

# Transformational Leadership and Financial Performance: The Mediating Role of Corporate Reputation

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## Abstract

This quantitative research study seeks to determine the effect of the transformational leadership style on the reputation and financial performance of manufacturing companies listed on the Indonesia Stock Exchange. Data was collected via a survey questionnaire distributed to manufacturing firms and processed using a structural equation model. The results indicate that transformational leadership can significantly improve a company's reputation, which in turn can improve its financial performance since company reputation was found to mediate the relationship between transformational leadership and financial performance. Of the four key dimensions of transformational leadership, intellectual stimulation was found to be the most powerful indicator of style. Transformational leadership, however, was found not to have a significant direct impact on financial performance and could even worsen it. These findings give the implication that companies must pay attention to how they implement transformational leadership as in the absence of a strong corporate reputation, this style of leadership alone will not improve their financial performance. This research is expected to be helpful to companies engaged in the manufacturing sector.

**Keywords:** Transformational Leadership, Corporate Reputation, Financial Performance.

## 1. Introduction

One of the key assets of an organization is its reputation (Choi & Wang, 2009). In order to increase profitability, a company must have a good reputation (de Salles Vance & de Angelo, 2007). Corporate reputation is the primary source of organizational performance. It has a strong relationship with financial performance (Roberts & Dowling, 2002; Eberl & Schwaiger, 2005). This is ample evidence in the relevant body of literature that a good corporate reputation among stakeholders provides benefits in the form of higher customer retention (Deslandes, 2011), increased repurchase (Preece, Fleisher, & Toccacelli, 1995), higher revenues (Rajan, Zingales, & Kumar, 2005; Shapiro, 1983), which leads to lower costs thanks to reduced capital cost (Beatty & Ritter, 1986). Fombrun (1996) defined corporate reputation as a network of affective or emotional reactions from consumers, investors, employees, and the public to the good or bad, strong or weak name of a company. Employees' positive reaction to the company is especially helpful in building and protecting its corporate reputation since they are seen as a credible source for external stakeholders (Grunig, Grunig, & Dozier, 2003; Men, 2011). According to Men and Stacks (2013), employees build their own information and dialogue networks on social media and talk about the company both inside and outside.

However, in order to benefit from a positive employee perspective, the company needs to have an appropriate leadership style (Eberl & Schwaiger, 2005). One transformational leadership style shown to have a positive effect on employee perception of organizational reputation is transformational leadership, not only directly but also indirectly, through employee empowerment (Eidson & Master, 2000; Roberts & Dowling, 2002). For one, adopting a transformational leadership style manifests itself in the way leaders communicate a shared vision and high-performance expectations, act as role models, and encourage collaboration among employees to achieve common goals (Bass, 1999; Masa'deh et al., 2016). Transformational leaders promote new perspectives and novel ideas, and seek quality relationships with their employees, showing concerns for their personal feelings and well-being, thereby directly fostering a favorable employee's overall perception of the organization and enhancing its reputation and ability to face changes (Men & Stacks, 2013). Moreover, transformational leaders have the ability to motivate their employees, stimulate their creativity, and increase their desire to work effectively; all of which ultimately improving the company's financial performance (Uddin et al., 2014).

Recent studies about the relationship between transformational leadership and financial performance, however, have for the most part been inconclusive in that some determined that this leadership style has positive significant effect (Ocak & Ozturk, 2018; Son, Phong, & Loan, 2020) while other found no significant effect (Chammas & Hernandez, 2018). Some studies have also examined the relationship between corporate reputation and financial performance (Derun & Mysaka, 2018; Baah, Jin, & Tang (2020). Most of the latter, however, only examine these relationships separately. Only a few combined the relationship between transformational leadership and corporate reputation to examine their impact on financial performance. This research seeks to do just that. Focusing on companies in the Indonesian manufacturing sector, it groups transformational leadership and corporate reputation and investigate their combined effect on financial performance. The manufacturing sector is one of the most significant contributors to Indonesia's GDP. In 2018, it contributed 19.86% of the national GDP and 19.62% in 2019 (Ministry of Industry, 2019). As shown by the cumulative decline in the value of their stocks, recently, Indonesian public manufacturing companies, however, have been experiencing a deterioration of their financial performance, which is one of the indicators used to measure a company's success in generating profits (Arief, 2020). This study has the potential to contribute to a better understanding of the nature of the direct relationship between transformational leadership corporate reputation on the one hand and financial performance on the other..

## 2. Literature Review

### *- Leadership Theory*

Leadership can be defined as the process of guiding or directing the behavior of others towards achieving a goal (Strukan, Nikolić, & Sefić, 2017). Leadership is always put forward as the basis for the success of an organization ( ). According to Zakeer Ahmed, Allah, and Irfanullah (2016), leadership theories include the "Great Man" theory, the trait theory, the contingency and situational theories, the style and behavior theories, the process leadership theory, and the transactional and transformational theories. The latter theories emerged in 1978 when Burns argued that leadership should be divided into two theories: transactional and transformational. In 2003, however, Burns claimed that leaders could not be both since transactional leaders seek to satisfy the basic needs of followers in exchange for achieving goals, whereas transformational leaders interact with followers in a mutually enriching environment that allows them to realize higher-order needs and their abilities to initiate the process of growth and self-transformation (Khanin, 2007; Gomes, 2014).

### *- Transformational Leadership*

Transformational leadership is one of the most popular theories in leadership. The term 'transformational' leadership was first used by Wilkinson and Downton in 1974 and the theory, developed by Burn in 1978, as noted above. In a nutshell, it is a type of leadership whereby company

leaders participate in the activities of their subordinates in order to establish good communication and ultimately increase motivation and morale (Burn, 1978). It has also been described as a leadership style that integrates creative enlightenment, energy and persistence, intuition, and sensitivity to the needs of others to implement an integrated strategic culture (Bass & Avolio, 1993). Transformational Leadership has four essential factors (Bass & Avolio, 1993):

1. *Idealized Influence* – Leaders become role models for employees so that the actions of leaders become habits to be followed by employees.
2. *Inspirational Motivation* – Leaders have high expectations of a target and the leader is able to achieve that target by motivating his subordinates.
3. *Intellectual Stimulation* – Actions are taken by the leader to raise awareness of a problem and challenge subordinates to be innovative through questioning assumptions, reframing problems, and solving old problems through new approaches.
4. *Individualized Consideration* – Leaders focus on developing their subordinates by providing support, encouragement, and training.

#### **- Corporate Reputation**

Corporate reputation can be defined as the perceptions and feelings of stakeholders about the organization (Fombrun, 1996). It can also be seen as representing stakeholders' expectations of future actions by the organization based on previous experiences which also shape the future behavior of customers and employees towards the company (Kaplan & Norton, 2001). Corporate reputation has been attracting increasing attention from academics and experts (Graham & Bansal, 2007; Choi & Wang, 2009; Derun & Mysaka, 2018; Baah, et al., 2020). It has been determined to be capable of measuring a company's net affective image as perceived by customers, investors, employees, and the general public (Eberl and Schwaiger, 2005; (Kontan, 2019 ).). According to Fombrun and Gardberg (2000), corporate reputation can be described in reference to the following six key dimensions:

1. *Emotional Appeal* – how much the company is liked, admired, and respected.
2. *Products and Services* – Perception of the quality, innovation, value, and reliability of the company's products and services.
3. *Vision and Leadership* – Extent to which the company demonstrates a clear vision and strong leadership.
4. *Workplace Environment* – Perception of how well the company is managed, what it is like to work for, and the quality of its employees.
5. *Social Responsibility* – Perception of the company as a good citizen in its dealings with communities, employees, and the environment
6. *Financial Performance* – Perception of its profitability, prospects, and risk (Fombrun & Gardberg, 2000).

#### **- Transformational Leadership & Corporate Reputation**

A corporate personality, also known as corporate character or identity, is the core of an organization. The main aspects of corporate personality are corporate culture and how the organization develops strategies (Nguyen, Melewar, & Hemsley-Brown, 2019; Mickson & Anlesinya, 2019). To build a reputation, companies must develop a corporate identity that is central and internal to the company's culture, which represents the modes that the company uses to generate uniqueness and competitiveness (Roper & Fill, 2012). Corporate identity communicates three aspects of the organization to its stakeholders, namely what the organization does, how it does it, and what it is (Olins, 1989). According to Bernstein (1984), the different stakeholders' perceptions of an organization are known as its corporate image. Thus, corporate image can be described as the vision of the organization's external stakeholders and the way they perceive the company's personality (Liu, Ko, & Chapleo, 2017). The corporate image of an organization is the result of a combination of various factors, such as the beliefs, values, and attitudes that individuals or organizations have.

The characteristics, i.e., the beliefs, values, and attitudes of an organization will not be affirmed without the input of transformational leadership and branding efforts so that employees feel this is the best place to work. In that sense, transformational leadership is a leadership style in which the leader works with his employees to understand the changes needed, generates a vision through motivation and inspiration, and finally achieves the desired target with a committed workforce (Bloom & McClellan, 2016). This leadership style is committed to boosting the performance of subordinates, their motivation, and morale and generating a sense of employee identification with the organization (company branding) in order to produce high commitment, employee loyalty, good performance, and ultimately an excellent corporate reputation (Kia, Halvorsen, & Bartram, 2019). Therefore, based on the above, the following hypothesis has been developed:

**H1:** *Transformational Leadership has a positive effect on Corporate Reputation.*

#### **- Corporate Reputation & Financial Performance**

Reputation impacts the future performance of a company Roberts and Dowling (1997). A good reputation will positively affect financial performance. Using the Fortune Most Admired Company report, Roberts and Dowling (2002) determined in a follow-up study that companies with a relatively good reputation were in a better position to maintain superior earnings over time. Choi and Wang's (2009) study corroborated this finding as they concluded that companies with a reputation for excellence are equally able to maintain superior profitability in the long term and recover from a low financial performance position faster than companies lacking a good reputation. This proves that reputation affects financial performance indirectly, which can be observed by examining the company's ability to maintain above average profitability in the long term. Orlitzky (2005) found that the leading cause of the positive effect on the company's financial results was reputation. Data collected by Fombrun, Van Riel, and Van Riel, C. (2004) support this finding as they were able to show that companies that enjoy a good reputation outperform companies with a bad reputation in all financial measures over a five-year period. Davies et al. (2004) found that reputation accounts for about 3-7.5% of income each year and should not be considered an expense but an investment toward increasing income. Additional studies have confirmed the relationship between reputation and earnings in a variety of industries. Focusing on the airline industry, Graham and Bansal (2007) found that every one-point increase in an airline's reputation makes consumers willing to pay 18\$ more for a plane ticket. In another study in the pulp and paper sector, Bragdon and Marlin (1972) concluded that companies with the best records on pollution control and the environment were also the most profitable. The results of several other studies also support a positive relationship between corporate reputation and company financial performance. Thus, based on all these studies, the following hypothesis was formulated:

**H2:** *Corporate Reputation has a positive effect on the company's Financial Performance.*

#### **- Transformational Leadership & Financial Performance**

In their study on the financial performance of manufacturing and service companies in China, Son et al. (2020) determined that transformational leadership has an influence on their financial performance. They also found that transformational leadership affects financial performance more effectively than operational performance. Strukan et al. (2017) and Thomson et al. (2016) argued that transformational leadership has a positive impact on a company's financial performance because it motivates leaders to initiate and implement significant changes in the company meant to encourage employees to work better. Both studies are consistent with prior studies. For example, in their study on Turkish manufacturing companies, Ocak and Ozturk (2018) found a positive relationship between transformational leadership and company performance as did Arifa and Akram (2018) in a similar study in Pakistan. In addition, in their meta-analysis compiling 25 years of research, Wang et al. (2011) showed that transformational leadership is closely and positively related to organizational performance and needed for better organizational performance. Accordingly, the following hypothesis could be developed:

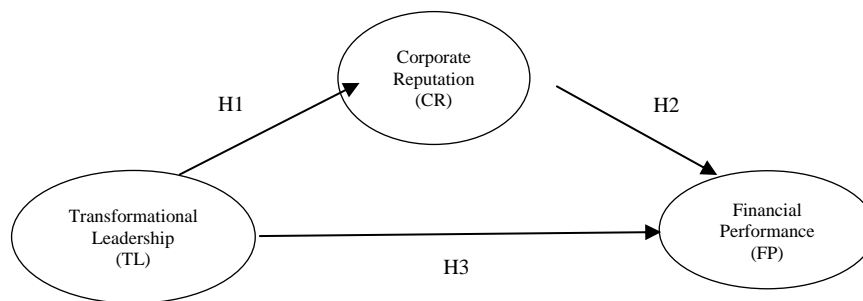
**H3:** *Transformational Leadership has a positive effect on the company's Financial Performance*

**- Mediating Effect of Corporate Reputation**

Corporate reputation is closely linked to transformational leadership, which is perceived as evidence of the ability of the company to articulate a clear vision and exhibit strong leadership (Fombrun & Gardberg, 2000). Various prior studies have confirmed the importance of the relationship between corporate reputation and financial performance (Graham & Bansal, 2007; Choi & Wang, 2009; Derun & Mysaka, 2018; Baah, et al., 2020). According to Kia et al. (2019), this leadership style is committed to boosting the subordinate performance by dint of being a role model and generating a sense of employee identification with the organization. Several prior studies have also confirmed the role of corporate reputation as mediator toward organization performance (Saeidi et al., 2015; Javed et al., 2020; Le, 2022). Therefore, based on all the above, the following hypothesis was formulated:

**H4:** *Corporate Reputation can act as a mediation in the relationship between transformational leadership and financial performance*

**3. Methodology**



**Figure 1:** Conceptual Model (created by authors for this study)

**- Research Design**

This study uses a quantitative approach. The primary data was collected using a 5-point-Likert-scale survey questionnaire (point 1 = strongly disagree and point 5 = strongly agree). Non-Probability Sampling was utilized so that a sample could be assembled based on the following criteria: (i) having registered email and access to the web, (ii) email address must be valid, and (iii) the company returns the questionnaire to the researcher. These criteria were necessary because the questionnaire was distributed, using via email. Out of the total number of questionnaires distributed, 46 questionnaires were answered by the company's employees. 30 companies met the criteria. The reason 16 questionnaires could not be used was because the unit analysis in this study is a company and it turned out that several respondents from the same company returned a completed questionnaire.

**- Measurement**

This study selected measurement items based on a thorough review of the relevant strategy literature. Minor modifications were made to reflect the focus of this study on the three research variables, namely, Transformational Leadership as the independent variable, Financial Performance as the dependent variable, and Corporate Reputation as the intervening variable connecting the independent and dependent variables. The scale used to measure Transformational Leadership was adapted from Bass and Avolio (1993) and designed to determine whether organizational leaders embrace transformational leadership through 4 criteria: Idealized Influence, Inspirational Motivation, Intellectual Stimulation, and Individualized Consideration. To measure financial performance, the scale developed by Anees-Ur-Rehman, et al. (2018) was used. It consists of 4 items: profitability, sales growth, profit growth, and sales margin. Finally, the model developed by Frombrun, Gardberg, and Sever (2000) was used to measure Corporate Reputation. The Reputation Quotient (RQ) was adapted. This model measures

Corporate Reputation in the eyes of stakeholders using 6 factors: emotional appeal, products and services, vision and leadership, workplace environment, social and environmental responsibility, and financial performance.

#### 4. Results and Discussion

The respondents were from 30 Indonesian manufacturing companies with total employee compositions as follows: 6 companies (20%) had less than 100 employees; 9 companies (30%) had 100-1000 employees; and 15 companies (50%) had more than 1000 employees. The total sample size follows Sekaran (2016) rule, which states that the sample size should be preferably 10 times or more as large as the number of variables in a study for multivariate research.

As to the respondents' profiles, it consisted of 19 men (63.33%) and 11 women (36.67%). 17 respondents (56.67%) were less than 30 years old; 11 respondents (36.67%) were 30-50 years old; and 2 respondents (6.67%) were more than 50 years old. In terms of seniority, 15 respondents had been working <5 years (50%), 5 between 5-10 years (16.67%), 6 between 11-20 years (20%), and 4 had been with the company for more than 20 years (13.33%). Table 1 shows the respondents' scores for each variable. Item CR/S&ER has the most significant mean value in the CR variable (4.33), which means that most of the manufacturing companies highly value their corporate reputation.

**Table 1:** Means, Range, and Standard Deviations

Indicator	Total Mean	Range	SD
TL/II	4.4	3	0.81
TL/IM	4.23	4	0.94
TL/IS	4.13	3	0.82
TL/IC	4.43	3	0.82
CR/EA	4.4	3	0.72
CR/P&S	4.57	2	0.57
CR/V&L	4.27	2	0.69
CR/WE	4.3	3	0.75
CR/S&ER	4.47	3	0.68
CR/FP	4.33	2	0.66
FP/P	3.97	3	0.81
FP/SG	4.03	3	0.93
FP/PG	4.0	3	0.87
FP/SM	3.93	3	0.87

To test the construct validity in this study, it is necessary to consider the convergent and discriminant validity. Convergent validity describes the extent to which the scale is positively correlated with other measures of the same construct, where the loading factor must be higher than 0.5 (ideally higher than 0.7). The data in Table 2 shows that almost all of the loading factors are more than 0.7, which means that the convergent validity of the data is excellent. Discriminant validity is used to measure the level of uniqueness of a construct compared to other constructs, in which the factor loading of the related latent variables must be higher than the cross-loading of other latent variables. As can be seen in Table

2, the loading factor for each related indicator is higher than the loading factor for other constructs. Through the evaluation of convergent validity and discriminant validity, it can thus be concluded that the construct of this research is valid.

**Table 2:** Combined Loadings and Cross-Loadings

	TL	CR	FP	Se	P value
TL/II	0.903	0.171	-0.05	0.117	<0.001
TL/IM	0.919	-0.059	-0.076	0.116	<0.001
TL/IS	0.931	0.019	0.074	0.115	<0.001
TL/IC	0.950	-0.124	0.048	0.114	<0.001
CR/EA	0.321	0.711	-0.102	0.128	<0.001
CR/P&S	-0.315	0.681	-0.164	0.130	<0.001
CR/V&L	-0.384	0.681	-0.164	0.130	<0.001
CR/WE	0.273	0.770	-0.242	0.125	<0.001
CR/S&ER	-0.164	0.826	-0.129	0.121	<0.001
CR/FP	0.229	0.761	0.398	0.125	<0.001
FP/P	-0.276	0.225	0.817	0.122	<0.001
FP/SG	0.187	-0.223	0.942	0.114	<0.001
FP/PG	-0.057	0.008	0.889	0.117	<0.001
FP/SM	0.107	0.020	0.930	0.115	<0.001

The results of the research reliability test are reported in Table 3, which shows that each variable has a composite reliability value and Cronbach alphas above 0.7. This means that each dimension used in measuring the variables of this study is reliable even though it is used several times. Therefore, every question used in obtaining data proved capable of being used as a measuring tool for this research.

**Table 3:** Correlations among Latent Variables with sq.rts. of AVEs, Composite Reliability, and Cronbach's Alpha

	TL	CR	FP	Composite reliability	Cronbach's alpha
TL	0.926	0.697	0.289	0.960	0.944
CR	0.697	0.741	0.532	0.879	0.834
FP	0.289	0.532	0.896	0.942	0.917

The effect size for the path coefficient value in Table 4 shows a value higher than 0.02, which means that the value is quite relevant. All the research variables indicate that the TL-FP relationship has the lowest effect size value, which is 0.054. The test results and the model of the relationship between the variables of this study can be seen in Figure 1.

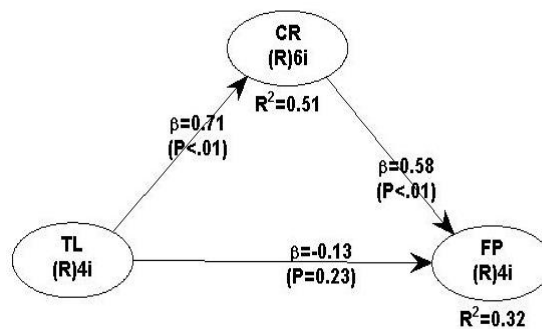
**Table 4:** Effect Size for Path Coefficients

	TL	CR	FP
TL			
CR	0.510		
FP	0.054	0.376	

Table 5 provides information on the direct and indirect relationships between the research variables. Regarding the direct relationship, it is known that the relationship between Transformational Leadership and Corporate Reputation is positive and significant ( $P < 0.01$ ), thus supporting H1. This shows that if a manufacturing company implements transformational leadership, it can significantly increase its corporate reputation. Thus, these results are in line with previous research by Roper and Fill (2012), in which Transformational Leadership is one of the leading drivers of increasing Corporate Reputation.

The relationship between Corporate Reputation and Financial Performance is positive and significant ( $P < 0.01$ ), so H2 is accepted. These results are consistent with Roberts and Dowling’s (1997) study, in which it was determined that a good corporate reputation positively affects future financial performance.

In addition, Figure 2 indicates that Transformational Leadership has a negative and insignificant effect ( $P = 0.23$ ) on Financial Performance. This finding aligns with previous research by Onagh & Hazimi (2018) and Doan et al. (2019) who reported a negative significant correlation between transformational leadership and its effects on financial performance. The indirect relationship between TL-CR-FP has a significant positive effect with a value of  $= 0.415$  and  $p < 0.001$ . Therefore, it can be concluded that CR can be a medium that helps TL in increasing FP, thus supporting H4.



**Figure 2:** PLS-based Structural Equation Model

**Table 5:** Inner Model Results

	Direct Effect	Indirect Effect	Total Effect
TL → FP	-0.127 (p=0.23)	TL → CR → FP 0.415 (p < 0.001)	0.288 (p =0.039)
TL → CR	0.714 (p<0.001)	-	0.714 (p <0.001)
CR → FP	0.581 (p <0,001)	-	0.58 (p <0.001)



The results indicate that transformational leadership has no significant and negative impact on financial performance ( $P = 0.23$ ), so H3 was rejected. This is consistent with Doan et al.'s (2019) findings that when employee awareness in the company is low, transformational leaders will worsen the company's financial performance. However, on the other hand, a positive and significant relationship ( $P < 0.01$ ) is seen in the relationship between transformational leadership and corporate reputation. This result is consistent with previous research by Kia et al. (2019) who determined that transformational leaders are generally committed to boosting their subordinates' performance, motivation, and morale in order to produce high commitment, employee loyalty, good performance, and ultimately a good corporate reputation. Thus, H1 is accepted. In addition, the relationship between corporate reputation and financial performance also shows positive and significant results, which means that H2 is also accepted. This is in line with previous research, most notably Orlitzky (2005), who found that the main cause of a positive effect on the company's financial results is reputation. Thus, it can be concluded that the implementation of transformational leadership to manufacturing companies in Indonesia has the capacity to ensure a positive assessment of corporate reputation, whereby a good corporate reputation will end up improving the company's financial performance and maintaining long-term profits.

As the above discussion suggests, the influence of corporate reputation in improving financial performance is primarily determined by the effectiveness of the implementation of transformational leadership. A corporate reputation that can help maintain superior profits in the long term can only have a positive effect on a company's financial performance as long as the latter is able to communicate its identity to every stakeholder and therefore create a positive perspective on the company. The stakeholder perspective on an organization – which is known as corporate image, as explained earlier – is the result of the beliefs, values, and attitudes that each stakeholder has towards the company. They can be formed through the implementation of an effective leadership style, one of which being transformational leadership. As is now clear, this is a leadership style in which the leader invites employees to work together in building a vision and mission in order to achieve the desired target. This type of leadership indirectly generates a sense of employee identity within the organization, enhances commitment, loyalty, productivity, and leads to a good corporate reputation. When leaders fail to implement transformational leadership, a good corporate reputation is difficult to create and not optimal in improving financial performance. In summary, these findings indicate that the successful implementation of transformational leadership increases corporate reputation, and corporate reputation is capable of improving financial performance. Therefore, companies must implement transformational leadership in order to create a good corporate reputation and ultimately help the company improve its financial performance.

## 5. Conclusion

In light of the declining GDP contribution of the manufacturing sector in Indonesia, it is clear that manufacturing companies must make take steps to improve their financial performance. As this study has determined, transformational leadership has the capacity to improve financial performance with the help of corporate reputation as an intervening variable. Indeed, transformational leadership has a significant positive impact on corporate reputation and corporate reputation significantly and positively impacts on financial performance, as was hypothesized in H1 and H2. The results related to the relationship between transformational leadership and financial performance, however, showed an opposite result, therefore H3 was rejected. Thus, while manufacturing companies in Indonesia can adopt a transformational leadership style, thereby substantially enhancing their corporate reputation and improving their financial performance and maintaining long-term profits since company reputation can act as a mediation in the relationship between transformational leadership and financial performance, this is not given, far from it.

Transformational leadership was found not to have a significant direct impact on financial performance and in fact could worsen it. In other words, since adopting a transformational leadership style cannot directly influence financial performance, transformational leadership – unless it positively impacts corporate reputation – will not in and of itself necessarily improve the financial performance of those manufacturing companies. But, as this study made it abundantly clear, transformational leadership can improve a company's reputation which in turn can improve the company's financial performance. These companies should therefore focus on creating or maintaining a strong corporate reputation in order to create sustainable profits and improve their financial performance. The reason this study has not been able to establish that transformational leadership has a significant positive impact on Financial Performance is due to following limitations: (i) The sample obtained is relatively limited, 46 questionnaires out of which only 30 questionnaires met the criteria; (ii) The sample is only limited to one industrial sector, namely the manufacturing industry, so there is no variation in the sample; and (iii) The limitations of the analysis model are not differentiated based on the characteristics of the company. Therefore, the researchers recommend that in future studies the number of research data is further reproduced and expanded with samples of company data from various types of industries. In addition, future research could be carried out using control variables, such as company size in order to identify differences in the effect of transformational leadership style on small, medium, to large companies.

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