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## **THE ROLE OF LEADERSHIP STYLES TO PROMOTE INNOVATION: EMPIRICAL EVIDENCE FROM A DEVELOPING COUNTRY**

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### **ABSTRACT**

This study investigates the role of transformational and transactional leadership for promoting innovation both directly and through absorptive capacity. Transformational leadership is measured using individualized influence (both attributed and behavioural), inspirational motivation, intellectual stimulation, and individualized consideration. Transactional leadership is conceptualized employing contingent reward and management-by-exception (active). Data has been collected using clustering sampling technique from small and medium enterprises (SMEs) of Pakistan, while Structural Equation Modelling is used for analysis. Results indicate that transformational leadership directly affects innovation and indirectly through absorptive capacity but not with transactional leadership style.

### **Keywords**

Transformational Leadership, Transactional Leadership, Innovation, SMEs, Absorptive Capacity

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### 1. INTRODUCTION

Today's organizations operate in a dynamic and competitive environment characterized by globalization and technological advancements (Gumusluoglu & Ilsev, 2009). Innovation is one of the vital elements for organizations to gain competitive advantage and ensure successful survival in such a competitive environment (Anderson, Potočnik, & Zhou, 2014; Woodman, Sawyer, & Griffin, 1993). Further, small and medium enterprises (SMEs) need to be more innovative to compete and survive in this environment (Uden, 2007). In this study, we utilize Gumusluoglu and Ilsev (2009) and Oldham and Cummings (1996) to define innovation as an organization's propensity to develop new product, bring improvements in existing product, and/or successfully introduce that product in market.

The innovation concept originates from the leadership of the organization (AGBOR, 2008). In essence, transformational leaders increase the behavioural hopes of their followers (Bass & Riggio, 2006) and search for followers' self-standards and personal ideas, and then shift to superior stage of goals and needs (Jung, 2001). Transactional leaders clarify the standards and expected outcomes to the followers (Bass & Avolio, 2004). These leaders actively monitor followers' behaviours or performance. So, absorptive capacity plays a positive role in recognizing the benefits for both parties. In the context of SMEs, CEOs/top managers/owners perform the role of leader (both transformational and transactional) in the organization. Researches have revealed the consequences of transformational leadership on the behaviours of followers and firms (Dvir, Eden, Avolio, & Shamir, 2002; Howell & Avolio, 1993; Lowe, Kroeck, & Sivasubramaniam, 1996), but the role of leadership for innovation in the context of developing countries and SMEs is limited.

The significance of innovation for organizational survival led researchers and practitioners to explore this topic in depth for the last few decades (Hana, 2013; Lee, Olson, & Trimi, 2012). However, research is still limited in the context of developing countries such as Pakistan. SMEs are considered as backbone of Pakistan's economy with a contribution of 30% and 20% to Gross Domestic Product and exports respectively; with a contribution of 90% of total businesses (Khan, Awang, and Zulkifli, 2013). Despite this, the SMEs in Pakistan find it difficult to survive in today's dynamic environment. In order to support SME businesses in Pakistan, the government of Pakistan took various initiatives such as the setting up of Small and Medium Enterprises Development Authority (SMEDA), and SMEs Bank, but the failure rate is still high (Hussain, Si, Xie, & Wang, 2010). Scholars such as Jung, Chow, and Wu (2003) and Tierney,

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