

## Impact of Transformational and Transactional Leadership Styles on Organizational Commitment and SMEs Business Performance: A Comparative Analysis

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**Abstract:** This study has investigated the impact of leadership styles on organizational commitment and business performance and impact of organizational commitment on business performance of SMEs in Bali, Indonesia. The study adopted a survey design using a semantic differential scale questionnaire sent to 118 managers and assistant managers from 59 SMEs out of the total population of 70 SMEs. The data analysis employed Partial Least Square (PLS-3). The result showed that both transformational and transactional leadership styles had significant positive effect on organizational commitment and SMEs business performance and organizational commitment had significant positive effect on business performance. The study concluded that transactional leadership was more appropriate in inducing commitment and business performance in small medium enterprises than transformational leadership style and therefore, recommended transactional leadership style for the small enterprises with inbuilt strategies for transition, the enterprises developed, grew and sustainability.

**Key words:** Business performance, organizational commitment, transformational, transactional leadership, enterprises, appropriate

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### INTRODUCTION

Studies on leadership and leadership effectiveness in particular have extensively been conducted over the last few years. The foci of those studies have varied, related to the purposes of both organization and individuals. One of the aims of the present study was concerned with the significance of improving performance of organization through leadership (Riaz and Haider, 2010). The study conducted by Jandaghi *et al.* (2009) discovered that a successful organization is one adopting an appropriate leadership style to influence all elements in the organization. This suggests that appropriate leadership will affect work effectiveness in facing the dynamics of environment both internal and external. The important role leadership plays in an organization is as a catalyst especially related to human resources more particularly in managing human capital and intellectual capital.

According to Kennedy *et al.* (2005), transformational leadership refers to ethical leadership style, that is the ability of a leader to promote intellectual stimulus deriving from the employee's inspiration and according to Bass (1985) a transformational leader uses and changes the employee's values to promote the organization's vision and purposes. Other researchers such as Avolio *et al.* (2004) and Dvir *et al.* (2002), claim that transformational

leadership style is an inspirational method that can motivate and uses such motivation to influence employees. On the other hand, transactional leadership, according to Burns, refers to the exchange of relationship between the leaders and subordinates. The main focus of transactional leadership is to clarify the relationship that exists between the leader and the subordinates wherein the former is supposed to understand the employee's needs that are in accordance with organization's purposes (Howell and Avolio, 1993). The important role played by transactional leadership concerns the existence of transaction wherein the leader gives rewards to employees with good performance and the leader's ability to achieve the purposes of the organization as well as giving punishment when the subordinates cannot perform as expected.

In terms of behavioral aspect, leadership also contributes significantly to organizational commitment, since leadership has alternative perspectives in promoting commitment. Research has produced inconclusive findings in regard to the effect of transformational and transactional leadership on organizational commitment and hence further research needs to be carried out. The study conducted by Swanepoel (2000) found that organizational commitment results from the role played by leadership in the implementation business strategy to

achieve the purposes of the organization. Lo and Ramayah (2009) found that transactional and transformational leaderships exert a positive impact on the purposes of the organization.

Studies examining the relationship between transformational leadership and organizational commitment have been carried out by Yang *et al.* (2011), Kordy (2013), Gumusluoglu *et al.* (2013) and also Peachey *et al.* (2014). Emery and Barker (2007) found a significant positive relationship between transformational leadership and organizational commitment. The present study argues that it is necessary to develop leadership through education and training in order to build a leadership behaviour and skills leading to effective transformational leadership. Avolio *et al.* (2004) found that transformational leadership significantly influences on organizational commitment. The study conducted by Porter (2014) examined the effect of each dimension of transformational leadership on organizational commitment. These studies suggest the significant contribution of transformational leader to motivating employees to work harder, providing opportunities to share the vision in an attempt to create good organization related to their (employees) personal involvement as well as finishing their work (Shamir *et al.*, 1998; Givens 2008).

While the relationship between transactional leadership and organizational commitment was carried out by Alamir who found that transactional leadership significantly influences organizational commitment. In a comparison of both types of leadership, transformational leadership is deemed to have a greater influence on organizational commitment than transactional one (Lo and Ramayah, 2009). Likewise, another study Marmaya *et al.* (2011) also found that transformational leadership has a stronger positive influence on organizational commitment than transactional leadership. Studies conducted by Fernandes and Awamleh (2014), Ejere and Abasilim (2015), Abasilim *et al.* (2013) and Ojokuku *et al.* (2012) found that transformational leadership significantly affects the performance of the organization while the results of research conducted by Timothy *et al.* (2011) showed that transformational leadership does not significant effect organizational performance of SMEs in Nigeria. While the study looked at the relationship transactional leadership with organizational performance conducted by Timothy *et al.* (2011) who found that transactional leadership significantly influence the organizational performance of SMEs elected in Nigeria.

Empirical studies showing the relationship between organizational commitment and business performance are presented in a study conducted by Roca-Puig *et al.* (2007) who found a positive relationship between organizational commitment on business performance. In the study conducted by Jing and Zhang the organizational

commitment was measured in terms of 5 dimensions, namely affective, normative, ideal, choice and economy. From the analysis it was found that the economic commitment does not significant affect organizational performance.

**Transformational leadership:** According to Bass (1985), transformational leadership is the type of leader who motivates subordinates through inspiration. Employees are challenged to develop a personality to concentrate on intangible quality such as sharing ideas values and vision in an effort to build good relationships within the organization. Moreover, Riaz and Haider (2010) suggest that transformational leaders inspire employees and make employees to display their best ability to achieve organizational goals.

In general, there are 4 dimensions, namely, idealized influence, inspirational motivation, intellectual stimulation and individualized consideration.

**Idealized influence:** This dimension refers to the perspective of employees who believe that the leader has the strength, charisma, confidence, conviction, consistency and ideas that affect the employees, so that employees are able to pull out the best performance and show respect.

**Inspirational motivation:** According to Moghali more specifically mentions six characteristics of the dimensions of inspirational motivation, namely speaking optimistically about the future, speaking enthusiastically about what should be done, expressing the viewpoint that can achieve future, showing self-confidence on the fact that will be faced, describing the exciting future and what must be considered and being able to solve challenging problems.

**Intellectual stimulation:** The third dimension refers to how leads with the best approach able to face challenges related to the confidence and trust and helps employees improve leadership capabilities of individual employees and organizations.

**Individualized consideration:** This dimension refers to the ability of a leader in understanding different employees, considering personal motivation and efforts to improve the motivation of employees and is capable of transferring responsibility to the employees as a primary goal.

**Transactional leadership:** Transactional leadership is a leadership style that is used in behavioral sciences. The originator of this theory is Burns who referred to this leadership style as an exchange relationship between the leader and the subordinates. Its main focus is the clarity

of the role of the leader and subordinates whereby a leader must know the needs of employees in achieving the organizational goals. Bass and Avolio (2000) and Avolio *et al.* (2004) discuss the transactional leadership attributes in two ways, the first is contingent reward and the other is management by exception.

Transactional leadership is one that switches the interaction between subordinates for rewards and increase their productivity. In short transactional leadership provides benefits to goal achievement while penalties will be awarded if the employee does not reach the target. Furthermore, Piccolo and Colcut simply defines transactional leadership as a contractual relationship between leaders and subordinates.

**Organizational commitment:** Porter (2014) define organizational commitment as the identification of the strengths of individuals with involvement in any organization. Each commitment can be generalized into three factors, namely; the strength of the confidence and acceptance of the values and goals of the organization; the desire to display the best performance for the organization and the desire to maintain the sense of being members of the organization. Matthieu and Zajac suggest that the definition of organizational commitment is a line of relationship between employees and the organization. Furthermore, Meyer and Allen offer a three-dimensional definition of the concept organizational commitment as follows: affective refers to the emotional state of employees, identification and involvement in the organization, continuance refers to the sensitivity to the costs incurred upon leaving the organization and normative refers to the reflection of feelings as an employee.

**Business performance:** Beer and Frese maintain that business performance is a subjective measure. Nevertheless, the organizational performance can be measured by using the rate of profit, the return on investment, the level of customer maintenance and sales growth. Meanwhile, according to Pelham measured the performance of the business based on business efficiency, growth of the market and the ability to make profit. In a general scale, organizational performance can be measured in terms of return on assets, return on equity, net growth rate and return on sales while the efficiency and effectiveness is also a measure for the performance of the organization. Ariyani *et al.* (2016) business performance is closely linked to the performance of individual, i.e. as actual achievement of employees compared with the expected accomplishments of employees.

Meanwhile, if viewed from the subjects in this study, namely SMEs, previous related studies have been

conducted by several researchers. According to study by Wiklund deployed such performance indicators as growth and financial performance to measure the performance of small businesses. The most creative research to date was carried out by Davis. Due to the difficulty in collecting the company's business performance data a survey was used to tap on the perception of managers regarding the performance of their organization in size (net profit) by asking for their opinion about the company's net profit.

## MATERIALS AND METHODS

**Research model framework and development of hypothesis:** Creating a superior business performance from changes in an increasingly competitive world demands a different kind of leadership than what was implemented in the past. Because of the global world organizations face a rapidly changing environment and leaders face new realities and challenges. What is now needed is a leader who can be agents of change and center of gravity who stays focused on the internal environment and allows people and organization to adapt and be successful while at the same time never relinquishes customer focus and an external perspective. Furnham asserts that the results of precise measurements of the quality of leadership is the effectiveness (reflects success leaders in achieving organizational results, goals, objectives and work needs of the subordinates). Thus, the size of the organizational performance in this study is represented by the extent to which the company achieves its business objectives. The research model is illustrated in Fig. 1.

Swanepoel (2000) found that organizational commitment results from the role played by leadership in the implementation business strategy to achieve the purposes of the organization. Gumusglou *et al.* (2013), Peachey *et al.* (2014) and Emery and Barker (2007) found a significant positive relationship between transformational leadership and organizational commitment. According to Alamir who found that transactional leadership significantly influences organizational commitment. In accordance with the above discussion, the following relevant hypothesis was inferred in this study:

- H<sub>1</sub>: transformational leadership will significantly and positively affect on organizational commitment
- H<sub>2</sub>: transactional leadership will significantly and positively affect on organizational commitment

According to studies by Kanter organizational commitment refers to an attached commitment as a form of individual and emotional feelings of employees on the

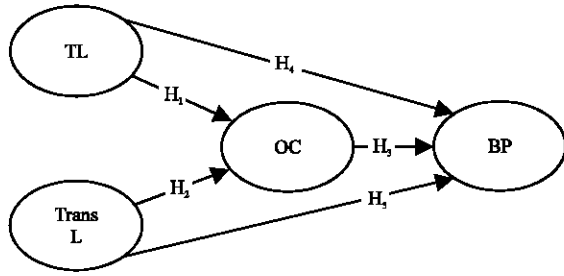


Fig. 1: Research model framework

organization. Meanwhile, Buchanan defines commitment as a partisan, individual feelings in achieving the goals and values of the organization in an organizational relationship. Roca-Puig *et al.* (2007) who found a positive relationship between organizational commitment on business performance. In accordance with the above discussion, the following relevant hypothesis was inferred in this study:

- H<sub>2</sub>: organizational commitment will significantly and positively affect on business performance

In the literature, the role of leadership significantly influences business performance. Studies conducted by Ejere and Abasilim (2013), Abasilim *et al.* (2014) and Ojokuku *et al.* (2012) found that transformational leadership significantly affects the performance of the organization. While the study looked at the relationship between transactional leadership and organizational performance conducted by Timothy *et al.* (2011) who found that transactional leadership significantly influence the organizational performance.

- H<sub>4</sub>: transformational leadership will significantly and positively affect on business performance
- H<sub>3</sub>: transactional leadership is significantly and positively affect business performance

**Sample and data collection:** To determine the sample size in this study, the probability sampling method more particularly stratified proportional random sampling was used, i.e., if a sample size of n drawn from a population size of N is based on grade level each unit in the sample has the same opportunities to be selected randomly. Furthermore, stratified random sample is proportional to a sample drawn so that, each unit of study or elementary unit of the population has equal opportunities to be selected as samples. Based on the assumptions above, the number of samples taken for this study with a quantitative approach as a whole is 59 SMEs. The samples were selected randomly using probability

Table 1: Population and sample

Business fields	No. of population	Samples
Fashion designer and manufacturer	27	24
Furniture and home decor	25	22
Spa and aromatic product	1	1
Specialties product	6	4
Accessories and jewellery	4	3
Service	7	5
Total	70	59

sampling method, that is stratified proportional random sampling whereby the strata were based on the types of business as presented in Table 1.

The respondents in this study were the managers and assistant managers of the SMEs (N = 118). The selection of the sample respondents was conducted using simple random sampling method through the lottery method without recovery (non-replacement) which means that every member of the population had an equal opportunity to be a one-time sample. The collected data were then analysed using Partial Least Square (PLS-3).

**Measurement:** As the current research aims to investigate the effects of transformational and transactional leadership on organizational commitment and their effects on SMEs business performance, through a comparative analysis, the study examined the relationship between variables using multifaceted scales adopted from several previous researches. The basis for data collection and analysis is a field study in which respondents answered all items on a 7-point semantic differential-scales ranging from “1” meaning “strongly disagree” to “7” meaning “strongly agree”. In addition, elements used to consider each of the constructs were primarily obtained from prior research. These elements provided a valued source for data gathering and measurement as their reliability and validity have been verified through previous research and peer reviews. The analysis in this study was conducted using PLS-3 approach that begins by evaluating the structural equation models for the evaluation of the measurement model (outer model) which aims to determine the validity and reliability of the indicators used and subsequently the inner model testing through the process of resampling bootstrapping.

## RESULTS AND DISCUSSION

**Evaluation of measurement model (outer model):** Evaluation of the measurement model in this study aims to assess the indicators (observed variables), reflecting a construct or latent variable. Indicators were tested to give meaning or symbol to the latent variable. Testing measurement model can be explained by convergent validity whereby research is the initial stage

Table 2: Coefficients outer loading for each indicator

Factors	BP	OC	Tranf. L	Transc. L
x1.1			0.644	
x1.2			0.825	
x1.3			0.765	
x1.4			0.872	
x2.1				0.891
x2.2				0.921
x2.3				0.892
y1.1		0.910		
y1.2		0.908		
y1.3		0.894		
y2.1	0.934			
y2.2	0.814			
y2.3	0.943			
y2.4	0.948			

Table 3: Cross loading

Factors	Business performance	Org. commitment	Tranf. L	Transac. L
x1.1	0.187	0.109	0.644	-0.068
x1.2	0.305	0.267	0.825	-0.234
x1.3	0.268	0.196	0.765	-0.235
x1.4	0.348	0.334	0.872	-0.032
x2.1	0.410	0.386	-0.153	0.891
x2.2	0.582	0.428	-0.163	0.921
x2.3	0.336	0.427	-0.163	0.892
y1.1	0.627	0.910	0.388	0.335
y1.2	0.631	0.908	0.286	0.426
y1.3	0.592	0.894	0.168	0.488
y2.1	0.934	0.648	0.291	0.487
y2.2	0.814	0.454	0.307	0.394
y2.3	0.943	0.692	0.370	0.450
y2.4	0.948	0.663	0.365	0.503

of development of the measurement scale where the values of 0.5-0.6 are considered sufficient loading factor. The test results and measurements of each study variable and indicator are presented in Table 2.

From Table 2, it can be seen that the values of all indicators were larger than 0.6 so that, it can be concluded that the validity criteria were met. Figure 2 presents the results of PLS statistical analysis. Testing the validity of reflective indicators using the correlation between the scores of items with a score of the construct. Suitable reflective indicators used to measure the perception that this study uses a reflective indicator. Table 2 shows that the loading factor gives a value above the recommended value that is equal to 0.5. The smallest value is 0.644 for transformational leadership indicator 1 (X1.1) that's means the indicators used in this study is valid or has met the convergent validity (Table 3).

Another method used to see the discriminant validity is to look at the value of the square root of Average Variance Extracted (AVE). Recommended value is above 0.5. Table 4 showed AVE values above 0.5 for all constructs contained in the research model. The lowest value AVE = 0.610 in the construct of transformational leadership.

**Test of reliability:** Reliability testing is done by looking at the value of the block of composite reliability indicator that measures the construct. Composite reliability results will indicate if a satisfactory score above 0.7. Here are the composite reliability values at the output.

Table 5 shows that the value of composite reliability for all construct is above 0.7, indicating that all construct the model estimated meet the criteria of discriminant validity. Value composite reliability the lowest is at 0.861 on the construct transformational leadership style. Test reliability can also be strengthened by Cronbach's alpha where output PLS-3 gives the following results in Table 6.

Recommended value is above 0.6 and Table 6 shows that the value of Cronbach's alpha for all constructs be above 0.6. Value lowest amounted to 0.791

Table 4: AVE

Parameters	AVE	Akar AVE
Business performance	0.831	0.911
Org. commitment	0.818	0.904
Tranf. L	0.610	0.781
Transac. L	0.813	0.902

Table 5: Composite reliability

Parameters	Composite reliability
Business performance	0.951
Org. commitment	0.931
Tranf. L	0.861
Transac. L	0.929

Table 6: Cronbachs alpha

Parameters	Cronbachs alpha
Business performance	0.931
Org. commitment	0.889
Tranf. L	0.791
Transac. L	0.886

Table 7: Communality redundancy

Parameters	Communality	Redundancy
Business performance	0.831	0.328
Org. commitment	0.818	0.072
Tranf. L	0.610	
Transac. L	0.813	

Table 8: R<sup>2</sup>

Parameters	R <sup>2</sup>
Business performance	0.581
Org. commitment	0.370
Tranf. L	
Transac. L	

on the construct of transformational leadership style. Table 7 shows that, all construct communality values above 0.5 are reinforce the results of testing with composite reliability and Cronbach's alpha. Furthermore, the value is equal to 0.328 business performance redundancy is high. Once the model is estimated to meet criteria outer model, next step is testing the structural models (inner model).

As can be seen in Table 8, 58.1% of the total variance of business performance was accounted for by the variable organizational commitment. The R<sup>2</sup> value of 0.730 for organizational commitment was the collective

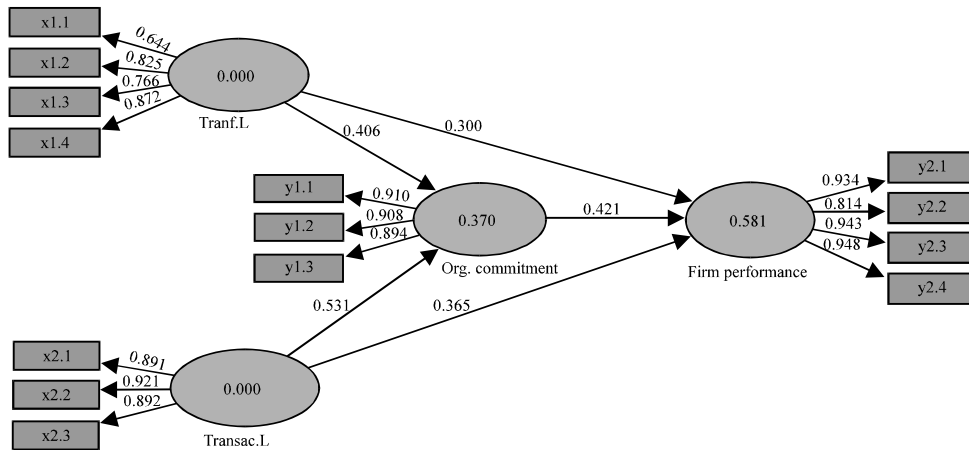


Fig. 2 : Outer loading and path analysis

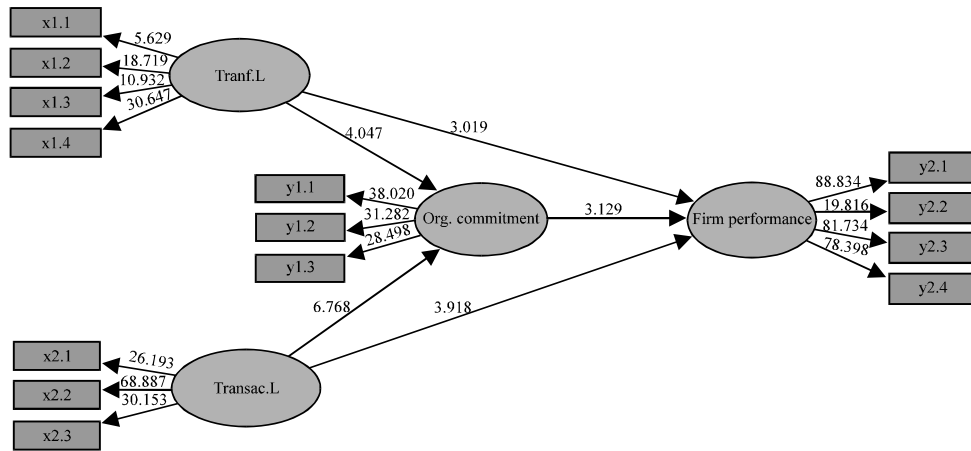


Fig. 3: Bootstrapping model

Table 9: Total effects (mean, STDEV, t-values)

Parameters	Original sample (O)	Sample mean (M)	SD (STDEV)	SE (STERR)	t-statistics ( O/STERR )
Org. commitment->firm performance	0.421	0.404	0.135	0.135	3.129
Tranf. L->firm performance	0.300	0.300	0.099	0.099	3.019
Tranf. L->Org. commitment	0.406	0.397	0.100	0.100	4.042
Transac. L->firm performance	0.365	0.375	0.093	0.093	3.916
Transac. L->Org. commitment	0.531	0.527	0.078	0.078	6.766

effect of transformational and transactional leadership. These statistical results indicate that the model was good enough and had relevant predictive power, that is 58.1% of the total variance of business performance could be accounted for by the research variables whereas the remaining 41.9% was accounted for by other variables. Subsequent analysis was focused on a series of tests, the results of which are shown in Fig. 3.

**Hypothesis testing:** The present research is a comparative study that examined the effect of transformational and transactional leadership on organizational commitment

and business performance of SMEs in the province of Bali, Indonesia. Therefore, a comparison was made of the path of the latent variables. The results of the statistical analysis are shown by Table 9. The relationship between transformational leadership and organizational commitment was significant with a t-statistic of 4.042 (>1.96). The original value of sample estimate was positive, 0.406 which indicates that the direction of the relationship between transformational leadership and organizational commitment is positive. Thus, H<sub>1</sub> in this study which states that ‘transformational leadership will significantly and positively influence on organizational

commitment' was confirmed. The relationship between transactional leadership and organizational commitment was also significant with a t-statistic of 6.766 ( $>1.96$ ). The original sample estimate value was positive, 0.531 which shows that the direction of the relationship between transactional leadership and organizational commitment was positive. Thus,  $H_2$  in this study which states that 'transactional leadership will significantly and positively influence on organizational commitment' was also confirmed.

The relationship between organizational commitment and business performance was significant with a t-statistics for 3.129 ( $>1.96$ ). The original sample estimate value was positive, 0.421 which indicates that the direction of the relationship between organizational commitment and business performance was positive. Thus  $H_3$  in this study which states that 'organizational commitment will significantly and positively affect on business performance' was confirmed. The relationship between transformational leadership and business performance was significant with a t-statistics of 3.019 ( $>1.96$ ). The original sample estimate value was positive, 0.300 which indicates that the direction of the relationship between transformational leadership and business performance was positive. Thus,  $H_4$  in this study which states that 'transformational leadership will significantly and positively affect on business performance' was confirmed.

The relationship between transactional leadership and business performance was significant with a t-statistic of 3.916 ( $>1.96$ ). The original sample estimate value was positive, 0.365 which shows that the direction of the relationship between transactional leadership and business performance was positive. Thus  $H_5$  in this study which states that 'transactional leadership will significantly and positively affect on business performance' was confirmed.

**Comparative testing of variables:** Table 8 also explains the comparison between the effects of transformational and transactional leadership on organizational commitment and business performance. The path coefficient of direct relationship between transformational leadership and organizational commitment is 0.406 whereas that between transactional leadership and organizational commitment is 0.531. This suggests that transactional leadership exerts greater influence on improving organizational commitment. This is a significant finding for this study. These results disprove the results of previous studies such as Lo and Ramayah (2009), that found transformational leadership is

deemed to have a greater influence on organizational commitment than transactional one likewise and another study (Marmaya *et al.*, 2011) also found that transformational leadership has a stronger positive influence on organizational commitment than transactional leadership.

A direct relationship between transformational leadership and business performance of SMEs is indicated by the path coefficient of 0.300 and the path coefficient of the direct relationship between transactional leadership and business performance is 0.365. It suggests that transactional leadership plays a more important role in improving the business performance of the SMEs adopting transformational leadership. In the study of the business performance of SMEs, transactional leadership roles have a greater impact because of the nature of the exchange is in this leadership. Business performance is extracted by an exchange in the organization. Subordinates who have good performance will be rewarded, adapted to the performance targets. This confirms the role of social exchange theory in organizations in which elements of the organization obtaining payment from the performance shown.

The direct relationship between organizational commitment and business performance is shown by the path coefficient of 0.421. Statistically, it means that organizational commitment has a more substantive influence than both styles of leadership in this study. This indicates that the organizational commitment brings about a greater impact on business performance. The organizational commitment to contribute more than a leadership role, this is due to the sense of responsibility and a sense of belonging to the organization. They have the intrinsic motivation to do all the work without encouragement from the outside especially the effect of leadership styles.

## CONCLUSION

Transformational leadership and transactional leadership have been discussed extensively in the literature on leadership that both leadership styles have positive impacts on the organization. But partially the two types of leadership can be compared in terms of their function and role. Transformational leadership has the ability to influence subordinates through the power of leadership inspiration by evoking subordinate's emotion while transactional leadership works through the process of transaction that exists between performance and organizational objectives. If linked to organizational commitment both leadership styles have a significant

impact but transactional leadership is more effective because of its nature as an exchange relationship. In the context of the present study, organizational commitment is built from such relationship. If linked to business performance, both leadership styles can also bring about a significant effect. However, transactional leadership plays a more important role, since one of its dimensions, contingent reward, dictates the manager to give rewards to those employees having the short-term and measurable target. Thus, transactional leadership is more suitable for SMEs to face transition, develop business, growth and sustainability.

### **LIMITATIONS**

This study aimed to compare the effect of transformational leadership and transactional leadership on organizational commitment and business performance of SMEs but the results of this study cannot be generalized to all sectors of SMEs.

### **SUGGESTIONS**

Future research should use longitudinal data and hence can be applied to all sectors of SMEs so that, the results can describe the condition of SMEs and can be applied by managers.

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