

THE ROLE OF DYNAMIC CAPABILITY AND ORGANIZATIONAL AGILITY IN IMPROVING MSMEs' PERFORMANCE

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ABSTRACT

Entrepreneurial dynamics encounter significant challenges in a competitive and fast-changing environment. This research aims to explore the role of dynamic capability and organizational agility in enhancing the performance of micro, small, and medium enterprises (MSMEs), particularly within the batik and embroidery sectors in Pasuruan Regency, specifically in the Bangil, Beji, Gempol, and Pandaan areas. Data was gathered from 48 MSMEs owners through questionnaires, and the analysis was performed using quantitative methods with SmartPLS 4.0 software to test the research hypotheses. The findings revealed that dynamic capability is essential for enhancing MSMEs' performance, while organizational agility also positively influences performance. Additionally, the study indicated that both dynamic capability and organizational agility positively impact the performance of batik and embroidery MSMEs in the Bangil, Beji, Gempol, and Pandaan regions. This research provides valuable insights for decision-making and strategy formulation in the face of market uncertainties, offering practical recommendations for MSMEs owners to enhance their efficiency and competitiveness.

Keyword : Dynamic Capability; Organizational Agility; and MSMEs Performance

ABSTRAK

Dinamika kewirausahaan menghadapi tantangan yang signifikan dalam lingkungan yang kompetitif dan cepat berubah. Penelitian ini bertujuan untuk mengeksplorasi peran kapabilitas dinamis dan kelincahan organisasi dalam meningkatkan kinerja usaha mikro, kecil, dan menengah (UMKM), khususnya di sektor batik dan bordir di Kabupaten Pasuruan, khususnya di wilayah Bangil, Beji, Gempol, dan Pandaan. Data dikumpulkan dari 48 pemilik UMKM melalui kuesioner, dan analisis dilakukan menggunakan metode kuantitatif dengan perangkat lunak SmartPLS 4.0 untuk menguji hipotesis penelitian. Temuan penelitian mengungkapkan bahwa kapabilitas dinamis sangat penting untuk meningkatkan kinerja UMKM, sementara kelincahan organisasi juga memengaruhi kinerja secara positif. Selain itu, penelitian ini menunjukkan bahwa kapabilitas dinamis dan kelincahan organisasi berdampak positif terhadap kinerja UMKM batik dan bordir di wilayah Bangil, Beji, Gempol, dan Pandaan. Penelitian ini memberikan wawasan berharga untuk pengambilan keputusan dan formulasi strategi dalam menghadapi ketidakpastian pasar, menawarkan rekomendasi praktis bagi pemilik UMKM untuk meningkatkan efisiensi dan daya saing mereka.

Kata Kunci : Kemampuan Dinamis; Kelincahan Organisasi; dan Kinerja UMKM

INTRODUCTION

In a dynamic business world, companies need to understand and adapt faster than their competitors. (Yi et al., 2023a). The development of dynamic skills is essential for the efficient utilization of knowledge resources, and dynamic knowledge-based skills can significantly enhance the growth of dynamic skills and abilities. (G. Li, 2022) Improved entrepreneurial skills can help MSMEs owners manage their businesses more efficiently, innovatively, and creatively, and adapt to change and uncertainty. Khalid & Firdaus, (2021) This capability consists of a set of interrelated skills and actions that are learned and repeatedly applied to improve the performance of the company compared to its competitors. (Khalid & Firdaus, 2021). For MSMEs owners, it is very important to improve the entrepreneurial skills of their resources through training so that they can gain a competitive advantage and adapt to rapid market changes.

The MSMEs batik and embroidery sector in Pasuruan Regency face many challenges in managing their business. Due to market competition, rapid and complex changes in the market environment, limited capital to meet production needs, and minimal human resource skills, production efficiency is low, and product performance is poor, making it difficult for the company to compete in a larger market. Although many previous studies have examined how organizational capabilities and agility affect MSMEs' performance, few have focused on their impact on the batik and embroidery industry in Pasuruan Regency (Hidayat et al., 2022). Soeparto (2021) argues that for batik and embroidery MSMEs in Pasuruan Regency to adapt to a rapidly changing environment and improve their performance, they must have more strategic dynamic capability. However, these batik and embroidery MSMEs in Pasuruan Regency face several problems in developing this dynamic capability, including a lack of investment in technology and human resources (Pratama et al., 2024). The study of Kamasak et al (2016) shows that the efficiency of dynamic capability, especially in a changing environment, positively affects the performance of MSMEs. Few researchers focus on how these capabilities are used in the batik and embroidery industry. Dynamic capability has little effect on MSMEs' performance (Nguyen et al., 2023), however, there has been no study on how MSMEs involved in batik and embroidery in Pasuruan apply this strategy. Moreover, Fitriati et al (2020) found that dynamic capability significantly helps to enhance MSMEs' performance. Results of Chatterjee et al (2022)

support this viewpoint, given that dynamic capability is necessary for the sustainability of the environment, which in turn improves the results of the competitive business. Yang (2023) points out that while dynamic capability generally enhances performance, it may not always have a significant impact under specific circumstances. Mukhtar et al (2024) research suggests that dynamic capability has no significant impact on MSMEs' performance under environmental dynamics. Research by Syafia & Maya (2021) shows that dynamic capability positively influences the performance of MSMEs. Referring to Akkaya & Qaisar (2021), how dynamic capability works in agile organizational practices and how it benefits the performance of MSMEs. Hernández-Linares et al (2021) have suggested that dynamic capability may not significantly influence the MSMEs' performance. Wilden et al. (2013) support this notion, indicating that enhancing dynamic skills does not necessarily result in better performance. Additionally, the context in which these capabilities are utilized appears to have little effect on MSMEs' performance. Similarly, Ojo et al. (2023) found that dynamic capability does not significantly impact MSMEs' performance. From the viewpoint of Rokhanawati et al. (2024), dynamic capability also does not seem to affect the performance of MSMEs.

Research conducted by Ottemoesoe et al (2021) Showed that MSMEs in fiercely competitive sectors depend much on their flexibility, which also defines their genetic connections. Riawan et al (2023) Found that lower efficacy might follow from MSMEs not being able to adjust, hence hampering them in meeting consumer demands and reacting to changing market dynamics. Organizational agility has to include spending on technology, staff development, and encouragement of continuous innovation. (Karini & Pertiwi, 2023). Overwhelming doubt and fear of change could lead companies to lose direction and pursue unstructured ideas; these are essential in developing a sustainable competitive advantage. (G. Li, 2022). Lack of competence and information could keep MSMEs from becoming agile; therefore, organizational agility would not have a significant effect on general performance. (Chan et al., 2019). Yuen & Baskaran (2024) Improving organizational agility can greatly increase sustainable long-term performance for small and medium-sized enterprises in digital transformation, particularly given the need for knowledge and skills development. With Gao et al (2020) And their colleagues. Fostering responsive business practices, organizational agility is very helpful for performance. Jing et al (2023) Results. Verify that business performance improvement

is greatly positively affected by organizational agility. Research from Çallı & Çallı (2021) Emphasizes the link between agility and MSMEs' performance since it shows that higher organizational agility significantly boosts commercial performance. Akkaya & Qaisar (2021) Demonstrate that for small and medium enterprises, organizational agility acts as a moderating variable in the dynamic capability market performance connection. Conversely, in their investigation Al-Omouh (2021) They discovered that organizational agility only moderately affects MSMEs' performance. If leadership does not completely back agility-related projects, organization members might suffer from a lack of commitment, reduced motivation, and poorer performance results.

According to existing data, there are many small business owners in the batik and embroidery sector in and around the Bangil region. There are 17 registered embroidery owners in the Bangil district and 3 in the Beji district. In addition, there are also 3 MSMEs batik owners in Bangil district, 3 MSMEs batik owners in Beji district and 1 MSMEs batik owner in Gempol district. According to the survey results, MSMEs owners in the batik embroidery sector face various problems that pose a challenge to their efforts. Still, only a few researchers closely investigate how dynamic capabilities and organizational agility enable batik and embroidery MSMEs to rise in competitiveness. Most earlier work would focus on MSMEs as a whole, therefore overlooking the unique characteristics of the batik and embroidery industry, dealing with different challenges related to market access, product development, and sustaining business independence (Hernández-Linares et al., 2021); Ojo et al., 2023). Furthermore, no research directly investigates how dynamic capabilities and organizational flexibility might improve the competitiveness of small to medium enterprises involved in Pasuruan's batik and embroidery. Furthermore, previous research suggests that dynamic capabilities and agility within businesses could improve the competitiveness of small to medium businesses (Nguyen et al., 2023); however, an exact empirical research regarding the use of these elements in the Pasuruan batik and embroidery business has not been carried out. Therefore, this study seeks to close this gap by investigating how dynamic capabilities and organizational agility might contribute to the performance of MSMEs specializing in batik and embroidery in Pasuruan, while presenting recommendations for government and business owners.

Dynamic capability perspective Hernández-Linares et al. (2021) and rooted in

the work of D. J. Teece et al. (1997), draws on the Resource-Based View (RBV) to characterize entrepreneurship as a collection of resources. According to Barney (1991) Entrepreneurship must cultivate a learning process to effectively adapt to changes in the environment. Yi et al. (2023b) Elaborate on how dynamic capability relates to resources and highlight the performance disparities among firms with similar resource levels, which can be attributed to their environmental contexts. Given the rapid pace of change in entrepreneurship, dynamic capability encompasses the ability to identify and create opportunities and threats, leverage those opportunities, and reorganize assets and structures to respond to shifts in the business landscape (Bojesson, 2024). Energetic organizational agility demands both speed and adaptability, focusing on hierarchical advantages. This agility emphasizes quick responses and adaptability as essential traits for navigating an increasingly dynamic environment (Kosasi, 2017). Organizational agility refers to an organization's capability to swiftly address changing customer demands and competitive pressures, while learning agility pertains to the ability to effectively acquire and utilize new knowledge (Ludviga & Kalvina, 2024). According to Ludviga & Kalvina (2024) Organizational agility is a blend of flexibility, speed, and responsiveness aimed at uncovering competitive advantages, whereas dynamic capability can be viewed as a novel approach to identifying these advantages (D. J. Teece, 2020).

The research highlights important implications for the business strategies of batik and embroidery MSMEs in Indonesia. It emphasizes the role of dynamic capability and organizational agility in enhancing competitiveness. Entrepreneurs are encouraged to focus on innovation, adapting to market changes, and improving operational efficiency. Policymakers can leverage these findings to develop training programs, funding opportunities, and regulations that support MSMEs' dynamic capabilities. Previous studies have indicated that access to technology, management training, and flexible funding can improve MSMEs' competitiveness (Ratnawati, 2020). Thus, this research contributes to academic knowledge while providing practical benefits for the MSMEs sector in Indonesia. This research objective, therefore, looks at how these two factors influence the performance of MSMEs in this sector. The researcher analyzed batik and embroidery MSMEs as a research object in terms of the lack of adaptation to rapid changes in the market and environment. This study uses

hypotheses and relevant concepts from research conducted in the context of entrepreneurship. The researchers compiled and distributed questionnaires to respondents as part of the data collection to analyze the patterns of batik and embroidery MSMEs in the Pasuruan Regency. This research uses a quantitative method with data processing using SmartPLS 4.0 (Hair et al., 2019). The objective of this study is to identify and understand the importance of dynamic capability and organizational agility in improving the performance of MSMEs to create competitive advantages in response to market changes.

Based on the above phenomenon, this study offers a new perspective on the importance of adaptation and innovation to address the challenges that arise in the business environment. This research provides insights into the important role of product efficiency, new market development, adaptation, and rapid and effective response to rapid market changes in improving MSMEs' performance, providing insights into decision-making and the development of strategies that support the success of MSMEs. The research examines how batik and embroidery MSMEs enable transformation with dynamic capability, organizational agility, and performance required for MSMEs owners to develop and improve their competitive performance.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Dynamic Capability

D. J. Teece (2020) describes dynamic capability as the process of integrating, building, and reconfiguring both internal and external resources to effectively navigate a rapidly evolving environment. Research conducted by Kihara (2018) also revealed that dynamic capabilities have a significant role in the innovation strategy of micro, small, and medium enterprises. This concept highlights the entrepreneurial skill to innovate, adapt to changes, and implement strategies that benefit customers while disadvantaging competitors. In their review, D. Teece et al. (2016) outline the purpose and methodology of their analysis. Kaur (2020) points out that an organization's ability to learn more quickly than its rivals is a crucial source of competitive advantage, aligning with the dynamic capability perspective, which posits that a firm's edge lies in its dynamic capability. This area of study has garnered significant interest from researchers, many of whom view dynamic capability as a vital resource for fostering entrepreneurial competitiveness (Gyemang & Emeagwali, 2020). Dynamic capability is the skills

businesses have to respond to different changes inside and outside, thereby enabling them to adapt effectively and be innovative (Eikelenboom & De Jong, 2018). Research by Wardaya et al (2019) shows that for the growth of micro, small, and medium enterprises (MSMEs), dynamic capability, including risk management, opportunity recognition, and innovation, is essential. By using and combining resources flexibly, these results indicate that such skills may significantly boost small company performance. Research into the topic, Trisnawati et al (2024), points out that the capability to sense, learn, and coordinate, which constitutes dynamic capability, assists MSMEs in adjusting to market transformations and sustaining a competitive edge. MSMEs owners and executives improve these skills so they can more flexibly meet changes in nature. (Saha et al., 2017). Dynamic capacities, according to Gyemang & Emeagwali (2020), positively affect organizational agility, which in turn causes enhanced competitive performance. According to D. J. Teece (2018), entrepreneurship necessitates the concurrent development and application of skills related to sensing, seizing, and reconfiguring resources to establish and sustain a competitive advantage. Indicators play a significant role in the dynamic capability framework, which has been used in a variety of research studies, including those conducted by and (Wagner et al., 2017).

Organizational Agility

Agility can be interpreted as the ability of an entrepreneur to survive and grow in a competitive environment with constant and unpredictable market changes, and to react quickly to a rapidly changing and fragmented global market (Akkaya & Qaisar, 2021). Chatwani (2019) Provides a predictive organizational readiness capability model response that guides the flow of knowledge to enable agile (proactive) action or rapid response. Organizational agility requires a system that is not rigid and can adapt to dynamic changes in the system, thus allowing the organization to evolve flexibly and respond to opportunities in new challenges while maintaining stability through sustainability, reliability, and efficiency in the application of work processes (Noor Sancoyo & Wicaksana, 2023). Research conducted by Rozak et al (2023) This ability has been shown to enhance the operational efficiency and competitive edge of micro, small, and medium enterprises in the scope of digitalization in business. Different from Kusumawati & Anik (2023), who explained that organizational agility creates

predictability in the business environment so that companies can cope with changes as much as possible and use changes as opportunities for further growth and development. Organizational agility refers to the capability of an organization to swiftly respond to shifts in environmental requirements and efficiently meet customer needs (H. Zhang et al., 2023). The MSMEs sector in Indonesia shows that entrepreneurial leadership and organizational culture, especially, affect organizational agility, therefore positively contributing to it (Khalid et al., 2020). In periods of market volatility, it is seen as an essential strategic asset needed for survival and achievement. Using organizational agility, MSMEs can quickly meet consumer demands, direct change, and improve their goods and services (Devie et al., 2023). Muhammad et al (2021) Suggest that agile companies can better adapt to outside changes, reach higher performance levels, and maintain a competitive edge in the market. For MSMEs looking to remain relevant, the capability to adjust to changing conditions is essential (Gao et al., 2020). For example, Kanten et al. (2017) Examined organizational readiness along speed, competence, flexibility, and responsiveness. Indicators play a significant role in the organizational agility framework, which has been used in a variety of research studies, including those conducted by (Suherman & Yusuf, 2021) and (Ananda & Sari, 2023).

MSMEs Performance

MSMEs performance is an expectation of achievement with financial and non-financial measures to achieve the financial performance of MSMEs, indicated by the increase in the number of sales, increase in working capital, and increase in profit trends, while the success of non-financial performance is measured by the increase in the number of workers and expanding the marketing area (Rokhayati, 2015). Syafia & Maya (2021) Also, emphasize the role of e-readiness and dynamic capabilities in improving company performance. Susilowati et al (2022) MSMEs' performance is the result of various business objectives that can be achieved through various effective strategies. Stated that the performance of MSMEs is used as a measure of success over time and can also be used as an input to improve or enhance performance in the future. Performance reflects the outcomes of both individual and team efforts within an organization, shaped by a variety of factors, to reach shared objectives over a specific timeframe (Ratnawati, 2020). Dynamic abilities are critical for increasing flexibility within companies, Rashidirad & Salimian (2020) Believe, these skills let companies not

only adapt to changes but also generate value by supporting continuous innovation and investigating fresh possibilities. Strong dynamic capability, when combined well with organizational agility, can increase organizational agility, which improves MSMEs' performance (D. Teece et al., 2016a). Awwad et al (2022) Say that typically most effective in micro, small, and medium-sized businesses, marrying dynamic capability with organizational flexibility, are innovation and the capability to react to market demands. Moreover, research Atobishi et al (2024) Dynamic capability significantly affects MSMEs' performance by increasing organizational agility. In her research on the MSMEs' performance, Ratnawati (2020) Identifies four key indicators: sales growth, profit growth, workforce expansion, and increases in market share. Indicators play a significant role in the MSMEs' performance framework, which has been used in a variety of research studies, including those conducted by (Thalia et al., 2024) and (Herlinawati et al., 2023), (Figure 1. Conceptual Background 1).

Hypothesis Development

Dynamic Capability to MSMEs Performance

The role of market change as a component of dynamic capability cannot be overstated. Studies by Octasyilva et al. (2022) It has been indicated that dynamic capability has a direct influence on MSMEs' performance, particularly in terms of dynamic environmental changes. Anindo Saka Fitri et al. (2022) Have emphasized that dynamic capability has a significant impact on the performance of MSMEs, highlighting the need for such a firm to foster continuous improvement and adaptability. Park et al. (2019) Argue that the importance of developing technological knowledge to guide internal strategies and drive innovation changes in the competitive market, so dynamic capability is important for performance. In line with Zheng (2021) Who emphasizes the positive effect of dynamic capability on the MSMEs' performance, especially in the context of sustainable growth.

H1: Dynamic Capability Positively Influences MSMEs' Performance

Organizational Agility to MSMEs Performance

Agile organizations tend to be more adaptable, competitive, and responsive to changes Susilawati (2024) Shows that organizational agility has a significant positive impact on MSMEs' performance outcomes, which emphasizes the need for flexibility and rapid adaptation to market dynamics. In addition, market entry agility, which

includes the ability to effectively execute business strategies, improves overall performance, allowing MSMEs to respond quickly and efficiently to customer demand (Ariadi et al., 2024). This adaptability is particularly important in the face of challenges such as intense competition and changing consumer preferences, which are common in the MSMEs sector (Ni Komang Deviana, 2024).

H2: Organizational agility positively influences the MSMEs' Performance

Dynamic Capability and Organizational Agility to MSMEs Performance

L. Li et al. (2020) Argue that organizational agility, as a manifestation of dynamic capability, allows entrepreneurship to effectively adapt and reconfigure resources in response to environmental changes. Akkaya & Qaisar (2021) Show that encouraging dynamic skills can improve MSMEs' performance, especially when combined with organizational agility. Thus, MSMEs that develop strong dynamic capability and foster an agile organizational culture are better prepared to respond to environmental changes and achieve sustainable performance (Eikelenboom & de Jong, 2019). Awwad et al. (2022) Further delve into the significance of dynamic capability and organizational agility, asserting that organizational agility positively influences MSMEs' performance by acting as a strategic approach for entrepreneurs to navigate environmental changes and seize emerging opportunities. This viewpoint is supported, according to Gyemang & Emeagwali (2020). There is a positive relationship between dynamic capability and organizational agility. In general, the results suggest that dynamic capability plays a vital role in improving a company's competitiveness. These findings align with earlier research by Oliva et al. (2019) Who highlighted the importance of robust dynamic capability in fostering organizational agility, a key element for MSMEs in terms of innovation and adapting to shifting consumer markets.

H3: Dynamic Capability and Organizational Agility Positively Influence MSMEs' Performance

RESEARCH METHODS

Method is a method of work that can be used to obtain something. While the research method can be interpreted as a work procedure in the research process, both in searching for data or disclosing existing phenomena (Zulkarnaen, W., et al., 2020:229). This research uses a quantitative research approach, based on positivism. Soegiyono (2020) This method is designed to study a specific population and collect samples,

utilize research instruments to collect information, and conduct statistical analysis to evaluate predetermined hypotheses with smartPLS 4.0 software this search aims to analyze how organizational agility and dynamic capabilities help to improve the performance of MSMEs in the batik and embroidery sector, with a validity test with a convergent validity value of >0.70 on the outer loading value and >0.50 for the average variance extracted value with the average amount of variance in the variables explained. (Hair et al. 2019) There is also a reliability test with a Cronbach's alpha value of >0.70 for the composite reliability value, which is different from Cronbach's alpha because composite reliability does not assume the same indicators, so loading must be >0.70 in research, >0.60 can be accepted (Hair et al. 2019). The population in this study was in Pasuruan Regency MSMEs, with the number of MSMEs in Pasuruan Regency reaching 257,144 units, consisting of 245,028 macro businesses, 992 medium businesses, and 11,124 small businesses (<https://www.pasuruankab.go.id>).

With a sampling technique using saturated sampling, namely a sampling data collection technique where researchers focus on the entire population of batik and embroidery MSMEs in Pasuruan Regency, with Bangil Beji Gempol and Pandaan areas, with a total research sample of 48 batik and embroidery MSMEs that have been in operation for at least two years and fulfill specific criteria (Soegiyono, 2020). Data was gathered through questionnaires sent to the owners or managers of MSMEs in the batik and embroidery sectors within the Pasuruan district, specifically in the Bangil, Beji, Gempol, and Pandaan regions. The questionnaire assessed three main variables with several indicators for each variable: dynamic capability related to sensing, seizing, and reconfiguring resources to establish and sustain a competitive advantage, Indicators play a significant role in the dynamic capability framework (D. J. Teece 2018). Organizational agility is related to speed, competence, flexibility, and responsiveness. Indicators play a significant role in the organizational agility framework (Kanten et al. 2017) MSMEs' performance is related to sales growth, profit growth, workforce expansion, and increases in market share. Indicators play a significant role in the MSMEs' performance framework (Ratnawati 2020). The study relied on original data collected directly from the participants, with no third parties involved. Responses were measured using a Likert scale ranging from 1 to 5, where 1 indicates strong disagreement and 5 indicates strong agreement (Soegiyono, 2020: 93).

RESEARCH RESULTS AND DISCUSSION

Description of Respondent Characteristics

The findings from the questionnaire distribution conducted by the researchers provide an overview of the respondents, who are owners of batik and embroidery MSMEs. The sample included 48 individuals from the Bangil, Beji, Pandaan, and Gempol regions. A significant majority of the respondents are female, accounting for 68.8%, and most fall within the age range of 35 to 40 years, making up 66.8% of the group. Additionally, a large portion of the respondents operate in the embroidery sector, representing 77.4%, with the majority of these businesses located in Bangil, which comprises 78.4% of the sample. (Table 2. Description of Respondent Characteristics)

Outer Model

In this research, the measurement model was developed using the partial least squares (PLS) approach, and data analysis was carried out with SmartPLS 4.0 software. Hair et al. (2019) The study involved a sample of 48 participants. As illustrated in Figure 2, the path coefficient from the external model indicates that dynamic capability contributes 0.296 to the evaluation of organizational agility and MSMEs' performance, while customer satisfaction contributes 0.510 to the assessment of MSMEs' performance, Figure 2. The results of data processing using SmartPLS 4.0 (2025).

Construct Reliability and Validity

The findings confirm the validity of the test model, which assesses how valid the research components are based on whether the outer loading values exceed 0.6 and the average is greater than 0.5 (Hair et al. 2019). Reliability testing evaluates the trustworthiness of the research components in delivering accurate results; components are considered reliable if the Cronbach's alpha value is above 0.60 (Hair et al. 2019). Given that this study utilizes intermediate-level data, the hypotheses were tested using SmartPLS 4.0. The research focuses on dynamic capability and organizational agility as independent variables, while MSMEs' performance serves as the dependent variable. (Table 3. Item Measurement, Outer Loadings, Reliability, and Validity).

The validity test results indicate that all items have satisfied the necessary criteria, specifically having an Outer Loading value greater than 0.5 and an Average Variance Extracted (AVE) value also exceeding 0.5. Therefore, it can be concluded that

all items demonstrate strong validity, suggesting that each item in the questionnaire shows a strong correlation with its corresponding question.

Discriminant Validity

Discriminant validity evaluates how distinct a construct is from other constructs, as well as the number of indicators that define it. To assess this validity, the Fornell-Larcker criterion is applied, with an acceptable threshold value. In addition to analyzing the cross-loading values, another method to determine discriminant validity involves examining the data. Specifically, the average variance extracted (AVE) for each indicator variable should exceed 0.5 to be considered satisfactory (Hair et al., 2019), (Table 4. Discriminant validity).

According to the test results presented in Table 4, the discriminant validity was assessed using the Fornell-Larcker criterion for easier interpretation. The findings indicate that the dynamic capability variable demonstrates strong discriminant validity, as its root mean square AVE value of 0.740 is higher than the correlation values between the variables. Similarly, the organizational agility variable also exhibits good discriminant validity, with an AVE value of 0.744 that surpasses the correlation between the variables. Additionally, the MSMEs' performance variable shows strong discriminant validity as well, with an AVE value of 0.720, which is greater than the correlation values among the variables.

Variance Inflation Factor (VIF)

In this study, multicollinearity is expressed as where two or more variables of highly correlated exogenous variables can cause the model's forecasting ability to decrease, The data is declared collinearity-free if the VIF value is <5 (Hair et al. 2019). The following are the results of the analysis that have been tested by researchers, (Table 5. Inner VIF_.

Table 5 shows that this study has a VIF value < 5 for all variables, which allows us to affirm that this research model avoids multicollinearity, with the results obtained, reinforcing the results of the indicators estimated in PLS-SEM, which have unbiased properties or can be described as (robust).

R Square

According to Hair et al. (2019) The R^2 value can be interpreted as follows: a value above 0.25 is considered weak, a value exceeding 0.50 is deemed moderate, and a

value greater than 0.75 is classified as strong. Below are the results of the R-squared values that have been analyzed, (Table 6. R Square).

The results of the R-squared value test in the research on MSMEs' performance variable show a value of 0,538. Thus, it can be concluded that the structural model of this study falls in the moderate category, 53,8%.

Q Square

One uses the Stone-Geisser Value (Q) to forecast the lost data points. The model is significantly predictive in the small category, slightly predictive in the medium category, and hardly predictive in the low category (Hair et al., 2019), with a range of 0.02 in the small category, 0.15 in the medium category, and 0.35 in the low category. With a value range of 0.02 in the small category, 0.15 in the medium category, and 0.35 in the low category, the model has less Predictive Relevance for a value of $Q < 0$ than for a value of $Q > 0$ (Hair et al. 2019). The Q Square value is obtained by the formula:

$$Q^2 = 1 - (1 - R^2)$$

$$Q^2 = 1 - (1 - 0,538)$$

$$Q^2 = 1 - 0,462$$

$$Q^2 = 0,538$$

Since the model used can account for 53.8% of the information in the research data, it can be inferred that the model in this study has a meaningful forecast value, based on Q-Square computation results of 0.538.

F Square

For those with a moderate effect with ($f^2 = 0.15$) and the greatest f square value ($f^2 = 0.35$), this value shows the size of the partial impact of each factor; therefore, partial testing in PLS can be divided into small effect ($f^2 = 0.02$) (Hair et al. 2019), (Table 7. F Square).

The F-Square value can be read in Table 7.

- a) Dynamic capability variables on MSMEs' performance variables have an F-square value of 0.103. This allows the MSMEs' performance variable to have a medium effect size from the dynamic capability factor.
- b) MSMEs' performance variable is sensitive to organizational agility, given an F-Square of 0.304. That way, the effect of the organizational agility variable on the MSMEs' performance variable has a large effect size.

Hypothesis Test

As noted in the study by Hair et al. (2019) The path coefficient ranges from -1 to 1. In addition, hypothesis testing between variables relies on either t-values or p-values. A notable impact on the variable is shown when the t-value exceeds 1.96 (the critical value from the t-table) or when the p-value falls below 0.05, (Table 8. Patch Coefficient).

Referring to the hypothesis testing data presented in Table 8, it can be inferred that the p-values for the study variables are all below 0.05. The dynamic capability variable has a T-statistical value of 2.467 and a P-value of 0.014, indicating a significant positive impact on MSMEs' performance, with an initial sample percentage of 29.6%. Likewise, the organizational agility variable has a T-statistical value of 4.013 and a P-value of 0.000, which is also less than 0.05. Therefore, it can be concluded that organizational agility significantly influences MSMEs' performance, with an initial sample percentage of 51%.

Discussion

This study shows that the performance of MSMEs is quite positively impacted by dynamic capability. This suggests that most MSMEs often concentrate on becoming competent in gathering data and understanding their customers' urgent needs. By using the market opportunities open, MSMEs could produce goods that satisfy consumer demands and employ more people. These results are in line with those of prior studies from (Rozak et al., 2023) and (Mongkol, 2021). According to the Resource-Based View (RBV) theory, Barney (1991) Dynamic capability significantly enhances MSMEs' performance through several means. Including dynamic capability allows MSMEs to react to changing surroundings, generate fresh ideas, and maximize resource utilization, therefore enhancing performance (Novita, 2024). MSMEs possess adaptable capability and are more inclined to produce new products and services that customers desire. The innovations include the improvement of existing systems as well as the development of new products. Innovating lets MSMEs get more customers, raise customer satisfaction, and in so doing boost sales and profitability. Market changes always result from shifts in technology, consumer tastes, or financial situations. Flexible MSMEs can quickly modify their business policies to meet these shifts. One's ability to adapt is crucial for staying pertinent and competitive in the industry. Dynamic capability also refers to

human resource development. MSMEs with staff training and development expenses will have more knowledgeable staff. Apart from their help with product innovation and expansion, experienced employees may positively affect operational performance. In so doing, good human resources development will, therefore, help to improve the general performance of MSMEs. MSMEs can develop long-lasting competitive advantages by leveraging dynamic capability. This advantage could result from product innovation, better customer service, or operational efficiency rises. MSMEs with an obvious competitive edge will be able to attract and retain consumers in a contested sector, hence increasing their financial performance. Dynamic capability is also vital when faced with disaster and uncertainty. MSMEs able to swiftly respond and adjust to catastrophes such as a pandemic or economic collapse would be more prepared to make it. Supporting the findings of Rokhanawati et al. (2024) Dynamic capability plays a crucial role in enhancing MSMEs' performance by fostering innovation and boosting strategic responsiveness. The capability to innovate and adjust to changes in the environment is essential for MSMEs. Kihara (2018) This is reinforced by stating that dynamic capability positively influences MSMEs' performance through various elements, including technology and leadership. This capability enables firms to adapt, integrate, and reorganize both internal and external resources to meet evolving market demands, thereby enhancing overall performance (Phong & Tam, 2024). Dynamic capability is vital for MSMEs in terms of innovation and adapting to market fluctuations. The research also indicates that dynamic marketing capability and innovation are strong indicators of success in the market (Syhachack et al., 2024). Additional studies emphasize the significance of dynamic capability in assisting MSMEs to adjust to and leverage new environments, highlighting the critical relationship between dynamic capability and MSMEs' performance, especially for MSMEs (Mukhtar et al., 2024). Mudalige (2022) Points out that MSMEs with strong dynamic capability can adapt more swiftly due to their resource management and innovative abilities in the face of new challenges. Furthermore, research by Rashidirad & Salimian (2020) Reveals a positive correlation between dynamic capability and competitive strategy, which ultimately influences value creation.

This research indicates that organizational agility significantly enhances the MSMEs' performance. This shows that most MSMEs often concentrate on anticipating

rapid market changes by taking advantage of open market opportunities. These results are in line with previous research from (Usman, 2023) and (M. Zhang et al., 2024). According to the Resource-Based View (RBV) theory, Barney (1991) Organizational agility significantly enhances the performance of MSMEs. The theory maintains that to get a competitive edge and excellent results, one needs inside assets, especially agility. The following parts will explore how small businesses' performance is affected by organizational agility. (Syed et al., 2024). MSMEs with a high level of agility can promptly adjust their marketing tactics as well as their goods and services according to changing customer needs and requirements. For instance, when a fresh fad arises or there is a shift in consumer behavior, responsive MSMEs may promptly change their goods to fulfill the demand, being sensitive to market changes, not only helps MSMEs to stay pertinent but also gives them a competitive edge. MSMEs can draw more customers and grow their market share by being able to react faster than rivals. Continuous innovation is also promoted by organizational agility. In the development of products or services, they aren't scared of experimenting with different methods. This refers to new offerings as well as enhancements in customer service and operations management. Constant invention is fundamental for sustained development. MSMEs still innovating will be free to adapt to market shifts and fulfill consumer demands. This will help to enhance MSMEs' performance and brand recognition. Greater operational efficiency affects not only revenue but also the capability of MSMEs to finance additional growth. Reduced expenses allow MSMEs to direct funds toward marketing, human resource development, or innovation. Essential to building teams equipped for fresh challenges is adaptive human resource development. Well-trained staff with applicable abilities will be better able to support innovation and operational efficiency, which in turn will boost MSMEs' performance. A study by Khalid et al. (2020) Also supports the idea that organizational agility positively influences MSMEs' performance. Similarly, Ludviga & Kalvina (2024) Found that when employees recognize their organization as agile, their engagement levels rise, leading to improved overall performance for MSMEs. Additionally, Ngeche & Kaluyu (2023) Emphasize that organizational agility serves as a valuable resource that facilitates effective change, allowing organizations to adapt to evolving environments and sustain a competitive edge. Holbeche (2019) Defines organizational agility as the capability to swiftly adjust

to market dynamics, meet customer demands, and uphold a competitive position. This adaptability is crucial for MSMEs, which often encounter unique challenges like limited resources and fluctuating markets. Research by Cho et al. (2023) Further demonstrates that organizational agility positively affects performance by enhancing responsiveness, flexibility, and innovation capability.

CONCLUSIONS

The results suggested that dynamic capability positively impacts MSMEs' performance. This study is consistent with the perspectives of Rahman et al (2023) and Jingwen et al (2025) Both of which use the same Resource-Based View (RBV) theory, Barney (1991). The ability to adjust, learn, and invent lets batik and embroidery MSMEs more effectively respond to changes in consumer demands and market trends, thereby raising their operational efficiency and competitive edge. Furthermore, it has been verified that organizational agility is very important in improving MSMEs' performance; this validates Zongyuan (2025) and Syed et al (2024), using the same Resource-Based View (RBV) theory (Barney, 1991). Batik and embroidery MSMEs can capture possibilities and successfully address problems, thanks in part to the organizations' & capability to promptly and nimbly negotiate changes within the corporate environment. This study showed that dynamic capability and organizational agility have a mutually beneficial connection, which positively impacts MSMEs' performance. Based on the Resource-Based View (RBV) theory, Barney (1991). This is in line with the points of view of Jankelová (2024) and García-Valenzuela et al (2023) He implies that fast companies excel at developing dynamic capability and that those with good dynamic capability are usually more flexible. By offering a thorough examination of how dynamic capabilities and organizational flexibility help to enhance the performance of MSMEs in batik and embroidery, this research effectively closes the information sources gap. These findings give much-appreciated knowledge for Pasuruan District's batik and embroidery MSMEs owners and managers, underlining the need to increase dynamic capability and organizational agility. Training, technology, and process innovations will greatly help small batik and embroidery MSMEs in Pasuruan District to improve their performance and competitiveness in a difficult market. The research recommends further investigation of other factors that might influence the link

between dynamic capability, organizational agility, and MSMEs' performance, as well as a review of this model in different settings.

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TABLE AND FIGURE

Tabel 1. Embroidery and Batik MSMEs

MSMEs	Location	Total
Embroidery	Bangil	33

Batik	Beji	4
	Pandaan	1
	Bangil	5
	Beji	4
	Gempol	1

Source: Pasuruan District Cooperative Office, Data Processed 2024
Conceptual Background

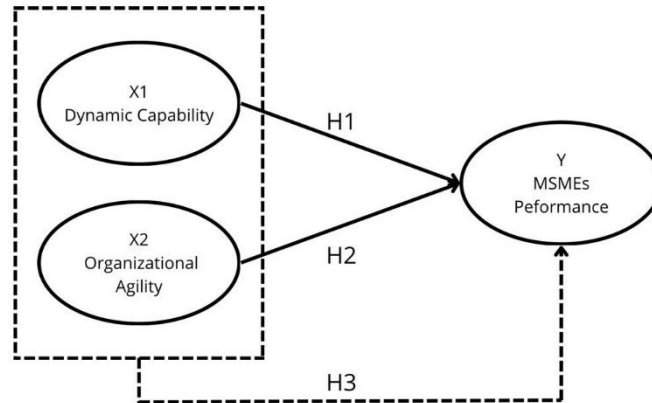


Figure 1. Conceptual Background 1
Source: Processed data, 2025

Table 2. Description of Respondent Characteristics

		Percentase
Business	Batik	23,6%
	Embroidery	77,4%
Location	Bangil	78,4%
	Beji	17,4%
	Pandaan	2,1%
	Gempol	2,1%
Age	30-35 years	8,4%
	35-40 years	66,8%
	40-45 years	24,8%
Gender	Male	31,2%
	Female	68,8%

Source: The results of data processing using SmartPLS 4.0 (2025)

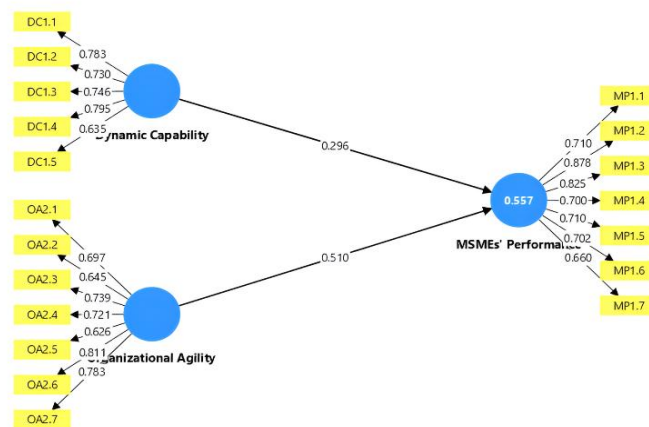


Figure 2. The results of data processing using SmartPLS 4.0 (2025)
Source: Outer Model Results

Table 3. Item Measurement, Outer Loadings, Reliability, and Validity

Item Measurement	Outer Loadings	Cronbach Alpha	Reliability (rho a)	Composite Reliability	AVE
Dynamic Capability					
As an MSMEs owner, I have identified customer needs	0,783	0,799	0,832	0,858	0,548
As an MSMEs owner, I have been tracking new market trends	0,730				
As an MSMEs owner, I have analyzed the actions of competitors	0,746				
As an MSMEs owner, I have sought information on the high demand from customers.	0,795				
As an MSMEs owner, I have formulated a new strategy.	0,635				
Organizational Agility					
I can respond quickly to customer needs	0,697	0,846	0,859	0,882	0,519
I can adjust production to the ups and downs of production.	0,645				
I implement technological or machine changes quickly	0,739				
I can train employees quickly	0,721				
I quickly implement decisions to deal with market changes	0,626				
I have the competence to anticipate market changes	0,811				
I have a quick response to customer demand	0,783				
MSMEs Performance					
Sales of my products have increased over the past three years	0,710	0,863	0,867	0,896	0,554
The marketing area of my products has expanded over the past three years	0,702				
I have a goal to increase the number of employees	0,878				
Annual sales of my business have increased every year	0,825				
My business assets have increased this year compared to last year	0,721				
My customer count is always increasing	0,660				
I use social media to increase business profitability	0,746				

Source: The results of data processing using SmartPLS 4.0 (2025)

Table 4. Discriminant validity

	Dynamic Capability	Organizational Agility	MSMEs' Performance
Dynamic Capability	0,740		
Organizational Agility	0,650	0,744	
MSMEs' Performance	0,695	0,716	0,720

Source: The results of data processing using SmartPLS 4.0 (2025)

Table 5. Inner VIF

	VIF
Dynamic Capability -> MSMEs Performance	1,932
Organizational Agility -> MSMEs Performance	1,932

Source: The results of data processing using SmartPLS 4.0 (2025)

Table 6. R Square

	R-Square	R-Square Adjusted
MSMEs Performance	0,557	0.538

Source: The results of data processing using SmartPLS 4.0 (2025)

Table 7. F Square

	MSMEs Performance
Dynamic Capability	0,103
Organizational Agility	0,304

Source: The results of data processing using SmartPLS 4.0 (2025)

Table 8. Patch Coefficient

Variable	Original sample	T-Statistics (O/STERR)	P-Values (STDEV)	T-Statistics (O/STERR)	P-Values	Description
Dynamic Capability ->MSMEs Performance	0,296	0,313	0,120	2,467	0,014	Significant positive
Organizational Agility ->MSMEs Performance	0,510	0,515	0,127	4,013	0,000	Significant positive

Source: The results of data processing using SmartPLS 4.0 (2025)