



# Social Network and Performance of Small and Medium Size Enterprises in Western Kenya: The Moderating Role of Charismatic Leadership

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## Abstract

Small and Medium Size Enterprises (SMEs) play an important role in the economic development of a country. However, existing research in Kenya indicate that their survival rate is low. To help address the constraints of SMEs performance, most practitioners and scholars have used innovation, technology and intellectual capital to increase performance among other variables with little emphasis on social network. Indeed, there is little research on how social network can improve the performance of SMEs. Further, the moderating role of charismatic leadership in this relationship remains largely unexplored. The study employed explanatory research design and targeted a population of 2000 respondents (top managers and employees) from the 1000 SMEs in the four counties of Western Kenya. Stratified sampling technique was used to determine the sample size of SMEs from both service and manufacturing sectors and then simple random sampling was done to select the SMEs and respondents that participated in the study. A sample size of 150 SMEs corresponding to 300 respondents was drawn and participated in the study. Factor analysis was done to ensure content, construct and discriminant validity. Hierarchical multiple regression model was used to test the hypotheses. Results of our study support a direct positive effect of social network on performance of SMEs. Additional analyses revealed that charismatic leadership moderates the relationship between social network and SME performance. To improve SMEs performance, SME managers should thus ensure that they maintain strong network ties with customers, suppliers, commercial banks and government agencies. so as to establish strong business networks.

**Keywords:** Social network, Charismatic Leadership, Small and Medium Size Enterprises

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## 1. INTRODUCTION

### 1.1 SME Performance

SMEs performance can be seen as how the firm provides value to its stakeholders such as owners, customers, society and even government. In other words, it indicates how thriving the management manages the firm resources (1). Another scholar (2) defined firm performance as the procedures of quantifying business firm actions in terms of accomplishing its objectives. Firms attain their objective if they succeed in satisfying their stakeholders' needs more than their rivals. Firm performance can be measured either by looking at economic variables or non-economic variables (3). In other words, it can be measured quantitatively or qualitatively (4). In the global economy, SMEs are largely recognized as engines of growth and development and are the backbone of the economy in many developed nations (5). SMEs play significant role in the economic development by creating employment, wealth creation, poverty eradication and creation of new firms (6). In Kenya, the sector contributed about 70% of GDP in 2013 (7). Past studies identified that a significant number of new SMEs fail within first five years of their business operation (8); (9). Several studies in Australia, USA and England showed that approximately 80% to 90% of SMEs fail within 5-10 years (8); (9). The collapse rate of SMEs is alarming for developing countries as well as developed countries (9).

In Kenya, despite having several SMEs startups, there is a high rate of failure and most enterprises are short lived and barely survive third anniversary (10). Sessional paper No. 2 of 2005 shows that despite the significant role by the SMEs, they have continued to experience many constraints like poor access to market and financial services and unfavorable policies. These have inhibited the realization of its full potential (11). To help address the constraints of SMEs performance, most practitioners and scholars have used innovation, technology and intellectual capital to increase performance (12) among other variables with little emphasis on social network. This is because it is often emphasized that personal relations between economic entities have a role in

creating trust, reciprocity and loyalty, which could represent a new source of competitiveness based on cooperation. Theoretical construction which includes common resources in the form of membership in associations, civic engagement, trust, reliability and reciprocity in social networks is the basis of the theory of social network which can have a bearing on SMEs performance. (13) Indicated that no detailed study has addressed the relationship between social network and the performance of SMEs or its impact on the overall growth of small enterprises.

Thus, there is scanty empirical evidence on how social network affect SME performance (14; 15; 16; 17). This study therefore, examined the direct effect of social network on SME performance as hypothesis 1 and the moderating role of charismatic leadership in effect of social network and SME performance as hypothesis 2. Hypothesis1: There is no significant relationship between social network and performance of SMEs.

## 1.2 Social Network and SME Performance

Network could be stated as a specific set of linkages among a defined set of actors. However, networks are also often defined as relationships between different actors (18; 19). Actors in a social network can be persons, groups, and collectives of organisations. Personal networking is defined as the management of relationships or alliances that the individual has with others in their society (18; 20). An organizational network is a voluntary arrangement between two or more firms that involves durable exchange, and sharing or co-development of new products and technologies (21). Others define networks as a set of interdependent actors, activities and resources (21; 22).

Networking is the mutual give and take that results in a win-win situation for everyone involved in the transaction (23). Networking in a small firm context could be defined as activities in which the entrepreneurially oriented SME owners build and manage personal relationships with particular individuals in their environment (24). Networking as an activity involves building relationships and connecting with other actors for various reasons. It emphasizes that every organization is dependent on and even its identity is created in interaction with other actors in the market (25). This is because the critical resources of a firm are linked to its exchange relationships with suppliers, customers and other counterparts with whom they exchange information, expertise, goods and services, payments and loans, among other issues (26).

The relationship between social network and firm performance can be explained by social network theory. The social network theory is a social science concept that discusses the connection and relationship in a social structure (27). The theory emerged in the late 19th century and it attempts to find something that might connect people in their group or communities. A social network is a generic way a set of nodes or actors are connected by a set of social relationships, ties, or a specified type of ties (28).

Empirical literature clearly indicates that social network, or the resources that entrepreneurs may access through their personal networks (29), allows entrepreneurs to identify opportunities (30), mobilize resources (31), and build legitimacy for their firms (32). For example, social network contacts are the most needed by businesses to overcome their difficulties in getting suppliers and customers at the early stage of business formation. Networks are thus perceived as significant for a firm's competitive advantage and success and firms often engage in networks to get access to important and complementary resources and information they lack, as well as to jointly develop new resources (33; 34). This would be especially important for small firms because they are often founded with limited resources and capabilities (35).

Often, firms are faced with resource constraints, which hamper their competitiveness, and ultimately, their performance. To overcome these constraints, (35) and (36) suggest that firms should engage in networks and alliances. It is by engaging in networks that firms get hold of essential complementing or scarce information, competencies, and resources to improve their competitiveness, which in turn enhance their performance in terms of increased market share and profitability. Networking and collaboration with other firms and individuals thus helps the small business to more quickly and easily adapt to changes on the market (37). Networking and collaboration can help the small business to shift and adapt to current trends (37). Further, (38) posit that firms experience greater profits when they engage in alliances with local partners on new markets.

Further, (39) also noted that small scale of an entrepreneurial enterprise after a start-up, an entrepreneur needs to use his/her social networks in order to build up business. One example is that networking is simply used to create sales. Other fundamental motivations for an entrepreneur to engage in networking have been argued; networking provides introductions to business associates (40); networking generates self-confidence (41); entrepreneurs can gain motivation, support, and encouragement from networking (42).

Additionally, (43) examined the impact of networking activities on performance of SMEs in a developing economy’s context. The study involved a survey of 413 manufacturing SMEs. The study hypothesized a positive relationship between SME actor’s involvement in actor bonds, a major element in networking activities and the resulting performance of their enterprises.

The findings suggested that by having social and economic bonds, SME actors are likely to enhance their resource mobilization and leveraging capacities which in turn can significantly improve their performance. Similarly, (44) studied the effects of social ties on resource leveraging strategies of Ghanaian small enterprise owners. Their findings were that social relationships or connections, which exist among firm owners or managers and entrepreneurs of Ghanaian firms play an important role in enabling these actors to acquire and leverage both tangible and intangible resources.

Likewise, (45) analyzed the role of owner-managers and networks in internalization of small handcraft firms. The study involved a survey of 40 firms and 4 case studies. Among the findings was the observation that performance in export business depends on how the owner-manager of the firm undertakes business interactions with other firms by forming networks. For instance, it was established that networks facilitate access to information and entry to export markets. Finally, (46) conducted a meta-analysis of the link between entrepreneurs' personal networks and small firm performance. Analysis of 61 independent samples indicated that the social network–performance link was positive and significant. Effect sizes of weak ties were smaller than those of structural holes, while network diversity had the largest positive effect on performance. Results also showed that the social network – performance link depends on the age of small firms, the industry and institutional contexts in which they operate, and on the specific network or performance measures used.

It is thus worth noting that the contribution of the present study lies not in testing Hypothesis 1 but rather in simply affirming what many scholars have found out.

We therefore tested hypothesis 1 (H<sub>01</sub>) as shown in the conceptual model Figure 1.

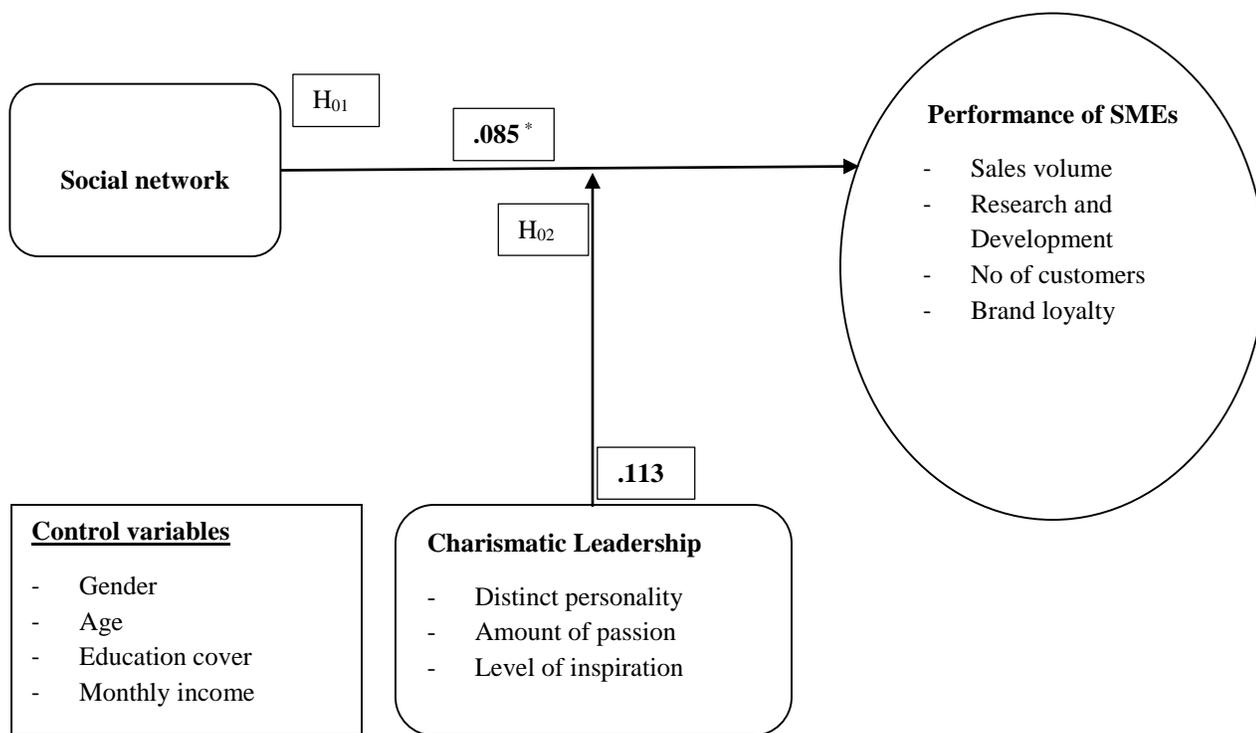


Figure 1. Model of Social network and SME Performance: Moderated by Charismatic Leadership

### 1.3 Effects of Charismatic Leadership

Theoretical perspectives have been proposed to explain the link between CEO charisma and firm performance. A study by (46) focused on how charismatic CEOs develop relationships to ensure the effective implementation of strategic decisions. They proposed that charisma and inspirational leadership are relevant because of their association with the implementation of the strategic decisions, and not so much because of their relationship to the choice of strategies.

Likewise, (47) argued that CEO charisma works through both “close” and “distant” relationships. The CEO’s charismatic behaviors increase team cohesion within the top management team, with whom the CEO is closely and directly involved, when the environment is uncertain. This cohesion then results in increased role modeling of charismatic behaviors at lower levels of management, heightening intra-group and intergroup cohesion and effort at lower levels. CEO symbolic behaviors, trust, vision, and storytelling also increase cohesion and effort at lower levels when there is perceived environmental uncertainty. The increased cohesion and effort from both the close and distant relationships lead to more coordinated performance of organizational units, resulting in higher organizational performance.

Another scholar (48) reported data from 69 U.S. and Canadian firms suggesting that CEO charismatic leadership measured at a point in time predicted subsequent firm performance. Thus, charisma was found to be related to both subjective and objective measures of strategic change. Further, (49) examined the relationships between charismatic leadership and multiple performance outcomes under different levels of environmental dynamism and per type of Chief Executive Officer (firm owner versus managing director). The study suggested that charismatic leadership enhances organizations profitability but not its liquidity and solvency. More (50) examined the relationships among CEO perceived charisma, CEO compensation packages, and firm performance in a sample of Fortune 500 companies over a 10-year period. Using hierarchical regression model, the study found significant direct relationships between CEO charisma and firm performance. Further, under uncertain market conditions, charismatic CEOs were able to boost the stock price, even though there was no evidence that these firms were internally managed better, as measured by ROA.

Further, (51) surveyed 128 CEO’s to establish whether CEO charisma affects performance. The results did not find a significant relationship. Similar findings were noted by (52). From our reviewed literature, there exists inconsistency in the findings on the relationship between CEO charisma and firm performance. This necessitated us to introduce CEO charisma as a moderator in our research model.

#### **1.4 The Moderating Role of Charisma on Social Network-Performance Relationship**

The contribution to knowledge lies mainly in testing Hypothesis 2 ( $H_{02}$ ) where we introduced charismatic leadership as a moderator in the model as shown in Figure 1 above and stated as;  $H_{02}$ ; Charismatic leadership does not significantly moderate the relationship between social network and performance of SMEs.

Experimental studies have shown that charismatic leaders express positive affect which, in turn, results in positive affect experienced by followers and teams within a firm (53). Scanty literature depicts charismatic leadership as a moderator in firm performance related studies. For instance, (54) hypothesized that more frequent leader’s charisma interaction will make the positive relationship between leader and team optimism stronger which can thus influence firm performance.

Charismatic leadership theory describes how followers attribute extraordinary qualities (charisma) to the leader. The theory has been extended in formal organizations (55; 56; 57; 58). The theory emphasizes the need for a manager in an organization to articulate an appealing vision, emphasizing ideological aspects of the work, communicating high performance expectations, expressing confidence that subordinates can attain them, showing self-confidence, modeling exemplary behavior, emphasizing collective identity and exhibiting social network. Charismatic leaders are expected to infuse work with values by articulating an attractive vision and behave in ways that reinforce the values inherent in that vision, which will increase the meaningfulness of the work their subordinates do. This in turn will increase subordinates’ willingness to and enthusiasm for their work (59).

From the scanty literature on the moderating role of charisma, for instance, (60) studied the moderating role of transformational leadership in the relationship between social networking and firm performance in information and communication technology companies in Malaysia. The study captured charisma as a dimension of transformational leadership. The study revealed that charisma among other transformational leadership dimensions significantly moderated the relationship between social networking and firm performance. The researcher (60), suggested a further research to build more empirical evidence on the moderating role of charisma on firm performance.

## **2. MATERIALS AND METHODS**

### **2.1 Respondents**

Respondents included 322 individuals comprising top managers and employees of the 161 sampled SMEs in Western Kenya. Stratified sampling was used to get SMEs in the service and manufacturing sector from each County and Sub-county in the region. The respondents were the top managers and employees of the sampled SMEs. Simple random sampling was used to select

employees from each sampled SME so as to ensure each employee had an equal chance of participating in the study. A total of 300 individuals completed the self-administered questionnaire, resulting in a response rate of 93.17 per cent.

## 2.2 Measures

All measures used a five point-likert response scale.

## 2.3 Social network

Social network was measured with items from the modification of the Putnam's Social Capital Questionnaire (61). A response scale in which 1 was "strongly disagree" and 5 was "strongly agree" was used. Questions that were elicited for instance included; "I am mainly concerned with the welfare of my own family and not much concerned with the welfare of others" "Please indicate the number of voluntary organizations you are a member of and the frequency of meetings"

## 2.4 Charismatic Leadership

Charismatic leadership is designed to address strengths and weaknesses of the leaders from the point of view of their followers. The employees completed a 29-item measure of charismatic leadership from the Conger and Kanungo's "C-K" Charismatic Leadership Questionnaire (62). A response scale used was one in which "1" denotes "never" and "5" denotes "always" as far as certain characteristics and behaviours of leaders are concerned. The items included; "This person uses non-traditional means to achieve organizational goals", "This person provides inspiring strategic and organizational goals", "This person has a vision; often brings up ideas about possibilities for the future", "This person inspires me to accept changes that come along", "person encourages me and my team to work in partnership", "This person inspires respect, trust and admiration".

## 2.5 SME Performance

This was measured using the Firm Performance Questionnaire (an extension of Santos and Brito (63) Questionnaire. The response scale used was in which "1" Decreased greatly "5" Increased greatly. Respondents were required to rate the SME performance compared to same time the previous year. The performance indicators that were rated include; "Change in the current estimated worth of the business", "Number of employees", "Sales volume", "Number of customers", "Product/service diversification", "Brand loyalty", "Distribution channels"

## 3. RESULTS

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### 3.1 Reliability Analysis

It is very important to study the properties of measurement scales and the items that compose the scales. Usage of SPSS software was done in order to ensure the variables in the model are reliable. Most commonly used reliability test is Cronbach's Alpha Index. This is due to the interpretation as a correlation coefficient and it ranges from 0 to 1. Besides that, using the Cronbach's Alpha Index can determine whether the questionnaire is reliable and the data can be used for further analysis (64). According to (64), the acceptance level of Cronbach Alpha Index should exceed 0.7. Table 1 show the result of reliability statistics for the study variables which were all above the 0.7 threshold.

### 3.2 Correlation analysis

According to (65), Pearson correlation is used to examine the relationship between the variables. If the value of correlation coefficient ranges from 0.10 to 0.29 is considered weak. Meanwhile the value range from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong according to (66). There is also an indicator that the correlation coefficient should not go beyond 0.8 to avoid multicollinearity (67). Multicollinearity occurs when two or more variables in the model are correlated and provide redundant information. It is often confusing and lead to misleading results. As presented in Table 1, correlation coefficients are less than 0.8; therefore, multicollinearity problem does not exist.

The results of the correlation analysis reveal that there is a positive and significant correlation between social network and SME performance ( $p < .01$ ). This implies that when an SME manager networks more, there may be an increase in the SME's performance. These findings are consistent with the findings of (33) and (34) who found a positive and significant association between social network and firm performance. There is a positive and significant correlation between charismatic leadership and SME performance ( $p < .01$ ). This implies that an SME run by a charismatic manager is more probable to perform better. The results are consistent with (14) who studied on the relationship between leadership development and social capital and found a causal assertion that one leads to the other.

**Table 1.** Descriptive Statistics and Correlation Matrix for the Study variables <sup>a</sup>

	$\alpha$	Mean	S.d	1	2	3	4	5	6	7
1. SME Performance	.917	4.2620	.64193	1.00						
2. Social Network	.807	3.5107	.46820	.119**	1.00					
3. CharismaticLeadership	.738	3.0031	.53026	-.045**	-.131**	1.00				
4. Age	.708	3.25	.849	.073**	-.026**	-.090**	1.00			
5. Education Level	.797	2.39	.809	-.457**	.196**	-.022	.115*	1.00		
6. Gender	.795	1.16	.369	-.001	-.014	.021	.155**	.088	1.00	
7. Monthly Income	.756	1.58	.553	-.023	-.179**	-.247**	-.100	-.162**	.029	1.00

<sup>a</sup>n= 300 after list wise deletion of missing data, \*\* P<.01 and \* P<.05

### 3.3 Hypothesis Testing

Hypothesis 1 was rejected. The results of the test of this hypothesis are presented in Table 2. The results indicate that social network significantly influences SME performance (P<.05). Examination of the hypothesis also revealed that the relationship was positive ( $\beta$ =.104) and that for every increase of one standard deviation in social network, there is a corresponding increase of 0.104 standard deviation in SME performance.

These findings are consistent with other studies (15; 16; 22; 37; 38; 39; 43; 44;).(35 and 36) further contented that when a firm engages in networks and alliances, they are expected to get hold of essential complementing or scarce information, competencies, and resources to improve their competitiveness, which in turn enhance their performance in terms of increased market share and profitability. The study findings therefore enrich literature on the relationship between social network and SME performance. Thus a CEO who engages in alliances with other partners/stakeholders due his/her high social network will make an SME experience greater profits.

**Table 2:** Regression Results for Social Network Predicting SME Performance

Variables	Model 1 Controls	Model 2 Direct Effects
<b>Parameter</b>	<b>Estimate</b>	<b>Estimate</b>
(Constant)	4.929 (.122)***	4.588 (.281)***
Age	.058 (.023) *	.051 (.022) *
Education Level	-.228 (.024) ***	-.232 (.023) ***
Monthly income	.010 (.035)	
Gender	.024 (.053)	
Social network		.104 (.085) *
R	.475	.557
R <sup>2</sup>	.226	.310
Adjusted R <sup>2</sup>	.216	.299
R <sup>2</sup> Change	.226	.022
F Statistic	23.471***	28.476***

Values of unstandardized regression coefficients, with standard errors in parenthesis \*p<0.05; \*\*p<0.01 \*\*\*p<0.001

Hypothesis 2 was rejected. The results of this hypothesis are presented in Table 3. When charismatic leadership was added, it produced F=23.847 and it was significant at p<0.001 level, hence confirming the fitness of the model. The entire group of variables in model 1 accounted 31.2% of the variance in performance of SMEs. This indicates that the addition of a moderator variable significantly improved prediction of SME performance. With the introduction of the interaction term, an overall model fit of F=20.391 which was significant at 0.001 level was produced. The results indicate that charismatic leadership has a significant moderating effect on social network (p<0.05).

**Table 3.** Moderated Regression Results

Variables Parameter	Model 1 Direct Effects Estimate	Model 2 Interaction Social Network Estimate
(Constant)	4.675(.298)***	4.333(1.285)**
Age	.050 (.022)*	.050 (.022)*
Education	-.232(.023)***	-.233 (.023)***
Social Networks	.103 (.085) *	.013(.341)*
Charismatic Leadership	-.031 (.035) *	.087 (.434) *
Charismatic Leadership x Social Network		.031 (.113) *
R	.558	.558
R <sup>2</sup>	.312	.312
Adjusted R <sup>2</sup>	.299	.297
R <sup>2</sup> Change	.002	.000
F Statistic	23.847***	20.391***

Values of unstandardized regression coefficients, with standard errors in parenthesis, \*p<0.05; \*\*p<0.01 \*\*\*p<0.001

#### 4. DISCUSSION

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In this study, we tested for the direct effect of social network on SME performance and the moderating effect of charismatic leadership on this relationship. Social network was found to have a positively significant influence on SME performance. Further examination revealed that for every increase of one standard deviation in social network, there is a corresponding increase of 0.104 standard deviation in SME performance. The findings therefore support the arguments within the network theory that actor bonds play a significant role in networking activities and that networks of relationships within and without a group constitute a valuable resource for the members of a group (68).

The findings on Hypothesis 2 provide evidence that charismatic leadership moderates the relationship between social network and SME performance. These findings therefore emphasize the importance of charisma in social networking hence SMEs managers need to embrace both attributes (charisma and social network) to enhance SME performance.

The results of this study not only enriches literature on SMEs as pertains to social network but has contributed to knowledge by determining that the interaction between charisma and social network is essential for SME performance

#### 5. CONCLUSIONS

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We conclude that an SME's top manager charisma buffers up social networking which consequently improves SME performance. The findings are invaluable to the SME sector in relation to development of social network of the managers which play a significant role in firm performance. To improve SME performance, SME managers should always ensure that they maintain strong network ties with customers, suppliers, commercial banks and government agencies. SME managers need to take responsibility to improve their networking. SME managers should therefore establish strong business networks that entail establishing a solid stock of connections.

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