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The Influence of Strategic Planning on the Business Performance of Small and Medium Enterprises in Sri Lanka: Mediating Role of Dynamic Capabilities

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Abstract

This study examines the mediating effect of Dynamic Capabilities (DC) in the relationship between Strategic Planning (SP) and Business Performance of SMEs in the Southern province of Sri Lanka. Dynamic capabilities are imperative for SMEs in their strategic planning process to overcome the challenges posed by the COVID-19 pandemic and economic crisis in Sri Lanka. A questionnaire survey was conducted by selecting 250 SMEs from the Southern province of Sri Lanka, and data were analyzed using Structural Equation Modeling (SEM) through Partial Least Squares (PLS). The findings indicate that there is a positive and significant influence of SP on performance. Results further confirm that there is a significant positive effect of SP and DC, as well as DC and the performance of SMEs. The study also confirms that DC partially mediates the relationship between SP and the performance of SMEs. The present study provides valuable insights for academics, policymakers, and industry practitioners. Further, the study contributes to the literature by confirming the mediating role of dynamic capabilities in the relationship between strategic planning and performance of SMEs. Findings provide practical implications for the SME owners, policy makers, business development service organizations, and government to take corrective actions to enhance the strategic planning and dynamic capabilities to enhance the performance of SMEs.

Keywords: Business performance, dynamic capabilities, small and medium enterprises, Sri Lanka, strategic planning

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Introduction

Small and Medium Enterprises (SMEs) are known as the backbone of any economy as they play a leading role in the economic development of the country. SMEs support for the sustainable development of the economy of developing countries, and they greatly contribute to the continuous development through poverty alleviation, unemployment reduction as well as increasing the gross domestic product. The International Labor Organization (2023) reported that about 90 per cent of all enterprises in many countries consist of SMEs, accounting for 70 per cent of employment globally. They provide a more significant percentage of contribution to creating employment, more than 50% and 40% of GDP worldwide. The SME sector includes 99.8% of all establishments (Gunawardana, 2020). The growth of the SMEs creates a multiplier effect, which is an increased demand for raw materials, services, and infrastructure. SMEs play a significant role in developing countries. It is recognised as the backbone of Sri Lanka's economy. These enterprises contribute 25% of exports and 52% of the GDP in Sri Lanka (Ministry of Industry and Commerce, 2023). Moreover, the Central Bank of Sri Lanka (2021) stated that there is a positive relationship between the existence of SMEs and the country's economic growth. However, due to the COVID-19 pandemic that spread in Sri Lanka during the recent past, business activities of SMEs were temporarily halted, and SMEs are facing various challenges like business survival, poor financial condition, continued employment, etc. (Robinson & Kengatharan, 2020). Therefore, SMEs should be able to remain steadfast in the face of these challenges and actively face the uncertainties in the business environment. During this situation, strategic planning (SP) capabilities of SMEs played a major role in overcoming the challenges and renewing their businesses in a new direction. Strategic planning can be introduced as an approach to achieve organizational goals to succeed, and this provides an organization with preconceived notions to ensure its long-term survival. Strategic planning provides the basis for planning for unexpected changes and preparing for the future. Strategic planning contributes significantly through the incentives for strategic implementation, evaluation, and control, and therefore SMEs should give more priority to strategic planning in improving their performance (Wijetunge, & Pushpakumari, 2014). It appears that in the context of Sri Lanka, although SMEs have faced various challenges in the past, there is still a decline in their tendency toward formal strategic plans (Wijesinghe, 2012). Although strategic planning is not very popular among SMEs, it was concluded that those who engaged in strategic planning had higher performance than those who did not. It has further emphasized the need for strategic planning in the face of intense competition and a dynamic business environment (Donakor et al., 2018). As a result, many SMEs today focus on strategic planning to successfully face business uncertainties, and overcome obstacles, and achieve their continuity in the business world. However, SMEs doing business in some rural areas of Sri Lanka show very little inclination towards strategic planning. SMEs have a high rate of failure within a few years of establishment and many organizations are underperforming. Even though the government and non-government entrepreneurship development agencies have taken various measures to avoid this situation, the probability of success is very low. Many researchers have identified that the lack of strategic planning is the main reason for the failure of SMEs. In order to successfully face the competitive environment, business activities should be carried out from the beginning according to a proper plan by analyzing the market, accepting risks and changing the strategic approaches of the business from time to time. Furthermore, researchers argue that it is important to identify the internal and external factors that influence the relationship between strategic planning and performance (Jayawarna & Dissanayake, 2019). Empirical studies on strategic planning and performance have been inconsistent and inconclusive (Agwu, 2018). Some studies have significantly shown that there exists a positive

relationship between strategic planning and performance (Haleem, et al., 2020; Orishede, 2020; Babatunde & Sanusi, 2020). In contrast, some studies show a significant negative relationship between strategic planning and performance (Jong et al., 2019; Ojha et al., 2020). These different results imply that there are intervening links between SP and performance (Oladele et al., 2021).

In the context of Sri Lanka, many business activities have been disrupted due to legal actions taken in response to the rapid spread of COVID-19. During this period, many SMEs were temporarily closed, and some businesses collapsed in the long term. At the same time, some business organizations successfully faced those challenges by changing their strategies as well as identifying and exploiting new business opportunities (Robinson & Kengatharan, 2020). In this context, Dynamic capabilities (DC) have been identified as crucial for SMEs to face strategically for the challenges in the turbulent business environment (Samsudin & Ismail, 2019). It has also gain prominence as SMEs are increasingly required to frequently scan and respond swiftly to likely environmental opportunities and threats (Teece, 2007). Thus, DCs of an organization could directly or indirectly influence business performance of SMEs. Several studies in strategic management research examined strategic planning, dynamic capabilities, and performance, respectively (i.e., Fadol et al., 2015; Donkor, Donkor & Kwarteng, 2018). Specifically, there is no research that investigated the mediating effect of dynamic capabilities in the relationship between strategic planning and business performance of SMEs in Sri Lanka. Moreover, it remains unclear though to what extent dynamic capabilities intervene the relationship between strategic planning and performance of SMEs (Lo & Leidner, 2018). Based on this argument and research gap, present study attempts to answer the research questions of "Does strategic planning impact business performance of SMEs in Sri Lanka?" And "Does dynamic capabilities of SMEs mediate the relationship between strategic planning and business performance?".

Literature Review

Strategic Planning

Various scholars have interpreted the concept of "Strategic Planning" differently in their studies. Strategic planning is one of the most commonly popular management tools (Phillips, Paul, Moutinho, Luiz, 2014). Brysin et al., (2018) define strategic planning as *"A disciplined effort to produce fundamental decisions and actions that shape and guide what an organization is, what it does, and why it does it. At its best, strategic planning requires broad yet effective information gathering, development and exploration of strategic alternatives, and an emphasis on future implications of present decisions"*. Strategic planning supports firms to approach uncertain conditions and complexities in the environment (Kraus et al., 2007). A manager should have a good understanding of the organization's strategic planning and know what the strategies are. Strategic planning creates the future of the organization and acts as a compass that points in the right direction to achieve goals under various uncertainties. Thus, strategic planning can be termed as an activity undertaken by managers to achieve the goals and objectives of an organization. Wijetunga & Pushpakumari (2014) conducted research in the context of Sri Lanka, and emphasized that Strategic Planning consists of eight distinct components*: "setting objectives, environmental analysis, strengths, weaknesses, opportunities and threats (SWOT) analysis, 8 strategy formulation, financial projections, functional budgets, operating performance measures and control and corrective procedures."* In this way, it can be seen how various researchers come up with different explanations for strategic planning. Accordingly, strategic planning is the process of identifying the direction

in which the organization should move and preparing the background to reach the desired goals and objectives of their organization (Otieno et al., 2018). Many SME entrepreneurs are not interested in engaging in strategic planning due to the limited knowledge they have about strategic planning and many SMEs operate their businesses based on traditional thinking. Since strategic planning touches every employee in the business, it leads to efficient achievement of goals and increases employee satisfaction. SMEs that engage in the strategic planning process are less likely to fail since it increases the ability to achieve return on assets, increase profitability and sales, and monitor progress to see if the business is moving towards desired goals and (Dwikat et al., 2022). Lack of bureaucracy in SMEs and the ease of making the necessary decisions, they can be flexible and adapt to strategic planning when needed (Khan & Khalique, 2014). Previous studies have identified three main steps in the strategic planning process as Strategy formulation, Strategy Implementation, and Strategy Evaluation (Rahman, 2019; Otieno et al., 2018).

Strategy Formulation

Strategy formulation refers to the process through which a firm defines its overall long-term direction and scope. It involves establishing the way a company creates value through the configuration of its activities and resources in the markets in which it operates (Porter, 1996). Based on the information gathered from the environmental analysis, a clear path must be created to reach the business goals. The business can develop individual strategies for each objective and this gives the ability to prepare a list of steps planned to achieve the objectives. Thus, the process by which an organization takes appropriate action to achieve its goals can be simply introduced as strategy formulation. Strategy formulation can be characterized in three main stages. They are Vision, Mission and Objectives (Rothaermel, 2017). The strategy formulation involves analyzing the organizational environment in which it operates, then developing a series of strategic decisions on how the organization will compete (Obosede, et al., 2016).

Strategy Implementation

After preparing the strategic plans, the relevant parties should work to implement them and the necessary resources should be allocated. Strategic implementation can be introduced as the most important part of the strategic planning process. Strategy implementation refers to the process of turning strategy into action and monitoring and assessing the results (Gimbert et al., 2010). Strategy implementation is a multifaceted, changeable, repetitive process in which managers and employees carry out a number of decisions and tasks, which are influenced by various organizational and environmental factors and are designed to realize strategic goals (Hrebiniak, 2006). In order to determine the success of this step, all parties in the business must have a clear understanding of the strategic plan. For this, every party in the business should be given good communication about the prepared strategic plans and the relevant parties can identify their role.

Strategy Evaluation

Strategy evaluation refers to assessing the results of strategic practices by gathering feedback and measuring performance. Under this, it can be decided what plans the business should implement in the future and whether the current strategies need to be changed. Strategy evaluation is the process of determining whether the plans implemented in the planning process ultimately helped to achieve the goals. The prospective planning process enables the selection of the most appropriate strategies and the ability to determine the extent to which they are appropriate (Punt et al., 2016). Strategy evaluation ensures that a firm is achieving

what it set out to accomplish. It compares performance with desired results and provides the feedback necessary for management to evaluate results and take corrective action as needed (Mumbe et al., 2019). The need for this stage arises because if there is any uncertainty during the implementation of the plan, it is necessary to be flexible and take the correct action. This gives the ability to face failures and assess them.

Dynamic Capabilities (DC)

Resource-based view (RBV) of the firm has gained widespread recognition and high-performing organizations are those that hold valuable, rare, non-substitutable, and imperfectly imitable resources (Barney, 1991). As the extension of RBV of the firm, Dynamic Capabilities emerged as an approach for understanding strategic changes that focuses not just on the current resource base and capabilities (Teece et al., 1997), but also on the importance of modifying them to adapt to the changing environments (Schilke et al., 2018, Tabaklar et al., 2021). In response, scholars highlight the importance of DCs in highly volatile environments (Eisenhardt & Martin, 2000; Helfat & Martin 2015; Teece, 2007). Thus, the DC approach appears to be one of the most popular in the field of strategic management (Teece et al., 1997; Eisenhardt & Martin, 2000; Arend, 2014), Firms must possess unique capabilities that are difficult to replicate in order to remain competitive (Teece, 2007). DCs refer to a firm's *"ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments"* (Teece et al., 1997, p. 516). Moreover, Teece (2007, p. 1319) developed a comprehensive definition of DCs as *"the capacity to sense and shape opportunities and threats, to seize opportunities, and to maintain competitiveness through enhancing, combining, protecting, and, when necessary, reconfiguring the intangible and tangible assets of an organization"*. This definition groups three DC as sensing, seizing, and transforming or reconfiguring capabilities of a firm. Subsequently, many scholars conceptualized DC in the literature. Barreto (2010) defines DC as *"the firm's potential to systematically solve problems based on its propensity to sense opportunities and make timely market-oriented decisions"*. Ferreira et al., (2020) defined DC as *"the ability of solving problems systematically, sensing opportunities and threats, making timely decisions, and implementing strategic decisions prudently to achieve the expected direction"*.

Teece et al., (1997) defined sensing capability as the *"ability to create or paraphrase the opportunities in the market and estimate the needs".* This ability can contribute to assessing, shaping, filtering, or calibrating all the available opportunities to enhance the innovation performance in a firm (Jin et al., 2015). Sensing capability describes the ability of a company to identify and understand changes and trends in the market, including customer preferences and competitors' actions (Teece, 2018). Seizing is the ability of a company to take advantage of opportunities that have been identified through sensing (Feiler & Teece, 2014). This involves developing and implementing specific routines and practices that allow the company to capitalize on the identified opportunities (Linde et al., 2021; Teece, 2007; Khan et al., 2014). Reconfiguring capability is defined as the means of re-structuring internal and external resources in response to recent changes in the business environment for creating competitive advantages (Teece, 2007). Further, DC can be defined as Exploitation, where firm refine competencies through repeated actions over extended periods of time (Eisenhardt & Martin, 2000), while through Explorations they search and create new competencies (Adjei 2012, Lew et al., 2013; Prange &Verdier , 2011; Sheng & Hartmann, 2019; Wu &Vahlne (2022); Winter & Szulanski, 2001).

Relationship between Strategic Planning and Business Performance

The performance of SMEs has been evaluated in different ways in different aspects and previous studies have used different variables to measure the performance in relation to the overall activities of entrepreneurs. In recent studies, different researchers have proposed different criteria for measuring performance, including annual revenue, annual sales, profitability, return on investment, market share and non-financial indicators, such as employee satisfaction, customer satisfaction, innovation, employment, competitiveness, reputation, and achievement of strategic goals (Fairoz et al., 2010; Wijetunga, & Pushpakumari, 2014; Wang, 2020). Previous research revealed that there is a positive relationship between strategic planning and financial performance and that SMEs that focus on planning have higher performance than those that do not (Wijetunga, & Pushpakumari, 2014). Many Studies have shown that there is a positive relationship between strategic planning and business performance. Sandada et al., (2014) also reveal that strategic planning is positively related to firm performance. Some studies have shown that by providing entrepreneurs with a better understanding of strategic planning, the performance of businesses can be increased (Mori et al., 2014). Maldeniya et al., (2021) find out that strategic management practices such as strategy formulation, strategy, implementation, and strategy evaluation have a positive impact on the business performance of SMEs in Sri Lanka. Further, Lestari et al., (2024) find out from their research that strategic planning positively influences on improving the performance and achieving goals of MSMEs in Indonesia. Moreover, Dwikat et al., (2022) revealed that systematic strategic planning positively influences the sustainable performance of manufacturing SMEs in Plestene. Alzahrani et al., (2023) also showed the positive relationship between SP and the performance of SMEs in Saudi Arabia. Moreover, several other studies are revealed the positive influence of SP on SME performance (Donkor et al., 2018; George et al., 2019).

H1: There is a significant positive effect of strategic planning on performance of SMEs

Relationship between Strategic Planning and Dynamic Capabilities

The concept of dynamic capabilities as the ultimate source of competitive advantage is at the forefront of strategy research (Hou & Chien, 2010). The literature discusses how SP and DCs interact in different ways, resulting in contradictory findings. This theoretical effort presents a brief review and argues that SP is one of the micro foundations of DCs because it supports the seizing and continuous alignment of assets and resources (Tabaklar ei al., 2021). Adjei (2012) emphasized that strategic organizational development direct to develop dynamic capabilities framework of capability exploitation. Under this perspective, SP has a role in the development and implementation of all organizational DCs and is not restricted to a DC specifically. It is argued that the interactions between SP, DCs, and performance over time can lead to the learning needed for better SP, DCs and performance in a virtuous and mutually reinforcing cycle (Araujo et al., 2022). The resource-based perspective focuses on strategies for exploiting firm-specific assets (capability exploitation) and also invites consideration of managerial strategies for developing new capabilities (Wernerfelt, 1984; Luo, 2000). Almansoori at al., (2022) revealed that strategic foresight has a significant positive effect on DC of firms in United Arab Emirates.

H2: There is a significant positive effect of strategic planning on dynamic capabilities of SMEs

Relationship between Dynamic Capabilities and Business Performance

SMEs with greater dynamic capabilities can have more opportunities to beat the competition (Teece, 2014). Martins (2021) found that dynamic capabilities positively affect SME performance in Ghana. Further, Dejardin et al., (2022) confirm that DC positively influences the firm performance prior and during the COVID-19 pandemic in Germany. DC enhances the performance of SMEs and more competitive in the food sector in Brazil (Ali et al., 2021). Abbas et al., (2019) examined how Taiwanese SMEs could develop dynamic capabilities for digital change and use its resources to drive higher performance. Wasantha et al., (2022) found that DC enhances the success and innovative orientation of women-owned SMEs in Sri Lanka. Moreover, based on the survey conducted in the UK, Europe and North America, DC significantly determines the MSE performance (Chiarelli, 2021).

H3: There is a significant positive effect of dynamic capabilities on business performance of SMEs

Strategic Planning, Dynamic Capabilities and Business Performance

The present study proposes that dynamic capabilities are the mediating variable of the relationship between strategic planning and performance of SMEs. It is likely to intervene between the strategic planning and performance relationship and identify the link that supports maximizing the SME performance. According to the dynamic capabilities' perspective, an extension of the resource-based view, in order to remain competitive, firms must possess unique dynamic capabilities that are difficult to replicate (Teece, 2007). Dynamic capabilities refer to a firm's *"ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments"* (Teece et al., 1997, p. 516). The various learning processes all contribute to the development of dynamic capabilities in a firm (Lo & Leidner, 2018). Without strong dynamic capabilities, VRIN resources, and a good strategy, any advantage is likely to be unsustainable. The dynamic capabilities that are core to enhancing processes and exploiting possibilities must be guided and informed by strategy and vice versa. Firms with weaker capabilities require different strategies than firms with stronger capabilities. Firms need DCs to modify or reconfigure their resource base to build competitive advantages or enhance performance (Pitelis et al., 2024). And the effectiveness of dynamic capabilities will be compromised by poor strategy (Teec, 2018). Pertheban et al., (2023) found that dynamic capabilities in terms of exploration and exploitation mediate the link between proactive strategies and performance of Malaysian SMEs.

H4: Dynamic capabilities mediate the link between strategic planning and business performance of SMEs

The conceptual model of the study is provided in Figure 1.

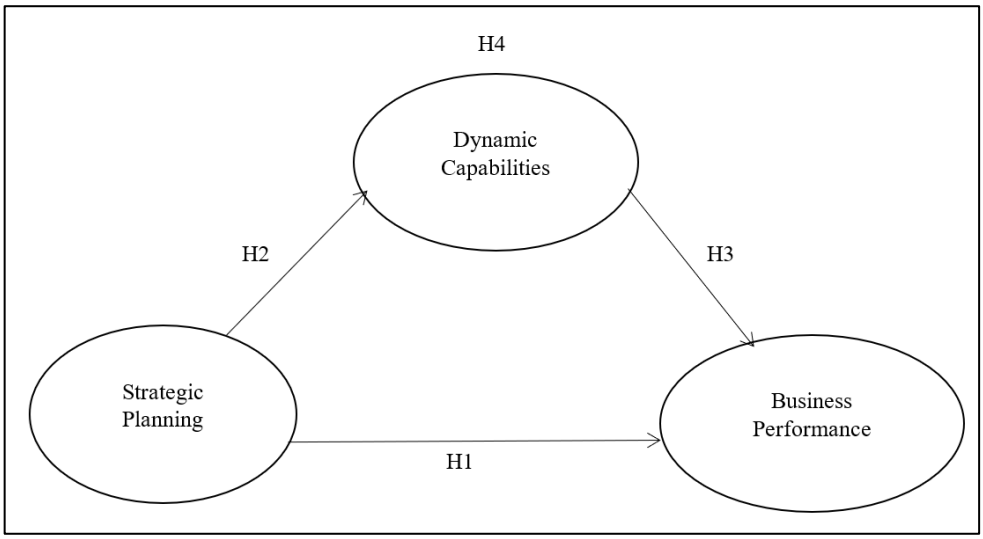

Figure 1: Conceptual Framework
Source: Developed by the researcher based on previous literature (2024)

Research Methodology

Population and Sampling

The target population of this research includes all the registered SMEs that are located in the Southern province of Sri Lanka. Hence, the SMEs registry of the district chamber of Commerce and industry of the three districts of the Southern province is considered as the sampling frame. There are around 400, 200, and 100 SMEs registered in the Chambers of Commerce and Industry in Galle, Matara, and Hambantota districts, respectively. Proportionately, 200, 100, and 50 SMEs were selected as the sample from Galle, Matara, and Hambantota districts, respectively, using the simple random sampling techniques.

Data Collection and Analysis

The current study has utilized primary and secondary data. Primary data refers to the raw data collected from the SME entrepreneurs in the Southern province. Primary data was used to understand the relationship between strategic planning, dynamic capabilities and performance of SMEs. A semi-structured questionnaire was developed to gather primary data from the selected sample. Data was collected by directly sending questionnaires to owners/managers of SMEs through online methods. Questionnaires consist mainly of two sections, and the first section includes a profile of the respondents and the business. Section two consists of Likert scale questions ranging from strongly agree 5 to strongly disagree -1 to measure the independent and dependent variables. Whenever relevant and required, the researcher carried out interviews as well. Finally, 256 questionnaires were returned and 06 questionnaires were removed from the study because of incompleteness. Moreover, the validity of data collection tools, the accuracy of information reliability, clarity, and response rate were investigated. Secondary data was collected from textbooks, journals, annual reports, and other documents. The Partial Least Squares Structural Equation Modeling (PLS- SEM) technique was used to analyze the data.

Measures

All the measures of independent, mediating, and dependent variables were extracted through an extensive literature review. Each item was measured using a five-point Likert scale questions ranging from 1-strongly disagree to 5-strongly agree. SP was measured using three dimensions, such as Strategy Formulation, Strategy Implementation, and Strategy Evaluation, using seven items for SF, three items for SI, and three items for SE derived from Wijethunga and Pushpakumari in 2014. Business performance was measured using subjective performance measurements since it is difficult to collect objective data from SMEs. Business performance was measured using items covering sales, employment, market share, innovation, and customer satisfaction (Fairoz et al. 2010, and Wasantha et al., 2022). The Dynamic Capabilities were measured based on the scale developed by Dynamic capabilities are measured through four items developed by Lew et al., (2013), and Lee & Rha (2016) through exploration and exploitation.

Results and Interpretations

Profile of the Respondents

Table 1: Demographic Profile of the Respondents

Demographic Profile	Criteria	Frequency	Percentage (%)
Gender	Male	155	62
	Female	95	38
Age	Below 25 years	20	08
	26 – 35 years	35	14
	36 – 45 years	70	28
	46 – 55 years	88	35
	Above 55 years	37	15
Education	G.C.E. Ordinary Level	110	44
	G.C.E. Advanced Level	75	30
	Certificate/Diploma	45	18
	Degree	20	08
Position	Owner/Manager	170	68
	Manager	80	32

Source: SmartPLS output (2024)

The demographic profile of the respondents is illustrated in Table 1. According to the findings, the majority of SME entrepreneurs were run by males, which is 62% out of all the respondents. Female SME entrepreneurs accounted for 38% of all SMEs. Further, respondents belonging to 46–59 year age group represent the highest percentage level of 35%. The second-highest rate is 28%, with the age range of 36 to 45 years. Based on the level of education, the majority of entrepreneurs have passed the G.C.E. Ordinary level examination with a percentage of 44% out of all the respondents. Next, SME entrepreneurs who passed the G.C.E. Advanced level exam represent 30% and SME entrepreneurs with a certificate or diploma level of

educationally qualified respondents represent 18%, while SMEs with a bachelor's degree account as 08% out of all the respondents. Also, the majority of entrepreneurs (68%) were owners and managers.

Profile of the Business

The SMEs who are in the manufacturing sector represent 70%, which is the highest percentage value among the respondents. The rest of the SMEs are in the service sector, which represents 30%. The majority of SMEs are sole proprietorships, which represent 78%. According to the findings, 44% of those surveyed SMEs were the age of over 15 years. Further, about 15% SMEs were 10-15 years of age, and 24% SMEs were in the age range of 5-10 years.

Assessment of the Measurement Model

The Measurement model was validated to ensure the reliability and validity of data. The measurement model has three latent variables with reflective measurement models as SP, DC, and BP. All outer loadings of reflective constructs such as SP, DC, and BP are well above the threshold value of 0.708 (Hair et al., 2017) except indicators of DC1 (0.610) and BP1 (0.694) and BP 2 (0.660). The indicators with outer loadings below 0.708 were not removed from the study because of deleting these will not have significant increase in composite reliability (CR) and average variance extracted (AVE). All indicators of the three reflective constructs exceed the minimum acceptable level for outer loadings. Reliability of the constructs was tested by using Cronbach's alpha and composite reliability (CR). As per Table 2, composite reliability values of all indicators of SP such as strategy formulation (SF), strategy implementation (SI), and strategy evaluation (SE) have high levels of CR as 0.912, 0.875, and 0.851 respectively. Further, DC and BP also show high internal consistency since the CR values are well above 0.7 (0.850 and 0.864). Moreover, since Cronbach's Alpha values of all constructs are greater than 0.70, which provides support for acceptable internal consistency (Hair et al., 2019).
The Convergent validity of the constructs were measured through average variance extracted (AVE) as indicated in Table 1. The AVE values of SF (0.597), SE (0.699), SI (0.656), DC (0.620), and BP (0.531) are well above the threshold level of 0.5. Thus, the three constructs have high levels of convergent validity.

Table 2: Reliability and Convergent Validity

	Cronbach's Alpha	Composite Reliability (CR)	Average Variance Extracted (AVE)
BP	0.780	0.850	0.531
DC	0.784	0.864	0.620
SF	0.887	0.912	0.597
SE	0.787	0.875	0.699
SI	0.738	0.851	0.656

Source: SmartPLS output (2024)

Further, the Discriminant validity of the constructs was measured by using the Fornell–Larcker criterion and the heterotrait-monotrait (HTMT) ratio. Table 3 demonstrates the Fornell–Larcker criterion of the constructs. It shows the square root of the AVE of each construct and correlations with other constructs to assess the discriminant validity. As per the Fornell–Larcker criterion, BP (0.729), DC (0.788), SE (0.836), SF (0.773), and SI (0.810) are

all higher than the correlations of these constructs, confirming the discriminant validity (Henseler et al. 2015).

Table 3: Discriminant Validity - Fornell and Larcker Criterion

	BP	DC	SE	SF	SI
BP	0.729				
DC	0.613	0.788			
SE	0.422	0.385	0.836		
SF	0.426	0.456	0.312	0.773	
SI	0.389	0.368	0.230	0.352	0.810

Source: SmartPLS output (2024)

Further, the HTMT ratio proposed by Henseler et al. (2015) was used to examine the discriminant validity. Table 4 shows the HTMT ratio of correlations and all the values are lower than the threshold value of 0.85 ensures the discriminant validity of the constructs.

Table 4: Discriminant Validity – HTMT Ratio

	BP	DC	SE	SF	SI
BP					
DC	0.764				
SE	0.527	0.482			
SF	0.492	0.548	0.370		
SI	0.492	0.480	0.302	0.437	

Source: SmartPLS output (2024)

Moreover, multicollinearity was assessed to determine whether there was a high correlation between two or more independent variables. Variance inflation factor (VIF) values of all independent variables are below 5 indicating that the absence of multicollinearity (Hair et al., 2019). As illustrated in Table 5, the VIF values in this study were below the recommended threshold; the absence of multicollinearity was confirmed.

Table 5: Outer Loading and Multicollinearity Statistics

Variable	Indicator	Outer Loading	VIF
Strategy Formulation	SF1	0.689	1.466
	SF2	0.778	3.518
	SF3	0.807	3.690
	SF4	0.799	3.539
	SF5	0.799	3.388
	SF6	0.769	3.395
	SF7	0.762	3.214
Strategy Implementation	SI1	0.806	1.486
	SI2	0.809	1.396
	SI3	0.814	1.531
Strategy Evaluation	SE1	0.857	1.621
	SE2	0.807	1.639
	SE3	0.844	1.680

Dynamic Capabilities	DC1	0.610	1.204
	DC2	0.842	3.427
	DC3	0.780	1.519
	DC4	0.916	4.195
Business Performance	BP1	0.694	1.350
	BP2	0.660	2.072
	BP3	0.784	2.468
	BP4	0.752	1.564
	BP5	0.747	1.464

Source: SmartPLS output (2024)

Assessment of the Structural Model

The structural model was assessed to examine the relationship among constructs and the predictive capabilities of the model (Hair et al., 2019). Accordingly, Coefficient of determination (R^2), predictive relevance (Q^2), and effect sizes (f^2) are essential in assessing reflective structural models. Coefficient of determination (R^2) provides evidence of predictive accuracy. As illustrated in Table 5, the R^2 values of BP (0.451) and DC (0.309) indicate that 45.1 percent variance of business performance can be explained by strategic planning and dynamic capabilities while 30.9 percent of the variance of DC can be explained by the strategic planning.

The Direct Effect

Hypothesis 1 stated that there is a significant positive effect of strategic planning on the performance of SMEs ($\beta = 0.446$, $t = 6.702$, $p < 0.05$) is supported by the data as indicated in Table 6. Thus, H1 is accepted. Further, as per the 2nd hypothesis, there is a significant positive effect of strategic planning on the dynamic capabilities of SMEs, also supported ($\beta = 0.556$, $t = 12.668$, $p < 0.05$). Moreover, hypothesis 3 stated that there is a significant positive effect of dynamic capabilities on the business performance of SMEs. This is also accepted based on the analysis ($\beta = 0.446$, $t = 6.702$, $p < 0.05$). Further, the effect size (f^2) of SP to BP is 0.046, SP to DC is 0.262, and DC to BP is 0.367 as indicated in Table 6. Effect size values of 0.02, 0.15, and 0.35 reflect small, medium, and large effects, respectively (Cohen, 1988). Hence, the SP reflects a small effect on BP, while SP represents a medium effect on DC, and DC reflects a large effect on BP. The predictive relevance of the model is indicated by Q^2. Hence, the Q^2 values of BP and DC are represented by 0.442 and 0.301, respectively and ensure that the model has predictive relevance of its endogenous constructs since the Q^2 values are greater than '0' (Hair et al. 2019).

Table 6: Coefficient of Determination and Predictive Relevance

	R-square	Q^2predict
BP	0.451	0.442
DC	0.309	0.301

Source: SmartPLS output (2024)

The Indirect Effect

The mediating effect of DC on the relationship between SP and BP has been examined. As per Table 7, the significance of the indirect effect and associated t value are then checked by using

path coefficients when the mediator (DC) is included in the model. The mediation effect can be identified as an indirect effect. The results of Table 6 reveal that the indirect effect (β = 0.175, t = 6.246, p< 0.05) is statistically significant. Thus, the direct and indirect effects are statistically significant, the magnitude of the mediator (DC) of this study considered to be partial. Hence, the 4th hypothesis stated Dynamic capabilities mediate the link between strategic planning and business performance of SMEs is accepted based on the finding.

Table 7: Path Coefficients (β) and Effect Size ($f^{2)}$

Path	Coefficient	T Statistics	P Values	f^2	Hypothesis Testing
DC -> BP	0.446	6.702	0.000	0.367	Supported
SP -> BP	0.307	4.880	0.000	0.046	Supported
SP -> DC	0.556	12.668	0.000	0.262	Supported
SP -> DC -> BP	0.247	6.246	0.000		Partially Supported

Source: SmartPLS output (2024)

Discussion

The results highlight the importance of both strategic planning and dynamic capabilities in enhancing the performance of SMEs. The result indicates that there is a significant positive relationship between SP and performance, as well as between DC and performance. This implies that SMEs that focus on strategic planning and developing dynamic capabilities would achieve higher performance. These findings are in line with the findings of Maldeniya et al. (2021), Alzahrani et al. (2023), and Dwikat et al. (2022), which highlight the positive impact of SP on performance as well as a positive relationship exists between DC and performance (Martins, 2021; Dejardin et al., 2022; and Sriyani et al., 2022). Moreover, this study revealed that SP also has a significant positive relationship with DC, confirming that SMEs that are given priority for SP may support the development of DCs. Additionally, the study found new insights into the mediating effects of dynamic capabilities on the relationship between SP and SME performance. Results are harmonious with the findings of Pertheban et al. (2023), and they found that dynamic capabilities in terms of exploration and exploitation mediate the link between proactive strategies and performance of Malaysian SMEs.

Conclusion and Recommendation

The present study found that there is a partial mediation between SP and performance of SMEs, verified that DC indirectly links with the SP and the performance of SMEs. Hence, the study concludes that SP would enhance SME performance when they develop dynamic capabilities. These findings are important for SMEs to focus both on SP and developing dynamic capabilities to enhance performance in a post-COVID and the period of economic crisis. Therefore, the current study empirically validates the role of SP and DC, which support SMEs to enhance their performance. Integrating dynamic capabilities as a mediator of the model of SP and performance relationship contributes to the literature of the Resource-Based View and strengthens the understanding of the indirect effect of SP, DC, and performance of SMEs, especially in the context of a developing economy like Sri Lanka. Practically economic crisis followed by the COVID-19 pandemic has created new challenges and opportunities for SMEs, and developing dynamic capabilities is important for SMEs to explore and exploit new opportunities while overcoming threats. It becomes important for SME owners/managers to focus their efforts on exploration and exploitation capabilities in achieving competitive

advantages in a dynamic, turbulent environment. Furthermore, SMEs that focus on strategic planning would enhance their performance better than their rivals. Therefore, it is imperative that SMEs need to analyze the business environment and prepare strategic plans to enhance their performance. The findings also provide valuable insights for business development service providers, government, and policymakers in facilitating SMEs to enhance their strategic planning skills for their survival in an uncertain business environment.

Limitations and Future Research Directions

Since the present study is cross-sectional in nature, longitudinal studies are needed to ensure the confirmation of findings through the data collection across different time periods. Further, data were collected through a self-administered questionnaire from the respondents for quantitative analysis, and data is subject to the perspective of the individual participants responding to the survey. Therefore, qualitative studies need to be conducted in order to have a more in-depth analysis about the phenomenon. Moreover, it would also be interesting to know if the moderating effect of dynamic capabilities on the relationship between strategic planning and SME performance in diverse economies

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