DYNAMIC CAPABILITY AND MSME BUSINESS PERFORMANCE: A CONCEPTUAL FRAMEWORK WITH DIGITAL TRANSFORMATION AND COMPETITIVE ADVANTAGE AS INTERVENING VARIABLES

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) face significant challenges in a volatile, technology-driven business environment. Although Dynamic Capability (DC) is recognised as a source of strategic advantage, the mechanism by which DC is translated into Business Performance (BP) through Digital Transformation (DT) and Competitive Advantage (CA) in the MSME context remains incompletely understood. This article aims to develop a conceptual framework integrating DC, DT, CA, and BP. Through a systematic literature review of publications from 2015–2025, this study proposes five main propositions: (1) DC positively affects DT; (2) DT positively affects CA; (3) DT mediates the relationship between DC and CA; (4) DC has a direct effect on CA; and (5) CA has a direct and positive effect on Business Performance (BP). This framework offers novelty by positioning DT and CA not merely as outcomes but as strategic transformation mechanisms that bridge organisational capabilities and ultimate market and financial performance. This synthesis helps MSME practitioners identify priority areas for developing dynamic capabilities to support effective digital transformation and sustainable business growth.

Keywords: dynamic capability, digital transformation, competitive advantage, business performance, MSMEs.

INTRODUCTION

The Micro, Small, and Medium Enterprises (MSMEs) play a vital role in the national economy, especially in labour absorption and contribution to the Gross Domestic Product (GDP). However, the high rate of business failures and the low growth rate of the middle class in MSMEs indicate a gap in capabilities to respond to market dynamics. The phenomenon of digital disruption has changed the competitive landscape, where the speed of adaptation is a determining factor for business continuity. Many MSMEs have access to technology but fail to achieve sustainable competitive advantage or meaningful improvements in business performance, while others have transformed, excelled, and grown rapidly.

This research aims to understand the factors shaping the resilience and growth of MSMEs in the digital era. Previous literature has often viewed technology adoption in isolation from strategic management capabilities. In fact, interest and ability to develop a business (growth intention) are greatly influenced by how entrepreneurs manage their internal resources. As with the Reasoned Action Approach, which

emphasises attitudes and behavioural control in forming the intention to develop (Pratiwi Octasylva et al., 2021), in the context of strategy, Dynamic Capability (DC) is the main predictor of the Organisation's Digital transformation behaviour.

DC is defined as a company's ability to integrate, build, and reconfigure internal and external competencies to deal with a rapidly changing environment (Teece, 2007). On the other hand, Digital Transformation (DT) is not just digitisation, but a fundamental change in business models and values driven by technology. Although the previous literature has extensively discussed the roles of technology and capabilities, three critical research gaps remain unresolved. First, previous studies have often created a "black box" around how internal resources are converted into external outputs, without explaining the mechanism of that transformation. Second, there are theoretical inconsistencies regarding the path of DC's influence: whether DC has a direct impact on Competitive Advantage (CA) and performance, or whether the impact must pass through DT as an intermediary. Third, the majority of research in the context of MSMEs stops at the formation of CA as the final outcome, even though CA is only a strategic position; without the realisation of measurable Business Performance (BP), these advantages do not have sustainable economic value.

To bridge this gap, this study offers a major novelty by developing an integrative conceptual framework that positions DT and CA as double intervening variables (chain intervening variables) linking DC to BP. In contrast to the conventional technology adoption model, this study introduces theoretical novelty by defining DT not merely as a hardware purchase (tech adoption) but as a strategic transformation mechanism driven by DC. Contextually, this model also provides empirical novelty for MSMEs, where dynamic capabilities that are informal and bricolage (limited resource utilisation) are explicitly mapped to lead to real business performance.

Based on the synthesis of the research gap and novelty, this article aims to provide a literature framework explaining how DC affects Business Performance (BP) with DT and CA as intervening variables. Based on the literature review, five propositions were proposed: (1) DC has a significant effect on DT; (2) DT has a significant effect on CA; (3) DT mediates the DC-to-CA relationship; (4) DC has a direct influence on CA; and (5) CA has a direct effect on Business Performance. This research is useful for MSME actors to improve dynamic capabilities and for stakeholders to design a more holistic digital transformation mentoring program to achieve optimal business performance.

RESEARCH METHODS

This study uses a qualitative approach with a systematic literature review (SLR) design to develop a conceptual framework. This approach was chosen because the main objective of this study is to synthesise scattered empirical and theoretical findings to build a new conceptual model that comprehensively explains the mechanisms of relationships between variables. The literature search and synthesis protocol adapts the PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) guidelines for conceptual studies.

Search and Data Collection Strategy

Data collection was conducted by searching scientific articles in reputable bibliographic databases, including Scopus, Web of Science, DOAJ, and Google Scholar. The publication time range used is the last ten years (2015–2025) to ensure the relevance of the findings to the context of digital disruption and current market

dynamics. The keywords used in the search consist of a combination of booleans: ("dynamic capability" OR "dynamic capabilities") AND ("digital transformation" OR "digitalisation") AND ("competitive advantage" OR "business performance") AND ("SMEs" OR "MSMEs" OR "MSMEs").

Data Analysis and Synthesis Techniques

Data from the selected literature were analyzed using content *analysis* and *conceptual mapping* techniques in three systematic stages:

1. Identification of *Theoretical Anchoring*: Examine the main theoretical foundations, namely *Dynamic Capability View* (DCV) and *Resource-Based View* (RBV).
2. *Relational Mapping*: Identify patterns of empirical and theoretical relationships between constructs (DC → DT → CA → BP) from previous literature, as well as map research gaps.
3. Integration and Framework *Development*: Combine findings across the literature to produce a formulation of five key propositions and a complete visualization of the conceptual framework.

LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK DEVELOPMENT

This research is rooted in the integration between *Resource-Based View* (RBV) and *Dynamic Capability View* (DCV). RBV postulates that valuable, scarce, and hard-to-replicate internal resources are a source of competitive advantage (Barney, 1991). However, in a volatile environment, a DCV is needed that explains how companies integrate, build, and reconfigure competencies to respond to rapid environmental changes (Teece, 2007).

Table 1. Conceptual Framework Development Reference

Author	Focus Object	Key Variables	Key Information/Theoretical Contributions
Teece (2007)	Multinational	*Sensing, Seizing, Reconfiguring*	DC as a micro-foundation of environmental adaptation and value creation.
Vial (2019)	General Organization	*Digital Transformation*	DT is defined as a process of changing the value and business model, not just IT adoption
Warner & Wäger (2019)	Large Companies	DC & *Digital Change*	DC is an absolute prerequisite for triggering and managing digital change.
Mikalef & Pereira (2019)	Company	*Big Data & Performance*	Dynamic capabilities mediate the relationship between technology and performance.

Soluk & Soto-Acosta (2020)	MSMEs	*Digital Adoption & Growth*	Fragmentary digital adoption without a strategy (DC) will fail to improve performance.
Richard et al. (2009)	Cross-Sector	*Business Performance*	Business performance must be measured multidimensionally (financial, market, and growth).

Dynamic Capability (DC)

In the context of MSMEs, DC is often informal and inherent in the intuition and vigilance of owner-managers. The DC dimension includes *sensing* (being aware of digital trends), *seizing* (mobilising limited resources or *bricolage*), and *reconfiguring* (adjusting business processes).

Digital Transformation (DT)

DT is not just the digitisation of manual processes but also fundamental changes in business models, cultures, and organisational structures, driven by technology, to create new value (Vial, 2019). DT is positioned as a strategic transformation mechanism that translates potential capabilities (DC) into tangible results.

Competitive Advantage (CA)

CA in MSMEs in the digital era includes digital *agility*, *customer intimacy*, operational efficiency, and expanding market reach. CA represents a superior strategic position that is difficult for competitors to replicate.

Business Performance (BP)

Business performance is the *ultimate outcome* of the company's strategy and operations. In MSMEs, business performance is measured using multidimensional metrics, including financial growth, market performance, and business continuity and growth (Richard et al., 2009). The CA that is formed must ultimately be realised in improving the performance of this business.

HYPOTHESIS DEVELOPMENT

Based on the above literature review synthesis, the following is the development of propositions for the proposed conceptual model:

Dynamic Capability for Digital Transformation (H1)

Sensing capabilities allow MSMEs to identify digital opportunities. Seizing capabilities enables resource allocation for technology adoption, while *reconfiguring enables* the integration of technology into operations. The literature indicates that without DC, DT efforts tend to stagnate.

H1: Dynamic Capability has a positive and significant effect on Digital Transformation in MSMEs.

Digital Transformation against Competitive Advantage (H2)

DT that has successfully resulted in operational efficiency, market expansion, and improved customer experience. Empirical studies confirm that digital maturity is positively correlated with market performance. Thus, DT directly contributes to the formation of CA.

H2: Digital Transformation has a positive and significant effect on Competitive Advantage in MSMEs.

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The role of Digital Transformation (H3)
Mediation DT acts as a mechanism of action. DC provides "potential", while DT is the "embodiment" of the execution of the change. Strategic capabilities must be translated into specific initiatives (DTs) to produce a tangible impact on competitive advantage.
H3: Digital Transformation mediates the relationship between Dynamic Capability and Competitive Advantage in MSMEs.
Direct Influence of DC on Competitive Advantage (H4)
Although DT is a crucial mediator, DC has intrinsic value. The ability to quickly reconfigure resources provides resilience to non-digital shocks. In addition, sharp sensing builds the social capital and customer trust that is the source of traditional CA.
H4: Dynamic Capability has a positive and significant effect directly on Competitive Advantage in MSMEs.
The Influence of Competitive Advantage on Business Performance (H5)
The competitive advantage (CA) of MSMEs must ultimately translate into measurable business performance. When MSMEs achieve *digital agility*, proximity to customers, operational efficiency, and expanded market reach, this will be immediately reflected in increased sales volume, profitability growth, and business continuity. The strategy literature confirms that CA is the main *antecedent* (predecessor) of a company's performance. Without the realisation of improved performance, the status of "superior" has no economic value.
H5: Competitive Advantage has a positive and significant effect on Business Performance in MSMEs.

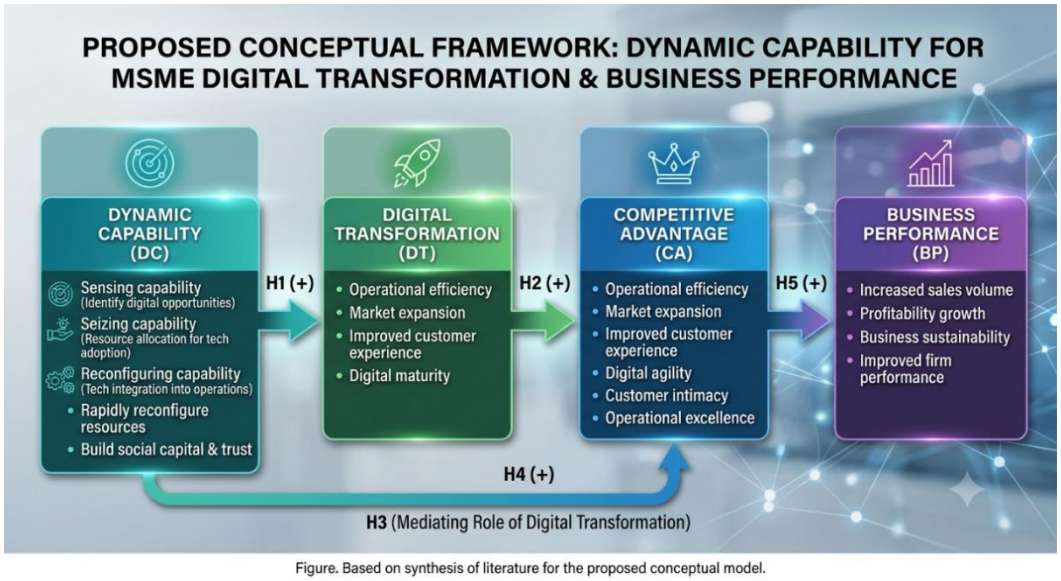

Figure. Based on synthesis of literature for the proposed conceptual model.
Figure 1. Conceptual Framework

Table 2. Operationalization of Research Variables

Variabel	Description	Dimensions	Indicator

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Dynamic Capability (DC) (Variabel Independen)	The ability of MSME organizations to integrate, build, and reconfigure internal and external competencies to respond to the rapidly changing business environment (Teece, 2007).	1. Sensing	• Vigilance of new technology trends • Ability to detect changing customer needs • Regular monitoring of competitor activities
		2. Seizing	• Speed in strategic decision-making • Creativity in making use of limited resources (bricolage) • Commitment to allocation of funds/time for new initiatives
		3. Reconfiguring	• Ability to change business processes to be more efficient • Flexibility in team/role restructuring • Willingness to learn and adapt (continuous learning)
Digital Transformation (DT) (Variable Intervening 1)	The process of fundamental changes in business models, cultures, and organizational structures driven by the adoption of digital technologies to create new value (Vial, 2019).	1. Digital Strategy	• Clarity of vision for the use of technology in business • Integration of technology into key value propositions • Data-driven long-term planning
		2. Digital	• Culture of

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		Culture	experimentation and tolerance for failure • Data-driven decision-making orientation • Openness to digital innovation
		3. Tech Adoption	• Use of e-commerce/marketplace platforms • Utilization of social media for marketing & services • Adoption of digital management system (accounting/CRM)
		4. Digital Org.	• Restructuring workflows to support digital • Team collaboration using digital tools • Security and management of customer data
Competitive Advantage (CA) (Variabel Intervening 2)	The superior position of MSMEs in the market results from operational efficiency, service differentiation, and business resilience in the digital era (Porter, 1985).	1. Digital Agility	• Speed of response to market changes • Ability to pivot business models quickly • Adaptability to external disruptions
		2. Customer Intimacy	• Personalization of services based on customer data • Customer satisfaction and loyalty levels • Intensive two-way interaction through digital channels
		3. Operational Eff.	• Reduced operational costs due to automation • Reducing human error. • Time efficiency in

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			order fulfillment
		4. Market Reach	• Expansion of market reach beyond geographical boundaries • Access to new customer segments • Increased brand visibility in the digital ecosystem
Business Performance (BP) (Dependent Variable)	The final results of MSME strategies and operations are measured through financial growth, market expansion, and business continuity (Richard et al., 2009).	1. Financial Performance	• Annual sales volume growth • Increased profit/profitability margin • Return on investment (ROI) of digital assets
		2. Market Performance	• Growth in the number of new customers • Increase in local market share • Customer order retention and recurrence rates
		3. Growth & Sustainability	• Growth in the number of employees or branches • Business resilience in the face of economic shocks • Expansion of new product/service variations

Managerial Implication

In this study, several important factors have major implications for improving the competitive advantage and business performance of MSMEs. It is known that several parties can be involved in improving the capabilities of MSMEs, namely:

1. MSME actors: It is necessary to focus not only on technology purchases but on the development of dynamic capabilities (sensing and learning) so that digital transformation runs effectively and really leads to increased sales and profitability.

2. Government: Can provide stimulus in the form of change management training and strategic assistance, not just hardware assistance, with the final target in the form of measurable MSME class growth.

3. Private Sector/Platform: Working with the government provides an ecosystem that makes it easier for MSMEs to reconfigure their business processes to win market share.

CONCLUSIONS AND RECOMMENDATIONS

Conclusion

This research, using a literature review approach, can provide a comprehensive overview of the influence of *Dynamic Capability* and *Digital Transformation* on *Competitive Advantage* and *Business Performance*. This study provides additional literature that determines the success of MSMEs, not only using technology adoption theories. However, this study shows that the factors shaping optimal business performance are the combination of dynamic capabilities (DC) and their realisation through digital transformation (DT), which together form a competitive advantage (CA). This study better describes the mechanism of value creation, in which capabilities realised through digital transformation form a competitive advantage, ultimately leading to real improvements in business performance (financial and non-financial).

Recommendations

Future studies are expected to use Structural Equation Modelling (SEM) to empirically test causal relationships among constructs in a diverse sample of MSMEs, particularly to test the full path to Business Performance. Then, moderating effects, such as government support or the intensity of competition, can be added to explain the relationship between constructs. In addition, further research can classify MSMEs by sector to provide an overview of differences in dynamic capability priorities across industries.

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