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TOWARD AN INTEGRATIVE RESEARCH FRAMEWORK FOR NEW VENTURE LEGITIMACY JUDGMENT FORMATION

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ABSTRACT

Legitimacy is a critical resource for new ventures. Yet, our review of the literature indicates that the process through which new venture legitimacy judgments are bestowed by stakeholders is under-theorized. Additionally, the consequences of the legitimacy judgment for the stakeholder have not been adequately incorporated in prior research frameworks. We employ the absorptive capacity construct to address these limitations and propose an integrative research framework that includes the stakeholder in the legitimacy judgment formation process, and paves the way for empirical testing of these underlying processes.

Keywords: New ventures; legitimacy; stakeholders; judgment formation; absorptive capacity

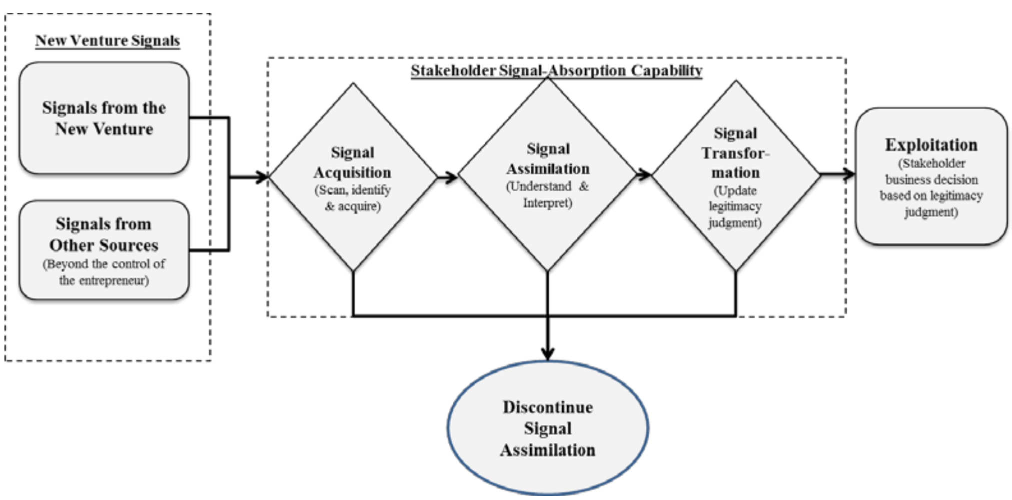
INTRODUCTION

Legitimacy is instrumental in the development, emergence, and growth of new ventures (e.g., Cornelissen & Clark, 2010; Tornikoski & Newbert, 2007; Zimmerman & Zeitz, 2002; Zott & Huy, 2007), and there is much research on this topic in the field of entrepreneurship (Bruton, Ahlstrom and Li, 2010). Given the importance of legitimacy to new ventures, founders are purported to craft and deploy signals to relevant stakeholders. Through these signals, new venture teams work to frame their business concept(s) in such a way that they are understood and accepted (Cornelissen & Clarke, 2010; Lounsbury & Glynn, 2001; Mitteness, Baucus, and Norton, 2013; Suddaby & Greenwood, 2005). Recent empirical studies focusing on new venture legitimacy indicate that both the signals deployed by new ventures and the judgments formed by stakeholders are an integral part of new venture legitimacy and ultimately, performance (e.g., Khaire, 2010; Le & Nguyen, 2009;

Nagy, Pollack, Rutherford & Lohrke, 2012; Pollack, Rutherford & Nagy, 2012; Rutherford, Buller & Stebbins, 2009). Thus, scholars suggest that both academics and practitioners may benefit from a clearer understanding of how stakeholders (evaluators) render legitimacy judgments (Bitektine, 2011; Lamin and Zaheer, 2012; Mishina, Block, & Mannor, 2012; Tost, 2011) and encourage further theory-building in this realm.

Separately, researchers have identified four characteristics of the legitimacy judgment formation process. We believe these characteristics assist in better understanding how legitimacy judgments are formed by stakeholders and the importance of those decision-making processes to stakeholders as competitors in their respective market spaces. First, they suggest that the stakeholder must "absorb" the incoming signals before forming a legitimacy judgment (Cohen and Levinthal, 1990; Griffith, Redding, and Van Reenen, 2003; Nagy et al., 2012; Pollack et al., 2012; Zahra and George, 2002). Second, the stakeholder can renege at various stages of the signal absorption process, if the information crossing the threshold is viewed to hold little value (Boulding, 1956; Galbraith, 2001; Kast and Rosenzweig, 1972). Third, the stakeholder will use new information to update his/her existing legitimacy judgment stance (Khoury, Junkunc, and Deeds, 2013; Kolb, 1984; Tost, 2011). Finally, the stakeholder reserves the right to exploit the legitimacy judgment to best serve his/her needs (Bowman and Hurry; McGrath, 1999; McGrath, Ferrier & Mendelow, 2004). Figure 1 offers the process-based view of the new venture legitimacy judgment process. We use this process model as the starting point for the development of an integrated research framework for new venture legitimacy judgment formation.

Figure 1: A Process-Based View of New Venture Legitimacy Judgment Formation



To further explore the stakeholder legitimacy judgment phenomenon in the case of new ventures, we review both the general legitimacy and new venture legitimacy literatures, with a focus on developments in the new venture legitimacy judgment realm. After conducting this review, we believe two important and underexplored aspects of new venture legitimacy judgment formation emerge: the legitimacy judgment formation process of the stakeholder and the competitive position that the stakeholder secures by making sound legitimacy judgments. We attempt to further explore these areas by: (1) using an absorptive capacity lens to provide a theoretical model for the stakeholder legitimacy judgment process in the context of new ventures; and (2) extending the new venture legitimacy judgment literature by considering stakeholders as competitors in their own market space, who create options for exploiting business decisions through the formation of legitimacy judgments.

In our attempt to introduce an integrative framework and theoretical extension of the stakeholder legitimacy judgment formation process, we first review advances made by prior researchers in defining the legitimacy judgment process. Next, we review the new venture legitimacy literature to identify trends and highlight opportunities for further theorizing. Then, we introduce our integrative model and discuss how absorptive capacity provides a theoretical perspective for combining the prior discussion of social judgments with the potential competitive position of the stakeholder. Finally, we provide implications and directions for future research in this area.

PERSPECTIVES ON LEGITIMACY

We begin by briefly highlighting the key attributes and applications of legitimacy found in scholarly contributions anchored in institutional theory, strategic management and entrepreneurship. From an institutional theory perspective, organizations can be viewed as legitimate entities if their actions and behaviors are adequately aligned with those considered dominant in a given context (Deephouse, 1996; Dowling & Pfeffer, 1975; Tost, 2011). Viewed through the institutional theory lens, a “state” of legitimacy is associated with a lack of questioning, or lack of inquiry into the organization and credibility of its practices (Scott, 1995). That is, when perceived as legitimate, an organization is argued to have obtained taken-for-granted status (Meyer & Scott, 1983).

Researchers contend that the strategic management perspective predominantly focuses on legitimacy as a resource (Ashforth &Gibbs, 1990; Dowling & Pfeffer, 1975; Suchman, 1995). From this perspective, organizations work to gain legitimacy through strategically crafting and sending signals to stakeholders. According to Suchman (1995), managers purposefully and carefully deploy such signals in an attempt to gain stakeholder approval and support. From the legitimacy as a resource perspective, positive legitimacy judgments beget subsequent positive legitimacy judgments and access to crucial resources (Rutherford & Buller, 2007; Rutherford, et al., 2009).

The entrepreneurship literature likewise recognizes legitimacy as a social judgment of the appropriateness, or the acceptability, of a new venture within a given context (e.g., Aldrich & Fiol, 1994; Lounsbury & Glynn, 2001; Zott & Huy, 2007, Bruton, et al., 2010). It is generally recognized that new ventures require access to critical resources to gain legitimacy; however, without legitimacy it is often difficult to gain access to such resources (Aldrich & Fiol, 1994; Lounsbury & Glynn, 2001; Packalen, 2007; Tornikoski & Newbert, 2007). A way to extricate oneself from this conundrum is to strategically deploy legitimizing signals, symbols, or stories that enhance firm legitimacy (Bell, 2009;

Delmar & Shane, 2004; Lounsbury & Glynn, 2001; Shepherd & Zacharakis, 2003), thus, improving the venture's likelihood of gaining access to key resources (Zott & Huy, 2007). Researchers have also argued that positive initial legitimacy judgments for the firm from one influential stakeholder often generate positive legitimacy judgments from other stakeholders (Rutherford & Buller, 2007; Voelkder and McDowell, 2010).

In sum, gaining positive legitimacy judgments and the subsequent access to crucial resources requires the new venture to convince relevant stakeholders that the firm is deserving of such an investment. Thus, stakeholder perceptions of legitimacy as a social resource are argued to hold greater importance than financial performance early in the life of the venture (Delmar & Shane, 2004; Khaire, 2010). In the subsequent section we briefly review the new venture legitimacy literature, highlighting trends that have occurred over time that point to the need for further theory development in this domain.

New Venture Legitimacy Judgements – A Synthesis of Prior Research

Work in new venture legitimacy appears to have accelerated in the last decade. Both Lounsbury and Glynn (2001) and Zimmerman and Zeitz (2002) provided conceptual views of legitimacy, paving the way for future conceptual and empirical work in this area. Lounsbury and Glynn (2001) argued that entrepreneurial storytelling facilities legitimacy, which leads to capital acquisition and ultimately improves performance. Shortly thereafter, Zimmerman and Zeitz (2002) provided a conceptual piece highlighting propositions related to the influence of cognitive, regulative, normative, and industry legitimacy on new venture survival and growth. Other theory-building contributions have focused on strategically undertaking legitimacy for resource acquisition (e.g., Godwin, Stevens, & Brenner, 2006; Packalen, 2007), the legitimacy threshold (Rutherford & Buller, 2007), and the mediating role of legitimacy on the relationship between new venture image and how entrepreneurs attempt to frame the venture to stakeholders (Cornelissen & Clark, 2010). One noticeable thread in the theoretical developments of new venture legitimacy is that this literature focuses on signaling from the entrepreneur's perspective, and the outcome accorded to the entrepreneur from crafting such signals. Such research indicates that prior theory developments related to new venture legitimacy have primarily focused on the demand side of the legitimacy equation, i.e., how entrepreneurs can work to influence legitimacy judgments, and have often viewed legitimacy acquisition from a cognitive legitimacy vantage point (Mitteness et al., 2013).

Rutherford and Buller (2007) contend that legitimacy is accorded to the firm by important stakeholders and that it cannot be forced. Yet, the processing of information by the stakeholder is held constant or is assumed away in most entrepreneurship research on the legitimacy phenomenon. Although discussions of legitimacy often refer to stakeholders (i.e., Cornelison & Clarke, 2010; Drori, Honig, & Sheaffer, 2009; Lumpkin, Moss, Gras, Kato, & Amezcua, 2011; Zott & Huy, 2007), Mitchell (2002: 188) argues that new venture formation should be viewed as a "stakeholder-centered phenomenon," since stakeholders serve as the deciding factor in new venture survival. Donaldson and Preston (1995) posit that a stakeholder-centered model has superior attributes because it allows for the inclusion of all individuals or groups of individuals with legitimate interests in the venture. Since these stakeholders are numerous and varied (i.e., investors, employees, suppliers, government, trade groups, customers, communities, etc.), individuals or groups of individuals will evaluate the firm from their unique perspective and determine its legitimacy in a particular realm, thereby, granting or withholding resources and influencing the performance of the firm.

Toward Stakeholder-Centered Perspective

Much of the early research on new venture legitimacy has focused on entrepreneurs' actions and the associated outcomes, thus, assuming that legitimacy is granted when some positive outcome occurs (e.g., Delmar & Shane, 2004; Khaire, 2010; Le & Nguyen, 2009; Maguire, Hardy, & Lawrence, 2004; Navis & Glynn, 2010; Ruebottom, 2013; Sine, David, & Matsuhashi, 2007). However, most recently, researchers have begun to shift their analyses to provide a broader exploration of the legitimacy phenomenon. Current empirical research attempts to extend the stakeholder perspective through analyses of stakeholder decisions related to legitimacy (e.g., Nagy et al., 2012; Pollack et al., 2012). While this is an important first step, we argue that further theorizing is needed to better understand this process.

USING THE ABSORPTIVE CAPACITY PERSPECTIVE TO EXPLAIN NEW VENTURE LEGITIMACY JUDGMENT FORMATION

Although great strides have been made in theorizing the stakeholder legitimacy judgment formation process, opportunities for refinement and extension remain, especially in the context of new ventures. Absorptive capacity provides a helpful lens through which to view the stakeholder legitimacy judgment phenomenon. Further, since stakeholders are argued to act in their or their referent groups' interests (e.g., Bitektine, 2011; Nagy et al. 2013), we contend that viewing the stakeholder as a competitor in his/her market space is an important next step in further refining legitimacy theory. The availability of knowledge is a critical element of this process (e.g., Nagy et al., 2012; Zott and Huy, 2007); thus, we propose that absorptive capacity provides a possible lens to view this process. The absorptive capacity construct is particularly useful in theorizing stakeholder new venture legitimacy judgments since it accounts for the following stakeholder attributes: (1) learning, cognitive limitations, and the use of heuristics, (2) the influence of the stock of prior knowledge, (3) signal-sourcing predisposition of the stakeholder, and (4) the potential gain that motivates the stakeholder to make such legitimacy judgments.

The term "absorptive capacity" appears most often in research on organizational learning. Researchers suggest that the need to manage change and to stay competitive requires organizations to dynamically adjust their capabilities (Teece & Pisano, 1994). Such capability adjustments demand the acquisition and use of new knowledge that must be "learned" by the firm. Cohen and Levinthal (1990) proposed that the difficulty experienced by firms may occur because organizational learning is attenuated by the "absorptive capacity" of the firm. Building on the seminal work of Cohen and Levinthal (1990), Zahra and George (2002) define absorptive capacity as the "set of organizational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organizational capability" (p. 186). Interestingly, Cohen and Levinthal's development of the absorptive capacity construct at the organizational level is rooted in "learning" at the individual level and draws on cooperative learning literature at the individual level (Dewey, 1933; Kolb, 1984; Garrison, Anderson, & Archer, 2001; Piaget, 1977; Volberda, Foss & Lyles, 2010).

Cohen (1991) succinctly highlights the striking similarity between the work conducted on "learning" and "absorptive capacity" at the individual and the organizational levels, respectively. Indeed, we have come full circle to find relevance of the absorptive capacity construct at the individual level of analysis, which Griffith and colleagues (2003) defined as the individual's ability to absorb and ultimately exploit new knowledge. There has been growing acceptance of the use of the absorptive capacity construct to research individual learning processes (i.e., the individual's ability to assimilate the signal). For example, Daghfous (2004) used individual absorptive capacity to explain the implementation of knowledge-intensive best practices. In a multinational study, Vance and Paik (2005) studied absorptive capacity in the context of host country nationals. Deng, Doll, and Cao (2008) studied the relationship between absorptive capacity and productivity of individual engineers. Hotho, Becker-Ritterspach, and Saka-Helmhout (2011) examined individual absorptive capacity through a social interaction lens, and Kankanhalli, Pee, Tan, and Chhatwal (2012) used it to study the antecedents of learning in a research context. Most of the empirical research on individual-level absorptive capacity has used the four-dimensional operationalization of the construct and has employed measures similar to those offered by research at the organizational level. Examples of such an approach include work by Daghfous (2004), Kankanhalli et al. (2012), and Hotho et al. (2011), which use descriptions of absorptive capacity by Cohen and Levinthal (1990), Szulanski (1996), Zahra and George (2002), and Todorova and Durisin (2007) to measure absorptive capacity. Hence, we extrapolate from this stream of research and apply the four dimensions of absorptive capacity to the stakeholder's legitimacy judgment formation process. The four dimensions are:

1. Acquisition encompasses the process of actively listening, identifying, and acquiring beneficial knowledge via signals from the new venture or relevant third party.

2. Assimilation represents the process involved in analyzing, synthesizing, and understanding the newly acquired knowledge from the new venture or third party.

3. Transformation refers to the process of rationalizing and combining the internalized knowledge with existing knowledge structures, which include adding or deleting knowledge to arrive at a new knowledge structure and a legitimacy judgment.

4. Exploitation refers to the process of putting the legitimacy judgment to use through decisions and actions that create value for the exploiter (the stakeholder).

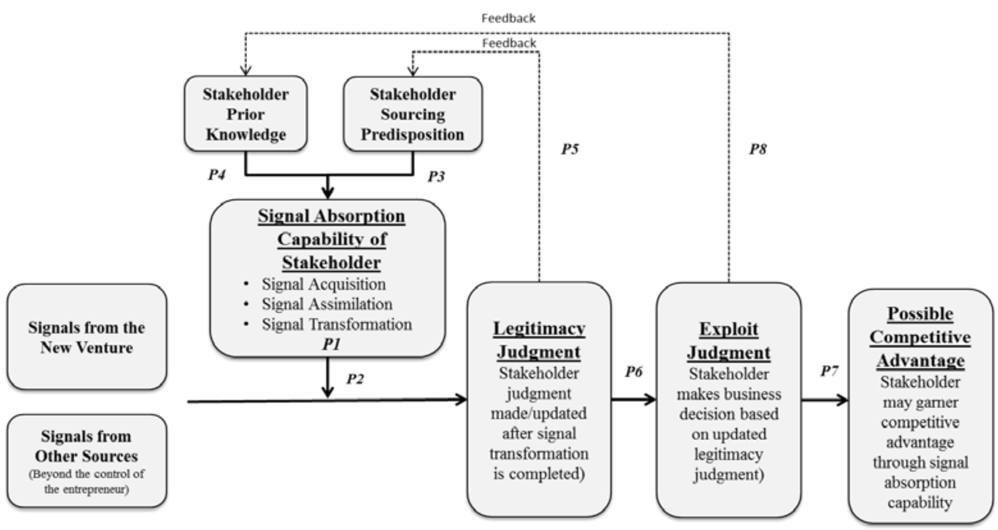
Applying Absorptive Capacity to New Venture Legitimacy

Applied to the legitimacy judgment formation context, it can be argued that absorptive capacity of the stakeholder influences the stakeholder's legitimacy judgment and the subsequent decision. New ventures do not have the "histories" that can be attached to more established organizations (Tornikoski & Newbert, 2007; Nagy et al., 2012; Pollack et al., 2012); thus, much of the stakeholder's judgment of the venture is based on active evaluation and learning (Pollack et al., 2012; Rutherford et al., 2009). In such situations, we contend that stakeholders combine current knowledge of the industry and firm with information shared by the new venture team and other relevant stakeholders to arrive at a legitimacy judgment. Although this basic process may exist for more established firms, Suchman (1995) and Tost (2011) indicate that new ventures often require more active and intense evaluation by the stakeholder since so little credible information exists for these entities. As will be noted later, information availability may assist the stakeholder in making valuable and potentially profitable decisions; thus, the absorptive capacity process, as a means to facilitate competitive advantage for the stakeholder, appears to serve as an interesting and useful lens through which to view the new venture legitimacy judgment process.

A FRAMEWORK FOR RESEARCH ON NEW VENTURE LEGITIMACY JUDGMENTS

We highlight the development of our research framework for new venture legitimacy judgments in Figure 2. Prior to developing the framework and discussing our propositions, however, it is important to address the assumptions of our model. First, we focus solely on new ventures because of the unique context in which the stakeholder arrives at a legitimacy judgment. Second, we assert that the judgment formation process for stakeholders is a dynamic, social process. In the following sections we provide support for our assumptions and offer propositions related to our framework.

Figure 2: Integrative Research Framework for New Venture Legitimacy Judgment Formation



Assumptions

Focus On New Ventures. As a social process, legitimacy judgment formation has often been examined in the context of established firms. Established organizations have financial histories, track records of performance, and demonstration of founder and manager competencies. New ventures often suffer from liabilities of newness (Lumpkin, Alexander, Gras, and Nason, 2010; Rutherford and Buller, 2007), since they are untested and unproven in the marketplace. Even so, new ventures have a critical need for resources, without which the venture will fail (Delmar and Shane, 2004). With little credible information about the founders, managers, and the business available (Rutherford et al., 2009), new ventures must consistently work to frame their venture as acceptable, appropriate, and worthy of resource investments from stakeholders (Tornikoski and Newbert, 2007). We contend that new ventures serve as a special case in terms of the legitimacy judgment process since new ventures have not yet established firm reputations and generally can provide little evidence of past success. In such a case, stakeholders must more actively evaluate the firm; thus, expending more cognitive effort in assessing the legitimacy of new ventures (Tost, 2011).

Stakeholder Judgments. Some assumptions regarding the order of the absorptive capacity process, stakeholder cognitive capacity, and the feedback involved in the formation of legitimacy judgments and business decisions were made as we conceptualized our framework for new venture legitimacy judgments. First, based on the evidence from prior research, we assume that components of the absorptive capacity process are sequentially positioned (Cohen & Levinthal, 1990), and that they follow the order presented in prior research. Secondly, we argue that a stakeholder has the cognitive capacity to determine whether or not a signal holds value – a common assumption across general models of stakeholder evaluation (e.g., Bitektine, 2011). Additionally, we assume that knowledge accumulation is path dependent (Cohen & Levinthal, 1990) and that the process will proceed until sufficient knowledge is gained by the stakeholder to make a final business decision (i.e., financing awarded versus no financing awarded; purchase made versus no purchase made; permit granted versus no permit granted) (Kast and Rosenzweig, 1972). These assumptions are aligned with those made by prior researchers and support the use of an integrative framework. In the subsequent section, we will use these assumptions to develop our propositions related to the new venture legitimacy judgment formation process.

The Signal Absorption Capability and Legitimacy Judgment Formation

The process framework (Figure 1) indicates that on receipt of the information from the new venture or other relevant party, the stakeholder begins to process the information and integrates it with his/her existing pool of knowledge. In the context of a new venture, the stakeholder can combine knowledge acquired from other sources with his/her existing knowledge to arrive at a new perception of legitimacy of the organization. The stakeholder's ability to create new and useful judgments about the legitimacy of an organization involves an ability to combine new information with existing knowledge into new and possibly different knowledge structures – a process that goes beyond simply attenuation of the newly acquired information. We call this the signal absorption capability of the stakeholder.

Components of the Signal Absorption Capability

Absorptive capacity theory suggests that the signal absorption process consists of sequential steps. Zimmerman and Zeitz (2002) argue that prior to legitimation, the stakeholder must first determine whether the new venture is of sufficient interest before proceeding to make a judgment. To make such a determination, Fosfuri and Tribó (2008) and Bansal and Clelland (2004) suggest that information is acquired by the stakeholder from the firm and other relevant stakeholders of the firm. That is, once the new venture team or other entities emit signals, the stakeholder must choose to expend resources (however small) to obtain the information and to determine whether the information holds value. Within our framework, this point would be represented by the acquisition stage of the signal absorption capability. If the information is seen to have value, it is moved by the recipient stakeholder toward assimilation.

Assimilation represents the process involved in analyzing, synthesizing, and understanding the newly acquired knowledge from the new venture or other entities. It facilitates an understanding of the new information, assesses its congruence with existing knowledge structures, and allows the stakeholder to assess whether the new knowledge needs to be reconfigured for it to be usefully employed (Lefkowitz & Lesser, 1988). Prior research suggests that other stakeholders or trusted entities may provide important information to facilitate the assimilation process, particularly in situations where information from the entrepreneur is scarce or questionable (Bitektine, 2011). When trusted and reliable information is available from other parties, then the stakeholder may engage in “cognitive economy,” which suggests the stakeholder will use heuristics, when possible, to avoid the costs of cognitive processing (Bitetkine, 2011; Bruton et al., 2010). However, in other situations stakeholders may be motivated to perform additional information search, despite the cognitive costs involved (Tost, 2011). If the acquired information is seen to have been adequately assimilated, it is moved toward transformation.

During signal transformation, the assimilated information is placed in the appropriate context to determine whether differences that exist between the extant knowledge and the new information need to be addressed. This allows the stakeholder to cognitively combine the signal with his/her pool of prior knowledge (Bansal & Clelland, 2004; De Clercq, & Dimov, 2008; Lane, Koka, & Pathak, 2006). In the context of the legitimacy judgment formation process, the assimilated information from both the new venture and relevant third parties is combined with the stakeholder’s existing knowledge structures. For example, when the new venture is seen as very similar cognitively to other ventures/firms in existence and when the stakeholder’s knowledge of these ventures is high, then this portion of the process should move more rapidly and require less effort by the stakeholder (Bitektine, 2011; Zott & Huy, 2007). At some point in the process, the stakeholder will form an initial judgment. If a predetermined legitimacy “threshold” (set by the stakeholder) has been met, then the stakeholder may move to execution of a business decision (e.g., invest versus do not invest) (Rutherford & Buller, 2007).

> *Proposition 1. The signal absorption process adopted by the stakeholder will include three distinct activities labeled*

acquisition, assimilation, and transformation.

Influence of the Signal Absorption Capability. Our development, anchored in absorptive capacity theory, suggests that the stakeholder's ability to combine new information with existing knowledge structures influences the new venture legitimacy judgment decision. In this conceptualization, the signal absorption capability moderates of the relationship between the signal emitted by the new venture and the stakeholder's legitimacy judgment. Thus, recognizing the path dependency characteristics of social judgments (Khoury et al., 2013; Mishina et al., 2012), we posit that the influence of signals related to the new venture on the legitimacy judgment will be moderated by the stakeholder's ability to acquire, assimilate, and transform these signal. Hence we offer the following proposition

Proposition 2. The signal absorption capability of the stakeholder moderates the relationship between signals emanating from the new venture and the legitimacy judgment formed by the stakeholder.

Acknowledging the Antecedents of Signal Absorption Capacity

Researchers have identified two antecedents of an individual's absorptive capacity: the stock of prior knowledge and the predisposition to source new knowledge. Recognizing that learning is path dependent (e.g., Harris, Mosakowaski & Dimov, 2008), researchers have demonstrated that the stock of prior knowledge influences an individual's ability to absorb new knowledge, i.e., to learn (Kole & Healy, 2007; Rehder & Murphy, 2003; Sohn, Anderson, Reder & Goode, 2004). In the context of our research, this suggests that the stock of prior knowledge held by the stakeholder influences the acquisition, assimilation, and transformation of new information emanating from the venture (Harris et al., 2008).

The second antecedent of absorptive capacity is the individual's predisposition to source "new" knowledge. Researchers have identified two factors that determine this predisposition. The first is the knowledge sourcing initiative of the individual (Gray & Meister, 2004; Kankanhalli, et al., 2012). The second is the individual's intrinsic motivation to learn (Gottfried, Fleming, & Gottfried, 2001). Further, researchers suggest that the individual's predisposition to access multiple sources of information influences their learning effectiveness (Kankanhalli, et al., 2012). In the development of our framework, we propose that both the stock of prior knowledge and the predisposition to source new knowledge influence the legitimacy judgment formation process.

These two antecedents are widely acknowledged to influence the signal absorption capability. That is, (1) the stakeholder's signal-sourcing predisposition can influence the ability to acquire the information arriving from the new venture, and (2) the stakeholder's stock of knowledge facilitates the ability to acquire new knowledge disseminated by the new venture or third party. Signal sourcing predisposition has been argued to facilitate a more extensive search for information as the stakeholder forms the legitimacy judgment. It is believed to relate positively to the legitimacy judgment (Bitektine, 2011; Tost, 2011). Research likewise indicates that stakeholders are expected to combine their stock of knowledge with the information transferred from the new venture as they form legitimacy judgments (De Clercq & Dimov, 2008). Both the stakeholder's signal-sourcing predisposition and stock of knowledge will assist in determining the value of the information signal (Bansal & Clelland, 2004) and in moving towards a legitimacy judgment. Thus, we expect the following.

> *Proposition 3. The stakeholder's signal sourcing predisposition is an antecedent that significantly influences the efficacy of the signal absorption capability.*

> *Proposition 4. The stakeholder's stock of knowledge is an antecedent that significantly influences the efficacy of the signal absorption capability.*

Until some legitimacy threshold is met by the new venture, the stakeholder may feel it is necessary to further evaluate the new venture, combining the updated knowledge set with forthcoming signals (Khoury, Junkunc, & Deeds, 2013). Mishina et al. (2012) argue that any observations or prior beliefs about the new venture will influence future assessments of information pertaining to it, since social judgments are path dependent. In this case, the updated information works to inform the stakeholder's predisposition to source subsequent signals, via the acquisition point. In other words, this would increase the stakeholder's propensity to source the signal via the recognition of valuable information that crosses this interface.

> *Proposition 5. Past legitimacy judgment(s) formed by the stakeholder significantly influence their current and future predispositions for sourcing signals.*

Exploiting the Legitimacy Judgment: Creating Real Options for the Stakeholder

Prior research suggests that stakeholders have ulterior motives regarding when to expend resources and form legitimacy judgments since each stakeholder will work to leverage relationships with ventures they see as beneficial to themselves, the community, or society (Bitektine, 2011). Nagy et al. (2012) and Pollack et al. (2012) argue that ultimately, new venture teams are granted legitimacy by stakeholders who believe the firm will generate value for them. Since stakeholders are also evaluated on their legitimacy judgments and business decisions, they too are involved in competition with other stakeholders to bolster their own legitimacy by choosing to legitimize firms that hold the greatest potential value and benefit. Bitektine (2011) indicates that since stakeholders are subjected to social judgments from their peers, the stakeholder will be attentive to how their legitimacy judgment will be perceived by relevant others. Mishina et al. (2012) argue that despite the social element of legitimacy judgments, it is possible that an individual stakeholder will evaluate the firm differently from other stakeholders, even within the same reference group.

In sum, since stakeholders often make both cognitive and financial investments in evaluating the firm in hopes of potential gain, we argue that stakeholders serve as competitors in their respective market. As a competitor, the stakeholder seeks to combine prior knowledge and the information supplied by the new venture as efficiently and expediently as possible in order to maximize value (or minimize prospective loss) for the resources invested in forming their legitimacy judgment and subsequent business decision. Thus, we argue that in the context of new venture legitimacy judgments, the stakeholder acts as a competitor for the attention of potentially valuable new ventures; thus, seeking the best opportunities available for his/her resource investments.

When a stakeholder determines that the firm has crossed some legitimacy threshold, legitimacy is established (or denied), and the motivation to source additional information about the new venture declines (Cornelissen & Clarke, 2010). The exploitation of the legitimacy judgment then occurs when the stakeholder executes some decision. This decision may be as simple as making a purchase, or as complex as joining the top management team or serving as a major financier of the venture. What is important to note is that although stakeholders make legitimacy judgments in differing contexts, all approach the execution of the decision by choosing from among several options generated as a result of the legitimacy judgment.

We contend it is possible to conceptualize the signal absorption capability as a tool used by the stakeholder to create real options that later can be "exercised" or exploited. An option secures an opportunity, but does not oblige the party to act on the opportunity if it does not appear attractive (Bengtsson, 2001; Kogurt and Kulatilaka, 2001). Our development suggests that the signal absorption capability can potentially present real options to the stakeholder. The stakeholder then has the opportunity, but not the obligation, to buy into (or disregard) these options (i.e., invest versus not invest, purchase versus not purchase, etc.). Option theory (Bowman and Hurry, 1993; Kogurt and Kulatilaka, 2001) informs us that this selection will be based on the expected value of the outcome and the timeframe available to exercise the option. Hence, we offer the following proposition.

> *Proposition 6. The stakeholder exploits the legitimacy judgment through actions that are constrained by the available timeframe and moderated by the expected value of the business decision.*

Work by McGrath and colleagues (McGrath, 1999; McGrath et al., 2004) suggests that, in the context of new venture legitimacy judgments, the decision not to exercise an option (resulting from a negative legitimacy judgment) limits stakeholder resources expended to exercise the option and minimizes the exposure to its consequences. However, the decision to exercise the option (resulting from a positive legitimacy judgment) could open the door to subsequent opportunities with the new venture or other lucrative ventures. Hence, successful option creation may allow the stakeholder to gain a competitive advantage relative to competitors in accessing and assessing opportunities (Bowman and Hurry, 1993). Therefore, we offer the following proposition

> *Proposition 7. The judicious choice of real options that result from the efficient and effective navigation of the legitimacy judgment process provides the stakeholder with a competitive advantage in the marketplace.*

Since social judgments are path-dependent (Khoury et al., 2013; Mishina et al., 2012), navigating the legitimacy judgment process regarding one new venture then informs the stakeholder's pool of prior knowledge for subsequent legitimacy judgments related to both that venture and related ventures.

Through the social process, the stakeholder obtains information about the new venture system, its top management team, and the environment or context within which it operates. Additionally, the stakeholder may receive pertinent information from other relevant stakeholders. As this information is acquired, assimilated, and transformed, the stakeholder uses knowledge about the new venture, and works to form the legitimacy judgment. The information absorbed through the judgment formation process accumulates and augments the signal absorption capabilities of the stakeholder, as can be seen via the feedback loop from the exploited judgment to the pool of prior knowledge in Figure 2. Our feedback loop indicates that knowledge as an output from prior experiences serves as an information (i.e., prior knowledge) input for the formation of subsequent legitimacy judgments (Kast and Rosenzweig, 1972). Researchers indicate that signals are most effective when crafted in a way that allows the stakeholder to tie the information to pre-existing knowledge structures (e.g., Cornelissen & Clarke, 2010; Elsbach & Kramer, 2003; Lounsbury & Glynn, 2010). Thus, we propose that prior legitimacy judgments inform subsequent ones and augment the stakeholder's absorptive capacity.

> *Proposition 8. Experiences that result from the exploitation of legitimacy judgment formation augment the knowledge base of the stakeholder; thus, influencing the stakeholder's absorptive capacity in future judgments.*

DISCUSSION

New ventures are untested, unproven, and often serve as sources of risk for interested stakeholders, yet new ventures require stakeholder support to survive. The literature related to social judgments of legitimacy indicates that stakeholders are the "grantors" of legitimacy. Thus, granting of positive legitimacy judgments by relevant stakeholders may allow fledgling firms to flourish rather than falter. Our review of the new venture legitimacy judgment context indicates that research is limited in its consideration of the stakeholder as an active participant in this social judgment process. Hence, we offer an integrative framework for new venture legitimacy judgment formation and work to extend theory-based research on stakeholder legitimacy judgment formation by considering the stakeholder as a competitor in the market for the new venture's attention.

We believe our integration makes two primary contributions to the new venture literature. First, we argue that legitimacy judgment formation is a learning process, and integrate prior research on legitimacy judgments with that of absorptive capacity to account for the cognitive limitations of the stakeholder in assessing the legitimacy of a new venture. Second, to our knowledge, this is the first study to extend this process by characterizing stakeholders as competitors for the new venture's attention. Stakeholders are interested in pursuing opportunities that will benefit them or the larger group they represent (Bitektine, 2011; Nagy et al., 2012; Pollack et al., 2012). Thus, the stakeholder may have significant human, financial, and social capital resources at stake if a positive legitimacy judgment is granted and the stakeholder decides to engage in a business relationship with the organization. Although prior research has accounted for the social scrutiny of stakeholders regarding their legitimacy judgments, the competitive advantage stakeholders may gain from exhibiting good judgment and subsequently sound business decisions has yet to be explored. In the following section, we address the theoretical implications of viewing new venture legitimacy judgments from this perspective.

Theoretical Implications

We offer what we believe to be five theoretical contributions. First, prior research suggests that stakeholders use their knowledge of industries and market spaces in executing business decisions. De Clercq and Dimov (2008) found that when venture capitalists invested in industries in which they had more knowledge, investments performed better than in those in which the venture capital firm had little experience. Researchers argue that in cases where the stakeholder has little internal knowledge; credentials, impression management, or gaining external knowledge may be critical to forming legitimacy judgments and subsequent business decisions (De Clercq and Dimov, 2008; Nagy et al., 2012). Such studies lead us to believe that our integration incorporating the signal of the entrepreneur and relevant others with the signal absorption capabilities of the stakeholder provides an improved theoretical basis for studies of new venture legitimacy judgments. Bitektine (2011) considers the use of heuristics when social judgments are enveloped in uncertainty, as in the case of new ventures. We argue that when Bitektine's work is considered in conjunction with research on the new ventures and with our current developments, the new venture legitimacy judgment formation process may best be represented by a situation in which heuristics, active evaluation, and information gathering are considered concurrently.

Second, we contend that the stakeholder may often be viewed as a competitor in his/her market space, since the investment of resources in wealth-generating ventures provides an opportunity for gain. If the stakeholder is a competitor in the market space for a new venture's attention, then the stakeholder must dynamically adjust his or her capabilities (Teece & Pisano, 1994) to gain competitive advantage. We argue that via absorptive capacity, stakeholders learn new information about the venture from prior experiences, the new venture team, and other relevant stakeholders. In all the "noise" about a venture coming from various entities, the stakeholder must work to actively evaluate the information and determine its value. The signal absorption capability of the stakeholder then becomes valuable, since effectively and efficiently navigating the process may allow him/her to use the "new" information and prior knowledge to make sound legitimacy judgments. Based on the legitimacy judgment, the stakeholder may decide to engage in or refrain from some business decision, depending on the assessment of whether the business opportunity appears attractive. By doing so, the signal absorption capability itself can be viewed as the stakeholder's "dynamic capability" since it can reshape the stakeholder's propensity to act and afford the stakeholder a competitive advantage over other stakeholders (Fosfuri & Tribó, 2008; Jansen, van den Bosch, & Volberda, 2005) in the market space. Considering stakeholders as competitors in their own market allows us to better understand the motivations of stakeholders in forming legitimacy judgments and opens the opportunity to view the stakeholder's business decision (based on the legitimacy judgment rendered) from a real options perspective.

Third, real options theory provides a lens through which the competitive stance of the stakeholder can be better understood. Prior research establishes that stakeholders make self-interested decisions. We argue that each time the legitimacy judgment formation process is enacted, it creates options for the stakeholder. Based on the legitimacy judgment, the stakeholder creates the option, but not obligation, to enter some business relationship with the new venture (Kogurt & Kulatilaka, 2001). By consistently choosing fruitful options over unfruitful ones (or consistently refraining from exercising unfruitful ones) via the signal absorption capability, the stakeholder may gain a competitive advantage in the market space. In viewing the stakeholder as a competitor for the attention of profitable ventures, we both account for the social judgments stakeholders themselves face, as well as the potential gain (loss) they may encounter from exploiting business decisions based on solid (poor) legitimacy judgments.

Fourth, the absorptive capacity process has been theorized as a sequential process (Cohen and Levinthal, 1990), and we assume it continues as such in the context of new venture legitimacy judgments. In viewing the stakeholder's judgment formation process in this way, we likewise provide opportunity for the stakeholder to exit at any point in which information is seen to hold some value. We believe this is reflective of the tenets of system theory (e.g., Boulding, 1956) and is in alignment with practice. In viewing social judgment formation as moderated by the signal absorption capabilities of the stakeholder (informed by motivation level and stock of knowledge), we account for signals from multiple sources, the cognitive capabilities of the stakeholder, the formation of the judgment based on these factors, as well as the opportunity to capitalize on sound judgments via exploitation of a business decision. If at any point a signal is seen to hold less value than the cognitive costs associated with signal absorption, then the stakeholder may choose to exit the judgment formation process. Again, under this scenario, efficient and effective use of the signal absorption capability can save the stakeholder time and resources by refraining from forming poor judgments and engaging in unprofitable business relationships with new ventures.

Finally, researchers argue that the social judgment process is path dependent (Khoury et al., 2013; Mishina et al., 2012). That is, prior judgments inform subsequent ones through cognitively combining incoming signals with the stock of prior knowledge (Bansal & Clelland, 2004). Once a legitimacy judgment is formed, and a business decision is rendered, the information gleaned from the stakeholder-new venture team interaction will become an input for subsequent legitimacy judgments (Harris et al., 2008; Kast & Rosenzweig, 1972). This accounts for the ability of the stakeholder to provide a response, based on his/her knowledge and context (Navis & Glynn, 2010). In viewing the signal absorption capabilities of stakeholders as a moderating influence, we account for the influence of prior knowledge as a source of information, which assists in building the signal absorption capabilities of the stakeholder. Better understanding the signal absorption capability, as well as the factors that may influence the development of this capability, are essential to moving stakeholder-centric new venture legitimacy judgment theory forward. In the subsequent section, we address how these theoretical contributions may guide future research and shape practical application of legitimacy judgment research.

Future Directions and Practical Implications

We believe our work to provide practical implications, as well as important directions for future research. Since small business and new venture research is often most applicable and useful when practical implication and future research are intertwined, we present them as such. In what follows, we examine the practical and research importance of stakeholder judgment processes, competitive position of stakeholders, stakeholder benefit from consistently making sound legitimacy judgments, and the real options that accrue from the stakeholder legitimacy judgment process.

Zott and Huy (2007) argue that entrepreneurs, who are skillful in signaling, are much more likely to gain access to the resources needed by the firm. Prior researchers contend that social actors can reduce the cognitive effort of the stakeholder by providing valuable information that reduces the time spent in processing the signal (e.g., Bansal & Clelland, 2004; Tornikoski & Newbert, 2007; Zott & Huy, 2007). Due to their uncertainty, new ventures require more active processing on behalf of stakeholders to determine legitimacy. Zhu, Hitt, and Tihanyi (2006) argue that the development of capabilities and competitive advantage in quickly globalizing markets is critical. We believe our integrative model provides a theoretical basis that explicates the most critical aspects of the judgment formation process, while also allowing for the influence of prior knowledge and motivation, threat of social scrutiny, and the stakeholder's desire to establish competitive advantage. Such a model provides a more comprehensive and compelling picture of this process, and paves the way for theory building and empirical testing of stakeholder new venture legitimacy judgments.

The efficient and effective navigating of the legitimacy judgment process, exercising of beneficial options, and the receipt of positive legitimacy judgments from other stakeholders may lead to an improved competitive position for the stakeholders. For example, consider an investor who renders a positive legitimacy judgment for a new venture. The investor makes an investment, and is widely known as part of the investment team funding the venture's activities. The new venture then becomes very profitable, yielding a considerable return on investment. After hearing of this investor's success, other high potential new ventures seek this stakeholder out for his/her expertise; thus, further augmenting the legitimacy of this stakeholder in spotting and funding high return ventures. The same situation can intuitively apply to consultants, executives, and alliance partners. In viewing the stakeholder as a competitor, we believe motivation (Liden & Mitchell, 1988), social desirability (Bitektine, 2011), and impression management (Barsness, Diekmann, & Seidel, 2005; Bolino, Kacmar, Turnley, and Gilstrap, 2008) from the stakeholder perspective are avenues that may produce interesting practical application and future research on stakeholder behavior and decision making.

Although researchers have proposed processes for stakeholder legitimacy judgment formation, how the stakeholder may gain benefit from the exploitation process has yet to be addressed. Stakeholders are viewed as grantors of resources or support for change in an industry; however, in reality, many stakeholders grant resources to new ventures in the expectation of some personal, professional, or financial gain. For example, an angel investor would make an investment in a new venture expecting that venture to yield a considerable return. A banker would lend to a new venture in the expectation that the loan be paid back with interest. A supplier may extend credit to the new venture in the expectation of repeat orders. Under the cases described, it is also feasible to assume that a stakeholder competes with other stakeholders to reap gains from legitimate entities. To our knowledge, our framework is the first to explicitly account for the exploitation of a business decision. When viewed as influencing the stakeholder's propensity to act, signal absorption can be viewed as a capability of the stakeholder, thus, accounting for the stakeholder's attempt to gain a competitive advantage. Such a viewpoint also allows the opportunity to explore the motives and decision-making processes of stakeholders in a different light. Additionally, future research in this area would likely have great practical and managerial implications since entrepreneurs could better understand the motivation or drivers of stakeholders in exploiting legitimacy signals to form their ultimate business decision.

In considering the stakeholder as a competitor, the decision-making process is a critical component of legitimacy judgment formation. We view the signal absorption capability as an option-creating tool since processing the information provided by the new venture creates an opportunity for the stakeholder. Based on the tenets of real options, we believe that this theoretical development can be used to explore the relationship between new ventures and stakeholders in this process, depending on the resources required to process the signal, as well as the time frame available to exercise the option. A real options lens provides a solid basis to contextualize the signal absorption capability since the speed with which a stakeholder moves through this process is likely specific to the stakeholder and the environment. Further, the importance of signal types can be explored when a real options perspective is taken into account for the importance of time and resources required to create the option (i.e., pass through the signal absorption capability).

CONCLUSION

Although legitimacy is necessary for all ventures, the resources afforded via legitimacy to new ventures are especially critical. Given their absence of track records and information on performance, new ventures necessitate additional scrutiny and evaluation on behalf of stakeholders (Lumpkin et al., 2010). In an attempt to explicate the legitimacy judgment process in the context of new ventures, we review the new venture legitimacy literature. This literature suggests that there are two opportunities to further theorize stakeholder judgments in the new venture context, which we develop in our framework for new venture legitimacy judgments First, we integrate prior research on legitimacy judgments with the absorptive capacity construct to account for the cognitive processing of the stakeholder in forming new venture legitimacy judgments. Second, we characterize the stakeholder as a competitor in his/her particular market space. Since stakeholders are self-interested, they pursue opportunities with new ventures they believe will benefit them or their referent group. Thus, stakeholders form a legitimacy judgment for a particular new venture, which creates an option but not an obligation to undertake some business opportunity. Prior research has addressed the social scrutiny stakeholders face for their legitimacy judgments, but to our knowledge, researchers have yet to characterize the stakeholder as a competitor for the new venture's attention or address the options legitimacy judgments create for the stakeholder. We believe our framework provides a more comprehensive view of the legitimacy judgment formation process in the context of new ventures and paves the way for empirical testing of these proposed processes.

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