

# Transformational Leadership and Industrial Relation Instruments as a Determinant of Firm's Performance Mediated by Industrial Relation Climate

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*Abstract:* - Globally companies have faced conflict in the workplace which led to unfavorable impacts on organizational performance. The dispute would cause an unfavorable workplace climate which leads to a reduction in the level of the firm's productivity and negatively impact the chance of the organization's survival. The objective of the study is to confirm the relationship between Transformational Leadership and IR instruments to IR Climate. And how IR climate relates to firm performance. A Descriptive quantitative study of 406 respondents from various industries in Indonesia was conducted. Participants of this study were from various stakeholders in organizations such as Directors, Managers, Employees, Heads of Unions, and members of unions from various types of organizations. The result shows that Transformational Leadership and Industrial Relations Instruments positively influence Industrial Relation Climate. And Industrial Climate has a positive relation to the Firm's Performance.

*Key-Words:* - Firm's Performance, Industrial Relation Climate, Industrial Relation Instruments, Transformational Leadership

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## 1 Introduction

Globally companies have faced conflict in the workplace which led to an unfavorable impact on organizational performance. The negative impacts on the firm can be manifested in loss of money such as revenue and assets lost and can be even worse in the loss of people's lives, [1]. The dispute would cause an unfavorable workplace climate which leads to a reduction in reduction of the level of the firm's productivity and negatively impact the chance of the organization's survival, [2].

On the contrary, [3], have reported that a conducive environment in the workplace has a

positive impact on organizational performance. Previous studies have revealed the positive influence of the Industrial Relations (IR) climate on employee satisfaction, loyalty, and commitment. The study also proved that the relationship between IR Climate and the productivity of the firm, and organization efficiency is positive and significant, [4]. The study, [5], argued that IR climate has a positive influence not only on an organization's level of performance but also on the employee's level. Fostering a conducive IR climate is required for survival in a highly competitive environment. To establish a good IR climate, the organization needs

to establish organizational flexibility to ensure employees' commitment, [2].

The current studies on IR climate mostly focus on the outcome of IR climate such as [6], conflict resolution and negotiation, [7], and organizational performance, [8]. The study, [9], argued that an IR climate that fosters collaboration has been linked positively to profitability and revenue, [9]. The study, [10], stated that a conducive IT climate positively influences organization and employee relationships. This favorable relationship between the organization and the employee produces a positive outcome such as better job performance, positive behavior, and all levels of commitment. A good IR climate affects a better attitude towards the leader and the employee's performance. Therefore, it is essential for an organization to develop and establish a positive IR climate.

Even though the positive outcomes related to a good IR climate are common knowledge,

however there are limited academic studies available, [2]. The academic literature on IR cannot catch up with the collection of facts and opinions from case studies and surveys from the real world. The possible reasons are such as what, [7], pointed out. The first point is that practitioners of industrial relations (IR) have little respect for theory and doubt its usefulness in real-world applications. The second point is that academics in the field tend to focus more on analyzing and describing practical aspects rather than delving into theoretical frameworks. The third point is that IR issues have relatively low priority on the political and practitioner agendas, which is evident in the limited number of publications on the subject.

A search conducted on the Science Direct database using the keywords "industrial relation" yielded only 149 results across all years. When further refined to include only "research" and "review" articles, the number decreased to a mere 118 publications. Among those 50 articles published in the last five years. The objective of this study is to contribute empirical evidence on the impact of leadership and IR instruments on the IR climate.

It is critical to understand the factors that influence a good IR climate. Previous studies claimed that related factors for good IR climates are such as leadership styles (e.g. ethical leadership styles), [10], social dialogue, [11], [12], employee voice, [13], employee representation, [14], employee participation, [15], [16], involvement of HR, [17], [18], trust, [19], organizational justice, [19], [20], Corporate Governance, [21], Union effectiveness, [22], [23], perceived labor-

management relation, [23], [24], management participation, [25], and Organization culture, [26].

A qualitative study from [27], revealed how leadership might play a critical role in the effectiveness of an organization. The study, [27], further confirmed that when participants claimed that there is a positive IR climate, usually there is a somehow top management involvement. This study also revealed that transformational leadership is considered effective leadership in fostering a positive IR climate. Yet, the current study on transformational leadership to IR climate is still limited.

The objective of this study is to answer the further study recommendation from [27], to confirm the relationship between transformational leadership style with IR climate. The studies confirm that having a good organization structure supporting the IR climate (IR instrument) is still lacking as well. This study also aims to confirm the influence of IR instruments on IR Climate. And how IR climate relates to firm performance.

This study contributes to strengthening the body of evidence of transformational leadership. Transformational leadership is one of the most studied leadership, however still limited to the IR climate. This study also contributes to enriching the literature on IR climate.

The structure of this writing starts with the Introduction and is followed by Literature Review. Afterward, the Methodology of the study is depicted. The following parts are Study Results and Discussion. This writing will be closed with a Conclusion, Limitation, and Recommendation.

## 2 Literature Review

### 2.1 Transformational Leadership

The perceived knowledge of top management on IR issues can be reflected by their involvement in IR. The involvement of top management is the reflection of how much the top management cares and this will lead to the creation of trust and reputation. The involvement of top management leads to a better intra-organizational relationship. Leadership has a critical role in the management function to ensure the maximization of organizational efficiency and to achieve the goals of the organization. Studies showed that leadership is critical in organizational effectiveness, [28]. Leadership plays an important role to make sure that every resource allocation would have a positive link to the organizational objectives. However, the

relationship between leadership roles and IR climate was only addressed by [10].

Transformational leadership refers to a leadership style characterized by a leader's ability to collaborate with their team, cultivate team identity, inspire and create an organizational vision, drive organizational change, and foster team commitment, [29]. Transformational leaders are recognized for their utilization of the four I's: idealized influence, inspirational motivation, individualized consideration, and intellectual stimulation, as outlined in the four I's of a transformational leader, [30]. Available studies showed that characteristics aligned with transformational leadership are usually known as characteristics influencing the crisis-handling effectiveness of leaders. Transformational leadership characteristics are such as building team confidence and trust, creating hope and sharing the big picture, building team relationships, and strengthening teamwork. A transformational leader is articulating a group vision or by encouraging cooperation among team members to strengthen their belief in their ability to overcome difficulties, [31].

In the IR study, previous studies have shown the role of leadership in a good IR climate. In [26], [1], the authors state how leadership is critically important in fostering a good IR climate in the organization. According to [1], in order to foster an effective IR climate, leaders should possess specific qualities. These qualities include self-awareness, which involves having a clear understanding of one's own strengths and weaknesses. Balanced processing refers to the ability to objectively evaluate information and consider different perspectives before making decisions. Relational transparency involves being open and honest in communication, fostering trust and cooperation within the organization. Lastly, internalized morals refer to leaders having a strong ethical compass and adhering to moral principles in their decision-making processes. These qualities are deemed crucial for leaders in creating and maintaining a positive and productive IR climate. How ethical behaviors of leaders support the development of positive employee relations in an organization is raised by [10]. In [2], [32], the authors claim that transformational leadership is positively linked to a good IR climate.

A study from [27], showed that most words raised to reflect effective leadership are communicative, coaching, participatory, flexible, supportive, harmonious, and valued.

Transformational leadership with the 4 I's are close to the described words.

### **H1: Transformational Leadership is positively linked to IR Climate**

#### **2.2 Industrial Relations Instruments**

In order to manifest the principles of industrial relations in everyday interactions among the participants of the production process, it is essential to establish a conducive environment and atmosphere that foster the growth and development of the mental and social attitudes associated with industrial relations, ultimately shaping the behavior of all parties involved in their daily interactions. To create such a supportive atmosphere, it is necessary to enhance the fundamental infrastructure that facilitates the implementation of industrial relations. As defined in Article 1, number 16 of Law Number 13 of 2003 concerning Manpower (also known as the "Labor Law"), industrial relations represent a system of relationships among the actors involved in the production of goods and/or services, which include entrepreneurs, workers/labor, and the government. These relationships are based on the values of Pancasila and the 1945 Constitution of the Republic of Indonesia.

To establish a healthy and dynamic industrial relations environment within a company, it is crucial to have appropriate industrial relations facilities and foster effective and meaningful communication between company leaders and labor unions or workers. The aim of this intensive, transparent, and honest communication is to build mutual trust and eliminate preconceptions and suspicions. The success of such communication largely relies on factors related to employee welfare, which reflects their assessment of the facilities and support provided by the company, [33].

Ensuring employee welfare is an integral aspect addressed in the collective labor agreement (CLA), with trade unions and bipartite institutions playing a significant role in shaping industrial relations, [33]. Organizations that overlook the importance of an IR climate are likely to face elevated production costs. Poor IR practices can result in inefficiency, unfavorable production outcomes, neglect of duties, worker absenteeism, and high employee turnover rates, [34].

## **H2: IR Instrument is positively linked to IR Climate**

### **2.3 Industrial Relations Climate**

The organization's IR climate can be defined as a total measurement of the relationship of labor management. Organization IR climate is a variable that mediates IR inputs and outputs. The concept is typically assessed using a range of factors that encompass the norms, attitudes, emotions, and actions that are common in the workplace, which includes the principle of "fairness and mutual respect". Industrial relations can be defined as the various activities associated with the dynamics of workplaces, such as the organizational structure, employment contracts, labor management, resolution of conflicts, and the perspectives and behaviors of workers within their workstations, [1]. The study, [35], referred to IR climate refers to how management, employees, and their representatives perceive and experience the relationships and interactions between employees in the workplace. IR climate is defined as the quality of labor-management relationship, [4], [10]. A positive IR climate is characterized by a trustworthy, respectful, and healthy relationship between management and employees, [10].

The dimensions of IR climate encompass various aspects, including cooperation, trust, mutual regard, joint participation, apathy, and hostility. These dimensions capture different aspects of the overall industrial relations climate within an organization or workplace, [7]. The six dimensions of IR climate are expected to depict the perceptions of the members of the firms on the norms and atmospheres in relation to union-management relations practice in the organization.

According to Dunlo's book "Industrial Relations System", [36], several variables have been identified as influencing the IR climate. These variables include technology, labor, and product market conditions, budgetary considerations, and the distribution of power within the organization or industry. These factors play a significant role in shaping the overall dynamics and functioning of the industrial relations system. The study, [37], expand the variable with the goals, value, power of the actors, and external factors such as ecological, economic, political, legal, and cultural, are also influencing the IR climate. The study, [38], state that the process of HR is also one of the factors influencing IR climate. The study, [39], points out that the Union Commitment itself affects the IR climate.

The Impact of organization size on IR climate has been highlighted by [38]. They found that the size of an organization is related to the frequency of strikes and the level of technology utilized. Additionally, the degree of organizational dependence on various environmental resources, including labor markets, has been explored by [40], in relation to its influence on the organizational climate.

The role of leadership factors in shaping the IR climate has also been examined by previous authors. The study, [26], states that, in addition to organizational culture, the top management team also has an impact on the IR climate. In [1], this study argues that leadership qualities such as self-awareness, balanced processing, relational transparency, and internalized morals significantly influence a positive IR climate.

The study, [7], identified several outputs of the IR climate, which they categorized into consensual and conflictual outcomes. Consensual outcomes include agreement on work and trade union organization, agreement on employment terms, and perceived effectiveness of negotiations. Conflictual outcomes, on the other hand, encompass strikes, turnover, and perceived disharmony within the organization.

In [4], their study state that IR climate has a great impact on productivity and efficiency. The study, [5], state that IR climate is positively linked with organizational commitment and union loyalty. The study, [20], argues that a good IR climate will influence employee performance. This is because fewer conflicts foster the work environment which leads to better employee performance. The study, [35], argues further that IR climate is influencing organizational performance.

## **H3: IR Climate is positively linked to Organizational Performance**

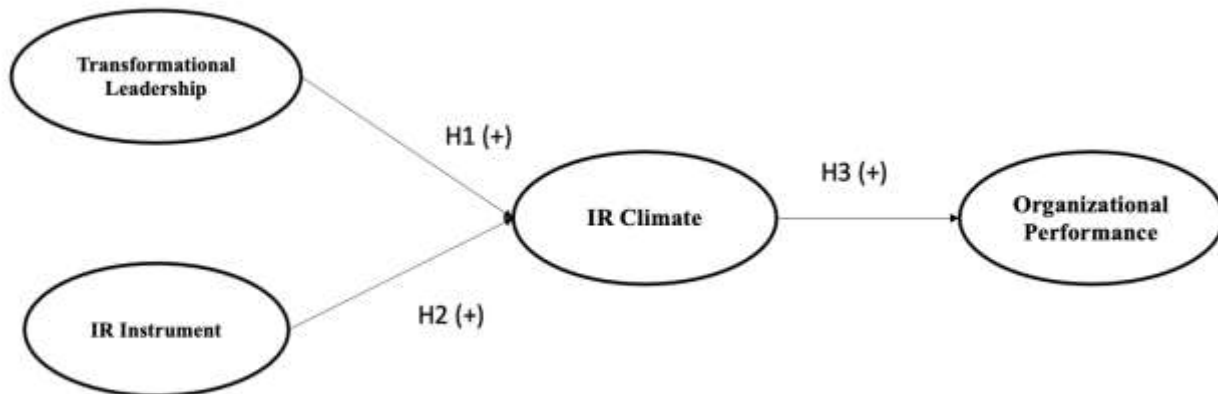


Fig. 1: Research Framework

### 3 Methodology

#### 3.1 Research Design

The research design employed in this study is descriptive quantitative to test the relationship among latent variables. Before respondents completed the questionnaires, they were provided with a brief overview of the research and asked for their willingness to participate. Only those who provided informed consent were included in the analysis. Data confidentiality and consent that the result of the study will be published in the academic paper were also disclosed.

Structured questionnaires were used as the instrument for data collection. The questionnaires were distributed through an online survey platform from March to June 2022. The questionnaires utilized a seven-point Likert scale, ranging from 1 (strongly disagree) to 7 (strongly agree), allowing participants to rate their opinions. Additionally, the questionnaire included demographic questions, such as age, gender, years of service, work location, industry, position, company size, and number of unions.

#### 3.2 Participants

In order to gain more insight, participants of this study were from various stakeholders in an organization such as Directors, Managers, Employees, Head of Unions, and members of unions from various types of organizations. Unit analysis was individual. The population is unknown,

therefore the sample size for this study was determined based on an unknown population. The minimum sample required for this study is 387. This study used the convenience sampling method.

#### 3.3 Measurement

The measurement scales used in this study for the four latent variables were derived from previous studies. The framework and measurement approach from the previous study served as a reference for the current study (Table 1).

Table 1. Measurement of Variables

Variable	Indicator	Reference
Transformational Leadership	Company leaders give priority to finding new opportunities for the company.	[41]
	Company leaders always clearly communicate the short-term goals of the Company.	
	Company leaders provide more motivation to company employees.	
	Company leaders play an important role in the company's operations.	
	Company leaders involve their teams in making decisions	
	Company leaders seek new perspectives in solving problems	
IR Instruments	The Labor Union and Company Management respect each other's existence.	[40]
	The Labor Union and Company Management hold joint discussions in finding solutions to industrial relations problems in the company.	
	Trade unions and company management involve the local manpower office and the industrial relations court if industrial relations issues cannot be resolved by both parties.	
	A collective Labor Agreement is a guide in the implementation of industrial relations in the company	
IR Climate	Trade Unions and Company Management work together in realizing harmonious industrial relations in the company you work for.	[40]
	Negotiations on industrial relations in the company took place in a conducive atmosphere.	
	A collective Labor Agreement is considered good by employees in the company	
	Generally, employees in companies are interested in the quality of the union-management relationship.	
	Employees assume the existence of a union.	
	The Trade Union has strong support from its members.	
	Trade Unions and Management exchange information openly within the Company.	
	Management seeks input from the Labor Union before initiating policy changes in the company.	
	Management and labor unions did not take long to resolve industrial relations disputes that occurred in the company.	
	The settlement of industrial relations disputes in the company does not end with a demonstration/strike	
Organizational Performance	In general, our company is able to earn profit from sales as expected.	[42]
	In general, the company is able to earn revenue as expected.	
	The company's performance can be maintained even better.	
	The company's sales can be maintained and even increased.	
	The company is able to produce successful innovative products	

### 3.4 Data Analysis

The collected data were analyzed using LISREL version 8.70. The analysis followed a two-step approach, which involved:

a) Measurement model analysis: This step aimed to assess the validity, reliability, and overall goodness of fit of the variables in the model. It examined the measurement properties of the latent variables and their indicators.

b) Structural model analysis: In this step, the predictive value and goodness of fit of the overall

model were evaluated. It focused on examining the significant relationships between variables and assessing the overall fit of the structural model.

Additionally, path coefficient analysis was conducted to determine the level of impact of each latent variable on its corresponding criterion variable. This analysis provided insights into the strength and direction of the relationships between the variables in the model.

## 4 Result

### 4.1 Demographic

The total number of returned and eligible questionnaires is 406. All data is valid to undergo further analysis. The survey results show male dominance by 80% or as many as 325 respondents from a total of 406, while the remaining 20% or 81 respondents are female. Of the total 406 companies that took part in the survey, most companies have employees above 1000 by 48%, companies with employees below 500 as many as 31%, companies with employees from 500 to 1000 as many as 18% and the rest as much as 3%. Out of the total companies that participated in the survey, it was found that 49% of them had only one dominant company with a union. The second largest group consisted of companies that had multiple unions, accounting for 36% of the sample. Additionally, 16% of the companies surveyed did not have any union.

Regarding the current positions or positions of the respondents, it was observed that out of the total respondents, 42% were employees, indicating that a significant portion of the participants belonged to the employee category. The second-largest group comprised Managers/Senior Managers/General Managers, accounting for 33% of the respondents. Labor union administrators represented 20% of the respondents, while Directors/CEOs/Commissioners/Company Owners made up 5% of the participants.

### 4.2 Analysis

Based on the provided information, it can be concluded that all the measurements used in the study are valid. This conclusion is based on the fact that all related indicators have outer loadings exceeding 0.5 and T-values exceeding 1.96, which are commonly accepted thresholds for validity.

Furthermore, the reliability of the measurements is established as the Composite Reliability (CR) and Variance Extracted (VE) for all indicators are greater than 0.7 and 0.5, respectively. These values indicate that the measurements are reliable.

Regarding the goodness of fit of the model, several criteria were evaluated. The Root Mean Square Error of Approximation (RMSEA) value of 0.078 is less than the accepted threshold of 0.08, suggesting a good fit. The Goodness of Fit Index (GFI) of 0.97, Comparative Fit Index (CFI) of 0.97, and Normed Fit Index (NFI) of 0.96, all exceed the recommended threshold of 0.90, indicating a satisfactory overall fit of the model.

In conclusion, based on the validity, reliability, and goodness of fit measures, it can be stated that the measurements used in the study are valid, reliable, and the overall model demonstrates a good fit.

From Figure 2 it can be seen that the relationship between both transformational leadership and IR Instruments to IR climate is positive. The relationship between IR climate to Organizational Performance is also positive.

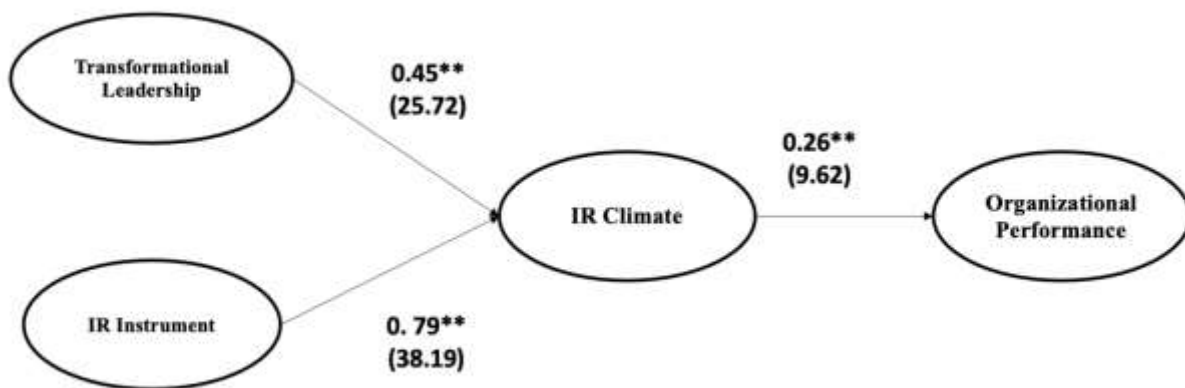


Fig. 2: Path Analysis Result

### 4.3 Hypothesis Testing

Table 2. Hypothesis Testing

Hypothesis		T-Value	Direction	Conclusion
H1	Transformational Leadership → IR Climate	34.27	Positive	H1 is supported
H2	IR Instrument → IR Climate	45.59	Positive	H2 is supported
H3	IR Climate → Organizational Performance	8.58	Positive	H3 is supported.

Table 2 showed the hypothesis testing result. For all hypotheses, the T-value figure is all above 1.65. Therefore, it can be concluded that all hypotheses are supported.

### 4.4. Discussion

The findings of this study indicate that the transformational leadership style has a positive and significant influence on the IR climate. This suggests that leaders who exhibit transformational leadership behaviors, such as inspiring and motivating their teams, considering individual needs, and stimulating intellectual growth, are likely to contribute to a favorable IR climate within the organization. The results highlight the importance of transformational leadership in shaping and fostering a conducive and harmonious work environment that promotes cooperation, trust, and mutual respect among employees and management. In [26], [1], the authors pointed out that leadership plays an important role in fostering the IR climate. IR climate will foster if trust, cooperation, mutual regard, and empathy are there. Transparency, role model, and relationship are important characteristics in fostering the IR climate, [1].

Transformational leaders are characterized by the four Is: idealized influence, inspirational motivation, individualized consideration, and intellectual stimulation, [30]. These leaders build team confidence and trust, create hope and share a compelling vision, foster strong team relationships, and strengthen teamwork. The transformational leadership style is often associated with charisma, delegation, inspiration, effective communication, and encouragement of innovation, [29]. Transformational leaders are known for their ability to inspire and motivate their teams, empower individuals, and stimulate intellectual growth, ultimately leading to positive organizational outcomes and a conducive work environment.

Transformational leaders are known to have four Is which are idealized influence, inspirational motivation, individualized consideration, and intellectual stimulation, which are known as the four I's of transformational leader, [30]. Transformational leadership characteristics are such as building team confidence and trust, creating hope and sharing the big picture, building team relationships, and strengthening teamwork. The transformational leadership style is charismatic, delegating, inspiring, communicating, and encouraging innovation, [29].

Transformational leaders are known to build team confidence, resist the status quo, and encourage change. This type of leadership understands that building trust is important. They also value the growth and development of the team. Therefore, as this study revealed, the transformational leadership style is suitable to build a good climate in the organization including the IR climate.

The result of this study also confirmed that the impact of the IR instrument is greater than transformational leadership. This might be due to



the IR instrument is showed how the organization implements its commitment in build a good IR climate. The instrument implementation shows that organizations first and foremost abide by the law. The second, its implementation shows the goodwill of the organization in search of a better solution to the conflict. Its implementation also shows how seriously the organization sees the welfare of its employee.

This study confirmed previous studies that IR climate influences organizational performance. A previous study has shown that a good IR climate enables harmony in the organization, [7]. A good IR climate reduced the number of strikes and conflicts. Therefore, it will increase productivity and efficiency, [4]. A good IR climate also influences absenteeism, it increases commitment and reduces turnover, [7], [4], [5]. All of those will lead to better organizational performance.

## 5 Conclusion

This study showed that the IR climate is positively influenced by transformational leadership and IR instruments. However, IR instruments show a greater impact on IR climate than Transformational Leadership. This is due to that IR instruments are about real implementation which can be witnessed by everyone. This study also confirmed that IR climate positively links to organizational performance.

This study possesses several limitations. First of all, this study only reviewed two internal factors. Other internal factors such as HR process, internal communication, and organizational culture can be recommended to be studied for future research. This study does not consider external factors such as government regulation, political and economic conditions, and the impact of the crisis. Further study to see the impact of external factors can be recommended.

This study is using self-assessment. Further study with mixed latent and fixed variables (such as performance), can be recommended. Further study to see the difference between the size of the company and the type of ownership of the company in fostering IR climate can also be suggested for further study.

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#### **Conflict of Interest**

The authors have no conflict of interest to declare.

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