

BRIDGING EMPLOYEE AGILITY AND FIRM PERFORMANCE: THE MEDIATING ROLE OF DYNAMIC CAPABILITY IN SME

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Abstract

This study examines the impact of employee agility on firm performance mediated by dynamic capability in SMEs in Bali. It aims to clarify how individual adaptability translates into improved organizational outcomes through dynamic capabilities encompassing sensing, seizing, and resource reconfiguration. Using a quantitative method, data from 122 SME managers were analyzed via structural equation modelling with partial least squares to test relationships among employee agility, dynamic capability, and firm performance. Results reveal that employee agility directly enhances firm performance and significantly fosters dynamic capabilities, which in turn positively affect performance and partially mediate the agility-performance link. This research bridges the gap between micro-level employee agility and macro-level dynamic capability, offering novel empirical evidence on their combined role in sustaining competitive advantage in SMEs. The findings underscore the importance for SME leaders and policymakers to develop agile employees alongside dynamic capabilities to succeed in uncertain, resource-limited markets. The study advances the dynamic capabilities framework by identifying employee agility as a critical micro-foundation driving organizational performance, providing strategic insights for SMEs targeting resilience and sustainable growth amid market volatility.

Keywords: *dynamic capability; employee agility; firm performance; SMEs*

INTRODUCTION

Employee agility, dynamic capability, and firm performance have become crucial constructs in organizational development discourse. Employee agility represents adaptability, resilience, and proactive behavior essential for thriving in uncertainty (Piriyakul et al., 2024). Dynamic capability enables firms to sense, seize, and transform resources, particularly in volatile environments (Huang & Ichikohji, 2024). Both constructs directly influence firm performance by improving innovation, resilience, and competitiveness (Mukherjee et al., 2024). Nevertheless, scholars have criticized the fragmented understanding of how agility manifests at individual and organizational levels (Wilson et al., 2024). SMEs, in particular, face constraints such as resource limitations and rigid structures, challenging the effective deployment of these capabilities (Kusumawijaya & Astuti, 2024). Still, the potential to shape strategic renewal and sustainable firm performance remains significant.

Small and medium-sized enterprises (SMEs) operate under heightened vulnerability due to resource scarcity, limited technological infrastructure, and volatile markets (Almohtaseb et al., 2024). Consequently, the integration of employee agility and dynamic capability becomes an urgent strategic imperative to foster resilience and adaptability (Motwani & Katatria, 2024). Employee agility enables faster responses to change, while dynamic capabilities provide a structural pathway to transform potential into actual performance outcomes (Sidabutar & Siswanto, 2024). This is especially critical during crises and digital transformation, where SMEs must rapidly adjust their business models to survive (Aboobaker et al., 2020). Furthermore, enhancing firm performance through internal agility and dynamic responsiveness offers a competitive edge necessary for growth and sustainability in constrained environments (Mukherjee et al., 2024). Despite growing interest in employee agility and dynamic capability, empirical studies specifically addressing their synergistic impact on firm performance remain scarce (Udin, 2024). The literature often treats these constructs in isolation, neglecting how agility at the employee level can be

transformed via dynamic capabilities into firm-level outcomes (Motwani & Katatria, 2024). This fragmented understanding limits the development of integrative models that explain causal pathways linking individual behavior to organizational results (Mueller & Jungwirth, 2020). Particularly in SMEs, where structural agility is low, the mediating mechanism of dynamic capability remains theoretically underdeveloped and empirically untested (Aboobaker et al., 2020). Hence, there is a compelling need to investigate how employee agility influences performance indirectly through dynamic capability in SME contexts (Kiranantawat & Ahmad, 2022).

Dynamic capability serves as a theoretical bridge linking employee agility to firm performance by transforming individual adaptability into organizational competence (Junker et al., 2021). Employee agility equips individuals to sense and respond to environmental changes; however, without organizational structures to capture and reconfigure such responsiveness, the performance impact remains latent (Fischer & Neumann, 2024). Dynamic capability mediates this interaction by orchestrating and scaling agile responses across firm operations (Atobishi et al., 2024). This mediation is especially relevant for SMEs, which must translate individual initiative into collective capability to maintain competitiveness and continuity during disruptions (Johansson et al., 2021). Thus, positioning dynamic capability as a mediator enables an explanatory framework that reveals how micro-level agility aggregates into macro-level performance outcomes (Heidt et al., 2022).

This study offers a novel contribution by constructing and empirically testing a mediation model that links employee agility to firm performance through dynamic capability, specifically within SMEs, a context underrepresented in prior research (Heidt et al., 2022). Unlike previous studies that analyze agility, capability, or performance in isolation, this model integrates these dimensions into a coherent causal framework (Fischer & Neumann, 2024). Furthermore, the study expands the conceptualization of agility by situating it at the individual level and examining its systemic transformation through organizational capabilities (Atobishi et al., 2024). This integrative approach addresses the fragmented literature and responds to calls for more sophisticated models that elucidate the mechanisms underpinning performance outcomes in resource-constrained environments (Junker et al., 2021). The purpose of this research is to examine the influence of employee agility on firm performance through the mediating role of dynamic capability within the context of SMEs. The study aims to determine whether dynamic capabilities translate individual-level agility into sustained performance outcomes.

LITERATURE REVIEW

Employee Agility

Employee agility has emerged as a cornerstone of workforce adaptability, enabling proactive responses to organizational change and uncertainty (Guo et al., 2020). It encompasses cognitive, behavioral, and affective dimensions that drive rapid decision-making and flexible execution in dynamic work environments. In SMEs, agility contributes to competitiveness through enhanced employee efficacy, knowledge flow, and organizational learning (Martins, 2022). However, critics argue that its conceptualization is fragmented and often overlaps with constructs such as resilience and adaptability, which can weaken its theoretical clarity (Ferreira et al., 2020). Empirical studies in SMEs further reveal structural constraints, such as hierarchical rigidity, that suppress the enactment of agility behaviors (Pertheban, 2023). Nonetheless, the strategic role in digital transformation and employee value creation, especially during crisis periods (Guo et al., 2020).

Dynamic Capability

Dynamic capability refers to an organization's capacity to sense, seize, and reconfigure resources in response to environmental volatility (Syhachack et al., 2024). In SMEs, it acts as a mediator enabling transformation and resilience amidst limited resources and heightened uncertainty (Zahoor & Lew, 2021). It facilitates digitalization, business model innovation, and strategic renewal, allowing firms to thrive even during systemic shocks (Martins, 2022). However, scholars highlight its abstract nature, complicating operationalization and empirical measurement in real-world contexts (Ferreira et al., 2020). Some also criticize its generalization across organizational sizes, noting that SME constraints may dilute capability enactment (Taghizadeh et al., 2020). The transformative impact of dynamic capability in translating individual competencies into organizational outcomes, making it essential for strategic adaptability (Zahoor & Lew, 2021).

Firm Performance

Firm performance encapsulates financial, operational, and innovation outcomes that reflect organizational effectiveness (Amoa-Gyarteng & Dhliwayo, 2024). In SMEs, it is influenced by internal agility, strategic orientation, and technological infrastructure (Abdalla et al., 2024). Although performance metrics offer tangible benchmarks for

success, they often neglect intangible drivers such as employee engagement and organizational culture, leading to incomplete assessments (Martins, 2022). Furthermore, criticisms point to the overemphasis on financial indicators, which can overshadow innovation and sustainability imperatives crucial for long-term growth (Ernest & Vincent, 2025). In defense, emerging studies incorporate multidimensional models that link performance with agility, digital readiness, and employee commitment, particularly relevant in SME contexts (Pertheban, 2023). Thus, firm performance is now increasingly framed as a holistic outcome of integrated human and dynamic capabilities.

The Impact of Employee Agility on Firm Performance

Employee agility significantly enhances firm performance by enabling adaptive, proactive, and resilient behaviors that align with dynamic organizational goals (Das et al., 2023). It fosters rapid response, innovation, and employee-driven transformation, which directly contribute to SME competitiveness (Clauß et al., 2021). However, its effect can be constrained by rigid hierarchies and poor network communication in SMEs. Some critics argue that agility is context-dependent, and its performance implications may not hold in resource-deficient firms (Bouguerra et al., 2024). The agility acts as a strategic enabler during turbulence, mitigating structural vulnerabilities (Wamba, 2022). Therefore, it holds strong potential for SMEs to convert human adaptability into sustained organizational performance. Therefore, this study hypothesizes:

H1: employee agility has a positive effect on firm performance.

The Impact of Employee Agility on Dynamic Capability

Employee agility catalyzes the development of dynamic capabilities by embedding micro-level responsiveness into organizational transformation processes (Dubey et al., 2020). In SMEs, agile employees enable faster sensing and seizing of opportunities through enhanced cognitive and relational flexibility (Guo et al., 2020). Yet, limitations arise from inadequate strategic integration and the difficulty in institutionalizing individual competencies (Wang & Prajogo, 2024). Critics question the scalability of employee agility in SMEs with constrained resources and low absorptive capacity (Li, 2022). Despite these critiques, studies affirm that agility, when supported by a conducive learning environment, evolves into dynamic capabilities (Maulid H Bwabo et al., 2024). Thus, agility is a precursor that activates and strengthens organizational transformation potential. Accordingly, the study proposes the following hypothesis:

H2: employee agility has a positive effect on dynamic capabilities.

The Impact of Dynamic Capability on Firm Performance

Dynamic capability enhances firm performance by enabling continuous sensing, reconfiguring, and integration of resources in uncertain environments (H. Zhang et al., 2023). SMEs benefit from dynamic capabilities through improved resilience, innovation, and business model adaptability (Das et al., 2023). However, the abstractness of the concept poses operational challenges, especially in quantifying its direct performance effects (Bwabo et al., 2023). Critics argue that resource limitations in SMEs may limit dynamic capability development and its linkage to measurable outcomes (Bai et al., 2022). Nevertheless, empirical evidence supports its role in mediating innovation and sustainability, especially when aligned with digital and strategic transformations (Dubey et al., 2020). Dynamic capability thus offers SMEs a competitive lever for long-term performance improvement. Therefore, the following hypothesis was developed:

H3: dynamic capability positively influences firm performance.

The Mediation of Dynamic Capability on the Impact of Employee Agility on Firm Performance

Dynamic capability mediates the relationship between employee agility and firm performance by translating individual responsiveness into systemic organizational advantage (Bronzo et al., 2024). Employee agility serves as the input enabling sensing and seizing actions that form the basis of dynamic capability (H. Zhang et al., 2023). However, the mediation effect may be weakened by gaps in organizational structure and learning infrastructure, which impede the institutionalization of agile behaviors (Pigola & da Costa, 2024). Critics highlight the conceptual overlap and ambiguity surrounding mediators in agility-performance models (Wamba, 2022). Nonetheless, counterarguments confirm the integrative role of dynamic capability in orchestrating individual actions into collective organizational outcomes (Dubey et al., 2020). Thus, dynamic capability acts as the mechanism enabling SMEs to realize the strategic benefits of employee agility. As a result, the following hypothesis is suggested:

H4: Dynamic capability mediates the effect of employee agility on firm performance.

METHOD

This research was conducted on 36.387 SME in the Province of Bali, Indonesia (Small & Medium Enterprise Cooperative Service in Bali Province, 2025). The sample size was determined using the Slovin formula, assuming a sampling error of 5%, the sample size of this study was 396. Data were collected from managers representing SME as research respondents. This research was conducted using an online questionnaire with the Google Forms application. 396 questionnaire links were sent to respondents via email, of the responses 122 were returned and confirmed valid, with an 30.80% validity rate. Data analysis was carried out using variance-based structural equation modelling with a partial least squares approach (Hair et al., 2017) with Warps PLS 7.0 (Kock, 2020). The variables were measured using items developed and employed in previous studies to ensure the study's validity and reliability. Multiple items were used to test each construct, and each item was evaluated using a five-point Likert scale that ranged from 1 (strongly disagree) to 5 (strongly agree). Employee agility was measured using 8 items adapted from the research of (Lai et al., 2021), is the ability of individuals within an organization to adapt quickly to changes, learn new skills, and respond effectively to dynamic market conditions: 1 Anticipation of problems related to change; 2 Initiation of activities that lead to solution of the change related problems and improvements in work; 3 Solution of change related problems; 4 Interpersonal and cultural adaptability; 5 Spontaneous collaboration; 6 Learning new tasks and responsibilities; 7 Positive attitude to changes, to new ideas, technology; 8 Tolerance to and dealing with uncertain and unexpected situation.

Dynamic capability was measured using 8 items adapted from the research of (Monferrer et al., 2021): 1 The workers in our firm are able to find alternative ways of doing their work; 2 Our firm is able to develop flexible processes to respond rapidly to changes and opportunities detected in our markets; 3 Our firm is able to change strategy rapidly according to our business priorities; 4 Our firm is able to apply external knowledge commercially; 5 Our firm is able to understand analyse and interpret information from the environment; 6 Our firm is able to combine its internal knowledge with external information; 7 Our firm has an organisational culture that promotes innovation; 8 Our firm is able to use knowledge from various sources to develop products efficiently and rapidly. Firm performance is measured using 8 items adapted from the research of (Abbas et al., 2019): 1 Our firm profit goals have been achieved; 2 Our firm sales goals have been achieved; 3 Our firm return on investment goals have been achieved; 4 Our products have a higher quality than those of our competitors; 5 We have a higher customer retention rate than our competitors; 6 We have a better reputation among major customer segments than our competitors; 7 We have a lower employee turnover rate than that of our competitors; 8 We have been more effective in new product development than our competitors.

Table 1. Descriptive statistics of respondent profile

		Frequency	Percent
Gender	Female	26	21.3
	Male	96	78.7
	Total	122	100.0
Age	20 - 30 years	26	21.3
	31 – 40 years	43	35.2
	41 and above	53	43.4
	Total	122	100.0
Education	Undergraduate	104	85.2
	Postgraduate	18	14.8
	Total	122	100.0
Work Experience	1 – 5 years	65	53.3
	5 and above	57	46.7
	Total	122	100.0

Source: The Authors, 2025

The descriptive statistics of the respondent profile reveal critical insights pertinent to understanding the urgency and relevance of the research outcomes. The majority of respondents are male (78.7%), reflecting a potential gender imbalance that may influence organizational agility and performance dynamics. Age distribution is skewed towards more experienced employees, with 43.4% aged 41 and above, suggesting that mature professionals predominantly shape organizational capabilities, a factor known to affect adaptability and knowledge transfer in SMEs. Educational attainment is high, with 85.2% holding undergraduate degrees, underscoring the intellectual capital available for dynamic capability development. Work experience is relatively balanced, with 53.3% having 1-5 years and 46.7% exceeding 5 years, indicating a blend of fresh perspectives and seasoned expertise, essential for fostering employee agility. These demographic factors collectively highlight the urgent need to harness such diverse human capital to enhance firm performance through agility and dynamic capabilities.

Table 2. Descriptive statistics of variables studied

	Theoretical Score		Actual Score		Mean	SD
	Min	Max	Min	Max		
Employee Agility	1	5	3.125	5.000	4.194	0.549
Dynamic Capability	1	5	3.125	4.875	4.118	0.466
Firm Performance	1	5	3.125	4.750	4.045	0.517

Source: The Authors, 2025

Table 2's descriptive statistics underscore the significant presence and variability of key constructs critical to SME performance. The high mean scores for employee agility (4.194) emphasize employees' strong adaptive capacity, a vital factor for organizational responsiveness in volatile markets. Dynamic capability's mean of 4.118 reflects a well-developed organizational ability to sense, seize, and reconfigure resources, which is essential for sustaining competitive advantage under uncertainty. Firm performance's mean score of 4.045 indicates favorable operational and financial outcomes, suggesting that agility and dynamic capability positively influence business success. The relatively low standard deviations across variables reveal consistent responses, affirming the reliability of these constructs in SMEs. Collectively, these results highlight the urgent need to further explore the interconnected roles of employee agility and dynamic capability in driving firm performance.

RESULTS

Measurement model analysis

Table 3. Results of goodness of fit research model

Evaluation	Value	Criterion
Average path coefficient (APC)	0.581*	significant if < 0.05
Average R-squared (ARS)	0.720*	significant if < 0.05
Average block VIF (AVIF)	2.648	acceptable if ≤ 5

*All significant at $p < 0.001$

Table 3 demonstrates the robust goodness of fit refer to Hair et al. (2017) for the proposed research model, with an average path coefficient (APC) of 0.581 indicating strong and statistically significant relationships among variables ($p < 0.001$), which aligns with prior findings validating the interdependence of employee agility, dynamic capability, and firm performance. The average R-squared (ARS) value of 0.720 reflects a high explanatory power, confirming that the model accounts for over 72% of the variance in firm performance, consistent with the resource-based and dynamic capability views emphasizing the explanatory strength of agility-capability linkages. Additionally, the average block variance inflation factor (AVIF) of 2.648, well below the acceptable threshold of 5, indicates minimal multicollinearity, supporting the distinctiveness of constructs in SME contexts. Collectively, these metrics underscore the urgency and validity of investigating the synergistic effects of employee agility and dynamic capabilities on SME performance.

Table 4. Validity and reliability test results

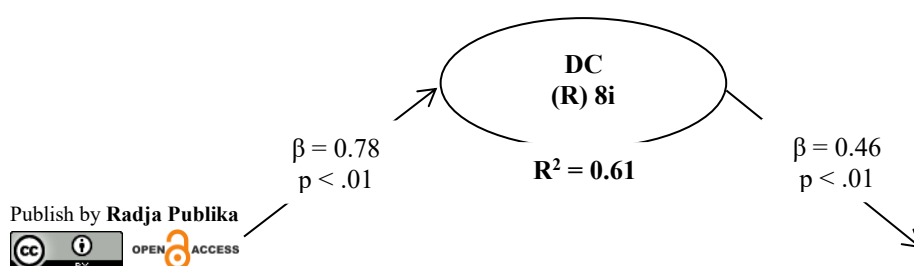
Variables		Factor Loading	AVE > 0,5	Q-square > 0	Composite reliability > 0.7	Cronbach's alpha > 0.7
Employee Agility	Ea1	0.823	0.742	0.608	0.904	0.879
	Ea2	0.730				
	Ea3	0.765				
	Ea4	0.714				
	Ea5	0.714				
	Ea6	0.773				
	Ea7	0.760				
	Ea8	0.701				
Dynamic Capability	Dc1	0.795	0.794	0.608	0.833	0.769
	Dc2	0.810				
	Dc3	0.821				
	Dc4	0.755				
	Dc5	0.784				
	Dc6	0.828				
	Dc7	0.721				
	Dc8	0.809				
Firm Performance	Fp1	0.788	0.760	0.825	0.871	0.829
	Fp2	0.747				
	Fp3	0.743				
	Fp4	0.784				
	Fp5	0.805				
	Fp6	0.786				
	Fp7	0.784				
	Ep8	0.758				

*All significant at $p < 0.001$

Table 4 presents robust evidence of validity and reliability according to Fornell and Larcker (1981) for the research constructs, critical for ensuring the credibility of the study's findings on employee agility, dynamic capability, and firm performance. Factor loadings for all indicators exceed the recommended threshold of 0.7, confirming strong item reliability and construct validity. Average Variance Extracted (AVE) values range from 0.742 to 0.794, surpassing the 0.5 benchmark, thus demonstrating satisfactory convergent validity and indicating that the constructs explain a substantial portion of the variance in their indicators. Composite reliability values from 0.833 to 0.904 and Cronbach's alpha scores from 0.769 to 0.879 reflect high internal consistency, validating the constructs as reliable measures within SME contexts. The positive Q-square values confirm predictive relevance, underscoring the model's capacity to explain and predict dependent variables effectively. Collectively, these rigorous validity and reliability metrics highlight the urgent necessity of this research to empirically ground theoretical constructs that explain how employee agility and dynamic capability interplay to enhance firm performance in SMEs.

Structural model analysis

The results of testing the research structural model can be seen in the following figure:



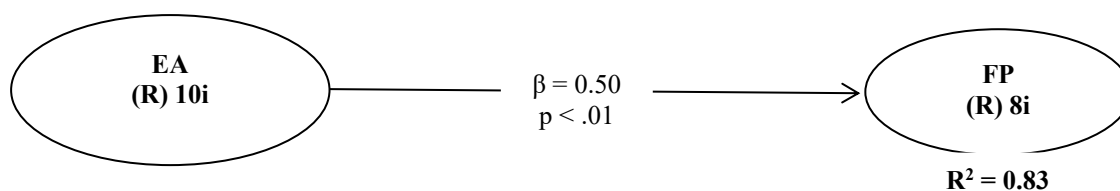


Figure 1. Research model testing results

The results of testing the structure of the research model for hypothesis testing are in the following table:

Table 5. Path coefficient

Variables	Employee Agility	Dynamic Capability
Dynamic Capability	0.783*	
Firm Performance	0.503*	0.458*

All significant at $p < 0.001$ *

Table 5 reveals strong, significant path coefficients highlighting the critical influence of employee agility and dynamic capability on firm performance in SMEs, emphasizing the urgent relevance of these constructs in current organizational research (Piriyakul et al., 2024). The substantial path coefficient of 0.783 from employee agility to dynamic capability underscores employee agility as a vital antecedent that activates and strengthens dynamic capabilities, corroborating findings that individual adaptability translates into organizational responsiveness and resource reconfiguration (Piriyakul et al., 2024). Dynamic capability's direct impact on firm performance, with a coefficient of 0.458, affirms its pivotal role as a mediator that facilitates sustained competitive advantage through innovation and strategic flexibility (Mai et al., 2024). Moreover, employee agility's direct effect on firm performance, with a coefficient of 0.503, indicates that agility not only indirectly influences outcomes via dynamic capability but also exerts a direct, positive influence, reflecting the dual pathways of impact posited in agility-performance literature (Amoa-Gyarteng & Dhliwayo, 2024). These strong coefficients emphasize the pressing need for SMEs to cultivate employee agility and dynamic capabilities to navigate turbulent environments and enhance organizational success. The high statistical significance ($p < 0.001$) of these paths further strengthens the validity and urgency of focusing research and practice on these constructs for SME resilience and growth.

Table 6. Mediation analysis

No	Variable	P → D	P → M	M → D	P → D	VAF	Result
VAF	relationship	without M			with M	value	
1	Employee Agility → Dynamic Capability → Firm Performance	0.503*	0.783*	0.458*	0.359*	0.416	partially mediate

Notes: P: predictor, D: dependent, M: mediator variable; * means $p < 0.001$.

Table 6's mediation analysis reveals the partial mediating role of dynamic capability in the relationship between employee agility and firm performance, underscoring a critical mechanism by which individual agility influences organizational outcomes in SMEs. The direct path from employee agility to firm performance (0.503, $p < 0.001$) alongside the significant paths from employee agility to dynamic capability (0.783, $p < 0.001$) and from dynamic capability to firm performance (0.458, $p < 0.001$) confirm the robustness of these relationships. The variance accounted for (VAF) according to Hair et al. (2017), value of 0.416 indicates that 41.6% of the effect of employee agility on firm performance is transmitted through dynamic capability, highlighting its substantial yet partial mediation role. This partial mediation suggests that while employee agility directly improves firm performance, its full potential is realized when channelled through dynamic capabilities that enable sensing, seizing, and resource

reconfiguration. The significance and magnitude of these mediation effects reflect the urgency for SMEs to develop dynamic capabilities to effectively harness employee agility, thereby enhancing resilience and sustained competitive advantage. This nuanced understanding advances strategic management theory and offers actionable insights for SME practitioners focused on agility-capability integration.

DISCUSSIONS

The Impact of Employee Agility on Firm Performance

The findings indicate that employee agility has a positive impact on firm performance within SMEs in Bali, highlighting the necessity for companies to adapt swiftly to changing market conditions (Pitafi & Ren, 2021). Employee agility fosters behaviors that allow SMEs to quickly capitalize on opportunities despite local resource constraints (Hanu et al., 2022). A substantial mean score for employee agility underlines its prominence among employees, identifying it as a critical driver for organizational success (Zhang et al., 2022). However, prior literature often critiques the imprecise definitions of agility, calling for more rigorous frameworks for measurement and operationalization (Udin, 2024). This research seeks to fill that gap by utilizing a validated multidimensional model tailored for SMEs, enhancing theoretical clarity (Akkaya, 2022). Future research should investigate how cultural aspects and leadership styles may amplify employee agility's contribution to performance (Marjerison et al., 2022). Practically, these findings encourage SME managers in Bali to cultivate an agile workforce focused on continual learning and flexibility to maintain a competitive edge.

The Impact of Employee Agility on Dynamic Capability

Empirical evidence shows that employee agility significantly influences the development of dynamic capabilities in Bali's SMEs, affirming existing theoretical perspectives that individual adaptability promotes effective resource management (Ali et al., 2022). The strong path coefficient signifies that agile employees enhance cognitive flexibility and knowledge sharing, essential for the processes of sensing, seizing, and reconfiguring resources, which are core to dynamic capabilities (Han Lai et al., 2021). However, challenges arise in SMEs with strict hierarchies and limited strategic integration, potentially hindering the implementation of agile practices (Al-Tit, 2020). This study's context-sensitive adaptation highlights the importance of communication networks in promoting capability development (Ilmudeen, 2021). While some caution that resource scarcity might limit dynamic capability effectiveness, counterarguments suggest that agility-focused micro-foundations can empower SMEs to bridge resource gaps (Heidt et al., 2022). Future research is encouraged to explore how digital tools and managerial discretion might shape the relationship between agility and capabilities (Das et al., 2023). The pressing implication for Bali's SMEs is to invest in developing employee agility as a strategic asset to nurture essential dynamic capabilities for sustainability and growth.

The Impact of Dynamic Capability on Organizational Performance

Dynamic capability is shown to be a crucial determinant of organizational performance in Bali's SMEs, mediating the effects of internal agility and enhancing strategic responsiveness to environmental challenges (Batra, 2022). The study's results indicate that dynamic capabilities account for a considerable proportion of performance variance, underscoring their importance in value creation (Bouguerra et al., 2024). Nonetheless, measuring dynamic capability is often complex, with research noting it can be perceived as nebulous (Do et al., 2021). This research addresses such challenges by employing robust, contextually applicable scales specifically designed for SMEs (Almohtaseb et al., 2024). Additionally, caution is warranted regarding potential redundancy in capabilities if they are misaligned with strategic objectives; thus, effective managerial oversight and orientation towards innovation are pivotal as moderators (Huang & Ichikohji, 2024). It is crucial for SMEs in Bali to develop their dynamic capabilities to advance innovation (Kusumawijaya & Astuti, 2023), resilience, and operational efficiency in increasingly competitive environments.

The Mediation of Dynamic Capability on the Impact of Employee Agility on Firm Performance

The partial mediation role of dynamic capability between employee agility and firm performance elucidates the critical mechanism converting individual adaptability into organizational success within Bali SMEs (Mukherjee et al., 2024). The VAF value indicates that dynamic capability of this relationship, emphasizing that agility alone is insufficient without organizational structures enabling resource reconfiguration and strategic renewal (Piriyakul et al., 2024). This finding aligns with dynamic capabilities theory asserting that micro-foundations like agility require orchestration at the organizational level to yield sustainable competitive advantage (Almohtaseb et al., 2024).

Criticisms of mediation models point to potential omitted variables such as leadership or digital capability; future research should incorporate these factors to refine understanding (Mai et al., 2024). The present study's urgency lies in its practical guidance for SMEs: developing dynamic capabilities is indispensable to fully leverage employee agility for improved firm performance, a vital consideration for policymakers and business leaders seeking to strengthen Bali's SME sector resilience.

CONCLUSION

This study confirms the significant and multifaceted impact of employee agility on firm performance within the context of SMEs in Bali, establishing agility as a critical driver of organizational success in dynamic environments. Employee agility directly enhances firm performance by fostering adaptability, proactivity, and resilience among employees. Moreover, it strongly influences the development of dynamic capabilities, which act as an organizational mechanism to sense, seize, and reconfigure resources effectively. The results demonstrate dynamic capability as a pivotal mediator, partially translating the benefits of employee agility into improved firm outcomes. The research model exhibits high explanatory power in firm performance accounted for by these interrelated constructs. Rigorous validity and reliability assessments confirm the robustness of the measures used. The findings reveal that agility alone is insufficient; it requires integration with dynamic capabilities to fully realize performance gains. These conclusions underscore the urgency for SMEs in Bali to cultivate both human agility and organizational capabilities to navigate volatile markets and sustain competitive advantage.

Practically, the findings highlight the need for SME leaders in Bali to strategically invest in developing employee agility through continuous learning, flexible work arrangements, and supportive leadership. Enhancing communication networks and reducing hierarchical rigidity will enable employees to apply agility more effectively, thereby building stronger dynamic capabilities. Managers must focus on orchestrating these capabilities to promote sensing and seizing opportunities, facilitating resource reconfiguration essential for sustainable performance. For policymakers, the study suggests designing programs to foster workforce agility and capability building as pillars for SME growth and resilience. Theoretically, the research contributes by empirically validating a comprehensive model linking employee agility, dynamic capability, and firm performance, addressing previous gaps in understanding micro-foundations of dynamic capabilities within SMEs. It advances the dynamic capabilities framework by clarifying the mediating role of agility and encourages future research to integrate cultural and technological variables to further enrich this theoretical domain.

While this study provides valuable insights, several limitations must be acknowledged. First, the cross-sectional design restricts causal inference and temporal dynamics of agility-capability-performance relationships. Longitudinal studies are needed to capture evolution over time. Second, the sample is geographically limited to Bali, which may constrain generalizability to other regions with different socio-economic and cultural characteristics. Third, although validated scales were used, the complex and sometimes overlapping nature of constructs like agility and dynamic capability might introduce measurement bias. Fourth, the study did not incorporate potential moderating variables such as leadership style, organizational culture, or digital technology adoption, which could influence the examined relationships. Finally, self-reported data may be subject to common method bias, despite statistical controls. Addressing these limitations would enhance the robustness and applicability of future research findings.

Future research should adopt longitudinal designs to explore the dynamic interplay of employee agility and dynamic capabilities and their evolving impact on firm performance over time. Expanding the geographic scope beyond Bali to include diverse SME ecosystems will improve the generalizability of findings and account for cultural and economic variability. Investigating the moderating and mediating effects of leadership styles, organizational culture, and digital transformation initiatives could provide a richer understanding of the mechanisms driving agility-capability-performance linkages. Additionally, integrating qualitative methods may yield deeper insights into how SMEs operationalize these constructs in practice. Exploring agility and dynamic capability in specific industry sectors or in crisis contexts, such as post-pandemic recovery, would further contextualize their relevance. Lastly, developing more refined and context-specific measurement instruments for agility and dynamic capability will strengthen theoretical and empirical rigor.

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