Political instability, resources, and political networking of firms in transition economies*

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Abstract

Firms engaging in political networking is a widely witnessed phenomenon in transition states where the economy shifts from central planning to market mechanism. In this article, we integrate the institutional-based and resource-based perspectives to propose that firms located in transition countries with higher political instability tend to invest more in political networking; firms with substantial specific resources help enhance/devalue the political networking as political instability increases. This paper tests these arguments by using a sample of 24,959 firms in former communist countries. Our results reveal an inverted U-shaped influence of political instability on firm political networking. Specifically, with the political environments getting increasingly unstable, innovation investment and industrial experience motivate firms to maintain political networks, while financial capital demotivates firms' investment in political networking. These findings shed light on deepening understandings of when and how political environments shape firms' strategic behaviors in transition economies.

Keywords: Political instability, political networking, transition economy, Eastern Europe
JEL Codes:: M16, M10

1. Introduction

Political networking is a widely witnessed strategic activity for firms in western and eastern economies alike (Chavance 2008; Kotabe/Jiang/Murray 2017; Liu/Yang/Augustine 2018; Zheng/Singh/Chung 2017). However, what factors determine how firms engage in political networking in transition economies? To better understand this phenomenon, most studies concentrate on the consequence of political networking, such as acquiring governmental resources (Ovtchinnikov/Reza/Wu 2020), policy favors (Yang/Bossink/Peverelli 2019), and political support (Goldman/Rocholl/So 2013). While internal resource considerations are important, recent studies have revealed that the specific institutional environment in which firms operate is a critical determinant of their strategic activities (Peng/Wang/Jiang 2008; Peng/Sun/Pinkham/Hao 2009).

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In particular, institutions in transition economies[1] have experienced a profound and revolutionary change since 1989, which also distinctly shaped their strategic behaviors, including political networking (Peng/Luo 2000). As one of the dynamics of large-scale institutional transition, political instability characterizes most of transition economies, such as Ukraine, Russia, and Poland (Brada/Kutan/Yigit 2006; Gurgul/Lach 2013). Politically unstable countries are more likely to experience political turnover, political conflict, government overthrow, terrorism, civil unrest, swift policy change, violence, and war (Aisen/Veiga 2013; Jong-A-Pin 2009; Krammer 2016; Witte/Burger/Pennings 2020). These can be seen still today, for example in Central Asia and East European Countries such as Kazakhstan, Armenia (Patnaik 2018; Reuters 2022), Ukraine (Chadwick 2022), and even in the Russia-Ukraine war (Zinets/Vasovic 2022). A great deal of literature has recognized the negative influence of political instability on national economic growth (Aisen/Veiga 2013; Jong-A-Pin 2009), national innovation output (Allard/Martinez/Williams 2012), firm innovation (Cumming/Rui/Wu 2016; Ovtchinnikov et al. 2020; Pertuze/Reyes/Vassolo/Olivares 2019), and firm performance (Zhou 2017). However, how such instable political environments directly determine a firm's strategic investment in political networking has remained largely under-analyzed.

Concentrating on this issue, we argue that (1) political instability in different transitional economies directly influences firms' political networking, and (2) firms' specific resources impact their ability and the demand of engaging in political networking in different instable political environments in distinct ways. We intend to adopt an integrative perspective that considers external political instability as well as internal unique resources. This integrative approach actively responds to the call for more integration of the institution-based view (IBV) and resource-based view (RBV) towards a better understanding of the determinants of firms' strategic activities in transition economies (Hillman/Hitt 1999; Lawton/McGuire/Rajwani 2013; Mellahi/Frynas/Sun/Siegel 2016). Specifically, we explore when and how firms invest in political networking in transition economies where institution systems are greatly different from those in Western countries.

In this study, we explore the relation between political instability and political networking in the context of 27 transition economies in Asia and Europe by

1 According to the International Monetary Fund (IMF), the term 'transition economy' refers to the economies that 'transform from centrally planned economies into market economies' (IMF 2000). In 2000, the IMF classified 28 countries as transition economies, including 24 in Europe and the former Soviet Union, and 4 countries in Asia, including China, Cambodia, Laos and Vietnam. In 2008, the World Bank recategorized ten countries that joined the European Union in 2004 and 2007 as transition-completed economies (Alam/Anos Casero/Khan/Udomsaph 2008). In this paper, we focus on firms in 27 transition economies in Central and West Asia and East Europe.

studying the extent to which the political instability arising from institutional transition shapes firms' investment in light of their own resources (Peng/Luo 2000; Yang et al. 2019). Our empirical testing reveals two main findings. We find that moderate political instability motivates firms to invest more in political networks, while highly unstable political environment devaluates firms' political networking activities in transition economies. Moreover, innovation investment and industrial experience reinforce firms' investment in political networking as political environments become more unstable, whereas firms with adequate financial capital develop fewer political networks when facing unstable political environments. Overall, this article makes the following contributions to existing literature: First, our findings contribute to IBV by revealing that an instable political environment has non-linear impact on a firm's political networking. Second, they allow a better understanding of a firm's strategic choices regarding political networking in former communist countries that are mostly characterized by unstable political environments, by using an integrated framework of IBV and RBV.

This article is set up as follows: Section 2 develops theoretical hypotheses about the direct and contingent influence of political instability on firms' political networking. Section 3 presents data, measurements, and methods of analysis, followed by the presentation of the findings in Section 4. Then, we discuss and work towards a conclusion in Section 5.

2. Theory and hypotheses development

2.1 Institution change and firm behavior in transition economies

The collapse of the Soviet bloc in Eastern Europe in 1989, and the dissolution of the Soviet Union, Yugoslavia and Czechoslovakia in the early 1990s meant a large number of, often newly formed, countries needed to reform their political and economic systems. Such transition economies experienced the dramatic shift from a centrally planned economy to a market-based system, in which the institutional transition reveals the characteristics as follows: First, the institutional lacunae led to deep recessions in the first post-communist years (Murrell 2005); then, the institutional construction was quick, but came with many continuity problems and a relatively large number of political maneuvers, government changes and political turnovers between 1990 and 2009 (Gurgul/Lach 2013). In the aftermath of the global financial crisis of 2009, some transition economies, for example Kazakhstan and Kyrgyzstan (Ruziev/Majidov 2013), as well as Ukraine (Grigoriev/Buryak/Golyashev 2017), have experienced economic recession due to the high degree of economic freedom and trade liberalisation (Shostya 2014), political unrest and social revolt. This has revealed that political instability has a negative impact on growth in at least ten countries in Central and Eastern Europe in the past two decades (Gurgul/Lach 2013).

In this context, firms in those transition economies have to cope with the institutional transition in general and political instability more specifically, and face two main problems. The first rests on the fact that firms are slow to adjust to the new forms of institutional construction, as governance structures had to be built on new foundations with 'the casting of decentralization' (Murrell 2005: 674). The other problem is the firms have to deal with the political instability brought by the great variety of national trajectories of system changes with the informal institutions and rules (Chavance 2008), based on their own specific resources.

To examine a firm's strategic behavior, performance, and internationalization in such context, the institution-based view (IBV) could provide a proper theoretical perspective (Banalieva/Eddleston/Zellweger 2015; Marquis/Raynard 2015; Peng et al. 2008). Because 'institutions directly determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy and to create competitive advantage' (Peng 2008, cf. Ingram/Silverman 2002: 20). Hence, in the context of institutional transitions, that is to say 'fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect organizations as players' (Peng 2003: 275), the firms would pursue reductions in the transitional cost and risk through informal institutions like political networking, to avoid the political uncertainty brought about by the dramatic changes in the formal institution (Li/Zhang 2007; Yang et al. 2019).

In addition to external environments, firms' strategic behaviors and competitive advantage are also determined by their internal resources (Barney 1991; Barney 2001; Peng et al. 2009). To be specific, under certain institutional environment, firm performance largely depends on what internal resources it possesses and how they are deployed (Barney 2001; Peng et al. 2009). In other words, political networking as a response to the changing political environments usually builds on a firm's internal resources. Obviously, the resource-based view (RBV) offers a complementary angle to analyze the extent to which a firm's political networking relies on specific resources to deal with political instability (Gaur/Kumar/Singh 2014; Meyer/Estrin/Bhaumik/Peng 2009). Hence, we intend to integrate the IBV and RBV perspectives to provide a relatively comprehensive analysis of the firms' strategic behavior particularly political networking in the context of political instability.

Thus, we first explore the direct influence of political instability on firms' political networking (Hypothesis 1). Then, we enrich our analysis by considering that organization resources will vary in terms of innovation, finance, and industrial or market experience when they are seeking to conduct political networking. Specifically, we explore how a firm's innovation investment (Hypothesis 2), financial capital (Hypothesis 3), and industrial experience (Hypothesis 4) shape the direction and intensity of their political networking in transition economies.

2.2 Political instability and firms' political networking

Firms' strategic activities and market behaviors are usually constrained by the market environment, social conditions, and institutional contexts (North 1990; Peng 2003). Current literature sees political instability as detrimental to economic growth and business performance (Alam/Uddin/Yazdifar 2019; Allard et al. 2012; Cumming et al. 2016; Nadeem/Liu/Ali/Younis/Bilal/Xu 2020; Roe/Siegel 2011). It often leads to government change, political conflict, and swift policy change (Krammer 2016; Witte et al. 2020); specifically, higher political instability brings higher environmental uncertainty and lack of continuity in policy (Allard et al. 2012). In politically unstable environment, thus, firms usually bear higher operation cost, transaction cost, and failure risk (Gulen/Ion 2016; Peng et al. 2008; Nadeem et al. 2020). As a strategic act, according to IBV perspectives, firms tend to rely more on political networking to manage the environment uncertainties and thus reduce transactions costs (Li/Zhang 2007; Peng/Luo 2000).

The 1989 revolutions brought with them series of fundamental changes in the political and economic systems of Eastern European and Central Asian countries which transformed themselves from socialism to capitalist regimes. Until now, most of them are still in transition to a market-dominated economy. Transition economies like Serbia, Russia, and Ukraine are often characterized by incomplete and inefficient formal institutions, leading to political instability (Khanna/Palepu 1997; Luu/Ngo 2019). Generally, as the political environment becomes increasingly unstable, such as unexpected political campaigns, casual policy interruptions, and frequent government change, the given business rules are usually too weak to regulate the market and define the transactions (Aisen/Veiga 2013; Deephouse 1996). In this context, to cope with such external political uncertainties, firms have to rely more on informal institutions (Marquis/Raynard 2015; Peng 2003). Among others, firms prefer to build and maintain ties with political authorities and government officials, which gives them an advantage towards acquiring government-controlled resources, institutional support, social and political legitimacy, and policy favors (Hillman/Keim/Schuler 2004; Lawton et al. 2013; Marquis/Raynard 2015; Zhao 2012). In particular, political ties help firms lobby officials, make political donations, and participate in election campaigns, which would in turn secure their business benefits. In summary, political instability induces substantial influence on enhancing a firm's propensity to build and maintain political networks.

However, once political instability increased to a certain level, firms' political networking would be largely discouraged. When the external political environment is extremely unstable, with continuous changes of government and frequent social unrest, the benefits from the investment in political networking can hardly mitigate the loss caused by environmental instability. For one, excessive

political instability would lead to high policy volatility and even drastic changes in the political system. In particular, the implementation and effectiveness of government policies will be weakened under dramatically uncertain conditions. Also, when investments are irreversible and increasing uncertainty is expected in the future, firms will reduce current investments until the uncertainty eases or is eliminated (Bernanke 1983; Pindyck/Solimano 1993; Bloom/Bond/Van Reenen 2007). For example, in political environments with regime turmoil, social unrest, and extremism and terrorism, market predictions are hardly achieved, and government policies are issued and abolished unexpectedly, which substantially confused firms' investment expectations and increases the cost of maintain reliable political ties. Under such circumstances, firms will adopt relatively conservative strategic behavior. That is, firms tend to abstain from political networking and even leave the local market to mitigate the adverse effects from external political risk shocks (Short/Ketchen/Shook/Ireland 2010; Mckelvie/Haynie/Gustavsson 2011).

Considering the above, we argue that political instability has a nonlinear effect on firms' political networking in transition economies.

Hypothesis 1 (H1): *In transition economies, political instability has an inverted-U shaped effect on firms' political networking. That is, as political instability increases, firms first increase their investments in political networking and then lower these investments.*

2.3 The contingent value of firm's specific resources

Innovation investment

Political instability motivates firms' political networking, but this does not mean that firms respond to external political instability in a homogeneous way since firms vary in terms of the internal resources they have. Generally, innovation is important for firms to form and maintain competitive advantage in transition economies (Barney 1991; Gogokhia/Berulava 2021). Thus, innovation investment largely shapes firms' strategic behaviors, including how to manage the environment dynamics and to what extent they mobilize the given resources (Barney 2001; Peng et al. 2009), regulating the influence of political instability on political networking.

First, political instability triggers uncertainty in markets, which would further amplify uncertainty around market expectations of new products. In general, the innovation process is filled with risk, failure, and uncertainty (da Silva Etges/Cortimiglia 2019), and this requires robust institutional supports such as more developed market system, less government intervention, and effective intellectual property protection (Pertuze et al. 2019; Xie/Qi/Zhu 2019; Yang/Sun/Yang 2015). However, political instability and political risk usually prevail in

transition countries, which are often unable to secure the benefits from product innovation. Political instability, together with innovation risk, further blur firms' expectations regarding product innovation. Under such conditions, building political networks with government officials allows innovative firms the advantage of access to government-controlled resources such as R&D subsidies and tax reduction, and to lobby the government to adjust industrial policies or implement preferential policies. It thus may help firms reduce risks arising from external political instability as well as internal innovation activities (He/Tian/Chen 2007).

Moreover, innovative firms tend to build political ties to acquire political legitimacy to improve their social status and gain social recognition in changing political environments (Tornikoski/Newbert 2007). Generally, innovation is very sensitive to uncertainty. Political networking helps obtain political legitimacy, which could mitigate the impact of uncertainty on new product launches (Czarnitzki/Toole 2013). In unstable political environments, it is difficult for customers and suppliers to trust and accept new technologies and new products due to limited rationality and the absence of effective information (Suchman 1995). That is, the public tends to question the reliability and stability of new products when there is lack of political legitimacy (Suchman 1995). Thus, firms that focus on product innovation would rely more on political networking to gain social and political legitimacy that would help them manage outside uncertainties in unstable political settings.

However, a highly unstable political environment may greatly amplify the risks involved in firms' innovation activities, and further demotivate firm's political networking. Increasing political instability implies frequent turnover of political actors, which makes the government-business ties increasingly unstable. In such situations, these ties increase the cost of renewing, rebuilding, and maintaining political ties, and this cost often outweigh the potential benefit of firms' political networking. Thus, in extremely unstable political environments, innovative firms demotivate their investment in political networking.

Hypothesis 2 (H2): *In transitional economies, firm innovation positively moderates the influence of political instability on firms' political networking. That is, in political unstable environments, innovative firms would rely more on political networking than non-innovative firms.*

Financial capital

Being in possession of adequate financial resource gives a firm the ability to employ internal and external financial capital to achieve their strategic goals (Coleman/Cotei/Farhat 2013; Cooper/Gimeno-Gascon/Woo 1994). In transition

economies, the development of financial systems is usually incomplete and can only provide limited support to firm operation and development. Particularly, an unstable political environment would exacerbate the uncertainty and inefficiency of financial institutions due to the interdependence of institutional components (Yang et al. 2015). Hence, in environments with political instability, the hurdles and risk of obtaining outside resources for firms that confront financing constraints are more evident. Firms with less financial capital are more likely to establish connections with government officials or political authorities to obtain informal protection, to alleviate the uncertainties arising from the insufficient financing systems, and to secure investment (Khwaja/Mian 2005; Peng 2003; Yang et al. 2019). Moreover, the financing constraints faced by firms may reinforce the positive influence of political instability on firms' political networking.

In transition economies, high political instability and policy uncertainty often make their imperfect financial systems more vulnerable, exacerbating the difficulty of obtaining external financing for firms with limited financial capital. Gulen and Ion (2016) suggest that policy uncertainty increases the probability of firm bankruptcy, further leading to the rising cost of external financing for firms. Higher financing costs constrain firms from investing in more promising projects and constrain their investment decisions.

However, firms are likely to take more prudent investment decisions regarding political networking in highly turbulent political environments. From RBV, for firms with unconstrained financing, the abundance of funding sources allows them to behave without internal funding constraints due to their relatively low barriers to accessing funds (Fazzari/Hubbard/Petersen/Blinder/Poterba 1988). Firms with limited financial resources are unable to obtain sufficient financing through external financial markets due to future cash flow shortages. Thus, extreme political instability may lead them to be more conservative in their strategic response to outside uncertainties such as reducing corporate investment (An/Chen/Luo/Zhang 2016; Gulen/Ion 2016; Zhang/Han/Pan/Huang 2015). Therefore, as the political instability increases up to a certain level, firms with financing constraints may give up on mitigating financial difficulties through political networking.

Hypothesis 3 (H3): *In transitional economies, financial capital negatively moderates the influence of political instability on firms' political networking. That is, firms with more limited financial capital are more likely to conduct political networking.*

Industrial experience

In transition economies, political instability usually induces policy uncertainties, business rule changes, and a re-balance of political power. The rapid changes

in established regulations may reshape the mechanisms of resource allocation, and particularly break the established relationship between the incumbents and political authorities (Banalieva et al. 2015). To deal with external uncertainties, firms make strategic decisions often building on their past market and industry experiences (Jansen/Curşeu/Vermeulen/Geurts/Gibcus 2013). Generally, newly established firms are much quicker in responding to market opportunities, and also have advantages in identifying and dealing with institutional voids to grasp business opportunities (McCarthy/Puffer 2016). However, new firms usually have limited experience in obtaining related social support, which leads them to resort to informal institutions (Liu et al. 2018; Peng/Luo 2000). Thus, new entrants are much motivated to connect with government officials through which they have an advantage for acquiring resources, financing, and the social legitimacy to get things done (Shane/Cable 2002; Baker/Nelson 2005).

However, new firms may retreat from political networks as political environments get extremely unstable. In highly unstable political environments, firms could benefit more from the cohesive and strengthened ties with political authorities, compared to general and loose political ties (Koka/Prescott 2008). The aged firms usually have substantial experiences in maintaining stable relationships with government officials and political authorities (Hillman et al. 2004). However, new firms are lacking such experiences and social capital (Shane/Cable 2002), which prevents them from engaging in political networking. Moreover, an increasingly unstable political environment may crowd new firms out of domestic markets. In transition economies, government policies often intend to favor industrial leaders or established giants over newcomers (Peng/Zhou 2005), resulting in an institutional environment that is not conducive to the survival and development of start-ups. This situation may motivate start-ups to invest in overseas markets that are developed and have a stable political environment (Wu/Wang/Hong/Piperopoulos/Zhuo 2016; Luo/Xue/Han 2010).

In summary, in moderately unstable political environment, new firms may be more motivated to build political networks, while aged firms are better suited to deal with political networking in highly unstable political environments.

Hypothesis 4 (H4): *In transitional economies, a firm's industrial experience positively moderates the influence of political instability on their political networking. That is, in political instable environments, experienced firms have more advantages when conducting political networking.*

3. Data and analytic approach

3.1 Dataset

We use survey data from two sources to test the proposed relationships. First, our firm-level data are drawn from the Business Environment and Enterprise Performance Survey (BEEPS) (2002, 2005, 2007, and 2009), which were collected by the European Bank for Reconstruction and Development (EBRD) and the World Bank. These surveys involved 24,959 firms in 27 countries in Central and Western Asia, and Eastern Europe, including most former communist countries: Albania, Armenia, Azerbaijan, Belarus, Bosnia, Bulgaria, Croatia, Czechia, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Tajikistan, Ukraine, and Uzbekistan. This data includes firms' basic information, such as location, size, age of the firm, and sales etc., as well as firms' detailed information on financing, innovation, and business-government interactions etc., which fits our study purpose. Second, our measure of political instability in a given country is drawn from the Worldwide Governance Indicator (WGI). The WGI measures the governance status of 215 countries and regions through six dimensions: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and anti-corruption (Kaufmann/Kraay 2008). Among others, we use the dimension of political stability as a proxy for the political instability of the country. Finally, we combined these two datasets by identifying the firm locations, resulting in a dataset that contains 24,959 firms in 27 countries in the years 2002, 2005, 2007, and 2009.

3.2 Measures

Political networking

Political networking (PN) refers to the behaviors and activities that a firm intends to build, and how it maintains connections with government officials and political authorities (Hillman/Hitt 1999; Yang et al. 2019). In existing studies, several indicators have been developed to measure firms' political networking such as informal payments to government officials, political lobbying, inviting former officials to join firms' Top Management Team (TMT) boards (Hillman 2004; Zhang/Tan/Wong 2015a). For example, Hillman (2004) argues that the spending on lobbying can be used to measure the intensity of firms' political networking. Consistent with Zhang et al.'s (2015a) findings, this article measures firms' political networking by identifying top managers' time commitment in interacting with government officials. That is, we quantify the political networking through coding the answer to the question 'In a typical week over the last year, what percentage of total senior management's time was spent

on dealing with requirements imposed by government regulations?' in BEEPS (Yang et al. 2019; Zhang et al. 2015a).

Political instability

We measure *political instability (PI)* by using the dimension of the Political Stability and Absence of Violence (PV) of the WGI. Political stability refers to the 'perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism' (Kaufmann/Kraay 2008). The score of this dimension varies between -2.5 and 2.5, with higher values indicating a higher level of political stability in a given year. For ease of understanding, we recode this score inversely so that it can represent the degree of political instability (Allard et al. 2012; Karnane/Quinn 2019; Krammer 2016). That is, the value of *political instability* ranges from -2.5 (extreme stable) to 2.5 (extreme unstable).

Innovation investment

Innovation investment *(INNOV)* usually lead firms to having advantageous to form competitive advantage, acquire specific resource, and buffer external uncertainty (Barney 2001; Nadeem et al. 2020; Pertuze et al. 2019; Yang et al. 2019). Building on innovation investment, conducting product and/or service innovation indicates a firm's efforts in building competence in transition economies. According to existing literature, we measure innovation investment by identifying firm innovation output (Xie et al. 2019). Thus, this paper identifies firms' innovation investment *(INNOV)* through the question 'During the last three years, has this establishment introduced new or improved products or services?' (Xie et al. 2019). We code *INNOV* 1 if a firm introduced new or improved products or services into market during the last three years, and 0 otherwise.

Financial capital

Financing is critical to firm survival and performance. This paper measures a firm's *financial capital (FC)* by evaluating a firm's financing availability in the transitional country. In the BEEPS survey, the answer to the question 'To what degree is Access to Finance an obstacle to the current operations of this establishment?' quite fits our measuring purpose, which is also widely used in current studies (Ullah 2019; Yang et al. 2019). The variable takes values 0–4 to represent the obstacle degree of firm financing. That is, 0 means no obstacle and 4 means very severe obstacle. For ease of understanding, we recode this measure reversely so that a value 4 means no obstacle. Finally, we add 1 to this resulting measure and obtain a new variable to indicate firm financial capital, this ranges from 1 (constrained financial capital) to 5 (unlimited financial capital).

Industrial experience

Industrial experience (IE) often indicates a firm's accumulated social capital and experience in dealing with market, business, and social issues (Jansen et al. 2013). In agreement with existent studies (Haltiwanger/Jarmin/Miranda 2013; Hillman et al. 2004), we use organization age to proxy the firm's industrial experience. That is, we obtain organization age by subtracting the year that the firm was established from the year that the survey was conducted, resulting the *IE* variable.

Controls

We consider the following control variables in our regression models. Prior studies have indicated that firm size usually contributes to strategic behaviors in transitional economies (Zheng et al. 2017). We control this size effect and measure *firm size* (***Size***) as the natural logarithm of the number of employees. *Qualification* (***Qualif***) (whether the firm was certified under internationally recognized quality standards) account for the capability to access to alternative resources, the advantage to build competence, and the buffer to outside uncertainties (Yang et al. 2019). Firms with substantial human capital are being advantageous to deal with uncertainties in product market as well as political environment (Zhang et al. 2015a). We define *human capital* (***HC***) as the percentage of employees with a university-diploma. *Ownership concentration* (***OC***) may impact the formation of political ties in transitional economies (Sun/Mellahi/Wright 2012). We use the percentage of shareholding by the largest investor as a proxy for ownership concentration of a firm. Controlling for *state-ownership background* (***SO***) can help estimate a robust effect, since firms that are or were state-owned, or that have state-ownership background are more likely to engage in political networking (Zheng et al. 2017). Thus, we construct a dummy variable to indicate state-ownership background, 1 for state-owned enterprise (SOE), privatized SOE, and private subsidiary of a former SOE, and 0 otherwise. Getting *subsidy* (***Subs***) indicates interdependence between firm and government, which may lead to more government-business interactions (Yang et al. 2019). We use a dummy variable to act as proxy for the subsidy, 1 for a firm that obtains government subsidies and 0 otherwise. In addition, a more developed economy is usually associate with more complete institutions, which may help demotivate political networking (Peng/Luo 2000). To control for this effect, we use the *GDP per capita* of the country (***GDP_PC***) to represent the economic development of the country (Nadeem et al. 2020; Pertuze et al. 2019). Lastly, our study also controls for the heterogeneous influence arising from industry and time by including the ***industry*** and ***year*** dummies.

3.3 Analytic method

We use OLS regression to investigate the influence of political instability on firm political networking. To be specific, we construct the following model (Model 1) to estimate the non-linear relationship between political instability and firm political networking (*i.e.*, testing H1).

$$PN_i = \alpha + \beta_1 \times PI + \beta_2 \times PI^2 + \boldsymbol{Control} \times \boldsymbol{\gamma} + \varepsilon_i \quad (1),$$

where β_1 and β_2 represent the coefficients of linear and nonlinear effects of political instability (PI) respectively, $\boldsymbol{\gamma}$ indicates the vector of the regression coefficients of the control variables, ***Control*** represents the vector of control variables, ε_i is the error term.

To examine how the relationship between PI and PN varies in different situations, we construct the following multiple linear regression models *i.e.*, Model 2–4, to test Hypothesis 2–4 respectively. In Model 2–4, β_3, β_5, and β_7 represents the regression coefficients of the moderation effects of a firm's specific internal resource i.e., innovation investment, financial capital, and industrial experience respectively; other parameters have the same meaning as in Model 1.

$$PN_i = \alpha + \beta_1 \times PI + \beta_2 \times PI^2 + \beta_3 \times INNOV \times PI + \beta_4 \times INNOV + \boldsymbol{Control} \times \boldsymbol{\gamma} + \varepsilon_i \quad (2)$$

$$PN_i = \alpha + \beta_1 \times PI + \beta_2 \times PI^2 + \beta_5 \times FC \times PI + \beta_6 \times FC + \boldsymbol{Control} \times \boldsymbol{\gamma} + \varepsilon_i \quad (3)$$

$$PN_i = \alpha + \beta_1 \times PI + \beta_2 \times PI^2 + \beta_7 \times IE \times PI + \beta_8 \times IE + \boldsymbol{Control} \times \boldsymbol{\gamma} + \varepsilon_i \quad (4)$$

4. Findings

4.1 Descriptive statistics

Table 1 shows the descriptive statistics (*i.e.*, means, standard deviation, VIFs) and the correlations matrix for all variables in our models. As we present in Table 1, the mean of time that firms spend on political networking is 8.65 %, and the political networking varies distinctly between firms (s.d=14.35). Moreover, the instability of political environments varies across countries in east Europe and central Asia ($Mean_{PI} = 0.031$; $s.d_{PI} = 0.757$). In addition, 43.7 percent of firms have introduced new products or services in the previous three-year period. The correlation between the political networking and political instability and moderators (i.e., innovation investment, financial capital, and industrial experience) display the expected signs. Table 1 also indicates that the value of variance inflation factor (VIF) of all independent variables is lower than 5, which shows that multicollinearity in our model is not a serious concern.

Table1: Descriptive statistics

	1	2	3	4	5	6	7	8	9	10	11	12
1.PN	1											
2.PI	0.072***	1										
3.INNOV	0.089***	0.004	1									
4.FC	-0.108***	-0.042***	-0.043***	1								
5.IE	0.047***	0.004	0.038***	-0.016***	1							
6.Qualif	0.066***	-0.083***	0.171***	0.014**	0.117***	1						
7.Subs	0.029***	-0.144***	0.057***	0.004	0.130***	0.130***	1					
8.GDP_PC	0.027***	-0.041***	-0.082***	0.020***	-0.011*	0.047***	0.057***	1				
9.Size	0.101***	0.050***	0.178***	0.030***	0.369***	0.299***	0.176***	0.007	1			
10.HC	0.005	0.156***	0.046***	0.027***	-0.096***	-0.017***	-0.044***	-0.060***	-0.131***	1		
11.SOE	0.057***	0.114***	-0.012*	-0.006	0.449***	0.093***	0.059***	0.023***	0.355***	-0.104***	1	
12.OC	-0.019***	-0.022***	-0.029***	0.010	-0.086***	-0.056***	-0.009	-0.066***	-0.156***	-0.015**	-0.187***	1
Mean	8.646	0.0314	0.437	4.584	15.73	0.177	0.081	370744	3.352	29.38	0.220	77.67
S.D.	14.35	0.757	0.496	1.246	17.44	0.382	0.272	739002	1.534	29.01	0.414	28.07
VIF		1.09	1.08	1.01	1.34	1.15	1.06	1.03	1.39	1.08	1.39	1.07

N=23,314; ***P<0.01, **P<0.05, *P<0.1.

4. 2 Regression results

Table 2 shows the regression results. Model 1 is the baseline model, which only includes control variables. Model 2 and Model 3 display the testing results of Hypothesis 1 which proposes an inverted U-shaped influence of political instability on firms' political networking. The findings indicate a positive influence of political instability on political networking ($\beta_{PI} = 1.468,\ p < 0.01; Model\ 2$), but this influence is reversed when the instability of the political environment increased at certain level ($\beta_{PI^2} = -0.914,\ p < 0.01; Model\ 3$). These findings support H1. Hypothesis 2 argues that innovation resources would enhance the inverted U-shaped relationship between political instability and political networking. The results in Model 4 imply that firm innovation positively and significantly moderate the influence of political instability on firms' political networking ($\beta_{PI*INNOV} = 1.157,\ p < 0.01; Model\ 4$). Thus, H2 gets support. In H3, we proposed that firms with adequate financial capital would devote fewer resources to political networking in unstable political environments. Model 5 reveals a negative moderation of financial capital on the 'political instability—political networking' link ($\beta_{PI*FC} = -0.485,\ p < 0.01; Model\ 5$). Obviously, our empirical findings support H3. Hypothesis 4 states that industry experience help firm enhance political networking as the political environment become more unstable. Results in Model 6 suggest that firms with inadequate industry experience are at a disadvantage to conduct political networking ($\beta_{PI*IE} = 0.021,\ p < 0.05; Model\ 6$). Clearly, our empirical evidence substantiates H4.

Table2: The influence of political instability on firms' political networking

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
PI		1.468***	1.765***	1.280***	3.966***	1.486***
		(0.139)	(0.152)	(0.190)	(0.548)	(0.198)
PI^2			-0.914***	-0.819***	-0.713***	-0.903***
			(0.189)	(0.189)	(0.194)	(0.189)
INNOV				1.083***		
				(0.215)		
PI*INNOV				1.157***		
				(0.273)		
FC					-0.931***	
					(0.085)	
PI*FC					-0.485***	
					(0.112)	
IE						0.015*
						(0.008)
PI*IE						0.021**
						(0.009)
Qualif	0.656**	0.924***	0.964***	0.841***	1.042***	0.989***
	(0.284)	(0.285)	(0.285)	(0.285)	(0.290)	(0.285)
Subs	0.222	0.828**	0.954**	0.956**	0.758*	1.010**
	(0.408)	(0.412)	(0.412)	(0.413)	(0.417)	(0.413)
GDP_PC	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Size	0.630***	0.573***	0.574***	0.516***	0.630***	0.548***

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	(0.082)	(0.082)	(0.082)	(0.082)	(0.083)	(0.083)
HC	0.015***	0.007**	0.006*	0.005	0.007*	0.007**
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
SOE	0.208	-0.127	-0.143	-0.001	-0.223	-0.386
	(0.266)	(0.268)	(0.268)	(0.269)	(0.273)	(0.291)
OC	-0.005	-0.006	-0.006*	-0.006	-0.005	-0.006
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
Year dummies	YES	YES	YES	YES	YES	YES
Industry dummies	YES	YES	YES	YES	YES	YES
Constant	5.319***	5.923***	6.485***	6.241***	10.465***	6.401***
	(0.501)	(0.503)	(0.516)	(0.518)	(0.640)	(0.518)

Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1.

We present the above findings visually in Figure 1–4. Figure 1 presents a significant inverted U-shaped relationship between political instability and firms' investment in political networking, supporting H1. Figure 2 plots the moderating effects of innovation resources on the relationship between political instability and political networking. As shown in Figure 2, innovative firms may confront more risks in market, leading to heavy dependence on political networks as the political environment gets more unstable. Figure 2 provides clear evidence to support H2. Figure 3 presents the marginal effect of political instability on firms' political networking at higher level (+1 s.d) and lower level (-1 s.d) of financial capital. It clearly indicates that the less financial capital a firm possesses would lead to more political networking activities in highly instable political environments. Thus, H3 gets support. Figure 4 shows that, in comparison with experienced firms (+1 s.d *IE*), firms with less industry experience (-1 s.d *IE*) conduct less political networking in unstable political environments, confirming the argument of H4.

Figure 1: The influence of political instability on firms' political networking

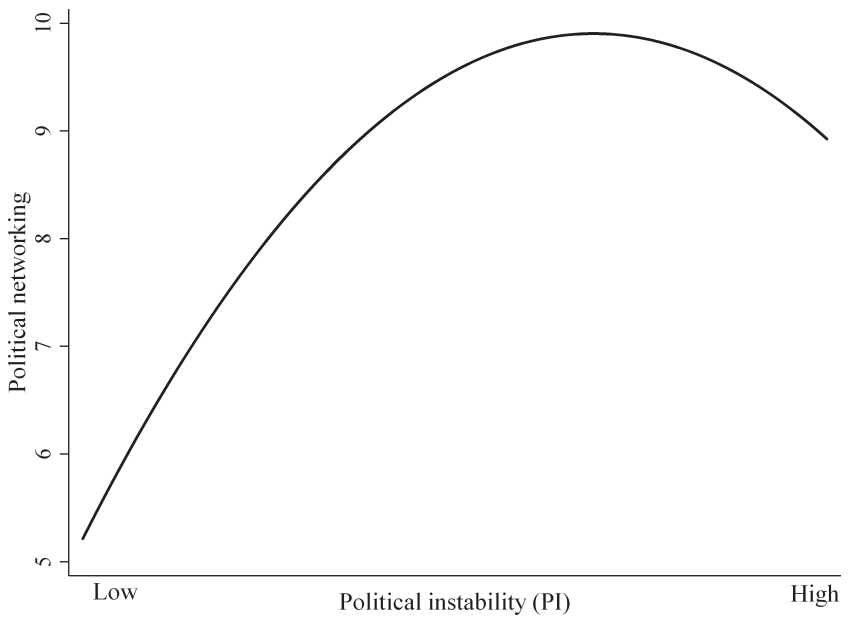


Figure 2: The moderation effect of innovation investment

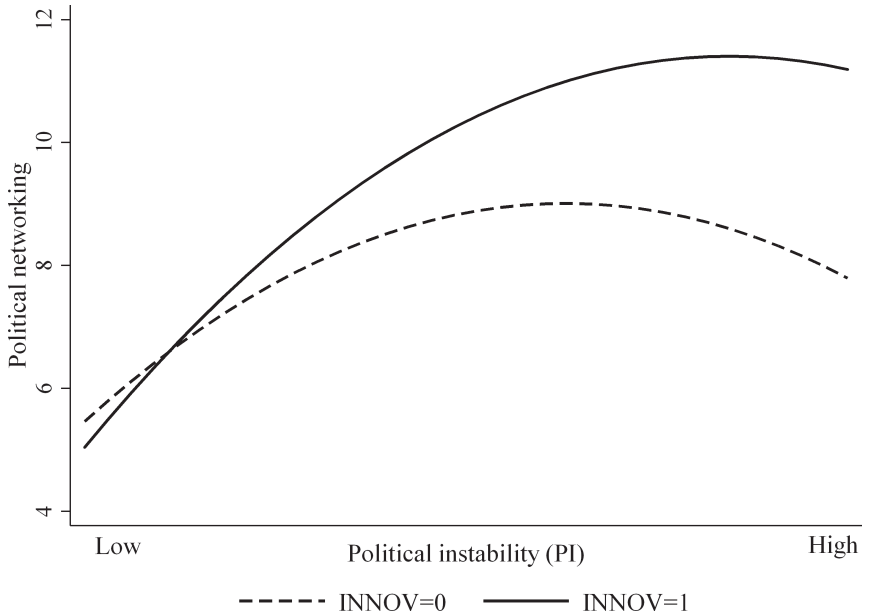


Figure 3: The moderation effect of financial capital

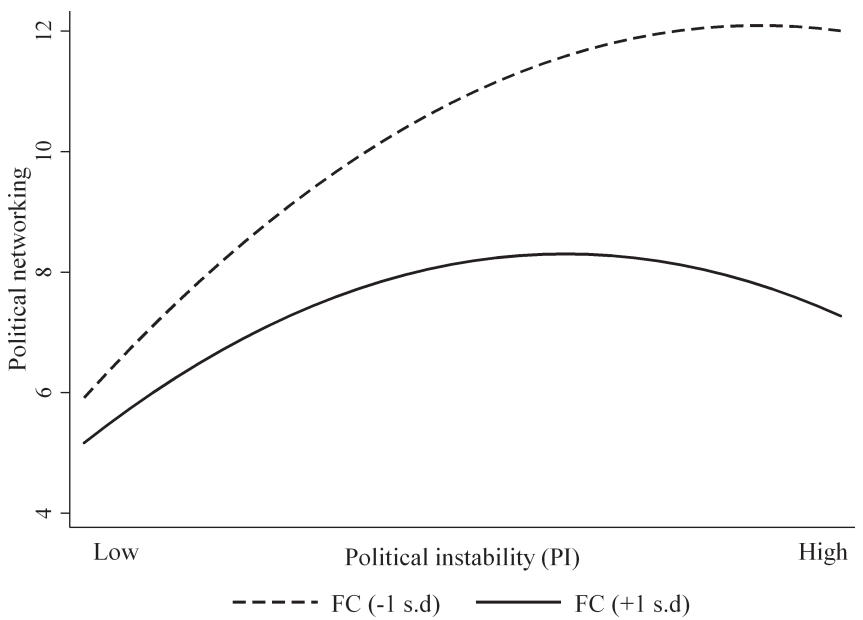
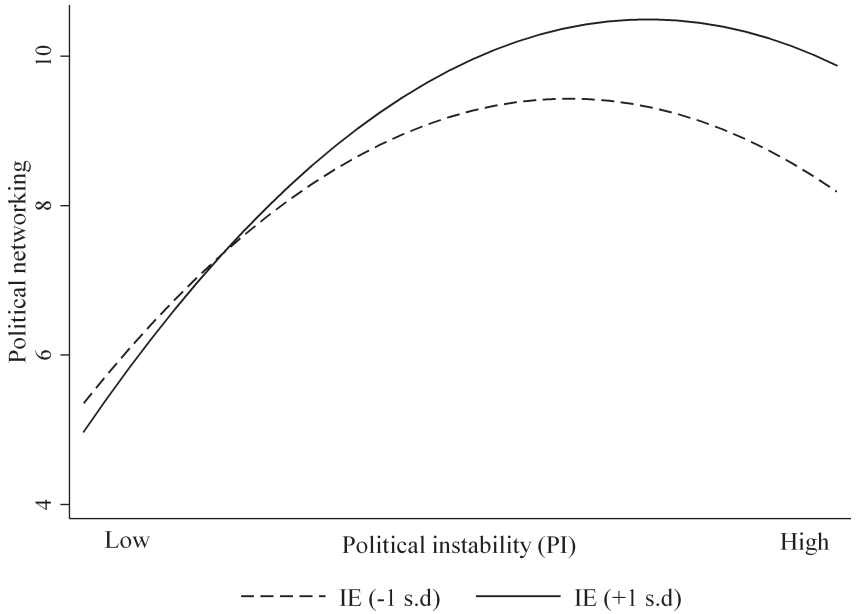


Figure 4: The moderation effect of industrial experience



4.3 Robustness checks

We conducted several tests to check how robust our findings are. First, we tested the robustness of the non-linear influence of political instability on political networking by using Haans, Pieters and He's (2016) method. We calculated the turning point of the inverted U-shaped line (*at* PI=0.965). When political instability increased to 0.965, firms' time investing in political networking achieved its maximum value. In particular, this value (0.965) was located well in the range of political instability (-2.5, 2.5). Then, we split our data into two groups: group 1 with political instability lower than 0.965, and group 2 with political instability larger than 0.965. Building on these two samples, we re-ran the regression model separately. As shown in Table 3, moderate political instability (PI<0.965) motivates firms' political networking ($\beta_{PI} = 1.864,\ p < 0.01; Model\ 1$), while highly unstable political environment (PI>0.965) lowers firm investment in political networking ($\beta_{PI} = -10.747,\ p < 0.01; Model\ 2$). The slopes on both sides of the political instability endpoints are significant and in the expected direction, further confirming the assertion of H1.

Table3: Regression by sub-groups

	Model 1 (PI<0.965)	Model 2 (PI>0.965)
PI	1.864***	-10.747***
	(0.190)	(2.044)
Qualif	1.088***	0.817
	(0.292)	(0.863)
Subs	1.364***	-3.596**
	(0.406)	(1.692)
GDP_PC	0.000***	0.000***
	(0.000)	(0.000)
Size	0.432***	0.964***
	(0.085)	(0.234)
HC	0.004	0.008
	(0.004)	(0.010)
SOE	-0.131	-0.030
	(0.285)	(0.701)
OC	-0.004	-0.008
	(0.004)	(0.010)
Year dummies	YES	YES
Industry dummies	YES	YES
Constant	6.830***	15.226***
	(0.527)	(2.504)

Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1.

Second, we adopted a subjective measure to indicate firms' political networking. Through this process, we identify the extent to which firms perceive that informal payments are required to get government-related issues solved (Uhlenbruck/Meyer/Hitt 2003). The BEEPS dataset records this information by asking top managers "it is common for firms in my line of business to have to pay some irregular 'additional payments or gifts' to get things done with regard to customs, taxes, licenses, regulations, services etc."; the answers are coded from 1 (never) to 6 (always). Then, we ran the model again using this newly constructed dependent variable. The regression results (see Table 4) indicate consistent findings.

Table4: Regression by using subjective measure of political networking

	Model 1	Model 2	Model 3	Model 4
PI	0.425***	0.399***	0.502***	0.384***
	(0.015)	(0.019)	(0.055)	(0.020)
PI^2	-0.153***	-0.147***	-0.124***	-0.148***
	(0.019)	(0.019)	(0.020)	(0.019)
INNOV		0.137***		
		(0.022)		
PI*INNOV		0.061**		
		(0.028)		
FC			-0.196***	
			(0.008)	
PI*FC			-0.021*	
			(0.011)	
IE				-0.004***
				(0.001)
PI*IE				0.003***
				(0.001)
Constant	2.781***	2.752***	3.650***	2.805***
	(0.052)	(0.052)	(0.064)	(0.052)
Controls	YES	YES	YES	YES

Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1.

Finally, we adopted an alternative method *i.e.,* Tobit regression, to rerun our models. In our dataset, political networking is non-negative values and less than 100. OLS estimation may obtain biased results for such data (Foster/Kalenkoski 2013). Our Tobit regression (see Table 5) suggests that the findings remain.

Table 5: Tobit regression results

	Model 1	Model 2	Model 3	Model 4
PI	1.863***	1.182***	5.790***	1.577***
	(0.219)	(0.277)	(0.781)	(0.286)
PI^2	-1.204***	-1.066***	-0.861***	-1.199***
	(0.278)	(0.279)	(0.284)	(0.279)
INNOV		2.526***		
		(0.311)		
PI*INNOV		1.560***		
		(0.394)		
FC			-1.541***	
			(0.121)	

	Model 1	Model 2	Model 3	Model 4
PI*FC			-0.876***	
			(0.161)	
IE				0.025**
				(0.011)
PI*IE				0.022*
				(0.013)
Controls	YES	YES	YES	YES
Constant	0.492	-0.570	7.038***	0.367
	(0.745)	(0.752)	(0.915)	(0.748)

Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1.

5. Discussion and conclusion

In this study, we explored the influence of political instability on firms' political networking in transitional economies by integrating the perspectives of institution-based view and resource-based view. We found that political instability in transition economies has a significant inverted U-shaped influence on firms' political networking. That is, with the political environments getting increasingly unstable, innovation investment and industrial experience motivate firms maintain political networks, while financial capital demotivates firms' investment in political networking.

This study makes several contributions to existing literature. First, it contributes to the institution-based view (IBV) by deepening the understandings of the non-linear role of institutional environment in shaping firms' political networks. In practice, political networking is widely witnessed in transition economies (Li/Zhang 2007; Liu et al. 2018; Kotabe et al. 2017). IBV argues that firms in transition economies are more likely to rely on political networks to deal with the uncertainties arising from incomplete and less developed institutions (Li/Zhang 2007; Marquis/Raynard 2015; Peng 2003). Although it proposes a linear relationship between institution development and political networking, the value of political networks is differentiated in specific institutional environments (Marquis/Raynard 2015; Meyer et al. 2009; Yang et al. 2019). Building on this, we further propose that the political instability exerts a non-monotonic effect on forming firm's political networks. Our empirical findings help to understand in what conditions and to what extent a firm in transition economies with political instability is (de-)motivated to conduct political networking activities. To be specific, rather than increasing dependence on political networks, firms may detach their connections with political authorities and government officials as the political environment becomes more and more unstable. In sum, we not only examined the behavior of firms' political networking as a positive consequence

of unstable political environments, but also extended the analysis to the negative consequences simultaneously, which offers a better view of the conditions under which the firms choose to build, or not build, political networks.

Second, our study is among the first that contributes to providing a relatively comprehensive analysis on firms' strategic choice of political networking in the context of political instability by integrating the IBV and RBV perspectives. So far, most studies have recognized that political networking is crucial for a firm's success in transition economies (Li/Zhang 2007; Liu et al. 2018; Peng 2003). It should be noted that the institution power driving firms' political network is not equally distributed (Meyer et al. 2009). Firms need to evaluate their internal resources to decide when and how to build and maintain the political network (Gaur et al. 2014; Peng et al. 2009). In this study, our findings show that firms conducting innovation activities, confronting financial constraints, and having more industrial experience in the market are more likely to rely on political networks to deal with political instability and secure their benefits. These findings also show the heterogenous effects of the political environment on firms in transition economies, as they consider the heterogeneity of a firm's resources and capabilities. Thus, our study implies that the strength and direction of the influence of the political environment largely depends on what internal resources a firm possesses.

We also contribute to understanding firms' political strategies in transition economies. In transition economies, firms usually confront uncertainties and inefficient institutional supports. Most firms do not passively accept such conditions, they often actively respond to manage outside political instability (Ovtchinnikov et al. 2020). For example, senior managers may invest their time and energy into connecting with government officials to access to business resources, obtain policy favors, and acquire political legitimacy, leading to buffering outside adverse influences (Yang et al. 2019; Zhang et al. 2015a). However, the motivation on political networking is not constant to all firms. Our findings show that innovative firms and financially constrained firms are better motivated to seek government and political supports. It implies that firms in transition economies tailor political strategies with their internal resources. Thus, to manage the uncertainties induced by political instability firms need to adjust their political strategies by considering when and how they would be benefited.

Several limitations in this study guide our future research. First, the concept of political instability in this study is a composite measure. This comprehensive construct is reasonable to explore the political instability at country level and its value in determining firms' political networking. However, we can understand political instability through various dimensions, such as politician turnover (Zhong/Lin/Gao/Yang 2019), terrorist attack (Tauringana/Tingbani/

Okafor/Sha'ven 2021), social unrest (Klapper/Richmond/Tran 2013), political conflict, and even war (Li/Arikan/Shenkar/Arikan 2020). While considering these dimensions may not change our main findings on the relationship between political instability and firms' political networking, they are worth further exploration in future research. Second, our quantitative design helps deepen the understanding of 'political instability—firms political networking' links, but largely failed to unpack the 'how' question. To understand how country-level political instability determines firm-level political networks, future studies need to conduct qualitative research such as case study to acquire a detailed picture of the mechanism and process through which political instability motivates and devaluates firms' investment in political networking. Third, our study builds on empirical data from the transition economies in west Asia and eastern Europe. The generalization of the findings may lead to biased knowledge because of the differentiated research contexts. As a solution, future studies may focus on the political instability in Asian and Latin American countries and delve into the consequences of political instability in different settings. Taking these studies together, may lead to obtain a vivid picture of what, when, how, and why political instability shape firms' political networking.

Overall, this study stresses the importance of considering political instability as a determinant of firms' political networking in transitional economies. It shows that firms' internal resources may reinforce or create a buffer for the influence of external political environment on internal political networking decisions in the context of transitional economies. This study can then serve as a starting point and contribute to further studies, for example, exploring political instability through various dimensions and the consequence of political instability; the phenomena in focus on political instability in emerging economies such as China, India, Brazil; and probing into how and when political instability does and does not reshape firms' political networking behaviors.

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