



# Knowledge management and organizational performance in the service industry: The role of transformational leadership beyond the effects of transactional leadership



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## ABSTRACT

This study examines a comprehensive model comprising of various relationships between transformational and transactional leadership, knowledge management (KM) process, and organizational performance. Data are collected from human resource managers and general managers working in 119 service firms. Exploratory factor analysis and hierarchical regression analysis are used to analyze the proposed hypotheses. The results indicate that transformational leadership has strong and positive effects on KM process and organizational performance after controlling for the effects of transactional leadership. Further, KM process partially mediates the relationship between transformational leadership and organizational performance after controlling for the effects of transactional leadership. Implications and directions for future research are also discussed.

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## 1. Introduction

Researchers always emphasized the importance of developing unique knowledge within firms to deliver new products/services and to distinguish it from competitors for achieving advantage (Menguc, Auh, & Shih, 2007). Delivering unique products/services to customers helps to improve customer satisfaction and sales volume, and so firms have observed the influence of knowledge development over performance (Bogner & Bansal, 2007; Tanriverdi, 2005). Since knowledge resides within the brain of employees, firms develop various strategies to create organizational knowledge through leveraging employees' knowledge. Human resource managers are get involved in the activities of finding suitable leadership style that supports implementation of knowledge management (KM) programs to augment organizational performance. Identification of suitable leadership style is essential in this turbulent environment since researchers have reported that different leadership styles have varying impacts on implementation of KM process (Bryant, 2003). Transformational leadership theory postulates that leaders exhibit certain behaviors that accelerate employees' level of innovative thinking through which they improve individual employee performance, organizational innovation, and organizational performance (Aragon-Correa, Garcia-Morales, & Cordon-Pozo, 2007; Colbert, Kristof-Brown, Bradley, & Barrick, 2008; Piccolo & Colquitt, 2006). Since transformational leaders greatly influence employees, whose engagement is enormously required for implementation of KM process,

the role of transformational leadership is focused on the implementation of KM process to improve organizational performance.

To date, scholars have empirically investigated the positive impacts of transformational leadership on individual performance (Dvir, Eden, Avolio, & Shamir, 2002; Wang, Law, Hackett, Wang, & Chen, 2005) as well as on organizational performance (Aragon-Correa et al., 2007; Peterson, Walumbwa, Byron, & Myrowitz, 2009). Similarly, KM scholars have also showcased that managing knowledge has positive association with organizational performance (Bogner & Bansal, 2007; Lee & Choi, 2003; Tanriverdi, 2005). Though these studies explained the direct impact on organizational performance, the following research questions are still unanswered: (1) Do transformational leadership behaviors influence performance of service firms after controlling for transactional leadership behaviors?; (2) Do transformational leadership behaviors help to implement KM process in service firms after controlling for transactional leadership behaviors?; and (3) Will KM process mediate the relationship between transformational leadership and organizational performance in the service firms after controlling for transactional leadership?

In order to answer these questions, this study investigates the nature of the relationships among transformational leadership, transactional leadership, KM process, and organizational performance. In particular, the purposes of this study are: to investigate the direct impacts of transformational leadership on KM process and organizational performance after controlling for the effects of transactional behaviors; and to examine the mediation role of KM process in the relationship between transformational leadership and organizational performance among service firms located in the Kingdom of Bahrain. These purposes integrate two important theories such as transformational leadership theory and knowledge-based view of the firm. In specific, application of

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transformational leadership theory on knowledge-based view of the firm is particularly focused in this study.

In this direction, this study contributes to literature in two ways. First, scholars have always focused on transformational leadership in the view of employees' reactions to leaders and their feeling of themselves and in the view of leaders' actions. Researchers concentrating on the former approach mainly investigated the mediation role of trust (Dirks & Ferrin, 2002; Pillai, Schriesheim, & Williams, 1999) and self-efficacy of employees (Gong, Huang, & Farh, 2009) in the relationship of transformational leadership with follower performance. The latter approach predominantly investigated the association of transformational leadership with organizational performance through implementing human capital management practices, improving organizational learning, and establishing organizational culture (Aragon-Correa et al., 2007; Xenikou & Simosi, 2006; Zhu, Chew, & Spangler, 2005). This study extends the latter approach to predict organizational performance with the help of the association between transformational leadership and KM process implementation. Second, this study examines transformational leadership as an antecedent of implementation of KM process to create advantage over their competitors. According to Grant (1996), knowledge-based view of firm rests on the assertions that organizations perform as repositories of employees' knowledge and competencies, which are valuable in the current firm and inimitable by other firms. Within this organizational system, such employees' knowledge is converted into organizational knowledge, which will then be protected as intellectual capital. A systematic survey conducted among top-level managers of service firms supports this study to understand the interrelationships among leadership, KM process, and organizational performance.

This paper is organized as follows: first, it reports the detailed review on the concepts of transformational leadership and KM process implementation and lists out the hypotheses to be tested in this study; second, it discusses the methodology adopted in this study and in specific, explains the procedure of collecting responses from participants and measures used in the survey questionnaire; third, it explains the procedure used for data analysis and its findings; finally, implications and future research directions are offered.

## 2. Theoretical framework

### 2.1. Transactional leadership and transformational leadership

Burns (1978) initiated the discussion of the importance of developing transformational leadership and transactional leadership styles in the organizations. Thereafter, Bass (1985) investigated the dimensions of such leadership styles and identified four components of transformational style namely idealized influence, intellectual stimulation, inspirational motivation, and individualized consideration and three components of transactional style namely contingent reward, active management by exception, and passive management by exception. According to Bass and Riggio (2006), contingent reward leadership behavior obtains employees prior agreement on the jobs to be done and exchanges rewards for delivering job performance within a time limit; a leader having active management by exception behavior supervises employees intensively, identifies errors or mistakes, and then takes corrective actions; and a leader having passive management by exception behavior interferes into the employees' work only when the mistakes or errors occur.

On the other hand, idealized influence behavior transforms leaders into role models for their employees, helps leaders to develop vision for organizations and to follow ethical principles, encourages them to involve in risk-taking activities, and supports employees to perform effectively under uncertain environment (Nemanich & Keller, 2007). Inspirational motivation behavior supports leaders to use strategies to motivate and inspire employees to achieve overall goals of the organization (Bass & Riggio, 2006). Intellectual stimulation behavior stimulates employees' intelligence to solve job problems by analyzing job problems in all facets and discourages use of traditional methods to solve

problems. Individualized consideration transforms a leader into mentor or coach for his/her employees and supports treating employees differently by providing equal opportunity to all employees. Scholars often highlighted charismatic leadership as combined idealized influence and inspirational motivation behaviors in the literature (Avolio, Bass, & Jung, 1999), and some quote idealized influence alone to represent charismatic leadership (Dubinsky, Yammarino, & Jolson, 1995).

Transformational leaders frequently show transaction-oriented leadership behaviors toward their employees (Bass, 1985). Transactional leadership is exhibited in the organizations based on a series of exchanges taking place between a leader and followers. Supporting this notion, Howell and Avolio (1993) asserted that a leader could exhibit both transformational and transactional behaviors with varying level of intensity when a situation requires managerial activities like acquisition of resources to accomplish vision.

### 2.2. KM process

Apart from implementing human resource management and organizational learning practices, transformational leaders also concentrate on establishing knowledge-supportive culture. Knowledge is of two types: (1) tacit knowledge – knowledge that is inimitable, valuable, underutilized, unarticulated, and residing in employees' brain; (2) explicit knowledge – knowledge that is distributable, easy to handle, documentable, and storable (James & Lucardie, 2003). Organizational knowledge is created by transforming these knowledge types into other form of knowledge, which is valuable, inimitable, and nontransferable by other firms. Thus, organizational knowledge becomes a source of sustainable competitive advantage. Devising strategies to properly manage knowledge is imperative for many organizations due to its significance for attaining organizational outcomes. Maier (2005) defines KM as “the management function responsible for regular selection, implementation and evaluation of knowledge strategies that aim at creating an environment to support work with knowledge internal and external to the organization in order to improve organizational performance” (p. 433). KM architecture comprises of KM process and KM infrastructure, and the interaction between these two components supports organizations to create organizational knowledge and to improve organizational innovation and consequently, supports achieving overall performance. Scholars frequently specify two kinds of KM process (Filius, De Jong, & Roelofs, 2000): (1) tactical KM process – by which employees collect information to solve problems, derive value from the collected information, learn from the value, and update the existing knowledge in the system; and (2) strategic KM process – by which organizations formulate KM strategy to assess, create, and sustain intangible assets, and align KM strategy with its business strategy.

According to Filius et al. (2000), tactical KM process includes the activities of knowledge acquisition, documentation, transfer, creation, and application. Knowledge acquisition is a kind of activity that attracts missing tacit and explicit knowledge from the external environment. Documenting knowledge relates to storing and retrieving knowledge from organizational system for example, databases and documents. Knowledge transfer allows employees to share their tacit and explicit knowledge to other employees inside and outside of their organizations. Knowledge creation is a process of creating knowledge in the forms of both tacit and explicit knowledge through a knowledge conversion process called socialization, externalization, combination, and internalization (SECI) process (Nonaka, 1994). Knowledge application allows employees to apply knowledge gained from inside or outside of the organization for their own purposes.

Implementing KM process in any kind of organizations is essential as it enhances learning capabilities of individual employees as well as group of employees (Liao & Wu, 2010). According to Crossan, Lane, and White (1999), learning emerges at individual employee level, group level, and institutional level, which are integrated by 4I process such as intuiting, interpreting, integrating, and institutionalizing. This

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