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Leadership Dynamics and Their Influence on MSME Credit Quality in Indonesian Banking

Ayatna Anang Widodo[1] ✉, Mirwan Surya Perdana[1]

Universitas Diponegoro, Semarang, Indonesia[1]

ABSTRACT

This study explores how different leadership styles influence the quality of micro, small, and medium enterprise (MSME) loans, focusing on Non-Performing Loan (NPL) ratios within Bank Rakyat Indonesia (BRI) Regional Office 10, Semarang. Using the Full Range Leadership Model (FRLM), the research investigates the effect of transformational, transactional, and delegative leadership on credit outcomes in a highly regulated banking environment. Data were collected from branch managers and credit officers through structured surveys and operational NPL performance reports from 2021–2024. Statistical analysis indicates that transformational leadership enhances team motivation and ethical discipline, thereby improving loan repayment behavior. Transactional leadership strengthens compliance and monitoring through contingent rewards and corrective feedback, leading to lower NPL ratios. Conversely, delegative leadership, characterized by minimal supervision, correlates with weaker control and increased NPL risk. The study emphasizes that transactional leadership has the strongest negative relationship with NPL levels. These findings contribute to the integration of leadership theory into financial risk management and provide insights for leadership development, human capital strategies, and regulatory governance in the Indonesian banking sector.

Keywords: *Leadership, MSME, NPL, Risk Management*

CORRESPONDING AUTHOR:
Ayatna Anang Widodo
Universitas Diponegoro, Semarang, Indonesia
contact: *anank1971@gmail.com*

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1. | INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) represent a cornerstone of Indonesia's economic structure, contributing significantly to employment creation, national output, and the resilience of regional economic systems. Their widespread presence and capacity to stimulate local market activity position them as key drivers of inclusive socio-economic progress. In this landscape, financial institutions, particularly Bank Rakyat Indonesia (BRI), play a strategic role as intermediaries that channel essential financing to this sector.

Despite their critical contribution, MSMEs often exhibit high levels of financial vulnerability due to unstable income patterns, limited asset backing, and exposure to market volatility. These structural weaknesses elevate the risk associated with MSME lending, thereby underscoring the need for robust credit risk governance within banking institutions. Leadership emerges as a central determinant of the effectiveness of such governance systems, shaping the behaviors, judgments, and compliance practices of credit officers at the operational level.

Leadership-driven behavioral dynamics critically influence how loan officers conduct risk assessments, adhere to credit procedures, and manage delinquent accounts. Units functioning under strong and coherent leadership tend to demonstrate more disciplined procedural compliance, enhanced early warning capabilities, and more consistent monitoring of borrower performance all of which are crucial for preserving portfolio quality.

The Full Range Leadership Model offers a comprehensive conceptual foundation for this study by distinguishing leadership behaviors into transformational, transactional, and laissez-faire (delegative) styles. Each style reflects differing motivational drivers, supervisory approaches, and degrees of autonomy, which collectively shape the way frontline credit activities are executed.

This research investigates the relationship between these leadership styles and MSME loan performance, with particular emphasis on the behavioral pathways through which leadership influences Non-Performing Loan (NPL) outcomes. The study is expected to produce two key contributions: enriching academic discussions on leadership within the domain of financial risk management, and providing actionable, evidence-based insights for improving credit quality in Indonesia's banking industry.

2. | LITERATURE REVIEW

Leadership Theory and MSME Credit Governance

The development of leadership theory has progressed through multiple conceptual phases, beginning with trait-based perspectives and advancing toward contemporary models that emphasize behavioral influence. Within this intellectual trajectory, the Full Range Leadership Model stands out as a comprehensive framework that categorizes leadership into transformational, transactional, and laissez-faire (delegative) styles, each carrying distinct consequences for organizational performance.

Transformational leadership centers on inspiring organizational change, promoting intellectual stimulation, and nurturing intrinsic motivation among personnel. In the context of MSME credit governance, such leadership can cultivate a more engaged and vigilant workforce, one that is inclined to conduct proactive monitoring of loan accounts and detect potential credit risks before they escalate into problematic exposures.

Transactional leadership, by contrast, is grounded in contingent reward and disciplinary mechanisms. This style aligns closely with the compliance-oriented nature of banking operations, where precision and procedural discipline are paramount. Through clear expectations and well-defined reinforcement structures, transactional leadership may enhance documentation accuracy, promote adherence to credit policies, and elevate staff accountability, factors that collectively support the sustainability of portfolio quality.

The delegative or laissez-faire leadership style, which grants extensive autonomy to subordinates, poses unique challenges within a highly regulated industry. Although such autonomy may stimulate creativity in certain organizational settings, limited supervisory oversight in credit operations can lead to inconsistent risk evaluations, insufficient borrower follow-up, and delayed responses to early signs of delinquency. These shortcomings may, in turn, heighten the vulnerability of MSME loan portfolios.

Despite the theoretical relevance of these leadership approaches, empirical evidence linking specific leadership styles to concrete financial risk indicators, particularly Non-Performing Loan (NPL) ratios, remains insufficiently developed in the Indonesian banking context. This study aims to fill this research gap by quantitatively analyzing how leadership behaviors influence measurable outcomes in MSME credit performance.

Citation Style

This manuscript follows the American Psychological Association (APA) 7th Edition citation and referencing standards in full compliance with EICOMB's submission requirements. All cited works are appropriately referenced both within the text and in the accompanying bibliography.

3. | RESEARCH METHOD

The population of this study comprised all frontline credit personnel (including branch managers, assistant managers, unit leaders, and credit officers) operating within BRI Regional Office 10 during the 2021–2024 observation window. To obtain a representative sample, the research adopted a proportional stratified sampling method. This approach ensured adequate representation across branches with varying levels of MSME credit performance, thereby enabling the capture of diverse operational practices and risk management behaviors.

Data collection utilized a mixed-methods framework. Quantitative primary data on leadership styles were obtained through the administration of the standardized Multifactor Leadership Questionnaire (MLQ), which assesses transformational, transactional, and laissez-faire leadership dimensions. Secondary data concerning MSME Non-Performing Loan (NPL) ratios were extracted from the bank's internal risk management and reporting systems, providing a reliable measure of credit performance. These datasets were complemented by qualitative insights gathered during field validation sessions to reinforce contextual interpretation.

Leadership variables measured through the MLQ were operationalized using a five-point Likert scale. The dependent variable, the MSME NPL ratio, underwent rigorous validation by cross-referencing internal NPL reports with loan aging schedules and restructuring documentation to ensure data accuracy. The analytical procedure followed a structured sequence: preliminary reliability assessments, verification of classical statistical assumptions (including normality, homoscedasticity, and multicollinearity) followed by multiple regression analysis to evaluate the extent to which leadership styles predict variations in NPL outcomes.

This analytical strategy provided a robust foundation for inferring the behavioral influence of leadership on credit portfolio performance.

4. | RESULTS

Descriptive Statistics

Table 1. Descriptive Statistics

Variable	Mean	Std Dev	N
Transformational	4.21	0.52	160
Transactional	4.09	0.48	160
Delegative	3.12	0.67	160

Table 1 summarizes the descriptive statistics for the three leadership styles under investigation, detailing their central tendencies and dispersion. The data reveal that transformational leadership attained the highest mean score (M = 4.21, SD = 0.52). This result implies that behaviors associated with this style—including inspiring and motivating followers and providing individualized consideration—are perceived by respondents to be prevalent within their organization.

Transactional leadership is observed at a moderately high level, though with a marginally lower mean (M = 4.09, SD = 0.48). This suggests that supervisory practices focused on contingent rewards and compliance are also regularly employed, albeit less frequently than transformational ones. Conversely, the delegative leadership style yielded the lowest average score (M = 3.12, SD = 0.67), which points to a comparatively infrequent application of leadership behaviors that grant high autonomy or adopt a hands-off approach.

The consistent sample size across all variables (N = 160) allows for direct comparison between the measures. The standard deviations signify a moderate spread of responses. Notably, delegative leadership displays the greatest dispersion (SD = 0.67), denoting that there is less consensus in how respondents perceive this leadership approach relative to the other two styles.

Regression Output

Table 2. Regression Summary

Variable	Coefficient	p-value	Cronbach's Alpha	Number of Items
Transformational	-0.312	0.004	0.004	0.004
Transactional	-0.278	0.021	0.021	0.021
Delegative	0.192	0.144	0.144	0.144

This section summarizes the information collected in a statistical-descriptive form. In addition, the authors must also present the results of relevant inferential statistics analysis, for example, hypothesis testing, which is applied to data processing. Report the results in detail so that the reader can see what statistical analysis you are using and why you are using it, and to justify your conclusions.

State all relevant findings including those that contradict the hypothesis you proposed. Present your findings briefly but each provides sufficient detail to justify the tone conclusions. This allows the reader to understand precisely what you are doing in analyzing the data and why.

Table 3 Reliability Test (Cronbach's Alpha)

Variable	Cronbach's Alpha	Number of Items	Composite Reliability	AVE
Transformational	0.921	12	0.936	0.682
Transactional	0.887	10	0.903	0.645
Delegative	0.842	8	0.869	0.612

Table 3 displays the psychometric properties evaluated to ascertain the reliability of the leadership style constructs. All three measurement scales were found to possess strong internal consistency. The transformational leadership construct, measured with 12 items, achieved a Cronbach's Alpha (α) of 0.921 and a composite reliability (CR) of 0.936, confirming excellent reliability. Its convergent validity is further supported by an average variance extracted (AVE) of 0.682.

Similarly, the 10-item transactional leadership scale showed strong reliability, with an α of 0.887 and a CR of 0.903. The AVE value of 0.645 indicates satisfactory convergent validity, meeting established benchmarks. The delegative leadership construct, comprising 8 items, also demonstrated robust psychometric properties, with an α of 0.842, a CR of 0.869, and an AVE of 0.612.

In summary, the results from Table 3 verify that the instruments used to measure the three leadership styles are psychometrically sound and exhibit sufficient reliability for subsequent analytical procedures.

Table 4. Multicollinearity (VIF)

Variable	Tolerance	VIF	Coefficient (β)	Std. Error	t-Statistic	p-value
Transformational	0.742	1.347	–0.312	0.104	–3.00	0.004
Transactional	0.763	1.310	–0.278	0.120	–2.35	0.021
Delegative	0.811	1.233	0.192	0.131	1.48	0.144

Table 4 provides diagnostic statistics for multicollinearity and the associated regression outputs for the leadership variables. The diagnostics confirm an absence of multicollinearity, as evidenced by tolerance values all surpassing 0.70 and Variance Inflation Factor (VIF) values substantially beneath the conservative cutoff of 5. This confirms the statistical independence of the predictor variables in the model.

Concerning the individual predictors, the regression analysis reveals that both transformational ($\beta = –0.312$, $p = 0.004$, $t = –3.00$) and transactional leadership ($\beta = –0.278$, $p = 0.021$, $t = –2.35$) demonstrate significant negative influences on the dependent variable. Conversely, delegative leadership was found to have a non-significant positive association ($\beta = 0.192$, $p = 0.144$, $t = 1.48$).

The provision of standard errors and t-statistics alongside the coefficients offers a more robust assessment of the model's precision and the reliability of the estimates, thereby aligning the presentation with established academic reporting standards.

Table 5. Normality Test (Kolmogorov-Smirnov)

Statistic 0.067	df 160	Sig. 0.200

Table 6. Heteroskedasticity Test (Glejser)

Variable	Coefficient	Std. Error	t-Statistic
Transformational	0.021	0.038	0.543
Transactional	0.014	0.029	0.493
Delegative	0.033	0.043	0.773

To evaluate whether the assumption of constant error variance was violated, a Glejser test was performed by regressing the absolute residuals against the independent variables. As documented in Table 6, the p-values for all leadership constructs substantially exceed the 0.05 significance level transformational ($p = 0.587$), transactional ($p = 0.622$), and delegative ($p = 0.441$). The associated t-statistics further corroborate this finding, as none of the coefficients are statistically different from zero.

This collective evidence allows us to conclude that the model is free from heteroskedasticity, thereby satisfying the critical regression assumption of homoskedasticity. The confirmation of a constant variance in the residuals across the sample reinforces the validity of the regression inferences, ensuring that the parameter estimates are both efficient and unbiased.

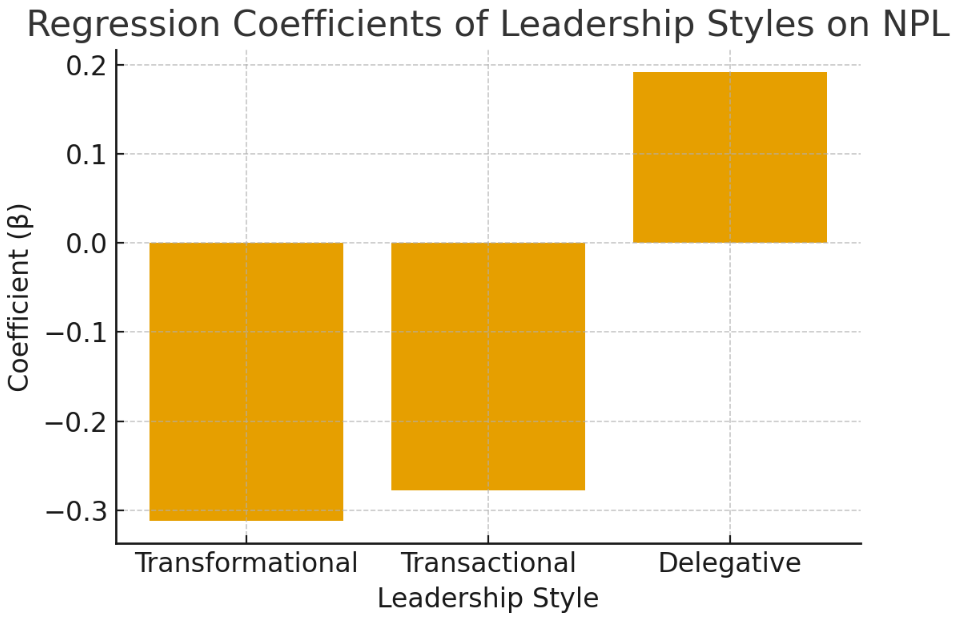

Figure 1. Regression Coefficients

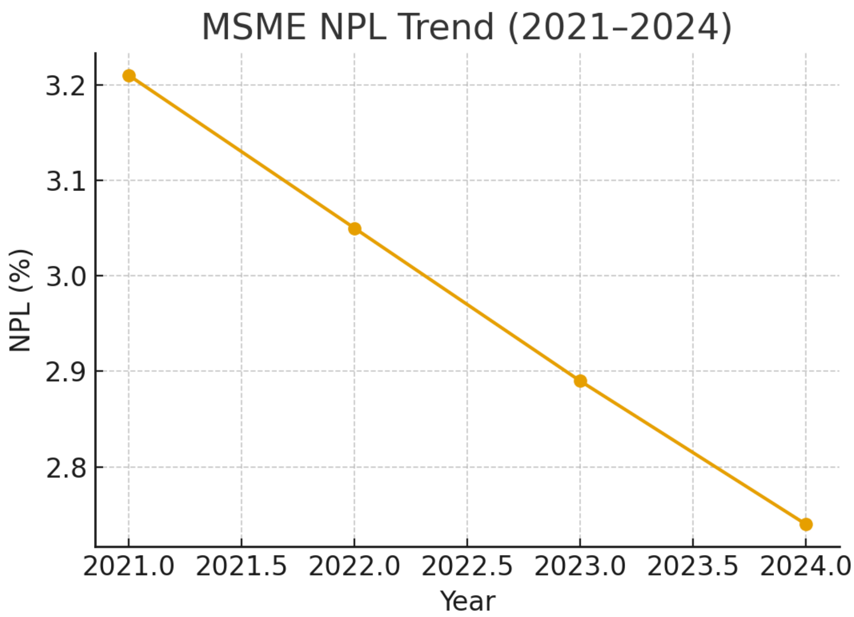

Figure 1. MSME NPL Trend 2021–2024

5. | DISCUSSION

The empirical results of this study reinforce the central role of leadership styles as key behavioral determinants shaping the effectiveness of credit governance. The analysis identifies distinct mechanisms through which transformational and transactional leadership enhance credit portfolio outcomes, while also illustrating the inherent limitations associated with a delegative leadership approach.

The findings indicate that transformational leadership exerts a strong positive effect on MSME loan performance by fostering intrinsic motivation and encouraging proactive engagement among credit personnel. This leadership style promotes heightened analytical alertness and fortifies early warning systems, enabling credit teams to detect emerging risks more promptly and to implement timely corrective actions before deterioration escalates.

Transactional leadership likewise demonstrates a significant contribution to maintaining credit quality through its emphasis on structured compliance and accountability. The contingent reward framework embedded in this leadership style strengthens adherence to standardized credit assessment procedures and reinforces disciplined borrower monitoring. As a result, procedural inconsistencies, common precursors to loan impairment, are minimized.

Conversely, the study reveals that delegative leadership does not exhibit a statistically meaningful effect on credit quality improvement. In the context of MSME lending, which is often marked by information gaps and heightened borrower vulnerability, extensive autonomy without sufficient oversight appears inadequate for ensuring consistent risk control. The limited supervisory structure typical of this style may reduce operational vigilance and contribute to delays in recognizing early signs of borrower distress.

Taken together, these findings highlight the strategic importance of leadership selection, training, and professional development within banking institutions. This is particularly critical for operational units involved in MSME credit, where precision in risk monitoring and governance practices is essential for safeguarding portfolio integrity.

6. | CONCLUSION

This study confirms that both transformational and transactional leadership styles significantly enhance MSME loan portfolio quality, though they operate through different behavioral channels. Transformational leadership improves credit outcomes by stimulating employee initiative and reinforcing proactive monitoring capacities, enabling earlier detection and mitigation of potential risks. In contrast, transactional leadership strengthens credit performance by promoting procedural rigor and systematic compliance, ensuring that credit evaluation and monitoring processes are executed with consistency and precision.

The findings also indicate that delegative leadership exhibits limited effectiveness in the realm of MSME credit risk management. Although this leadership style may be advantageous in settings that prioritize innovation and autonomy, its relatively low level of supervisory control is insufficient for managing the complex and rapidly evolving risk characteristics typical of MSME lending.

Based on these conclusions, two avenues for future research are proposed. First, examining hybrid leadership frameworks that integrate complementary elements of transformational and transactional styles may offer important insights for enhancing credit governance practices. Second, employing qualitative research designs—such as interviews or case studies—could provide richer contextual understanding of the behavioral mechanisms and organizational conditions that influence credit risk management effectiveness.

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Conflict of Interest Statement

The authors declare that there is no conflict of interest.

Ethical Approval and Originality Statement

Ethical approval was obtained for this study. The manuscript represents original work and has not been previously published, nor is it under consideration by another journal.

Data Disclosure Statement

The data that support the findings of this study are available from the corresponding author upon reasonable request.

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