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Impact of Institutional and Business Distance on Subsidiary Performance: The Mediation of Subsidiary Entrepreneurship

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Abstract

Purpose – This study aims to identify the importance of subsidiary entrepreneurship as a key factor when MNE attempts to invest in challenging overseas markets. Through the simultaneous consideration of institutional theory and entrepreneurship theory, this study would like to examine how Korean subsidiaries in the Middle East improve their performance locally.

Design/methodology – To reflect the characteristics of emerging markets, this study conducted a survey of Korean subsidiaries in the Middle East in cooperation with KOTRA and analyzed the hypotheses using a structural equation model based on 249 valid responses.

Findings – The findings of this study are as follows. First, we found that institutional and business distance would positively affect subsidiaries' entrepreneurship. The result that subsidiaries' entrepreneurship is positively affected by institutional and business distance implies that attempts to close the difference between heterogeneous markets would increase subsidiaries' innovative proactiveness, such as R&D and creative marketing strategies. Second, we confirmed that the institutional and business distance positively mediate the subsidiaries' entrepreneurship growth, leading to high performance. Therefore, Korean subsidiaries are required and prepared to establish strategies to better understand institutional and business distances in advance and reduce the liability of foreignness by conducting customized research and training programs before sending Korean expatriates to local subsidiaries in the Middle East.

Originality/value – This study contributed to institutional and entrepreneurship theory by proving the traditional relationship between institutional and business distance to subsidiaries' performance and the mediation of subsidiary entrepreneurship.

Keywords: Business Distance, Emerging Markets, Entrepreneurship, Institutional Distance, Middle East Market
JEL Classifications: F23, L23, L62

1. Introduction

The Middle East region has long been recognized as a potential market with considerable economic promise. With over 575 million consumers, the region is of significant interest to international businesses seeking to expand their global reach. The International Monetary Fund's (IMF) 2022 report forecasts that the region's growth rate of 3.6% will surpass the

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global average rate of 2.7% in 2023, making it an even more attractive destination for investment. Furthermore, the ongoing mega-transformation and diversification of industry and energy mix in the Middle East, fueled by its oil money, are contributing to what is referred to as the so-called “Arabian Dream.” This initiative is exemplified by “Vision 2030.” Regarding the size of sovereign wealth funds, the UAE ranks third, Kuwait fourth, Saudi Arabia eighth, and Qatar eleventh, all actively being used to launch new projects that pique the interest of multinational enterprises (MNEs) and the international financial markets.

However, at the same time, the region is regarded as one of the most challenging markets to access for multinational firms due to its remarkably diversified language, ethnicity, and religion. There are many different political and economic systems among the region’s nations. Moreover, because of sensationalistic media coverage, the Middle East region has lagged behind other developing countries in East Asia and Latin America in terms of luring FDI (UNCTAD, 2006).

Institutional attributes, such as authorized representatives or localization policies, are often seen as major differences that hinder foreign business activities in the Middle East. Authorized representative policies require foreign businesses to partner with a local representative with legal authority to act on their behalf. This can pose challenges for foreign firms, as finding a reliable and trustworthy local representative can be demanding. Similarly, localization policies require foreign businesses to hire and train local employees, which can be costly.

In addition, business attributes can also pose challenges to foreign businesses. Religion-driven business practices (e.g., adhering to halal food standards and observing prayer times) can pose challenges for foreign firms unfamiliar with these practices. Family business networks are also prevalent in the Middle East and can make it difficult for foreign businesses to compete with established local players. Another significant business attribute is using IBM (Inshallah-As God’s will, Bukra-Tomorrow, and Malish-No matter) in business practices.

From the 1970s onwards, there has been a reciprocal growth in economic significance between South Korea (hereafter referred to as Korea) and several Middle Eastern nations. Amid the Middle East’s oil boom, Korean businesses had the chance to expand their regional operations (Levkowitz, 2010). In the 2010s, the so-called “another Middle East boom” led to a significant increase in Korean exports to Middle Eastern countries, from 7.6 billion USD in 2000 to 32.9 billion USD in 2011, accompanied by a corresponding rise in direct Korean investment. This investment resulted in the establishment of many overseas offices by Korean firms, particularly in the construction and engineering industries. (Levkowitz, 2010b)As of 2020, 194 Korean companies were active in 18 Middle Eastern countries, including the GCC, Iraq, Israel, and Morocco (MOFA, 2020). The trade and investment would see exponential growth, as the crown prince of Saudi Arabia recently visited Korea and made 30 billion USD in deals. Still, Korean companies consider the Middle East a tough market due to its institutional and cultural differences.

Institutional and business distance have frequently been cited as important factors to take into account when a firm enters emerging countries. The argument has been made that various factors moderate the relationship between institutional distance and the performance of MNE subsidiaries. Such a stream of IB literature includes entry mode (Younis and Elbanna, 2022), subsidiary ownership strategies (Gaur and Lu, 2007), and MNE's international diversity (Chao and Kumar, 2010). Although doing business in nations with different regulatory structures has drawbacks, according to Gaur and Lu (2007), institutional arbitrage is possible in distant regulatory environments. Additionally, they discovered a U-shaped association between regulatory and institutional distance and the survival of foreign subsidiaries. According to Konara and Shirodkar (2018), emerging markets offer distinctive and significant circumstances for reevaluating the impact of regulatory and institutional distance on the performance of overseas affiliates. However, research on the costs of being a foreign company generally contends that when MNE subsidiaries perceive a high level of institutional distance, they face greater uncertainty about the host environment and must incur high costs for learning and adapting to the local "rule of the game." As a result, these subsidiaries' competitive advantages tend to decline (Park and Roh, 2019; Shirodkar and Konara, 2017).

Studies have proven that business distance, such as cultural differences and market structure, affects an MNE's performance. Azar and Drogendijk (2014) found that the negative effect of business distance on firm performance was more pronounced for emerging market firms than for their counterparts in developed markets. They investigated that the negative impact of business distance on emerging market firms' performance was partially mitigated by their absorptive capacity, which refers to their ability to acquire and utilize knowledge from their foreign operations. Vahlne and Johanson (2017) developed the business distance perspective and proposed that firms can overcome the challenges of business distance by developing new resources and capabilities, as well as leveraging existing ones, to reduce the gap between themselves and the foreign market. Azar and Drogendijk (2019) found that business distance can have a detrimental impact on firm performance but suggested that business networks may offer a potential solution to mitigate these negative effects.

Some studies focused on the importance of entrepreneurship as a critical solution for entering unfamiliar foreign markets. Tavakoli and McKiernan (1999) argue that entrepreneurship helps MNEs access various resources and market information. According to Audretsch and Keilbach (2004), entrepreneurship is closely related to subsidiary performance because it can improve overall competitiveness. So, by distributing various product and process innovations created in various national markets throughout an MNE's network, entrepreneurship can lower the risk of subsidiary business failures and promote greater performance in innovation (Ghoshal and Bartlett, 1990; Zahra and Garvis, 2000). Avlonitis and Salavou (2007) also argued that entrepreneurship positively affects innovative management. Tracey and Phillips (2011) emphasized the significance of the institutional context in determining the nature of entrepreneurship in emerging markets. They argued particularly that, while significant institutional uncertainty in emerging countries might be a deterrent to entrepreneurship, it can also present crucial entrepreneurial chances. Despite the above backdrop, few studies have paid attention to the relationship between institutional, business distance, and subsidiary performance in the Middle East context. Moreover, there is a lack of consideration of the hypothesis that institutional and business distance can affect subsidiaries' entrepreneurship. Therefore, our key research questions focus on these factors in light of the above. In the following ways, we hope to contribute to the existing literature. First, this study emphasized the significance of subsidiary entrepreneurship as a key factor, particularly when MNEs attempt to invest in challenging foreign markets such as the Middle East. Second, this study expanded traditional institutional theory while simultaneously considering a firm's entrepreneurship in the emerging market. While the existing studies consider institutional distance a challenge to overcome, our study regards institutional and business distance as antecedent triggers for an MNE subsidiary's entrepreneurship. That is to say, actively filling the gap between business and institutional distance would reduce the liability of foreignness (LoF), positively impact the entrepreneurship of subsidiaries, and eventually contribute to the performance of subsidiaries.

Last but not least, although most literature has focused on the subsidiary performance of developed countries in emerging markets, only a few studies have examined the subsidiary performance of middle-income countries in emerging markets. Williams, Colovic, and Zhu (2017) found that MNE subsidiary performance in an emerging market depended on locally hired managers and that integration-responsiveness (I-R) played a role in outperformance in Chinese subsidiaries. Ours is one of the few studies examining the mediating effect of entrepreneurship between institutional factors and the performance of Korean subsidiaries in the Middle East. We would like to provide a timely implication as more Korean subsidiaries are expected to invest and establish subsidiaries in the Middle East following Saudi Arabia and Korea's recent mega-deal in 2022.

The remainder of our paper is organized as follows: In Section 2, we review the theoretical background of the linkages among institutional distance, business distance, and subsidiary performance and put forth our hypotheses on the relationship between the subsidiary's entrepreneurship. We then describe our methodologies- survey, sample, and verification of measurement in section 3. In Section 4, we present our findings by PLS-SEM. Finally, we summarize our contributions and limitations, as well as potential future research directions.

2. Literature Review and Hypothesis Development

Based on institutional theory, we connect with existing discussions on entrepreneurship in emerging markets. MNEs leverage their positions across multiple institutional environments and achieve competitive advantage by transferring learned or developed practices from existing institutional environments to new ones (Roth and Kostova, 2003). The internationalization of MNEs has received attention in the past decades in the study of strategy, marketing, and entrepreneurship. For example, Kusi, Gabrielsson, and Kontkanen (2021) examined the concerns of MNEs entering foreign markets in connection with entrepreneurship (Kontinen and Ojala, 2010; Ojala, 2015). These studies emphasized the importance of entrepreneurship in resolving the cultural, psychic, and institutional distances in countries where MNEs have entered. In this vein, academics have increasingly relied on institutional theory to comprehend the process of supporting entrepreneurship in emerging economies as MNEs accelerated their entry there to gain a location advantage. Concerns about both formal institutions (e.g., laws, technologies, and the regulatory environment) and informal institutions (e.g., values, practices, and norms) that have been witnessed to have a significant impact on entrepreneurial behavior are what define the institutional theory (Morris, Avila, and Allen, 1993). Because it is explicitly interested in institutional change as well as the role of players in influencing institutional processes, institutional theory offers a compelling viewpoint for exploring various types of entrepreneurship (Phillips and Tracey, 2007). Hoskisson et al. (2011) noted that institutional theory is excellent at explaining its impact on entrepreneurial activity in the early stages of market emergence. Baron (1998) argued that institutional distance could be regarded as a specific perception for entrepreneurs of MNEs, and scholars such as (Oviatt and McDougall, 2005; Zahra, 2005) emphasize that recognized institutions in overseas markets play an essential role in promoting entrepreneurship in subsidiaries. Meanwhile, a notable characteristic of emerging markets is that the institutions underpinning them are often unstable and underdeveloped (Meyer, 2001). MNEs entering emerging markets often face these institutional risks and focus their resources and capabilities on coming up with ways to address them. Ahlstrom and Bruton (2006) emphasized that understanding this is a key factor in the survival of a subsidiary because fundamental and comprehensive institutional changes characterize it as emerging economies mature. Fortwengel and Jackson (2016) explained that the entrepreneurship of MNEs in emerging markets plays an important role in structuring business activities from an institutional perspective. In other words, MNEs frequently take on the role of institutional entrepreneurs, and their actions may serve as significant structured events that help institutionalize emerging markets (Dimaggio, 1988). Thus, institutional theory offers a useful framework for how MNEs in developing markets can make use of the institutional environment and add value by resolving institutional issues (Hoskisson et al., 2000). We propose that institutional and business distance will have a significant impact on entrepreneurship in generating performance for subsidiaries entering emerging markets.

2.1. Entrepreneurship and Subsidiary Performance

Entrepreneurship is a positive attitude toward the existing uncertainty in corporate management. It can be defined as a kind of risk-taking tendency for managers or organizations, as an attitude to actively respond to market changes by capturing and challenging new market opportunities and carrying out continuous innovation (Covin and Slevin, 1991). Scholars specify entrepreneurship in various forms, including changes and innovation activities to adapt to new environmental transformations conducted at the strategic level of a firm, in addition to general technological innovation (Zahra, 1996). In the context of MNEs, entrepreneurship focuses on subsidiary initiatives to examine the active behavior of subsidiaries conducting business in the local market (Birkinshaw, 1997). It includes new product development activities that reflect the preferences of the local market and process innovation to promote production efficiency (Verbeke and Yuan, 2013). In a similar vein, an expanding body of research emphasizes how crucial entrepreneurship is to the overall success of MNEs. Several researchers, including Zahra and Covin (1995), explain that entrepreneurship often contributes to MNEs' competitive advantage in existing or emerging markets (Stopford and Baden-Fuller, 1994). Prahalad and Oosterveld (1999) argue that MNEs rely on entrepreneurial development in subsidiaries and at headquarters to develop new markets and build new technologies that can achieve superior performance. Audretsch and Keilbach (2004) point out that entrepreneurship is closely related to subsidiary performance because it can increase overall competitiveness by improving business diversity and creating and delivering the knowledge needed for a subsidiary's competitive advantage (Lee, Yang, and Roh, 2020). Sarabi et al. (2020) explained that managers of MNEs have an important influence on the subsidiaries' value and that their entrepreneurship is positively related to subsidiary performance. As such, entrepreneurship can reduce the risk of subsidiaries' business failures and promote greater performance in innovation by spreading various product and process innovations developed in various national markets throughout an MNE's network (Ghoshal and Bartlett, 1990; Zahra and Garvis, 2000). Thus, we suggest the following hypothesis.

Hypothesis 1. Entrepreneurship positively affects an MNE subsidiary performance.

2.2. Institutional Distance

The essence of institutional theory is that organizational actors seek organizational success under institutional restrictions (Meyer et al., 2009). The normative, cognitive, and regulatory characteristics of international business influence the strategy and operations of overseas affiliates (Dimaggio, 1988). Meyer (2001) claims that it mediates MNE acceptance of norms and practices within a socially built system of standards, rules and cognitive frameworks in various host settings. Institutional distance, which refers to the extent to which institutions in the home country and host countries differ, has been used to characterize the difficulties encountered by multinational corporations seeking to establish operations in various countries. Institutional distance is especially worrisome for Western multinational enterprises operating in emerging economies, where differing regulatory systems may hinder international commerce (Henisz, 2003). According to Kostova and Zaheer (1999), the greater the institutional gap between the home and host countries, the more difficult it is for MNEs to gain legitimacy and transfer practices. According to Xu and Shenkar (2002), enormous institutional distances create competing demands for the host country's outward legitimacy (or local responsiveness) and internal consistency (or globalization) inside MNE networks. As a result, the more the host economy deviates from the MNE's preferred environment, the more difficult the adaptation. These theoretical considerations show that the various degrees of distance may influence strategic decisions in international companies in very diverse (Arslan and Larimo, 2011; Zhang et al., 2014). Shirodkar and Konara (2017) contend that institutional variations between headquarters and host nations influence investors' internal exchange of knowledge and practices as well as their exterior drive for legitimacy in the local environment. Accordingly, institutionally distinctive contingencies must be considered when designing entry strategies. Moore et al. (2015) examined entrepreneurship as the normative and cultural awareness distance increased. Moreover, Kostova and Zaheer (1999) emphasized that the greater the institutional gap between the subsidiary and the nation in which it operates, the more complicated and risky it might be for businesses in developing markets to switch provided systems and build new organizational fields. As such, MNEs are likely to have more difficulty protecting and utilizing corporate-specific resources in countries where systems are inefficient or insufficient (Gaur and Lu, 2007).

In this vein, previous research has highlighted the impact of institutional distance on the performance of foreign subsidiaries operating in developing countries (Chao and Kumar, 2010; Konara and Shirodkar, 2018). For example, Xu and Shenkar (2002) examined the effect of institutional distance on the performance of foreign corporations that have entered developing countries. Gaur and Lu (2007) found that institutional distance had a significant impact on subsidiary performance in emerging markets. Therefore, the institutional context of emerging markets is expected to promote entrepreneurial activities and incidental performance in connection with the driving force of MNEs' competitive advantage, and the following hypothesis is suggested.

Hypothesis 2a. Institutional distance positively affects entrepreneurship.
Hypothesis 2b. Institutional distance positively affects an MNE subsidiary performance.

2.3. Business distance

In achieving the performance of MNEs, the institutional aspect and business distance, including cultural and psychic distance, play essential antecedents. Extant studies examining the internationalization process of MNEs have focused on similarities with their home countries in establishing the production bases of firms in overseas markets (Johanson and Vahlne, 2009). Vahlne and Johanson (2017) pointed out that entrepreneurs seek opportunities in familiar overseas markets to reduce the risks of business distance. Meanwhile, opportunities arising from the rise of emerging economies such as China and India have increased multinationals' interest in business-distant markets, called "institutional voids" (Ratten et al., 2007). Therefore, entrepreneurship has been drawing attention as it becomes vital to understand a firm's internationalization and review how entrepreneurs take risks and manage them (Shrader, Oviatt, and McDougall, 2000). Several studies have explored the relationship between business distance and entrepreneurship's pursuit of business possibilities (Fitzsimmons and Douglas, 2011; Krueger, Liñán, and Nabi, 2013). They expect that entrepreneurship is a manager's unique perceptual composition, and entrepreneurship will have different opportunistic perceptions concerning overseas markets. Although business distance may hinder internationalization, foreign market opportunities would drive localized action as the entrepreneur "may not see national boundaries as an obstacle, but rather sees international markets as open and waiting to be exploited" (Madsen and Servais, 1997). Several empirical studies have found a positive relationship between the effect of business distance and subsidiary performance (Evans and Mavondo, 2002; O'grady and Lane, 1996). Evans and Mavondo (2002) confirmed that psychic distance has a significant proportion of the variance in financial performance and strategic effectiveness. Dikova (2009) documented that there is a significant impact on the relationship between psychic distance and the performance of foreign subsidiaries.

Therefore, in the globalizing world, entrepreneurship that can recognize and catch opportunities and entrepreneurs' perceptions of business distance to foreign markets can act as triggers in creating subsidiaries' performances. Thus, we put forth the following hypothesis.

Hypothesis 3a. Business distance positively affects entrepreneurship.
Hypothesis 3b. Business distance positively affects an MNE subsidiary performance.

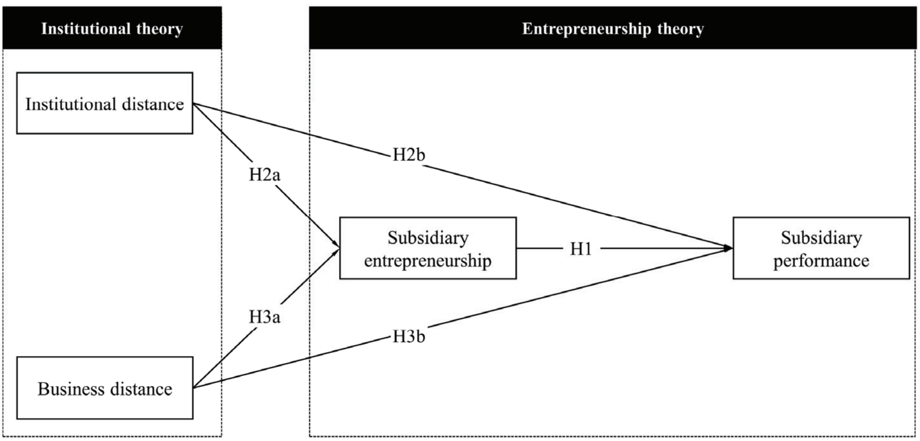

Fig. 1. Research Model.

3. Methodology

3.1. Research Context and Sample

The Middle East market is attracting more attention from transitional and developed countries, including South Korea, due to the responsible business practices of local firms. The potentiality of the Middle East market raises the value of importance and business opportunities (Salam, Jahed, and Palmer, 2022). However, to enter an emerging country around the Middle East, a sufficient preliminary investigation of the target country is necessary, along with the challenging preparation process for the actual entry. In setting up a consumer goods subsidiary in Iran, Dutch-based Unilever had to examine the specific preferences, purchasing behaviors, and tastes of Iranian consumers; eventually, in food product manufacturing, Unilever signed a joint venture partnership with Golestan to keep up with the market's sophistication. Such a market-fit strategy is also required when entering emerging countries such as China, Brazil, and the Middle East. Since localism rather than global standards is still prevalent in emerging countries, it is vital to figure out which norm dominates the market rather than try to overcome its ever-changing nature. Therefore, emerging countries' substantial business and institutional distances may have acted as barriers to growth for MNE's subsidiaries (Zhao and Guo, 2022).

Family businesses, which comprise 90% of all companies in the Arab Middle East, employ 80% of the workforce and contribute to 60% of the region's GDP. Since family businesses in the Arab world are inherent in a collectivist culture, the practice of nepotism, in which family members are hired and treated preferentially, can be considered a business distance between developed countries and the Middle East (Samara, 2021). In addition, discriminatory treatment for each country exists. For example, although Saudi Arabia encourages foreign investment in principle, 100% foreign investment is rare, and various benefits require a 25% stake in Saudi Arabia as a minimum requirement (IMF, 2019). Domestic companies in Saudi Arabia are exempt from income tax, but foreign companies, including joint ventures, are subject to a 20% income tax. Some Middle Eastern countries operate an exclusive system that allows foreigners to conduct business activities only through sponsors. Since banking transactions, visa issuance arrangements, and various business activities are performed under the sponsor's endorsement, operational restrictions, and various disadvantages coexist.

Regarding this contextual situation, this study surveyed Korean companies that entered the Middle East in cooperation with KOTRA (the Korea Trade-Investment Promotion Agency). KOTRA is one of the most reliable trading organizations, established to support companies that have entered or are planning to enter overseas. The questionnaire was prepared by first reviewing the existing literature and then holding a meeting with KOTRA working-level members. The questionnaire items for each variable, mainly used in previous studies, were slightly modified for our research design. The questionnaire was delivered to the KOTRA Middle East Trade Center and mailed to 300 companies operating local businesses. 250 questionnaires were returned, and only 1 missing value was found during the gathering process; 249 valid responses were selected as the final sample. The response rate was 83%, which is relatively high. Most of the respondents were at the level of department heads or directors, a position in which they could suggest opinions on the survey questions intended for our research purpose.

3.2. Variables and Measurement

To measure subsidiary performance, a questionnaire was constructed on revenue, market share, and overall satisfaction in the local market compared to competitors (Ambad, Wahab, and Society, 2016; Han, 2021; Williams, Colovic, and Zhu, 2017). Referring to Wang and Chung (2020), we measured institutional distance by the extent to which the foreign market is similar to or different from the domestic market in terms of political systems, legal systems, and regulations. With a conceptual approach similar to institutional distance, the business distance was measured through three questions about the political and economic environment and business practices (Azar and Drogendijk, 2014). Lastly, subsidiary entrepreneurship was measured by questions about R&D, technology, new products and services, management techniques, creative marketing strategies, and innovation resources for the local market (Felzensztein et al., 2015). The latent variables used in this study consisted of 4 and were measured using a 7-point Likert scale ranging from 1 point for "not at all" to 7 points for "very much."

3.3. Analysis Method

After identifying optimum factors by factor analysis, PLS-SEM is a consistent technique that can increase the explanatory power of each latent factor's impact on the dependent variable. Since there is no constraint on normality in this setting, multivariate analysis can be performed without concern for sample size (Hair et al., 2016). Using *plssem* command in STATA 16, all procedures necessary for PLS-SEM verification were carried out: reliability of latent variables, confirmatory factor analysis, discriminant validity, and convergent validity. The Sobel test was performed through bootstrapping to verify the significance of the mediating effects (Zhao et al., 2010).

Table 1. Sample Demographic

Variable	Category	Frequency (N)	Percent (%)
Respondent's position	Manager	42	16.86
	Senior manager	41	16.47
	Director	79	31.73
	Senior director	59	23.69
	Executive	28	11.24
Industry	Manufacturing	148	59.44
	Service	84	33.74
	Others	17	6.83
Number of employees	< 11	42	16.87
	11-30	53	21.29
	30-50	44	17.67
	51-100	46	18.47
	101-200	21	8.43
	> 200	43	17.27

3.4. Descriptive Statistics and Confirmatory Factor Analysis

Table 1 shows the demographic information of the respondents and firms used in the study. First of all, as for the position of survey respondents, the director had the most with 31.73% (N = 79), followed by the senior director with 23.69% (N = 59). Regarding industry, manufacturing accounted for 59.44% (N = 148), and service accounted for 33.74% (N = 84). For the number of employees, most responses are evenly distributed.

We investigated whether our sample and response are plausible for reliability, convergent and discriminant validity, and internal consistency among items. Table 2 shows the results of the confirmatory factor analysis. To reach high reliability and effectiveness of the study, observed variables less than 0.7 in standardized factor loading were excluded, and then a total of 16 observed variables were selected. The standardized factor loading (SFL) of each observed variable was greater than 0.8, exceeding the recommended level of 0.7, and all were significant at the 0.001 level (Hair et al., 2009).

Table 2. Confirmatory Factor Loading, Mean and Standard Deviation

Construct	Item	Scale item	SFL	Mean	SD
Subsidiary performance	SP1	Revenue growth	0.95	4.63	1.44
	SP2	Market share growth	0.95	4.57	1.40
	SP3	Customer growth	0.97	4.58	1.41
	SP4	Overall satisfaction	0.94	4.71	1.42
	SP5	Overall growth	0.92	4.64	1.39
Institutional distance	ID1	Political system	0.93	5.10	1.33
	ID2	Legal system	0.93	5.43	1.35
	ID3	Regulation	0.79	4.85	1.45
Business distance	BD1	Political environment	0.93	4.41	1.35
	BD2	Economic environment	0.91	4.56	1.29
	BD3	Business practices	0.84	4.46	1.48
Subsidiary entrepreneurship	SE1	R&D, technology, and innovation	0.82	6.02	1.02
	SE2	New product or service	0.88	6.06	0.99
	SE3	Management techniques	0.87	5.55	1.21
	SE4	Creative marketing strategy	0.85	5.74	1.17
	SE5	Innovative resources development	0.82	5.42	1.22

Notes: All SFLs are significant at $p < 0.001$.

3.5. Convergent and Discriminant Validity

Table 3 displays Cronbach's alpha, composite reliability, correlations between latent variables, average variance extracted (AVE), square-rooted AVE, and HTMT (the heterotrait-monotrait ratio of correlations). Cronbach's alpha, composite reliability, and rho_A all passed the recommended threshold of 0.7 (Hair et al., 2009), securing reliability and convergent validity (Henseler, Hubona, and Ray, 2016).

The minimum value of AVE is 0.719, suggesting that all exceeded the recommended criteria of 0.5. Furthermore, when the values of AVE and SQRT(AVE) were compared, the degree of self-explaining was higher than the correlation with other latent variables. Since all HTMT values were less than 0.85, discriminant validity was confirmed for latent variables (Henseler, Ringle, and Sarstedt, 2015). Considering AVE, SQRT(AVE), and HTMTs together, our research model has sufficient discriminant validity (Chin, 2013; Hair et al., 2016).

Table 3. Inter-construct Correlations, Convergent and Discriminant Validity

Construct	1	2	3	4
1 Subsidiary performance	1			
2 Institutional distance	0.300	1		
3 Business distance	0.345	0.498	1	
4 Subsidiary entrepreneurship	0.313	0.375	0.352	1
Cronbach's alpha	0.971	0.861	0.921	0.902
Composite reliability	0.977	0.915	0.944	0.927
rho_A	0.973	0.892	0.950	0.907
AVE	0.896	0.783	0.807	0.719
SQRT(AVE)	0.947	0.885	0.898	0.848
HTMT < 0.85	Yes	Yes	Yes	Yes

Notes: rho_A=Dijkstra and Henseler's composite reliability AVE=average variance extracted, SQRT=square rooted.

3.6. Common Method Bias Test

The PLS-SEM verification may be subject to common method bias (CMB) due to the arbitrary interpretation of the respondent. To identify this bias, we employed the following two methods. First, the extent to which a single factor explained all observed variables used in the path analysis through the principal component was confirmed (Podsakoff et al., 2003). When the principal component analysis for 16 observed variables was performed according to Harman's single-factor procedure, we affirmed that the degree of explanation by a single factor was 27.5%, which is less than the threshold of 50%.

Second, PLS-SEM was used to confirm multicollinearity between latent variables (Kock and Lynn, 2012). The concern of collinearity inside the model can be avoided by using this approach. The variance inflation factor (VIF) across latent variables varied between 1.013 and 1.678 but did not surpass the upper bound of 3.3. It is therefore established that our path model does not suffer from the multicollinearity problem.

4. Empirical test

4.1. Results of PLS-SEM

In this study, the effect of each latent variable was verified using a structural equation model. Fig. 2 presents the causal relationships of our hypotheses, the standardized path coefficient, significance, and explanatory power. The path coefficient of institutional distance to subsidiary entrepreneurship was 0.266, which was statistically significant at the 0.001 level. The path coefficient of business distance to subsidiary entrepreneurship was positively significant (b = 0.220, p < 0.01). The path coefficients of institutional and business distance were 0.119 and 0.191, respectively, which were statistically significant ($p < 0.05$, $p < 0.01$, respectively). Finally, the path coefficient from subsidiary entrepreneurship to subsidiary performance was 0.191 ($p < 0.01$). In addition, as a result of examining the R^2 of endogenous latent variables, it was found that subsidiary entrepreneurship was 0.170 and subsidiary performance was 0.161.

Table 4 shows the results of comparing the influence of direct and indirect effects of latent variables. The paths with only direct effects were institutional distance → subsidiary entrepreneurship (0.27), business distance → subsidiary entrepreneurship (0.22), and subsidiary entrepreneurship → subsidiary performance (0.19). Paths with both direct and indirect effects had institutional distance → subsidiary performance (0.17) and business distance → subsidiary performance (0.26).

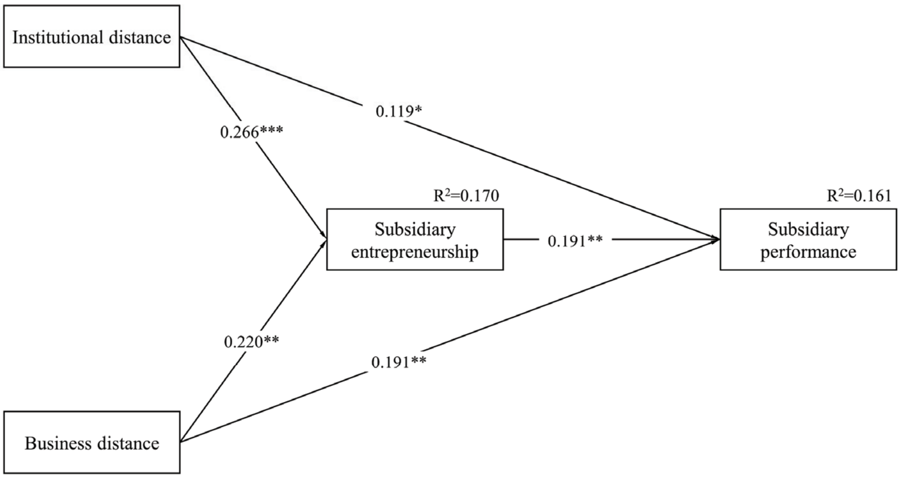

Fig. 2. Results of PLS-SEM.

Table 4. Direct, Indirect, and Total Effect

Effect	Direct	Indirect	Total
Institutional distance → Subsidiary performance	0.12	0.05	0.17
Institutional distance → Subsidiary entrepreneurship	0.27		0.27
Business distance → Subsidiary performance	0.22	0.04	0.26
Business distance → Subsidiary entrepreneurship	0.22		0.22
Subsidiary entrepreneurship → Subsidiary performance	0.19		0.19

To verify the mediating effects inherent in the model between latent variables, we adopted the bootstrapping method and verified the significance of the indirect effects through 5,000 iterations. Bootstrap is significant only when the confidence interval of the bias-corrected confidence interval (BCCI) does not contain 0 (Sobel, 1982). BCCI can be seen as having the highest strong consistency for the estimator for bootstrap iterations. In Table 5, the mediating effect of institutional distance on subsidiary performance through subsidiary entrepreneurship was 0.051 (standard error = 0.021, z = 2.376), and the mediating effect of business distance on subsidiary performance through subsidiary entrepreneurship was 0.042 (standard error = 0.019, z = 2.201). All mediating effects were significant without including 0 in the BCCI of all paths.

Table 5. Mediation effects with bootstrap

Statistics	ID→SE→SP	BD→SE→SP
Indirect effect	0.051	0.042
Standard error	0.021	0.019
z-statistic	2.376	2.201
p-value	0.017	0.028
95% Confidence Interval	[0.009, 0.093]	[0.005, 0.079]

Notes: (1) 5000 iterations for bootstrapping, (2) confidence level is 95%, (3) ID=institutional distance, BD=business distance, SE=subsidiary entrepreneurship, and SP=subsidiary performance.

5. Discussion and conclusion

This study has attempted to combine institutional and entrepreneurship theory and provide the relationship between institutional factors and subsidiaries' performance. In addition, we expanded the existing literature by capturing the mediating role of subsidiary entrepreneurship from institutional triggers to subsidiary performance in emerging markets. By comparing direct and indirect effects and investigating the significance of the mediating role of subsidiary entrepreneurship using the bootstrap via the Sobel test, we confirmed that the institutional theory could be applied to the entrepreneurship perspective in the emerging market.

5.1. Theoretical Implications

Our research has the following theoretical implications: First, this study verified the relationship between institutional and business distance and subsidiaries' entrepreneurship in the Middle East. The conventional causal relationship, which centers on the resource-based view, posits that differences are the primary obstacles that impede the growth of foreign businesses (Cavusgil, Knight, and Riesenberger, 2007; Vahlne and Johanson, 2017); however, we found these factors to be activators of subsidiaries' entrepreneurship. Despite recognizing the importance of subsidiaries' institutional and business distance in entrepreneurial activities, existing literature generally seeks general entrepreneurship rules that can ignore these factors (Lin and Tao, 2012; Zahra and Wright, 2011). However, these institutional and business pressures are important in explaining the entrepreneurship of subsidiaries. Therefore, these institutional and business distance attempts to reinforce entrepreneurship discussions in the international business literature.

Second, we aim to extend the current research by investigating the correlation between institutional and business distance and the entrepreneurship of Korean subsidiaries operating in the Middle East. Our findings demonstrate a positive relationship between institutional and business distance and subsidiary entrepreneurship (Wang and Chung, 2020). This suggests that efforts to bridge the gap between dissimilar markets could boost innovative activities among subsidiaries, including research and development and imaginative marketing strategies (Han, 2021). The study's sample comprises survey responses from 249 Korean firms with subsidiaries in the Middle East, a region that is geographically and culturally distant from Korea. Thus, becoming familiar with others' business practices and profoundly understanding the partner countries' political and legal systems or regulations would eventually lead to performance growth in the subsidiaries. Given that most Korean companies active in Middle Eastern countries are in the manufacturing and construction industries, which are heavily reliant on the legal system and regulations, this has significant implications (Younis and Elbanna, 2022).

5.2. Managerial implications

Managers should be aware of the following managerial implications as a result of our findings. First, we found that greater institutional and business distance is associated with stronger entrepreneurial activity, which in turn is linked to positive outcomes. As a result, companies must conduct customized research and training programs for Korean workers before deploying them to Middle Eastern subsidiaries. It attempts to understand the institutional and business distance better beforehand and set a strategy to reduce it. The relevant departments at the headquarters and subsidiaries must be aware of local laws and restrictions continuously changing and upgrading. Moreover, one should be aware of the Middle East's unique business attributes, slower pace but long-term trust-based business, family network, and religion. It is highly recommended that one take sufficient time to build rapport with business partners in the Arabian market; hesitation would harm long-term business opportunities. Another example is LG Electronics which is a good case of localization. It introduced a new microwave model specializing in Arabian African foods as well as a new "pink service"- a specialized training program for female engineers in Iran, the UAE, and Qatar based on the fact that male engineers are not allowed to visit a female customer's home when she is alone.

Second, collaboration with local companies or personnel is crucial to quickly adapting to the new emerging markets. Despite recent innovative transitions, the Middle East is recognized for its highly network-based culture and a strong preference for local companies. For example, some Middle Eastern countries require foreign companies to meet a specific ratio of local employees, local contents of the product, and local partnerships. The sponsorship system increases transaction costs for foreign companies. In this regard, identifying a quality local partner with relevant experience and a strong network can support a firm's entrepreneurship and performance growth.

Third, related associations can establish a joint-cooperation program to exchange ideas and become more familiar with each other. For example, KOTRA and the Korea Chamber of Commerce and Industry (KCCI) jointly hold a business forum with Saudi Arabia with High government officials and chief business people. During these sessions, one could directly share their environment to understand each other or propose challenges and bottlenecks while operating a business in the Middle East to find solutions to remove the institutional barrier.

Lastly, building and imprinting own brands to consumers in the local market is recommended while operating subsidiaries in the Middle East. When considering the long-term trust-based and family network business environment in the Middle East, it is more desirable to have its own private brands (PB) and collaborate with major local firms or entities, if possible, to earn more trust and positive impacts from Arabian consumers.

5.3. Limitations and Future Research Directions

Although we presented meaningful theoretical and practical implications, future studies can overcome our limitations. First, we limited our survey pool to Korean companies operating in the Middle Eastern market. To measure the precise effect in emerging markets, future study could consider a comparative study, including other regions such as Africa or Latin America. Second, although this study's sample size is adequate for statistical analysis, it can be considered insufficient compared to other studies. The result is from the survey of 249 Korean companies from KOTRA offices in the Middle East Region, and it is the only data available worldwide. This study's relatively small sample size is primarily the result of rigid sampling. For further surveys, one could categorize the respondent firms by company sales amount, industry, and the ratio of local employees. Third, we used cross-sectional data, which limits the ability to infer cause-effect correlations. Given that entrepreneurship is evolving due to changes in the business environment, future research can explore longitudinal data to understand the performance of subsidiaries due to entrepreneurship.

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