

HOW DYNAMIC CAPABILITIES DRIVE DEVELOPMENT EFFECTIVENESS: EMPIRICAL EVIDENCE FROM THE WORLD BANK GROUP IN INDONESIA

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ABSTRACT

Multilateral development organizations are increasingly expected to deliver effective results in environments characterized by uncertainty, complex stakeholder landscapes, and evolving policy priorities. Yet limited empirical evidence explains how internal organizational capabilities translate into perceived development effectiveness. This study examines whether the World Bank Group's ability to sense stakeholder needs translates into effectiveness through the sequential activation of seizing and reconfiguring capabilities within the context of Indonesia's development portfolio. Using stakeholder perception data from the Indonesia Country Opinion Survey and a serial mediation design, the analysis tests a theory-driven model in which sensing capability influences effectiveness through resource mobilization and adaptive partnership adjustment. Results reveal that sensing capability does not directly predict perceived effectiveness once mediating mechanisms are considered. Instead, its influence operates fully through indirect pathways. The dominant mechanism runs through seizing capability, indicating that the ability to deploy sector expertise across domains such as human capital, infrastructure, institutions, and sustainability constitutes the primary channel through which effectiveness is realized. Reconfiguring capability provides an additional but smaller contribution, reflecting the role of responsiveness and flexibility in sustaining alignment with evolving development needs. The full sequential pathway from sensing through seizing and reconfiguring to effectiveness is statistically supported, demonstrating that adaptation functions as an integrated process rather than a set of independent activities. These findings advance understanding of how dynamic organizational processes shape development outcomes and suggest that strengthening technical delivery capacity and institutional adaptability may be more consequential than investments in diagnostic capability alone. The study highlights the importance of examining internal capability mechanisms to better understand how development institutions convert environmental awareness into stakeholder-recognized results.

Keywords: Dynamic capabilities, multilateral development effectiveness, stakeholder perceptions, serial mediation, World Bank Group

INTRODUCTION

Multilateral development organizations operate in environments characterized by overlapping crises, institutional complexity, and rising expectations for demonstrable impact. Since 2020, global shocks such as the COVID-19 pandemic, climate risks, and geopolitical volatility have increased demands on development institutions to respond rapidly while maintaining accountability and effectiveness (Organisation for Economic Co-operation and Development [OECD], 2020). In

emerging economies, effectiveness increasingly depends not only on financial scale but also on the organizational capacity to learn, adapt, and coordinate across sectors. Dynamic capabilities theory conceptualizes such adaptive capacity as the ability to sense environmental changes, seize opportunities through resource mobilization, and reconfigure organizational arrangements to sustain performance under uncertainty (Teece, 2025). This perspective has gained renewed relevance as scholars emphasize that organizational responsiveness is central to navigating turbulent policy environments and delivering public value (Kattel, 2022; Panagiotopoulos et al., 2023).

Indonesia provides a particularly salient context in which to examine these dynamics. The economy has demonstrated resilience, with real GDP growth projected at approximately 5 percent in 2024 and 5.1 percent in 2025, yet structural vulnerabilities remain, including labor market informality and uneven distributional outcomes (International Monetary Fund [IMF], 2024). Although the national poverty rate declined to around 9 percent, employment quality challenges persist, with a large share of workers engaged in informal or precarious employment (World Bank Group, 2024a). Climate and disaster exposure further complicate development coordination, with substantial portions of districts classified as facing elevated risk, which increases the need for adaptive policy responses and flexible partnerships (World Bank Group, 2023). Within this evolving landscape, the World Bank Group maintains a large and diversified engagement portfolio involving lending, advisory services, and private sector instruments, creating coordination demands that require continual adjustment of strategies and delivery mechanisms (World Bank Group, 2024b).

Despite broad recognition that adaptability matters for development outcomes, the empirical literature on development effectiveness remains dominated by frameworks that emphasize outputs, compliance, and evaluation criteria rather than internal capability processes. OECD guidance notes that evaluation systems can become overly procedural, limiting learning if not carefully contextualized (OECD, 2021). Similarly, research on aid effectiveness highlights that conventional metrics often focus on observable results such as disbursement efficiency or growth outcomes, which may obscure the organizational mechanisms that produce those results (Dreher et al., 2024). As a consequence, effectiveness is frequently treated as an outcome to be measured rather than a process to be explained, leaving limited insight into how development institutions convert information into action.

Dynamic capabilities theory offers a mechanism-oriented lens for addressing this limitation by emphasizing higher-order routines that enable organizations to integrate knowledge, deploy expertise, and renew structures in response to changing conditions (Teece, 2025). Yet public sector research suggests that empirical operationalization of dynamic capabilities remains challenging, particularly because adaptation processes are embedded in political and institutional contexts that shape decision making (Kattel, 2022). Recent systematic reviews further argue that understanding the mediating pathways through which dynamic capabilities influence performance remains a critical frontier, as many studies continue to rely on direct associations without modeling underlying mechanisms (Scheuer & Thaler, 2023). In the context of multilateral development finance, empirical tests of the sensing, seizing, and reconfiguring sequence remain scarce, especially when effectiveness is evaluated through stakeholder perceptions rather than project outputs.

This gap carries significant implications. Dynamic capabilities theory suggests that adaptation emerges from the interaction of sensing environmental signals, mobilizing resources to respond, and transforming organizational arrangements to sustain alignment (Teece, 2025). If effectiveness depends primarily on sensing, then

investments in diagnostics and stakeholder engagement would be sufficient. However, if effectiveness depends on the sequential activation of capabilities, weaknesses in resource mobilization or institutional flexibility could undermine performance even when environmental awareness is strong. Evidence from project management research indicates that capability dimensions often interact in complex ways, with joint presence rather than isolated strength driving outcomes (Bechtel et al., 2023). Understanding these mechanisms is therefore critical for identifying where organizational reforms should focus.

For the World Bank Group in Indonesia, the stakes are amplified by the scale and diversity of its operations and by evolving development priorities. Program reviews highlight the need to adjust interventions in response to changing government priorities, lessons from the pandemic, and emerging global public goods challenges such as climate transition (World Bank Group, 2024b). At the same time, variations in regional risk profiles and sectoral needs require continuous recalibration of partnerships and delivery models (World Bank Group, 2023). Without a clear understanding of how internal capabilities translate into perceived effectiveness, reform efforts risk focusing on information gathering without strengthening implementation or adaptability.

To examine these mechanisms empirically, this study draws on stakeholder perception data from the World Bank Group Country Opinion Survey for Indonesia, which captures evaluations from government, private sector, civil society, and academic stakeholders regarding the institution's effectiveness and responsiveness (World Bank Group Country Opinion Survey Program, 2025). Building on recent calls to model mediating pathways in dynamic capabilities research (Scheuer & Thaler, 2023), the study conceptualizes sensing capability as influencing effectiveness through sequential seizing and reconfiguring processes. The empirical strategy employs a serial mediation framework consistent with regression-based conditional process analysis (Hayes, 2022), allowing assessment of indirect effects and the extent to which capability activation explains perceived effectiveness.

This study contributes in several ways. First, it extends dynamic capabilities theory into the domain of multilateral development finance, demonstrating its relevance for explaining effectiveness in complex policy environments rather than competitive markets alone (Teece, 2025). Second, it complements the development effectiveness literature by shifting attention from evaluation metrics toward internal organizational mechanisms that shape outcomes (Dreher et al., 2024; OECD, 2021). Third, it provides evidence relevant to institutional reform by identifying whether effectiveness is primarily driven by sensing, by resource mobilization, or by adaptive reconfiguration, thereby informing how development organizations can strengthen their capacity to deliver results in uncertain environments.

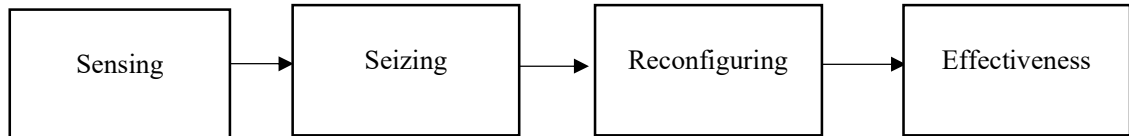
METHODS

Research Design

This study adopts a quantitative research design to test Hypotheses H1 through H6, which collectively examine the mechanism through which organizational sensing capability translates into stakeholder-perceived effectiveness within a multilateral development institution. Grounded in the dynamic capabilities' framework, which conceptualizes adaptation as a sequential process involving sensing, seizing, and reconfiguring (Teece, 2007), the analysis evaluates whether effectiveness emerges through the hypothesized capability activation pathway rather than directly from

environmental awareness. To test H1–H6, we employ a serial mediation design using regression-based conditional process analysis (Hayes, 2022). This approach enables simultaneous estimation of the hypothesized relationships linking sensing to seizing (H1), sensing and seizing to reconfiguring (H2–H3), the effects of seizing and reconfiguring on effectiveness (H4–H5), and the full serial mediation pathway through which sensing influences effectiveness (H6). The design allows direct assessment of whether the dynamic capabilities sequence operates as theorized.

Figure 1. Conceptual framework



Data Source and Sample

Data were drawn from the World Bank Group Indonesia Country Opinion Survey Fiscal Year 2025, a structured stakeholder perception survey designed to capture external assessments of the institution’s effectiveness, responsiveness, and sectoral engagement. The survey targets respondents with direct experience interacting with the World Bank Group, including national and subnational government officials, civil society organizations, private sector actors, academic institutions, development partners, and internal staff. This multi-stakeholder design provides a broad vantage point on organizational performance and reduces the risk of single-source managerial bias. The initial dataset comprised 340 respondents. After treatment of missing responses and screening for multivariate outliers, the final analytic sample consisted of 265 observations. The resulting sample size exceeds commonly recommended thresholds for mediation analysis and provides sufficient statistical power to detect indirect effects (Hayes, 2022).

Measures

All constructs were operationalized using items from the World Bank Group Country Opinion Survey (COS) for Indonesia and measured on a ten-point response scale (1 = lowest evaluation; 10 = highest evaluation). Explicit reference to item codes from the survey codebook enhances replicability and transparency in construct operationalization. Sensing capability reflects stakeholders’ perceptions of the organization’s effectiveness in identifying needs and maintaining situational awareness through engagement with key actors in the development ecosystem. This construct captures boundary-spanning activities and environmental interpretation. It was operationalized as the mean of three items assessing effectiveness in collaborating with national government (C2_1), civil society organizations (C2_5), and academia or research institutions (C2_7). These items collectively capture the organization’s ability to gather information and understand evolving stakeholder expectations.

Seizing capability represents the organization’s capacity to mobilize and deploy expertise across core development domains. Consistent with the theoretical definition of seizing as translating insights into coordinated action, this construct was modeled as a second-order composite derived from perceived effectiveness across

sectoral areas. Items included human capital indicators (B3_1–B3_5), infrastructure indicators (B4_1–B4_5), institutional strengthening indicators (B5_1–B5_8), and sustainability indicators (B6_1–B6_5). Domain-level means were first computed within each thematic block and subsequently averaged to form a global seizing index, reflecting the breadth of expertise deployment across the organization's portfolio.

Reconfiguring capability captures perceptions of organizational adaptability and flexibility in adjusting strategies and partnerships in response to changing conditions. This construct was operationalized using the mean of responsiveness to country needs (C1_1) and flexibility when circumstances change (C1_3), which reflect adaptive renewal processes consistent with dynamic capabilities theory.

Organizational effectiveness was measured using respondents' overall assessment of the World Bank Group's effectiveness in helping Indonesia achieve development results (A2). This item provides a holistic evaluation of perceived performance across engagements and serves as the dependent variable.

Composite scores were calculated as arithmetic means of available items following recoding of non-substantive responses (e.g., "Don't know," coded as 11) and administrative missing values to missing. This approach preserves scale properties and minimizes bias associated with item nonresponse while maintaining comparability across constructs.

Data Preparation

Survey responses coded as "Don't know" or administratively missing were treated as missing values prior to analysis. Composite scores were computed using available item responses, and cases with missing data on key model variables were excluded through listwise deletion. The decision to use complete-case analysis reflects the focus on estimating relationships among observed constructs without introducing imputation assumptions. The hypothesized relationships were tested using a serial mediation model consistent with PROCESS Model 6 (Hayes, 2022). The model estimates the effect of sensing capability on effectiveness through two mediators representing seizing and reconfiguring capabilities while simultaneously accounting for direct and indirect pathways. Indirect effects were evaluated using bias-corrected bootstrap confidence intervals based on 5,000 resamples, a procedure widely recommended for mediation analysis because it does not rely on normality assumptions for the sampling distribution of indirect effects (Preacher & Hayes, 2008). An indirect effect was considered statistically significant when the confidence interval excluded zero.

The analysis focuses on three theoretically relevant pathways: the indirect effect through seizing alone, the indirect effect through reconfiguring alone, and the full sequential pathway linking sensing to effectiveness through both mediators. Evidence of full mediation is inferred when the direct effect of sensing becomes non-significant after accounting for mediators while indirect effects remain significant, consistent with contemporary perspectives on mediation inference (Zhao et al., 2010). Prior to estimation, standard diagnostic procedures were conducted to assess linear regression assumptions. Distributional properties were examined through skewness

and kurtosis statistics, multicollinearity was evaluated using variance inflation factors, and homoscedasticity was assessed through residual diagnostics. The data satisfied conventional thresholds, supporting the validity of parameter estimation.

FINDINGS

Table1. Serial Mediation Results: Dynamic Capabilities and WBG Effectiveness

Path	Coefficient (β)	p-value
Sensing \rightarrow Seizing (a_1)	0.741	< 0.001
Sensing \rightarrow Reconfiguring (a_2)	0.466	< 0.001
Seizing \rightarrow Reconfiguring (d_{21})	0.487	<0.001
Seizing \rightarrow Effectiveness (b_1)	0.622	< 0.001
Reconfiguring \rightarrow Effectiveness (b_2)	0.189	0.011
Direct effect (c')	0.084	0.263

Table 2. Indirect Effects (Bootstrapped 5,000 samples)

Pathway	Effect	95% CI	Significant
Ind1: Sensing \rightarrow Seizing \rightarrow Effectiveness	0.461	[0.328, 0.600]	Yes
Ind2: Sensing \rightarrow Reconfiguring \rightarrow Effectiveness	0.088	[00.009, 0.176]	Yes
Ind3: Sensing \rightarrow Seizing \rightarrow Reconfiguring \rightarrow Effectiveness	0.068	[00.007, 0.139]	Yes
Total indirect effect	0.617	[0.472, 0.782]	Yes

Note: Estimates derived from PROCESS Model 6 with bias-corrected bootstrap confidence intervals.

Results of the serial mediation analysis are summarized in Table 1. The model exhibits strong explanatory power across the capability sequence, accounting for 56.0% of the variance in seizing capability, 68.6% in reconfiguring capability, and 58.8% in stakeholder-perceived effectiveness, indicating that the dynamic capabilities framework captures substantial variation in perceived organizational performance.

Consistent with the theorized capability activation logic, sensing capability is strongly associated with seizing capability ($\beta = 0.741$, $p < 0.001$), suggesting that greater effectiveness in engaging stakeholders and interpreting environmental signals is closely linked to perceptions of the organization's ability to mobilize and deploy expertise across domains. Sensing also demonstrates a positive association with

reconfiguring capability ($\beta = 0.466$, $p < 0.001$), indicating that environmental awareness relates not only to expertise deployment but also to perceived responsiveness and flexibility. In addition, seizing capability is positively related to reconfiguring capability ($\beta = 0.487$, $p < 0.001$), consistent with the view that resource mobilization supports adaptive adjustment.

With respect to performance outcomes, seizing capability emerges as the dominant predictor of effectiveness ($\beta = 0.622$, $p < 0.001$), whereas reconfiguring capability contributes a smaller yet statistically meaningful incremental effect ($\beta = 0.189$, $p = 0.011$). The direct association between sensing and effectiveness is not statistically distinguishable from zero ($\beta = 0.084$, $p = 0.263$), indicating that sensing alone does not translate into perceived effectiveness once downstream capabilities are taken into account.

Bootstrapped indirect effects further clarify the mechanism. The largest pathway operates through seizing capability (indirect effect = 0.461, 95% CI [0.328, 0.600]), indicating that the primary way in which sensing contributes to effectiveness is by strengthening the organization's capacity to deliver sectoral expertise. A smaller but significant pathway operates through reconfiguring capability (indirect effect = 0.088, 95% CI [0.009, 0.176]). Importantly, the full sequential pathway linking sensing to effectiveness through both seizing and reconfiguring is also supported (indirect effect = 0.068, 95% CI [0.007, 0.139]), consistent with the dynamic capabilities proposition that adaptation unfolds through an integrated sequence of activities.

Taken together, the pattern of results indicates that sensing capability exerts its influence primarily through capability activation rather than direct effects. Seizing represents the central conduit through which environmental awareness is converted into stakeholder-recognized performance, while reconfiguring provides complementary adjustment that enhances alignment with evolving conditions. The absence of a direct sensing effect alongside significant indirect pathways is consistent with a full mediation pattern, suggesting that effectiveness is shaped by the organization's ability to translate insight into action and adaptation rather than by awareness alone.

DISCUSSION

The findings indicate that organizational effectiveness in complex institutional environments is best explained as an outcome of sequential capability activation rather than direct environmental awareness. Consistent with dynamic capabilities theory, sensing does not directly translate into stakeholder-perceived effectiveness once downstream processes are accounted for, suggesting that awareness must be converted into resource mobilization and organizational adaptation to generate observable value (Teece, 2007). This pattern aligns with empirical research showing that dynamic capabilities influence performance primarily through mediating mechanisms such as operational alignment, innovation, and learning processes rather than through direct effects (Scheuer & Thaler, 2023). The evidence therefore reinforces the view that sensing represents latent potential that becomes consequential only when coupled with execution and renewal.

The results further highlight seizing capability as the dominant pathway through which effectiveness is realized, indicating that stakeholders place greatest weight on the organization's ability to deploy expertise and translate knowledge into actionable solutions. This finding is consistent with studies demonstrating that resource orchestration and managerial capability constitute critical drivers of organizational performance because they convert strategic intent into coordinated action (Teece et al., 1997). In parallel, empirical evidence from project and organizational contexts shows that capability deployment plays a central role in shaping performance outcomes by enabling alignment between environmental demands and operational responses (Bechtel et al., 2023). The smaller but significant contribution of reconfiguring capability underscores the complementary role of organizational flexibility, suggesting that adaptive adjustment enhances effectiveness by sustaining alignment under changing conditions.

The confirmation of a significant serial pathway linking sensing, seizing, and reconfiguring provides direct empirical support for the processual logic of the dynamic capabilities' framework. Rather than functioning as independent attributes, the capabilities operate as an integrated sequence in which environmental interpretation informs resource mobilization, which in turn enables organizational renewal. This finding responds to calls within the literature to move beyond aggregate tests of dynamic capabilities and instead examine the mechanisms through which they operate (Scheuer & Thaler, 2023). Moreover, the results extend dynamic capabilities theory into the context of multilateral development institutions, supporting arguments that the framework retains explanatory relevance in public and hybrid organizations characterized by political complexity and multi-stakeholder governance (Kattel, 2022).

These insights carry implications for both theory and practice. Theoretically, the findings challenge interpretations that equate stakeholder engagement or environmental awareness with effectiveness, emphasizing instead the importance of capability activation processes. For development effectiveness research, the results suggest that organizational performance cannot be fully understood through outcome indicators alone but requires attention to how institutions mobilize expertise and adapt delivery mechanisms. Practically, the evidence implies that strengthening execution capacity and institutional flexibility may yield greater gains in perceived effectiveness than investments in diagnostic processes alone. At the same time, the cross-sectional design limits causal inference, pointing to the value of longitudinal and multi-method research to examine how capability sequences unfold over time and across stakeholder groups.

Notwithstanding its contributions, this study is subject to several limitations that open avenues for further inquiry. First, the cross-sectional nature of the data constrains causal inference regarding the temporal sequencing implied by the dynamic capabilities' framework, as sensing, seizing, and reconfiguring are inherently evolutionary processes that unfold over time. Longitudinal designs or panel data would allow future research to examine how capability activation trajectories shape effectiveness across different phases of development programs or policy cycles. Second, the analysis relies on stakeholder perceptions, which, while appropriate for

capturing relational effectiveness in multilateral settings, may be influenced by cognitive biases or differential exposure to organizational activities. Combining perceptual measures with objective indicators such as project performance metrics or portfolio outcomes could strengthen robustness and provide a richer understanding of capability-performance linkages. Third, the empirical context focuses on a single country case, and although Indonesia represents a complex and policy-relevant setting, generalizability to other institutional environments remains an open question. Comparative studies across countries or multilateral organizations could assess whether the relative importance of sensing, seizing, and reconfiguring varies with institutional maturity, governance structures, or levels of environmental turbulence. Finally, future research could explore boundary conditions and microfoundations, including leadership practices, organizational culture, or political constraints, to better understand when and how dynamic capability sequences translate into development effectiveness. Such extensions would deepen theoretical insight into capability activation mechanisms and inform institutional strategies for enhancing adaptive performance in complex policy environments.

CONCLUSION

This study shows that stakeholder-perceived effectiveness in a multilateral development institution emerges from a structured process through which environmental awareness is translated into coordinated action and adaptive renewal. The evidence indicates that the ability to engage diverse stakeholders strengthens the organization's capacity to mobilize expertise across sectors, which in turn supports flexible adjustment of partnerships and delivery arrangements as conditions evolve. Importantly, awareness alone does not directly enhance perceived effectiveness; its influence materializes only when supported by effective deployment and adaptive capabilities, highlighting the interdependence of organizational processes. By demonstrating that effectiveness is shaped by an integrated sequence of sensing, mobilization, and reconfiguration, the findings reinforce the view that institutional impact depends on how organizations convert insights into operational responses rather than on diagnostic capacity alone. This perspective extends understanding of organizational adaptation in complex policy environments and underscores that strengthening execution and flexibility alongside stakeholder engagement is central to sustaining credibility and delivering development results.

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