

Literature Review: Strategic Leadership, Employee Empowerment Dynamic Capabilities, Operational Capabilities, and Sustainable Performance in SMEs

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ABSTRACT

This study, using Shanghai, China as a case study, provides a comprehensive literature review of the relationships between strategic leadership, Employee Empowerment Dynamics (EEDC), operational capabilities, and sustainable performance of SMEs. Drawing on strategic leadership theory and the dynamic capabilities perspective, this review integrates existing knowledge from multiple academic databases to construct a comprehensive conceptual framework. The literature indicates that in the resource-constrained environment of SMEs, strategic leadership is a key prerequisite for capability development. Employee Empowerment Dynamics Capabilities (EEDC) is a unique mechanism by which strategic leaders influence organizational performance, enabling firms to perceive, grasp, and reallocate resources to respond to environmental changes. Operational capabilities are considered complementary processes supporting daily efficiency and sustainable development activities. This review identifies significant research gaps, particularly insufficient attention to the contextual factors influencing these relationships in the Chinese urban business environment, and the unclear interaction between Employee Empowerment Dynamics Capabilities (EEDC) and operational capabilities in driving sustainable performance. By integrating these concepts, this paper constructs a unified framework, making a theoretical contribution to the literature on SMEs leadership and sustainable development, while also providing practical insights for managers and policymakers supporting SME development in Shanghai's dynamic economic environment.

KEYWORDS

Strategic leadership; Employee Empowerment Dynamics Capabilities (EEDC); Operational capabilities; Sustainable performance; Small and medium-sized enterprises (SMEs)

1. INTRODUCTION

Small and medium-sized enterprises (SMEs) constitute the backbone of economies worldwide, driving innovation, generating employment, and fostering economic growth [1]. In China, SMEs have emerged as critical drivers of industrial transformation, particularly within innovation-driven urban economies such as Shanghai [2]. Despite their economic significance, SMEs face persistent challenges related to resource constraints, intensified competition, and rapidly evolving market dynamics that threaten their long-term sustainability [3]. These challenges require a deeper understanding of the strategic mechanisms by which SMEs can enhance sustainable performance.

Strategic leadership has been identified as a pivotal organizational capability that enables firms to navigate complex environments and achieve competitive advantage. Traditionally examined within the context of large corporations, strategic leadership in SMEs represents an underexplored yet theoretically significant domain [1]. This literature review synthesizes existing research on the relationships between strategic leadership, employee empowerment dynamic capabilities, operational capabilities, and sustainable performance in SMEs, with particular attention to the Chinese context. The review aims to identify theoretical foundations, empirical evidence, and research gaps that inform the development of a conceptual framework for understanding these relationships in Shanghai's SMEs sector.

2. THEORETICAL FOUNDATIONS

2.1. Resource-Based View and Dynamic Capabilities Theory

The theoretical underpinnings of this review draw primarily from the resource-based view (RBV) and its extension, the dynamic capabilities view (DCV). The RBV posits that firms achieve sustainable competitive advantage through the possession of valuable, rare, inimitable, and non-substitutable resources [2]. However, critics have noted that the RBV inadequately explains how firms maintain an advantage in rapidly changing environments [2], giving rise to the dynamic capabilities framework. Teece's conceptualization of dynamic capabilities emphasizes the firm's capacity to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments. Dynamic capabilities represent higher-order organizational abilities that enable firms to modify their resource bases, thereby creating pathways for sustained performance. Within the SME context, dynamic capabilities assume particular significance, as smaller firms typically lack the slack resources that buffer larger organizations from environmental turbulence [4].

2.2. Strategic Leadership Theory

Strategic leadership theory focuses on the executive-level behaviors and decisions that shape organizational direction and performance. Strategic leaders are responsible for making decisions under conditions of ambiguity, developing organizational capabilities, and shaping the cognitive frameworks through which members interpret their environment [1]. Unlike general leadership theories that emphasize interpersonal influence, strategic leadership theory specifically addresses how top-level leaders affect organizational outcomes through strategic choices and capability development [1].

Recent scholarship has extended strategic leadership theory to entrepreneurial contexts, recognizing that SME leaders perform functions analogous to their corporate counterparts but within resource-constrained environments that demand distinctive adaptive capabilities [1, 5]. This extension acknowledges that strategic leadership in SMEs encompasses not only formal planning activities but also the informal influence processes through which owner-managers shape organizational trajectories.

3. STRATEGIC LEADERSHIP AND SME PERFORMANCE

3.1. Conceptualizing Strategic Leadership in SMEs

Strategic leadership in SMEs encompasses the cognitive, behavioral, and decisional processes through which owner-managers and top teams guide their organizations toward sustainable outcomes. Research by Quansah and colleagues conceptualizes strategic leadership practices as encompassing vision articulation, strategic decision-making, and the development of organizational capabilities that

enable adaptation to environmental demands [1]. Unlike transformational leadership, which emphasizes inspirational motivation and individualized consideration, strategic leadership focuses more specifically on aligning organizational resources with environmental opportunities.

The distinctive characteristics of SME leadership merit theoretical attention. SME leaders often combine strategic roles with operational responsibilities, creating unique dynamics in which strategic decisions are closely integrated with day-to-day implementation [4]. This integration can accelerate the translation of strategic intent into organizational action but may also create cognitive overload, limiting attention to long-term capability development.

3.2. Direct Effects on Performance

Empirical evidence regarding the direct relationship between strategic leadership and SME performance presents a nuanced picture. While some studies report positive direct effects, research by Mohamed Shekar in the Bahraini context found that transformational leadership exhibited no significant direct influence on SME performance, instead operating entirely through the mediating mechanism of dynamic capabilities [4]. This finding aligns with Quansah and colleagues' observation that strategic leadership effects on firm performance are fully mediated by employee empowerment, dynamic capability, and resilient dynamic capability [1].

These mediation findings carry important theoretical implications. They suggest that strategic leadership contributes to performance not primarily through direct intervention in operational matters but rather through the cultivation of organizational capabilities that enable employees to respond effectively to environmental contingencies. This interpretation resonates with broader dynamic capabilities scholarship, which emphasizes that leaders' primary contribution lies in shaping the organizational systems and processes through which capabilities emerge and evolve [6].

4. EMPLOYEE EMPOWERMENT DYNAMIC CAPABILITIES

4.1. Conceptual Foundations

Employee empowerment dynamic capability (EEDC) represents an organization's capacity to systematically delegate decision-making authority, provide resources for autonomous action, and develop employee competencies that enable effective responses to emerging challenges [1]. This construct differs from static conceptualizations of empowerment by emphasizing the organizational capability to continuously adjust empowerment practices in response to changing circumstances.

Elgamal's model of dynamic organizational capabilities positions empowerment alongside agility and resilience as core components of organizational vitality [6]. Within this framework, empowerment capabilities enable organizations to leverage distributed intelligence throughout the workforce, thereby enhancing responsiveness to local contingencies while maintaining strategic coherence. The dynamic quality of empowerment capabilities lies in the organization's ability to recalibrate autonomy-accountability balances as environmental conditions evolve.

4.2. Mediating Role in Leadership-Performance Relationships

The mediating role of EEDC between strategic leadership and performance outcomes has received consistent empirical support. Quansah and colleagues demonstrated that employee empowerment dynamic capability fully mediates the strategic leadership-firm performance relationship in SMEs [1]. This mediation pattern suggests that strategic leaders influence performance primarily through their effects on the organizational systems that empower employees to exercise judgment, take initiative, and adapt their behaviors to emerging circumstances.

Theoretical explanations for this mediation draw on both motivational and cognitive mechanisms. From a motivational perspective, empowerment enhances intrinsic motivation, commitment, and discretionary effort [3]. From a cognitive perspective, empowered employees possess both the authority and the contextual understanding to make decisions that align with organizational objectives while responding appropriately to local conditions. Strategic leaders cultivate empowerment capabilities through role modelling, resource allocation, and the design of organizational structures that delegate authority while maintaining accountability.

4.3. Empowerment in the Chinese Context

Research examining employee empowerment within Chinese SMEs reveals both universal principles and context-specific manifestations. Studies conducted in Shanghai and other Chinese innovation hubs indicate that empowerment practices are increasingly adopted by high-tech SMEs seeking to enhance adaptability and innovation [2]. However, cultural factors including power distance and collectivist orientations may moderate the forms that empowerment takes and the mechanisms through which it affects performance.

Zhang and colleagues' research on Chinese high-tech SMEs emphasizes that adaptive leadership behaviors, including the delegation of authority and the cultivation of learning orientations, significantly influence sustainable business performance [2]. Their findings suggest that empowerment capabilities in the Chinese context operate within relationship-based governance structures, where trust and reciprocal obligation complement formal delegation mechanisms.

5. OPERATIONAL CAPABILITIES

5.1. Defining Operational Capabilities

Operational capabilities refer to the organizational routines and processes through which firms execute day-to-day activities, transform inputs into outputs, and deliver value to customers [7]. Unlike dynamic capabilities, which focus on changing the firm's resource base, operational capabilities pertain to the performance of ongoing functional activities that generate current revenue and sustain existing operations.

Research by Yong distinguishes between operational performance—the efficiency and effectiveness with which firms conduct their current activities—and innovation performance, which relates to the development of new products, processes, or business models [7]. This distinction carries theoretical significance because the capabilities that support operational excellence may differ from those that enable innovation and adaptation.

5.2. Relationship with Dynamic Capabilities

The relationship between operational and dynamic capabilities has generated theoretical debate. Some scholars conceptualize them as distinct capability hierarchies, with dynamic capabilities operating as higher-order abilities that shape operational routines. Others argue for more reciprocal relationships, where operational capabilities provide the foundation upon which dynamic capabilities build, while dynamic capabilities enable the continuous improvement and reconfiguration of operational processes.

Yong's research on digital technology adoption in Chinese SMEs provides empirical evidence relevant to this debate. The study found that digital technology-enabled dynamic capabilities positively relate to innovation performance [7], which in turn associates positively with operational performance. This chain of relationships suggests that dynamic capabilities influence operational

outcomes indirectly through their effects on intermediate performance dimensions, rather than through direct modification of operational routines.

5.3. Operational Capabilities and Sustainability

The connection between operational capabilities and sustainable performance operates through multiple pathways. Efficient operations reduce resource consumption and waste, contributing directly to environmental sustainability. Effective operations enhance customer satisfaction and financial performance, supporting economic sustainability. Moreover, operations that incorporate stakeholder concerns and ethical practices contribute to social sustainability [3].

Research on SMEs in Shanghai and other Chinese cities indicates that operational capabilities significantly influence enterprise management efficiency and long-term viability. However, the relationship between operational capabilities and sustainability may be moderated by environmental factors, including market turbulence, regulatory demands, and competitive intensity.

6. SUSTAINABLE PERFORMANCE IN SMES

6.1. Conceptualizing SME Sustainability

Sustainable performance in SMEs encompasses economic, social, and environmental dimensions that collectively determine the firm's capacity to maintain viable operations over extended time horizons [2-3]. Unlike financial performance measures that capture historical outcomes, sustainability constructs emphasize the firm's future viability and its relationships with multiple stakeholder groups.

The economic dimension of sustainability includes profitability, growth, and financial stability that enable continued operation and investment. The social dimension encompasses fair treatment of employees, positive community relationships, and ethical conduct that maintain legitimacy and stakeholder support. The environmental dimension involves resource efficiency, waste reduction, and ecological responsibility that align with regulatory requirements and societal expectations [2].

6.2. Antecedents of Sustainable Performance

Research has identified multiple antecedents of sustainable SME performance. Strategic leadership contributes by establishing vision and values that integrate sustainability considerations into strategic decision-making [5]. Dynamic capabilities enable continuous adaptation of sustainability practices as conditions evolve. Employee empowerment engages workforce creativity in identifying and implementing sustainability improvements [3, 8].

Studies specifically examining Chinese SMEs highlight the importance of digital transformation and innovation capabilities as drivers of sustainability. Zhang and colleagues found that SMEs with proactive digital strategies and strong innovation capabilities exhibit greater resilience, growth potential, and competitive strength [2]. These findings suggest that sustainability emerges not from static optimization but from ongoing adaptation and learning.

7. THE SHANGHAI CONTEXT

7.1. SME Landscape in Shanghai

Shanghai represents a distinctive context for examining SME performance dynamics. As China's commercial and financial center, Shanghai hosts a diverse population of SMEs operating across manufacturing, services, technology, and creative industries [2, 9]. The city's advanced infrastructure,

access to talent, and integration with global markets create opportunities for SME growth while simultaneously exposing firms to intense competition and rapid environmental change.

Research by Wang and Husain examining SME management in Shanghai identifies administrative factors, decision-making processes, and leadership practices as critical determinants of organizational efficiency [9]. Their findings suggest that effective management of administrative functions—including planning, organizing, commanding, coordinating, and controlling—significantly influences enterprise performance. However, the study also notes that leadership authority must be strategically employed rather than overexerted, suggesting nuanced relationships between leadership intensity and outcomes.

7.2. Policy Environment and Sustainability

Chinese government policies increasingly emphasize SME development as a driver of innovation and employment. The Digital China Strategy and various SME support initiatives create an enabling environment that shapes the opportunities and constraints within which Shanghai's SMEs operate [2]. Policy attention to sustainability, innovation, and digital transformation influences the strategic priorities of SME leaders and the capabilities they seek to develop.

The Shanghai municipal government's focus on high-tech industrial development, exemplified by zones such as the Zhanjiang Hi-Tech Industrial Park, creates concentrated ecosystems where SMEs can access resources, networks, and knowledge that support capability development [2]. These policy-enabled ecosystems potentially moderate the relationships between strategic leadership, capabilities, and sustainable performance.

8. RESEARCH GAPS AND SYNTHESIS

8.1. Identified Gaps in the Literature

This review reveals several significant gaps that warrant further investigation. First, while studies have examined strategic leadership and dynamic capabilities in SMEs, limited research simultaneously considers both employee empowerment dynamic capabilities and operational capabilities within unified frameworks. The interplay between these capability types—and their relative contributions to sustainable performance—remains theoretically underdeveloped.

Second, research examining these relationships within the Chinese context, and specifically within Shanghai, remains limited. Studies by Zhang and colleagues [2] and Wang and Husain [9] provide valuable foundations, but the distinctive characteristics of Shanghai's SME sector—including its international orientation, technological sophistication, and competitive intensity—merit dedicated investigation.

Third, the sustainability dimension of SME performance requires more nuanced operationalization. Many studies employ financial or operational measures that capture only the economic dimension of sustainability, neglecting social and environmental aspects that increasingly determine long-term viability [3, 8].

Fourth, the mechanisms through which employee empowerment dynamic capabilities translate into operational outcomes remain incompletely specified. While research establishes mediation relationships [1, 4], the processes linking empowerment to operational effectiveness—including decision-making quality, employee motivation, and knowledge sharing—require further elucidation.

8.2. Proposed Conceptual Integration

Synthesizing the literature reviewed, a conceptual framework emerges in which strategic leadership influences sustainable SME performance through the sequential mediation of employee

empowerment, dynamic capabilities, and operational capabilities. Strategic leaders shape the organizational conditions—including delegation practices, resource allocation, and cultural norms—that enable employee empowerment and dynamic capabilities to develop. These empowerment capabilities, in turn, enhance operational capabilities by engaging employee knowledge and initiative in the continuous improvement of operational routines. Finally, operational capabilities directly contribute to sustainable performance by enabling efficient resource utilization, effective stakeholder response, and consistent value creation.

This sequential mediation model extends previous research that has examined individual mediating pathways [1, 4] by proposing more complex capability chains linking leadership to sustainability outcomes. The model acknowledges that strategic leadership effects may operate through multiple mechanisms simultaneously and that different capability configurations may be optimal under varying environmental conditions.

8.3. Contextual Considerations

The proposed relationships likely operate differently across SME types and environmental contexts. Firm characteristics, including size, age, industry, and ownership structure, may moderate the strength of relationships between leadership, capabilities, and sustainability. Environmental characteristics, including market turbulence, competitive intensity, and regulatory demands, may similarly moderate these relationships [4-5].

In the Shanghai context, the advanced technological infrastructure, access to global markets, and policy support for innovation may amplify the importance of employee empowerment and operational capabilities relative to other performance determinants. Conversely, intense competition and rapid change may require more dynamic capability configurations than those sufficient in less demanding environments.

9. CONCLUSION

This literature review has synthesized existing research on strategic leadership, employee empowerment dynamic capabilities, operational capabilities, and sustainable performance in SMEs, with particular attention to the Shanghai context. The review reveals that strategic leadership influences sustainable performance primarily through the cultivation of organizational capabilities, with employee empowerment dynamic capabilities playing a particularly important mediating role. Operational capabilities represent the mechanisms through which these higher-order capabilities translate into tangible performance outcomes.

The Shanghai context presents distinctive opportunities and challenges for SMEs seeking sustainable performance. The city's advanced infrastructure, access to talent, and policy support create enabling conditions for capability development, while intense competition and rapid environmental change demand continuous adaptation. Understanding how strategic leaders in Shanghai's SMEs navigate these conditions to build capabilities that support sustainability represents a significant opportunity for theoretical development and practical insight.

Future research should empirically test the proposed sequential mediation model using rigorous quantitative methods, examine potential moderators of the relationships identified, and investigate the specific mechanisms through which employee empowerment capabilities influence operational effectiveness. Qualitative research exploring how strategic leaders in Shanghai's SMEs conceptualize and cultivate these capabilities would complement quantitative findings and provide a richer understanding of contextual dynamics.

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