

The Relationship between Charismatic and Democratic Approach on Organizational Transparency of Islamic Insurance Institutions

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This study was undertaken to examine the relationship between the charismatic and democratic style of leadership on organizational transparency evidenced from Islamic insurance organizations in Malaysia. This study aims to investigate the extent of transparency practices based on the adoption of certain leadership styles namely charismatic and democratic. 185 employees of the Islamic insurance companies participated in this study. For the analysis procedures, Smart-PLS version 3.1 was used to assess the instrument and test the research hypothesis. The results of path modelling analysis indicated that both charismatic and democratic approach have a significant effect on organizational transparency. It could be described that a leader with high level of charisma and democracy are likely to practice high level of transparency in his/her leadership in the organization. This study further suggest that this area to be extended in the context of Malaysia as it has yet been undertaken in the scope of leadership and governance specifically. This study contributes to the theoretical body of knowledge as it provides further empirical literature to the factors contributing to the improvement of transparency practice in an organization.

JEL Codes: D22, G22 and G34

1. Introduction

When the reformation of financial sector started in 1970s, Malaysian economy followed the gradual approach by liberalizing the interest rates but eventually abolished it in order to mitigate the world economic recession that could impact Malaysia. However, in 1991, it was reintroduced (Ang & Mckibbin 2005). Following the occurrence of the Asian financial crisis in 1997, various economies were affected and Malaysia was one of them. Reasons for this crisis were due to the problems in the economic policy. First, the inappropriate macroeconomic policy adopted by incompetent management of institutions. Second, the pressure of increasing the interest rates which led to liquidation of banks. Last but not least, the exploitation of asset prices by international banks (Johnson et al., 1999). After the crisis, different from other affected countries, Malaysia adopted the absorption strategy where instead of closing the banks, a banking restructuring program was initiated with the aim to merge domestic banks and finance companies in a small number of group (Ang & Mckibbin 2005). This indirectly provides the platform for Islamic products to expand their market share and attracting interests from potential investors.

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Successful organizations can be determined by who make the most progress towards sustainable practices and at the same time have leaders who believe that the right thing to do is good for business (Adams 2013). Good governance is about the processes for making and implementing decisions. Not necessary about making 'correct' decisions, but about the best possible process for making those decisions. Leadership involves strategically developing and implementing plans and policies with accountability and transparency. Good leadership, which requires the ability to face challenges to achieve results in a complex conditions. Lord et al. (2009) have highlighted that good governance cannot be achieved without having effective leadership. When the leadership is poor, it is unlikely for a leader to have clarity about process and decision-making.

Studies on leadership style have attracted many researchers to explore the types of leaders adopted by organizations (Abdul Rani et al., 2008; Alkahtani et al., 2011; Jayasingam & Cheng, 2009; Voon et al., 2011). However, results from their findings showed a variety of leadership style preference for their respective organizations, which will be further discussed in later section. In addition, previous studies have suggested that charismatic and democratic leader are preferred among employees and at the same time, capable to give positive effect on organizational outcomes (Nazatul Shima et al. 2008; Sharifah & Normala 2012; Jayasingam & Cheng 2009; Kuppusamy et al. 2010). On the other hand, to improve governance, organization transparency is required as it contributes to stability as well as reducing severe organization's problems (Nier 2005). In the setting of this study, transparency was only transcribed in terms of disclosure of Shariah compliance by Takaful operators although it indicated a high conformance to Bank Negara's guidelines (Nor Aziah 2012), the extent of the level of transparency practices remained untested empirically. Furthermore, we observed that there are lack of studies undertaken by researchers with respect to how both charismatic and democratic approach could affect the transparency outcome of Takaful organizations. Such situation motivates us to fill in the gap of the related literatures by quantifying the magnitude and nature of the relationship between charismatic leadership, democratic leadership, and transparency. Therefore, the objective of this paper is to examine the relationship between leadership style of charismatic and democratic towards organizational transparency.

The remainder of this paper is structured as follows. The next section provides a review of relevant literature including the development of this study's hypotheses. Section 3 explains methodology employed to undertake this study. Section 4 outlines the results and findings generated from the analysis procedures. Discussion section is presented in section 5. Last section would be the conclusion of this study.

2. Literature Review

Traditionally, charismatic leadership as defined by sociologist Max Weber in 1947, occurs during a social crisis when a leader emerges with a radical vision that offers a solution that attracts followers who believe in the vision (Yukl 2010). Charismatic leadership is in fact has the close relation, or even, the same meaning as transformational leadership because transformational leader does possess charisma (Men & Stacks 2013). The charisma factor describes a unique individual who make his followers believe in his vision to bring the organization forward (Northouse 2013). Common definition of democratic leadership is the guidance by a leader where all individuals are involved in the decision-making process to determine what needs to be done and how it should be done. Gastil (1994) argued that previous definitions of democratic leadership by (Bass 1990) lacked conceptual precision.

He described democratic leadership as behaviour that influences people in a manner consistent with and/or conducive to basic democratic principles and processes, such as self-determination, inclusiveness, equal participation, and deliberation.

2.1 Good Governance Practices

In Malaysia, the Malaysian Code of Corporate Governance (MCCG) is the main cornerstone of the governance reforms agenda. It provides guidelines on the principles and best practices in corporate governance and the directions for the implementation as well as charts the future prospects of corporate governance in Malaysia (Ponnu 2008). Among various principles of governance, transparency is one of the core principle of good governance. It assures that corruption could be minimized, the views of the minorities are heard and considered in the decision making process and implementation stage (Parigi et al. 2004). In other words, transparency means sharing information and acting in an open manner. With this practice, it measures how good a management at making necessary information available in a candid, accurate, and timely manner. Norman et al. (2010) explained that when a leader is transparent, followers come to know what the leader values and stands for, and that the leader understands who they are as well. A critical element of transparency is to figure out just how open a leader should be or just how much to hang on the line, for while there is a possibility of being too little transparency and sometimes it can be too much (Walker & Pagano 2008). Pertaining to the leadership context, relational transparency is one of the underlying measure of authentic leadership (Northouse 2013). It refers to being open and honest in presenting oneself to others. It is about communicating openly and being real in relationships with others. Such behaviours promotes trust through disclosures and minimizing displays of inappropriate emotions (Walumbwa et al., 2008).

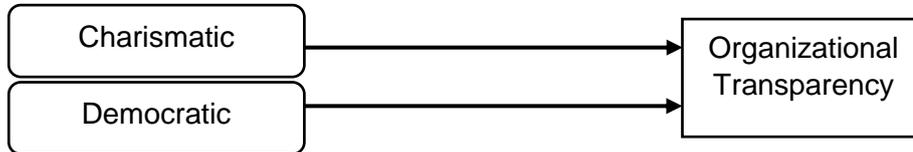
2.2 Hypotheses Development

Few studies were undertaken by previous researchers to examine the effect of charismatic and democratic approach on organizational outcomes based on different samples, such as 200 employees of various sectors in Malaysia (Nazatul Shima et al. 2008), 100 women entrepreneurs (Kuppusamy et al. 2010), 400 employees of various industries from public and private sectors (Jayasingam & Cheng 2009), and 150 companies comprised of managers in the Northern part of Malaysia (Alkahtani et al. 2011). From these studies, Nazatul Shima et al. (2008) posits that employees are more incline to charismatic leaders to lead the group and consequently effect positively towards organizational performance (Kuppusamy et al. 2010). Meanwhile, democratic approach also showed its significant contribution on organization's change (Alkahtani et al. 2011). Furthermore, this factor also found to be an important antecedent to leadership effectiveness, of which leading them in achieving their goals (Jayasingam & Cheng 2009). Although these studies have proven the importance of both approaches, we assert that there are still attention given in studying the impact of leadership on organizational outcome by using these approaches.

With respect to this study's environment, the aspect of transparency practices were conducted based on annual reports of 7 registered Takaful operators in Malaysia (Nor Aziah 2012). Through content analysis, it was found that Takaful operators in general showed high conformance of Shariah compliance to the central bank's guidelines. Despite the favourable transparency outcome stated above, we argue that the level of transparency were not determined by a specific factors, instead only been identified whether did those operators

practice adequate disclosure or not. The literature has been used as the basis of establishing a conceptual framework for this research as exhibited in Figure 1.

Figure 1. Conceptual Framework



The linkage between charismatic leadership and organizational transparency was conceptualized as leaders with high charisma has the tendency to exhibit transparency in their decision-making (Ray & Ray 2011). On the other hand, transparency through democratic leadership arises when decision-making and information sharing were conducted on a decentralized process (Wang 1994). Thus, it indicates a relationship that exists between both leadership approaches and organizational transparency. However, these linkages were only described as a concept and yet to be tested empirically.

From the above discussions, we predict that charismatic and democratic approach are able to positively influence transparency. Hence, it was hypothesized that:

- H₁: Charismatic leadership positively related to transparency.
- H₂: Democratic leadership positively related to transparency.

3. Methodology

This study employed quantitative research design where survey was used as the main instrument for gathering data. The respondents in this study involved employees from Takaful operators throughout Peninsular Malaysia. Data were distributed randomly to employees based on convenience sampling technique for the data collection procedure. For confidential reasons, the name of respondents are kept anonymous.

The survey questionnaire was designed by adapting measurement from various studies. There were three sections, namely Part A, Part B, Part C, and Part D. Part A described the charismatic leadership style which consists of 5 items. Four items were adopted from (Northouse 2001) and remaining item adopted from the Multifactor Leadership Questionnaire Form 5X (MLQ) (Northouse 2013). Part B described the democratic leadership style which consists of 5 items. Four items were adopted from (Northouse 2012) and remaining item adopted from (Clark, 2004). Part C described the organizational transparency which consists of 5 items. Four out of five items were adopted from the relational transparency scales (Northouse 2013). Remaining item used additional question adopted from (Palanski et al. 2010). Part D described the demographic information of respondents such as gender, age, race, level of education, designation in organization, and work experience.

500 survey questionnaires were distributed to the Takaful employees, and only 185 usable questionnaires were returned to the researchers, yielding 37 percent of the response rate. The distribution method was conducted in two approaches; first stage, researchers

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distributed the survey using hard copy questionnaires and sent to half of the respondents; and the other half were sent using electronic survey. The survey questionnaires were answered by participants based on their consents and on a voluntary basis. Sample size of this study was based on Krejcie & Morgan (1970) decision model and exceeds the minimum sample of probability sampling.

To test the hypotheses, partial least squares (PLS) approach using the Smart-PLS version 3.1 (Ringle et al. 2005) to analyse the data. Two procedures were undertaken; firstly, the measurement model that includes reliability and validity testing; and secondly, the structural model using bootstrapping method to determine the significance level of loadings, weights, and path coefficients (Chin 2010).

4. Results and Findings

Table 1 shows that majority of the respondents were female (54.6 percent), aged between 26 – 35 years old (65 percent), mostly participated were Malays (92.4 percent), bachelor's degree (49.3 percent), almost half of the employees were holding the position of executive (40 percent), and with working experience less than five years (46.5 percent).

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Table 1: Summary of frequency analysis

Demographic	Frequency (n = 185)	Percentage (%)
Gender:		
Male	84	45.4%
Female	101	54.6%
Age:		
≤ 25 years	35	10%
26 – 35 years	97	65%
36 – 45 years	8	17%
46 – 55 years	4	8%
≥ 55 years	0	-
Race:		
Malay	171	92.4%
Chinese	7	3.8%
Indian	7	3.8%
Others	0	-
Education:		
SPM/STPM	24	13%
Diploma	50	27%
Bachelor's Degree	91	49.3%
Masters	16	8.6%
PhD/Doctor of Philosophy	1	0.5%
Others	3	1.6%
Designation:		
Executive	74	40%
Senior Executive	30	16.2%
Assistant Manager	23	12.5%
Manager	8	4.3%
Senior Manager	0	-
Others	50	27%
Working Experience:		
≤ 5 years	86	46.5%
6 – 10 years	58	31.3%
11 – 15 years	23	12.4%
16 – 19 years	9	4.9%
≥ 20 years	9	4.9%

Note:

SPM/MCE : Sijil Pelajaran Malaysia/ Malaysia Certificate of Education

STPM/HSC : Sijil Tinggi Pelajaran Malaysia/Higher School Certificate

RM : Malaysian Ringgit

Prior to the measurement model evaluations, it is appropriate for us to conduct common method variance to ensure that there is no systematic bias that could influence our data. We use the common marker variable (Lindell & Whitney 2001) to test the level of common method bias. This approach requires a theoretically non-related variable with the tested variables in this study, indicating a marker in its relationship on the observed variables (Podsakoff et al., 2003). Based on the marker variable analysis, four constructs were used and the highest covariance for a construct stated at 1.4% variance attributable to bias (11.8% latent variable correlation). Since the marker does not account for majority of the variance and not exceeding average variance of 40.7% (Podsakoff et al. 2003), hence, we conclude that common method bias is not a critical issue for our analysis.

4.1 Measurement Model

A two-step process in this model assessment focused on the measurement models (Henseler et al., 2009). At this stage, the constructs' reliability and validity were examined according to certain criteria associated with its specification. Table 2 shows the results of discriminant validity and convergent validity and then reliability in Table 3. For convergent validity, all loadings that have values of average variance extracted (AVE) larger than 0.50 indicating that it met the acceptable standard of convergent validity (Fornell & Larcker, 1981; Hair et al., 2011). Discriminant validity was tested using Heterotrait-monotrait (HTMT) for each construct to ensure that they are empirically distinct from each other. The HTMT value of 0.90 indicate that discriminant validity is established (Gold et al., 2001; Teo et al., 2008). The results show that the independent variables are statistically different with the dependent variable (Hair et al., 2014; Henseler et al., 2015).

Table 2: Convergent and Discriminant Validity of Constructs

Constructs	AVE	1	2	3
Charismatic	0.873			
Democratic	0.798	0.888		
Transparency	0.769	0.823	0.883	

Note: Charismatic and Democratic constructs measuring a similar phenomenon of leadership.

Indicator loadings of the outer assessment is absolute standardized where it should be higher than 0.70 (Hair et al., 2011; Henseler et al., 2009) which can be found in Table 3. In sum, the measurement model for validity met the criteria.

Table 3: Indicator Loadings and Cross Loadings of Constructs

Constructs	Measurement Item	Charismatic	Democratic	Transparency
Charismatic	CHRSM1	0.935		
	CHRSM2	0.934		
	CHRSM3	0.935		
Democratic	DEMO1		0.884	
	DEMO3		0.918	
	DEMO5		0.878	
Transparency	TRNSP1			0.835
	TRNSP2			0.896
	TRNSP3			0.905
	TRNSP4			0.866
	TRNSP5			0.880

Composite reliability was used to indicate the internal consistency reliability of the constructs. The acceptable level of composite reliability should be higher than 0.70 (Hair et al., 2011; Henseler et al., 2009). Table 4 shows the results of internal consistency reliability that is greater than 0.70, indicating the instrument used in this study is reliable.

Table 4: Composite Reliability and Cronbach's Alpha

Constructs	Composite Reliability	Cronbach Alpha
Charismatic	0.954	0.928
Democratic	0.922	0.874
Transparency	0.943	0.925

4.2 Structural Model

Next process was to test the structural model. The results are presented in Table 5 and Figure 2. The R^2 values for the endogenous variable in this study is 0.677 which suggest that the modelled variables of charismatic leadership and democratic leadership in the analysis had explained 67.7 percent of the variance in organizational transparency. The high R^2 values substantiate the model's predictive accuracy.

The result of testing the model displayed that explanation was positively and significantly related to organizational transparency at $p < 0.000$ ($\beta = 0.357$, $t = 4.664$; $\beta = 0.509$, $t = 6.819$, respectively), therefore H_1 and H_2 were supported. This result demonstrates that charismatic leadership and democratic leadership do seen as important predictors to organizational transparency.

This findings also supported by the Q^2 value of Stone-Geisser's predictive relevance (Hair et al., 2014). After running the blindfolding procedure (Chin 1998; Henseler et al. 2009), we obtained the Q^2 value of transparency (0.516), which is well above zero, indicating the predictive relevance of the PLS path model. Therefore, the explanatory variables showed its capability to predict the endogenous variable.

5. Discussion

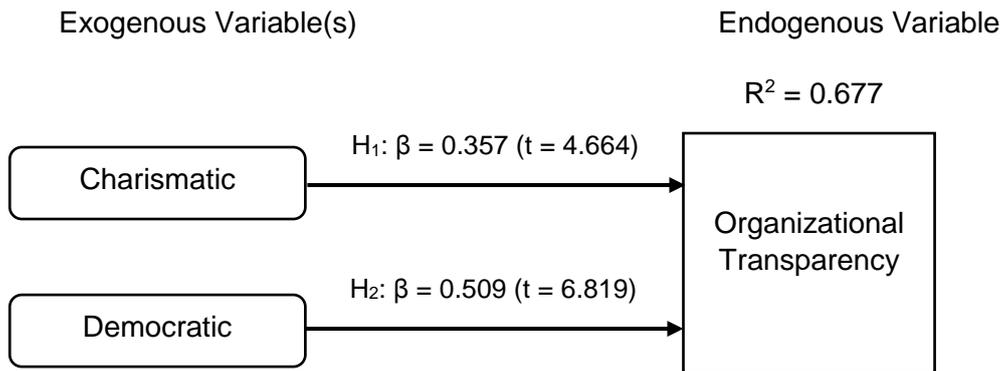
This study hypothesized the relationship between charismatic leadership, democratic leadership, and organizational transparency. The result shows that both leadership practices act as important predictors of transparency in the studied organization. Viewing the context of this study, leaders with high level of charisma and democracy most likely to practice high level of transparency in their decision making and actions. The findings of this study is supported by (Ray & Ray 2011; Wang 1994) who respectively indicated that charismatic leader has the tendency in exhibiting transparency in making decisions whilst democratic leader would practice transparency in a decentralized decision-making process via information sharing. This demonstrates consistency with the result of this study. In addition, this findings showed consistency with Kuppusamy et al. (2010) and Alkahtani et al. (2011) indicating that charismatic leadership and democratic leadership able to contribute towards the improvement of transparency in Takaful organizations. Although both approaches significantly affect transparency, we suggest that democratic leadership seems to have a stronger effect on transparency than charismatic leadership.

Table 5: Path Coefficients and Hypothesis Testing

Hypothesis	Relationship	Coefficient	T-statistics	Supported
H ₁	Charismatic → Transparency	0.357	4.664	Yes
H ₂	Democratic → Transparency	0.509	6.819	Yes

Note: Significant at *t-value >1.96

Figure 2. Results of the structural model analysis



The theoretical contribution of this study, this study reveals two important outcomes: firstly, charismatic leadership and democratic leadership have a positive effect on transparency. This results explain that when leaders demonstrate both approaches to stimulate their followers to come up with a decision-making, it could lead to an increased transparency practice in an organization. Secondly, this study supports the notion of charismatic leadership theory by Conger and Kanungo (1998) and democratic leadership theory by Bass (1990) on its capability in predicting organizational outcome such as transparency practice especially in the setting of Takaful environment. On the other hand, this finding contribute to the empirical literature of organizational transparency studies by highlighting the importance of leadership factors in contributing to the improvement of transparency among other antecedents in previous studies.

6. Conclusion

This study examined the relationship of charismatic and democratic leadership with transparency. Based on the results, it can be concluded that leadership factors have a positive impact on transparency. Our findings suggest that in order to improve transparency in an organization, it is best to consider leadership factors that are, charismatic leadership and democratic leadership as the important antecedents that could to lead to positive outcome, particularly in Islamic insurance sector. In addition, our study discovered that democratic leadership has a superior effect in influencing transparency compared to charismatic leadership.

This study is not without limitation. We were not able to utilize random sampling approach due to company policy and confidentiality issues when it comes to distributing surveys directly to employees in the operation floor. Thus, distribution was conducted with the help of office managers or company’s representative. Future researchers should consider

applying different strategies that enable them to undertake random sampling technique when collecting data and at the same time, not jeopardizing company's policy.

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