

Research on the Effects of Cognitive Legitimacy on the Performance of New Venture

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Abstract

It has always been an important issue in the field of entrepreneurial research for startups to overcome the threshold of legitimacy to obtain external resource support. Based on the study of the concept of cognitive legitimacy and the performance of new venture, this paper discusses the mechanism of the effect of cognitive legitimacy on the performance of new enterprises, and puts forward the relationship hypothesis. This paper chooses the new ventures from the TV show “Winning in China” as a sample of the study, and we use SPSS statistical analysis software to perform hypothesis testing of data. The results show that the cognitive legitimacy has a positive influence on the performance of the new enterprises.

Key words: Cognitive legitimacy; New ventures; Performance

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INTRODUCTION

It is critical for start-ups to access to external resources. However, efforts to obtain resource support often tend to fail due to the prevalence of “new entry defects” in new enterprises (Aldrich & Fiol, 1994). These deficiencies include lack of business history to demonstrate its

reliability, hard to attract outstanding employees to quickly build core competencies, and the difficulty of establishing stable and reliable relationships with clients, investors and other stakeholders (Stinchcombe, 1995). These defects are called the “legitimacy threshold” in the growth of new businesses (Zimmerman & Zeitz, 2002).

There are many scholars studying the performance of new enterprises from different perspectives, such as entrepreneurs, strategies, external environment and resources. Although legitimacy has an important influence on the survival and development of new enterprises, there are not many studies combining the cognitive legitimacy with the performance of start-up enterprises, there is still room for further discussion on the relationships between cognitive legitimacy and entrepreneurial performance. In this paper, we hope to explore the related problems of the performance of start-up enterprises from a new perspective.

1. THEORETICAL BACKGROUND AND HYPOTHESIS

1.1 Cognitive Legitimacy

Legitimacy is an “important resource that can help organizations gain access to other resources” (Zimmerman & Zeitz, 2002). On the basis of summarizing the predecessors’ research, Suchman (1995) puts forward the definition of legitimacy which has been widely accepted by scholars, namely: Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.

Legitimacy is an intangible resource, and scholars classify the types of legality from the source of legitimacy according to their own research objects and purposes. Singh et al. (1991) divided the legitimacy into internal legitimacy and external legitimacy according to source;

Scott (1992) divided the legitimacy into regulative legitimacy, normative legitimacy and cognitive legitimacy; Dacin et al. (2007) proposed five types of legitimacy associated with strategic alliances which are market legitimacy, relational legitimacy, social legitimacy, investment legitimacy and alliance legitimacy. At present, it is widely accepted by scholars to divide legitimacy into regulative legitimacy, normative legitimacy and cognitive legitimacy. Regulatory legitimacy comes from the rules and regulations formulated by the government, professional organizations, industry associations and other relevant departments. If the business behavior in full compliance with these rules and regulations, then the enterprise has regulatory legitimacy in the eyes of its external stakeholders (Deephouse & Carter, 2005); Normative legitimacy is derived from social values and ethical norms, which reflects the judgment of the public about “doing the right thing” for the enterprise. It is based on whether corporate behavior is conducive to the promotion of social welfare, or accepted by social values and ethical norms (Suchman, 1995); Cognitive legitimacy is formed by the acceptance and recognition of things or activities. When it's familiar to people, it has cognitive legitimacy (Aldrich & Fiol, 1994).

1.2 New Venture Performance

New venture refers to the economic entities which start by entrepreneur through the identification of business opportunities and integration of resources. A new venture generally has the characteristics of small scale, rapid growth and organic organizational structure. However, new ventures are generally in the enterprise's start-up and growth period and tend to encounter new entry defects compared with mature enterprises.

Organizational performance is seen as a reflection of organizational effectiveness and output, and the researchers have gradually matured their research on organizational performance. In the literature review of the performance of new business, we find that the researchers have great differences in the definition of the performance dimension of the start-up enterprises and the choice of the measurement indicators, it is because that the current research has not yet formed a unified, and on the other hand the researchers often choose different dimensions and indicators according to their research content and the needs of the object. From the point of view of the division of performance indicators, the measurement method can be divided into single index measurement and multi-index measurement. Initially, scholars believe that the goal of the enterprise is to maximize profits, a single economy, such as sales returns, productivity, etc. can measure the performance of new ventures (Capon, Farley, & Hoenig, 1990). However, as scholars gradually realize that the business objectives are multiple, single-target measurement can't fully reflect the performance of enterprises, so the measurement of start-up performance

should be based on a wide range of indicator. Kaplan et al. (1990) uses the Balanced Scorecard to divide firm performance into four dimensions: customer, finance, internal processes, and learning growth. Wiklund (2005) measures the performance of the new enterprise in terms of financial performance and growth. The financial performance is measured by three aspects: gross profit, profitability and cash flow. The growth of enterprises is reflected by the growth of sales and employees (Wiklund & Shepherd, 2005).

This study adopts the venture capital of the newly created enterprise as a comprehensive index to measure its performance. Venture capital reflects investors' insight into the professional quality and leadership of the entrepreneurial team and the comprehensive judgment on the growth and profitability of startups in the investment decision-making process.

1.3 The Mechanism of Cognitive Legitimacy on the Performance of Start-Ups

As an important resource, cognitive legitimacy plays an important role in the development of enterprises, which brings consistency and credibility to the enterprise. On the one hand, organizations with legitimacy tend to have the common recognition and comply with the values and behavior norms. They don't need to invest a lot of energy in terms of collective mobilization and cost a lot of the cost while the legitimacy helps to prevent the problem of “collective action” and make the organization action consistency (Suchman, 1995). On the other hand, legitimacy not only affects the behavior of external stakeholders, but also affects their understanding of enterprises. External stakeholders will not only think the enterprise with legitimacy has more investment value, but also think that enterprises conform to their ideas, and they are more reliable, in which companies can be trusted.

Lounsbury and Glynn (2001) used the theory of legality to explore the question of cultural entrepreneurship from the individual level of entrepreneurs. They define cultural entrepreneurship as the process of storytelling that mediates between extant stocks of entrepreneurial resources and subsequent capital acquisition and wealth creation. Entrepreneurs should help startups to gain access to resources and market opportunities by gaining access to legitimate identities which are recognized and accepted by external stakeholders (Lounsbury & Glynn, 2001). Tornikoski and Newbert (2007) studied the question of legitimacy of the entrepreneurial process from an organizational level. They contend that the process of organizational emergence can be understood and predicted by viewing it as a quest for legitimacy. The external stakeholders are reluctant to put resources into new ventures due to lack of historical records. As a result, new ventures can only gain legitimacy and win the trust of the public to access to the resources by obeying regulations and effective control of the external

environment (Tornikoski & Newbert, 2007). Delmar (2004) analyzes the legitimate needs and acquisition problem of entrepreneurship in the new industry from the perspective of industry level. Compared with the startups in mature industries, the risks in the new industry are greater and the demand for legitimacy is stronger. The reason for this is that there is no consistent standard and norm in the new industry, and also the external public does not understand the new industry. In this case, the new enterprise must adopt different methods instead of the traditional methods to obtain the legitimate resources effectively, thus obtaining external resource to support to improve the performance of the new enterprise (Delmar, 2004).

Based on the above discussion, this paper makes the following hypothesis: Cognitive legitimacy has a positive influence on the performance of new ventures.

2. RESEARCH METHODS AND DATA ANALYSIS

2.1 Data Source and External Validity

The data in this paper comes from 18 startups in the commercial reality show “Winning in China”. “Winning in China” is a national TV commercial reality show on CCTV, which has been broadcast three times since 2006. The players show their excellence leadership and business insight through a series of programming arrangements by describing their own start-up companies and projects, thus win the support of the judges and access to venture capital investment. It is a good point of view for the study of reality TV shows while it provides a whole process of observing entrepreneurs themselves and their businesses through telling stories thus enhancing their cognitive legitimacy to seek resource support. The use of coding from media sources is a well-established methodological technique, and this method is just now gaining traction within the domain of entrepreneurship (Pollack, Rutherford, & Nagy, 2012). One main concern related to the data collection method is external validity. Maxwell et al. (2011) acknowledged concerns related to validity and addressed these succinctly by noting that studies

from multiple television shows (e.g., “Who Wants to Be a Millionaire,” “Weakest Link,” “Deal or No Deal”) have “confirmed the general applicability of television shows to ‘real world’ decision making” (Pollack, Rutherford, & Nagy, 2012). The method also proves feasible when Matthew studied the relationship between effective preparation and resource acquisition by using commercial war programs to encode data (Ibid.).

2.2 Coding Procedure

Building on the works done by Maxwell, Matthew and other researchers using data collection through coding of television show episodes, we developed specific coding procedures. The coders come from graduate students who have the best academic background in managerial discipline and the best grades. Coder training took place over the course in an entrepreneurship class. Thirty students who were familiar with the relevant literatures and our research were chosen as encoders. Each coder watched a set of (six) business narrative videos and filled out the Likert scale questionnaire. The measurement scale of cognitive legality is derived from the measurement scale developed jointly by Jeffrey and Matthew. The measurement indicators of the performance of the new ventures are expressed in terms of the amount of venture capital invested in the program show.

2.3 Reliability Analysis and Validity Analysis

We constructed a questionnaire to test the indicator of cognitive legality with five items. Using the data collected, the 5 items were subjected to an exploratory factor analysis (EFA) utilizing principal axis factoring and oblimin rotation, with the scree test criterion used to confirm the items relate to just one factor. A single-factor model was declared and estimated in SPSS Modeler Professional. All 5 items estimated loaded well, with no issues related to low factor loadings (<.50) existing. The estimated factor solution accounted for approximately 64.798% of the total variance in the data and exhibited a KMO measure of .834. Table 1 is the complete list of the items resulting from this EFA. From the result, each of the factor loading of the five items is above 0.7, indicating that the scale has good validity. Cronbach’s alpha value is 0.863, indicating that these items achieved an adequate reliability.

Table 1
Exploratory Factor Analysis for Cognitive Legitimacy

ITEM	Factor loading	Cronbach’s Alpha
1. I envision this business receiving high-profile endorsements in the future	0.858	
2. I envision this business receiving favorable press coverage in the future	0.733	
3. Because of the founder’s experience, this business has a founder who benefits the organization	0.847	0.863
4. I envision this business having a top management team who will benefit the organization	0.751	
5. I envision this business having the resources to be successful in its industry	0.826	

KMO = 0.834
Bartlett’s Test of Sphericity Approx. Chi-square =408.461
P = 0.000

2.4 Data Analysis and Result

Table 2 shows the analysis results of descriptive statistics and correlation matrix: The cognitive legality is positively correlated with resource acquisition. ($r=0.516$, $p<0.01$). The hypothesis is proved that cognitive legitimacy has a positive influence on the performance of new ventures.

Table 2
Descriptive Statistics and Correlation Matrix

	1	2
1. Cognitive legitimacy	1	
2. New venture performance	0.516**	1
<i>M</i>	3.6022	5.8111
<i>SD</i>	0.72157	2.2167

Note. $N=180$; * $P<0.05$; ** $P<0.01$ (2-tailed).

CONCLUSION AND DISCUSSION

The new ventures have “legitimacy threshold” because of the lack of business history and continuous and reliable relationship with the stakeholders. It leads to the failure of enterprises to acquire resource support. This paper examines the influence of cognitive legitimacy on the performance of the new enterprise from the perspective of cognitive legality by coding data from media resource. We conclude that the cognitive legitimacy of the start-up has a positive impact on its performance.

The research of this paper confirms that the cognitive legitimacy of the new enterprise has a positive effect on its performance. For start-up entrepreneurs, they need to actively expound enterprise vision, mission and values, etc., so as to establish image of known and accepted to the masses. It is important to overcome the “legitimacy threshold” of new enterprises to obtain the resources needed for the survival and development of enterprises.

This paper has made some theoretical contributions to the cognitive legality and the relationship between the performance of the new enterprise. However, this research also exists some limitations, mainly including the focus of this article is the cognitive legitimacy building of start-ups, and there is no measurement of legitimacy for other types such as institutional legitimacy or normative legitimacy because of the lack of effective data. In addition, more strategic studies on how to build legitimacy, especially cognitive legality, are needed in subsequent studies.

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