

SMEs Performance in Indonesia: The Role of Leadership and Culture

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We drew on resource-based theory for this empirical study, as an overarching model and derived two hypotheses that link elements from transformational leadership, entrepreneurial orientation, and firm performance as well as a similar link from organizational culture. The present empirical study assumes that transformational leadership style vis-à-vis with organizational culture are intangible resources that facilitate the effective altering entrepreneurial orientation into the relatively higher level of firm performance. The specific empirical study examines this links in a small and medium enterprise context. We surveyed 100 owners/senior managements from various type of small medium enterprises at Indonesia by means valid and reliable measurement instruments. As hypothesized, entrepreneurial orientation mediated the relationship between transformational leadership and firm performance as well as organizational culture and firm performance. Implications and directions for future research are discussed.

Keywords: Transformational leadership, Culture, Firm performance, Entrepreneurial orientation (EO)

INTRODUCTION

Small-medium enterprises (SMEs) play a significant role in the development of a country (Mazzarol, Volery, Doss & Thein, 1999). Beck, Demircug-Kunt, and Levine (2005) found a strong association between the importance of SMEs and GDP per capita growth in 45 countries. Also, statistics indicate that SMEs contributes to local and international markets for a substantial proportion of exports (Knight, 2001). Indonesia has a large number of small and medium business sectors: around 99.91% of all companies can be categorized as small and medium enterprises. This certain category contributes about 42.24% to GDP with total employment absorption of 91.3 million (Shaban, Duygun, Anwar & Akbar, 2014). Small-medium enterprise in Indonesia typically leads by the owner who acts as manager, which has five to nineteen employees, to run all activities in their business. Thus, the leader plays a key role to attain a higher level of firm performance. Also, SMEs needs supporting work environment to be innovative and competitive. Hence, the culture of the organization is crucial for SMEs to more competitive to pursue the business opportunities.

Transformational leadership is widely examined that can boost an organization to have a relatively higher level of performance. A meta-analytic study showed that transformational leadership has generated a consistent finding of a positive relationship between transformational leadership and performance (Wang, Oh, Courtright, & Colbert, 2011). In addition to transformational leadership, organizational culture as the prime independent variable, the present study looks at organizational culture, which constitutes the secondary independence variable. A meta-analytic study showed that organizational culture has a positive relationship to performance (Hartnell, Ou, & Kinicki, 2011). However, to best our knowledge very few studies examine the impact of the transformational leadership and organizational culture on firm performance in the context of the small-medium enterprise particularly in the transforming economy country such as South East Asia country, include Indonesia. Meta-analysis EO to firm performance (Rauch, Wiklund, Lumpkin, & Frese, 2009).

Due to transformational leadership and organizational culture may foster innovativeness and proactiveness, we sought also to examine indirect mechanism through which transformational leadership and organizational culture may affect firm innovation and thereby firm performance is by shaping an entrepreneurial orientation. The present study's aim is to invoke resource-based theory regarding firm's resource namely transformational leadership, and organizational culture may act as intangible resources to attain a high level of firm performance through a mediating variable: entrepreneurial orientation. Several empirical studies have been examined entrepreneurial orientation and leadership as key variables that impact on business performance, particularly in small-medium enterprise (Lee and Peterson, 2000). Below, we first theorize the links between the key constructs in the hypothesized model. After a Methods and Result section, we discuss the finding with the purpose of extending this and future research.

LITERATURE REVIEW

The study addresses the gaps and links organizational culture and transformational leadership to firm performance through entrepreneurial orientation. By focusing on this linkages, this study has to potential to provide small medium enterprise

the understanding of SME's performance. In this study we focus on small medium enterprise since this type of organization is dominantly lead by the owner who responsible day-to-day activities to their small number of employees.

In addition to leadership and organizational culture, EO contains of the corporate policies and practices which allow an organization to perform in entrepreneurial activity toward potential business opportunities (G. T. Lumpkin & Dess, 1996). EO is usually defined as "the simultaneous exhibition of innovativeness, proactiveness, and risk taking" (Stam & Elfring, 2008: 98). Entrepreneurial orientation can also be viewed as the foundation of entrepreneurial process in the firm which related to intrapreneurship (Rauch et al., 2009). Thus, key important factors in entrepreneurship is the process to what extent the autonomy for employee behavior and firm attitudes toward new opportunities can beneficial for an organization to the higher level of performance. Lumpkin and Dess (1996) formulate a model of entrepreneurial orientation that is a common model that usually used by entrepreneurship scholar in an empirical setting. They provide that there are five dimensions of entrepreneurial orientation – autonomy, innovativeness, risk taking, proactiveness and competitive aggressiveness (G. T. Lumpkin & Dess, 1996).

Some empirical studies show that EO has significant relationship towards performance, it shown by a Meta analytic study which reported in 51 published articles (Rauch et al., 2009). Nevertheless, several studies also pay attention about unclear about position of EO in the firm. Researcher argued that an organization in particularly small medium enterprise might be will face difficulty to translating EO-performance link when the role of leadership not be take into account (Gupta, Macmillan, & Surie, 2004). Leadership will shape employees' work environment and the culture as well so that it will aligning the interest among members and the organization. Thus, the role of transformational leadership style and organizational culture in SME may relatively lead to the higher level of firm performance. The operationalization between the constructs are discussed below.

Transformational Leadership

In this study, the first two independent study that we explored is transformational leadership. Bass (1985) introduced the concept of transformational and transactional leadership (Kuhnert & Lewis, 1987). Contrary to the transactional leader who practices contingent reinforcement of followers, transformational leader inspires, intellectually stimulates and individually consider others (Bass, 1999). A study by (Avolio, Bass, & Jung, 1999) with the total of 3786 respondents in 14 independent samples, re-examined the components of transformational and transactional leadership using Multifactor Leadership Questionnaire (MLQ). They found that the MLQ was best represented by six lower order factors that consist of: charisma, intellectual stimulation, individualized consideration, contingent reward, active management by exception and passive avoidant. Three correlated higher-order factors are: transformational, developmental exchange and corrective avoidant (Avolio et al., 1999).

Regarding to the MLQ explanation, Hater & Bass (1988) offers improvements to the MLQ instrument management by exception by dividing into two parts: active vs. passive. Drath, McCauley, Palus, Van Velsor, O'connor and McGuire (2008) conducted a study on ontology science of leadership. They found that the general concept of

leadership requires ontology development. As an alternative they offer the concept of direction, alignment and commitment. The aspects is expected to contribute to the development of leadership, both theory and practice. Direction is the collective agreement of the company's vision, mission and goals. Alignment is collective communication and coordination within the organization. Commitment is the willingness of each element of the organization to promote the collective interest above personal interest. In Asian context, transformation leadership has a strong positive effect on firm sales growth (Harsanto & Roelfsema, 2015). How culture associate to the innovation is explored below.

Culture

Hoogan and Coote (2014) state that innovation is prerequisite for success in competitive business environment in the service economy. Precusor of innovation in organization than can sustain organization and foster innovation is culture. Schein (1990) defined organizational culture as “a pattern of basic assumptions that a group has invented, discovered or developed in learning to cope with its problems of external adaptation and internal integration and that have worked well enough to be considered valid, and therefore, to be taught to new members as the correct way to perceive, think and feel in relation to those problems”. Ogbonna & Haris (2000) found that competitive and innovative cultures are positively related to organizational performance.

The difference culture across countries affect entrepreneurial activity one to another country. Morosini (1998) showed that national culture values of individualism and power distance explain national differences in rate of inventiveness and Widiyanto (2010) found that Individualism dimension (using Hofstede approach) affect national entrepreneurial activity. Culture effects the point of view that impact how members in an organization faced issues, as well as they view's their business ecosystem (Johnson, 2002). Individuals would become entrepreneur when they involved and supported in entrepreneurship environment and culture (Turró, Lopez & Urbano, 2013). All in all, culture is one key play an important role related for economic behavior, innovation and entrepreneurship.

Entrepreneurial Orientation

This study employee entrepreneurial orientation as mediating variable to investigate the linkage between leadership, organizational culture to firm performance. A study by (Covin, Green, & Slevin, 2006) with 110 manufacturing firms' samples indicated that there is a positive effect of EO on sales growth rate. Entrepreneurial orientation may be viewed as the entrepreneurial strategy-making processes that key decision makers use to enact their firm's organizational purpose, sustain its vision, and create competitive advantage (Rauch et al., 2009). A popular model of EO suggests that there are five dimensions of EO –autonomy, innovativeness, risk taking, proactiveness, and competitive aggressiveness (G. T. Lumpkin & Dess, 1996). Further research sampled 124 executives from 94 firms found that there are two different approach to entrepreneurial decision making – proactiveness and competitive aggressiveness- which may have different effects on firm performance where this differences were particularly

apparent in the way firms relate to their external environment (G.T Lumpkin & Dess, 2001).

Firm Performance

Business Performance is the result of the efforts by the company. Business performance is a multidimensional concept. There are many indicators that can be used to measure the performance of the company. At least it is reflected to the two main types namely financial and non-financial measurement. Financial measurement are usually obtained from secondary data include, among others, omzet, profit, return on investment as well as a variety of other financial ratios. Nonfinancial measurement includes aspects like satisfaction, reputation, degree of innovation, employee growth, market expansion and other non-financial measurements. (Rauch et al., 2009)

Hypotheses

Based on review of literature on transformational leadership, entrepreneurial orientation, culture, and firm performance, we develop hypotheses by placing entrepreneurial orientation as a mediating variable between transformational leadership and organizational culture vis a vis to firm performance. Two hypotheses are developed,

H1: Entrepreneurial orientation mediates the relationship between transformational leadership and firm performance.

H2: Entrepreneurial orientation mediates the relationship between organizational culture and firm performance.

FIGURE 1 ABOUT HERE (HYPOTHESIZED MODEL)

RESEARCH METHODOLOGY

Sample

We collected data on small medium organization in Bandung Indonesia during mid-2014. We performed survey to the owners or senior management as key informants for our survey due to the owner have better knowledge of the entire organization than else (Engelen, Flatten, Thalmann and Brettel, 2014). The survey involved 100 small medium enterprises in Bandung, Indonesia. Questionnaires distributed online and offline. Bandung is capital city of West Java province and one of largest city in Indonesia that well known as Paris van Java. This city also considered as significant SMEs development with many young creative entrepreneurs and several SMEs production and trade areas with specific products.

Measures

We measured transformational leadership, organizational culture and entrepreneurial orientation constructs using well-established measures on a-point Likert-type scale (1 to 5).

Transformational leadership. Transformational leadership was measured using MLQ that has five dimensions such as idealized attributes, idealized behaviors, inspirational motivation, intellectual stimulations and individual consideration.

Organizational culture. We employed items from Schwartz (2006) to measure organizational culture.

Entrepreneurial orientation. To measure entrepreneurial orientation, we employed items that developed by Rauch, Wiklund, Lumpkin & Frese (2009).

Business performance. We used sales growth as objective firm performance.

TABLE 1 ABOUT HERE

Analysis

To analyze data in this study, we use variance structural equation modeling using PLS. It aims to test the measurement model and the structural model. To predict the connection between variables we conducting correlation analysis. Researchers use PLS because this technique can provide a standardized regression coefficient for the model paths, which can be used to measure the relationship between latent variables. PLS also gives the factor loading for each item so that the interpretation of measurement equal to loading the interpretation of the results of a factor analysis component. Furthermore, PLS allows researchers to use a lot of measurements (multiple measures) on the dependent variable and the independent variables and indicators in order to assess the reliability of the construct (construct reliability) as well as the correction of incorrect measurements (measurement error).

TABLE 2 AND 3 ABOUT HERE

FINDINGS

This study investigated the relationship between leadership, culture, entrepreneurial orientation and firm performance. Overall 100 qualified responses yielded from owner and senior management of SMEs in Bandung area. Owner and senior management have been selected for those segments are representative who most know the condition of the company. Owner chosen as respondents because in SMEs almost all owners runs their business. Senior management was selected because they were expected to be a key informant on vrious characteristics and data that is being explored in this research include the history and performance of the company. Sample composition which contains the industry type, respondent position, firm size and firm age is shown in table 1.

In this paper we have hypothesized that there is relationship between transformational leadership and organisational culture to firm performance with mediating role of

entrepreneurial orientation. In order to predict the relationship between one variable to other variable we perform correlations between variables. The correlations table is shown in table 2. From table 2 it becomes clear that we can expect there are relationship between transformational leadership and organisational culture to firm performance. It becomes an insight to proceed to next step of analysis.

Despite its particular importance in small medium enterprise, but lack of study, which explored it into account when scrutinizing entrepreneurial orientation determinants in small medium enterprise. In this regard, our study attempts to account for the effect of leadership and culture as determinants of construct entrepreneurial orientation, in turn, enhance business performance (financial measurement). Our finding empirically confirms that culture and leadership play as pivotal variables to entrepreneurial orientation, which in turn effect on financial performance.

DISCUSSION AND IMPLICATION

These present study showed that the linkage of transformational leadership and culture, entrepreneurial organization and firm performance is supported. It indicates that role of transformational leadership and culture are the driver of entrepreneurial orientation and in turn, effects on firm performance.

In this study, we have examined the effects of transformational leadership styles and entrepreneurial orientation on the firm performance regarding an emerging market country. These linkages have been studied in the previous study, however, not in the similar additional combination link. Thus, there is a potential gap, which invokes empirical evidence of the relation between transformational leadership style and organizational culture of organization on the one hand and between entrepreneurial orientation and firm performance on the other hand. This study indicates that the link of transformational leadership, organizational culture and an entrepreneurial orientation of the firm are a booster for sustainable firm performance. Thus, it may explain the resource caravan of COR theory, in which transformational leadership and organizational culture are resource apparently for performance of a SME.

We also found that transformational leadership style (a rather Western concept) may have a positive impact on the entrepreneurial orientation of the SME. This may indicate a significant contribution to the small medium enterprise literature. Entrepreneurship in emerging market is on the rise both as a behavioral phenomenon as well as an explanatory variable of the firm performance (Harsanto & Roelfsema, 2015). Furthermore, the contribution of the paper is to add to the understanding of the effects of transformational leadership style and organizational culture in the context of emerging markets may have different impacts. Southeast Asia country like Indonesia has discrepancy structures and cultural attributes and thereby it is frequently argued that transformational leadership has no cultural relevant with the rules and social context. Instead, we indeed support the evidence for this. Transformational leadership scale might be useful for further research in Asian values context. However, other leadership style such as servant leadership or empowering leadership might be fruitful to investigate for further study.

Transformational leadership as viewed as a strong and visionary leader is useful for SME in facing dynamic environment. They can enhance the capability of their employees through their ideas, vision and intellectual stimulation. This leadership style is needed for SME in Indonesia that already face with ASEAN economic community 2015 that obviously generate market to more competitive. On the other hand, culture confirms as major drivers of a firm's entrepreneurial orientation (Engelen et al, 2014). Indonesia as characterized by strong collectivism and high power distance which need an adhocracy culture to be more competitive and advancing entrepreneurial orientation instead of being hierarchical organizational culture. Our findings show that transformational leadership exerts significantly effect to entrepreneurial orientation. It is likely strong leadership which has transformational leadership style enable the strategy making the process to the goal of the organization become reachable and has clear objectives (Covin, Green & Slevin, 2006). In addition, a transformational leader has charisma and persuasive approach to fostering their subordinates to do what he wanted. Furthermore, as predicted early that culture as predicted early significantly influences entrepreneurial orientation. It is supported study before that culture may important variable that plays as a key construct as determinants of entrepreneurial orientation (Shane 1992, Jenkins Johnson, 2002). Organizational culture may shape how organization behave and it will influence an organization to be proactive, aggressive or passive. SME in Indonesia rely on both leadership and culture to elevate the initiative of the organization to expand their business. For instance, they will not take in into account that international market as such a potential market if they merely focus in the domestic market. Therefore, it is reflective by the vision of the leader or owner of an SME to strivings and expanding their business. In addition, the expansion of SME in Indonesia generally may face several obstacles such as the capability to speak in international language and capacity to fulfill requirement of their international clients.

This study also elevates research on transformational leadership style. Extant research has treated transformational leadership as antecedents of performance but to based our knowledge very few study that examine the impact of transformational leadership to firm performance (Wang et al., 2011). Our research provides a contribution that may useful for leadership scholars that transformational leadership and organizational culture are pivotal *resource* that subsequently to entrepreneurial orientation impacts on firm performance. Our research also provides understanding the role of the EO–performance relationship.

The present study has the limitation that should be noted to useful avenues for further research. These present study may have a problem of common method variance due to similar sources of response although we minimized it with objective performance variable (e.g. sales growth). Therefore, future studies should minimize this potential issue by using multi-trait multi-method (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). Thus, different type of study should be perform such as qualitative research or experiment study to get more insight to understanding the link. In addition, the future study may also conduct longitudinal study to remedy issue of reverse causality by use lagged performance. Future studies should also examine whether there are certain differences among type of organizations that affect the link between constructs in hypothesized model. Instead SME leader may lead in small group member level, future studies should examine this to learn how the effects on the EO and firm performance relationship.

CONCLUSION

Although some studies have been examining of the role of leadership to performance in the small medium enterprise, very few studies that examine this phenomenon in emerging markets, include Indonesia. This study may give us evidence that transformational leadership style relatively related to surviving in dynamics environment in particularly emerging market such as Indonesia that not always have easiness of doing business. Therefore, the transformational leader may significantly influence how the entrepreneurial orientation in SME is flourished through motivating, inspiring and act as role model for employees to perform better. Also, the transformational leader may also influence the strategy making and breakthrough to win in more competitive circumstance.

As emerging market SME in Indonesia need to be agiler to coping boundaries in the near future. It is fit for SME in Indonesia to have a leader who has transformational leadership style in order to win the challenges. Transformational leadership may be as an intangible resource that associated with strategic making to fostering firm performance. Hence, transformational leadership showed link to entrepreneurial orientation which lead to strategic decision in order to achieve superior firm performance.

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TABLE

Table 1 Sample Characteristic

	Percent
Industry	
Manufacturing - Food	36
Manufacturing - Textiles & Garments	15
Manufacturing - Publishing, printing and Recorded media	6
Manufacturing - Furniture	4
Service - Transportation	4
Service - IT	6
Other	29
Position of Respondent	
Owner	66
Senior management	34
Company Size	
< 5	37
6 to 10	24
11 to 30	22
30 to 50	5
>50	12
Firm Age	
< 10	79
10 to 20	19
> 20	2
Sample Size: N=100	

Table 2 Descriptive Statistics and Correlations

	1	2	3	4
1. Transformational Leadership				
2. Organisational Culture	0.58**			
3. Entrepreneurial Orientation	0.59**	0.47**		
4. Firm Performance	0.14	0.16	0.22*	
Mean	3.89	3.82	3.54	26.42
Standard Deviation	0.551	0.524	0.599	38.66

*p = 0.02 (two-tailed)

**p = 0.01 (two-tailed)

Table 3 Path coefficient variables

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (O/STERR)
Culture -> EO (Entrepreneurial orientation)	0.323107	0.364361	0.137668	0.137668	2.347001
EO (Entrepreneurial orientation) -> (FP) Firm Performance	0.423622	0.448702	0.065899	0.065899	6.428380
Leader -> EO (Entrepreneurial orientation)	0.521777	0.485822	0.160736	0.160736	3.246182

t >1.645, two tail significance

FIGURE

Figure 1. Hypothesized model

