impact on profitability and organizational success. *The Entrepreneurial Executive*. 15(1): p. 47-71.
- [38] Li, Y., et al., Ethical leadership and subordinates' occupational well-being: A multi-level examination in China. *Social Indicators Research*. 116(3): p. 823-842.
- [39] Ihua, U. B., SMEs key failure-factors: a comparison between the United Kingdom and Nigeria. *Journal of Social Science*, 2009. 18(3): p. 199-207.
- [40] Ives, B., M. H. Olson, and J. J. Baroudi., The measurement of user information satisfaction. *Communication of ACM*, 1983. 26(10): p. 785-793.
- [41] Beaver, G., Management and the small firm. *Strategic Change*, 2003. 12(2): p. 63-68.
- [42] Gibb, A. and T. Webb, Policy issues in small business research. 1980: Saxon House Aldershot.
- [43] Morris, M. G., V. V. and P. L. Ackerman, Gender and age differences in employee decisions about new technology: an extension to the theory: of planned behavior. *IEEE Transactions on Engineering Management*, 2005. 52(1): p. 69-84.
- [44] Matzler, K., et al., The relationship between transformational leadership, product innovation and performance in SMEs. *Journal of Small Business & Entrepreneurship*, 2008. 21(2): p. 139-151.
- [45] Hayat, N. and M. T. Riaz, The influence of the SMEs top-level manager's leadership styles and their entrepreneurial orientation on the business performance. Available at SSRN 1884069.
- [46] Zhu, W., The effect of ethical leadership on follower moral identity: The mediating role of psychological empowerment. *Leadership Review*, 2008. 8(3): p. 62-73.
- [47] Avolio, B. J., Full leadership development: Building the vital forces in organizations. 1999: Sage.
- [48] Rowe, K., The imperative of evidence-based instructional leadership: Building capacity within professional learning communities via a focus on effective teaching practice. 2007: Citeseer.
- [49] Stoner, J. a. G., D., Management. 2001: New York: Prentice Hall Incorporation.
- [50] Uchenwamgbe, B., Effects of leadership style on organizational performance in small and medium scale enterprises (SMEs) in Nigeria. *European Journal of Business and Management*, 2013. 5(23): p. 53-73.
- [51] Bennis, W., Nanus (1985) *Leaders: The Strategies for Taking Charge*. 1995, New York: Harper and Row.
- [52] McGrath, R. G. and I. C. MacMillan, The entrepreneurial mindset: Strategies for continuously creating opportunity in an age of uncertainty. Vol. 284. 2000: Harvard Business Press.
- [53] Avolio, B. J., B. M. Bass, and D. I. Jung, Re-examining the components of transformational and transactional leadership using the Multifactor Leadership. *Journal of occupational and organizational psychology*, 1999. 72(4): p. 441-462.
- [54] Rowe, W. G., Creating wealth in organizations: The role of strategic leadership. *The Academy of Management Executive*, 2001. 15(1): p. 81-94.