

Buidling Interorganizational Networks in an Emerging Economy: The Role of Cognitive Legitimacy

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Principal Topic

In this study, we adopt an organizational legitimacy approach to explore some of the antecedents to the formation of new ventures' interorganizational networks in emerging economies. Participation in interorganizational networks, particularly with large, established partners, offers numerous benefits to new ventures. Networks provide access to a variety of resources and complementary skills, allow new and small players to achieve economies of scale through specialization within a carefully chosen subset of value-chain activities, and/or to generate superior knowledge and capabilities through collaboration (Chetty & Wilson, 2003; Havnes & Senneseth, 2001; Westhead, Uchbasaran, & Binks, 2004; Belso-Martinez, 2006). In addition to these strategic benefits, the endorsement by large, established organizations in the interorganizational network reaffirms the social status of entrepreneurial ventures and demonstrates that they are socially appropriate and desirable partners, thus providing an important source of normative legitimacy. (Aldrich & Fiol, 1994; Deeds et al., 1997; Zimmerman & Zeitz, 2002; Dacin et al., 2007). In emerging economies, network-based strategies are particularly viable, because the horizontal and vertical interorganizational linkages partially substitute for the inefficient market-clearing mechanisms of open-market exchange, effectively reducing transaction costs (Khanna & Palepu, 1997; Peng et al., 2005) and overcome the prohibitively high costs of information search and monitoring through referral trust and solidarity (Hoskisson et al., 2000; Zhou et al., 2007) .

While the strategic benefits and legitimizing functions of interorganizational networks have been well documented in the literature, the genesis of networks has received far less attention (Ahuja et al., 2012). This is surprising, because, as Stuart & Sorenson (2007: 217) argue, entrepreneurs may differ in their ability to create or benefit from networks. In this paper, we address this gap by exploring some of the antecedents to the formation of entrepreneurial networks. We take an organizational legitimacy perspective and focus in particular on new ventures' cognitive legitimacy, or the state of their "taken-for-grantedness". Our underlying premise is that new ventures need to overcome a certain "threshold" of cognitive legitimacy (Zimmerman & Zeitz, 2002; Rutherford & Butler, 2007) in order to be accepted by established partners in interorganizational networks.

Cognitive legitimacy stems from "widely held beliefs and taken-for-granted assumptions that provide a framework for everyday routines" (Scott, 1994: 81). As Zimmerman & Zeitz (2002: 420) explain, to gain cognitive legitimacy, "the new venture tries to put forward the impression that its identity is such that it provides what is needed as desired and will be successful in the business domain in which it purports to operate". Achieving cognitive legitimacy, or "being-taken-for-granted" is critically important in the context of emerging markets, because their lack of information transparency makes the objective evaluation of underlying quality and intent particularly problematic.

We explore three means through which new ventures can acquire cognitive legitimacy: education of the entrepreneur, development of a formal business plan, and development of a formal organizational structure. The education level of the entrepreneur indicates to what extent s/he possesses knowledge and skills that are expected to benefit the new venture. The formal business plan signals professionalism (Delmar & Shane, 2004; Honig & Karlsson, 2004; Tornikoski & Newbert, 2007) and articulates the entrepreneur's vision in conformity with prevalent cognitive schemata (Leo & Guild, 2010). Further, the development of a formal organizational structure indicates that the new venture is becoming isomorphic with the prevalent rationalized concepts of organizational work institutionalized in society (Meyer & Rowan, 1977; DiMaggio & Powell, 1983). Thus, the three mechanisms help the new venture acquire cognitive legitimacy and thus improve its prospects to be accepted into the interorganizational networks of established players. Formally: (H1a) The education level of the entrepreneur; (H1b) Developing a formal business plan; and (H1c) Developing a formal organizational structure will be positively associated with the size of the new venture's interorganizational network.

We next argue that the legitimizing effects of developing a business plan and a formal organizational structure will be stronger early in the life of the new venture. This is because early in their organizational life cycles entrepreneurial ventures act "as if" (Gartner et al., 1992) to create the impression that they are fully functioning organizations with a permanent place in the market (Tornikoski & Newbert, 2007). Formal business plans and organizational structures are important components in the impression management process. With time, the role of impression management is likely to wane, to be replaced by strategic considerations, such as the development of proprietary resources or the optimal configuration of the new venture's value chain. Formally: The association of (H2a) having a business plan; and (H2b) having a formal organizational structure with the size of the new venture's interorganizational network will decrease with the age of the new venture.

Method

To test our hypotheses, we use data from a nationally representative large scale survey of the state of small business in Saudi Arabia, commissioned by the Ministry of Labor (n = 1222). Consistent with prior empirical research, we define new ventures as owner-managed firms eight years or younger (Zahra, 1996; Wang & Bansal, 2012). We measure the size of the interorganizational network as the sum of five binary items indicating whether or not the new venture has a supplier, distributor, financing, alliance, or a partnership agreement with a large business. Our independent variables are measured by three self-reported items, whether or not the new venture (1) has a formal business plan, (2) has a formal organizational structure showing positions, units, and departments, and (3) the education level of the owner (on a 6-point ordinal scale). The hypotheses are tested using negative binomial regression specifications, controlling for industry sector and the age, size, and capital structure of the new venture.

Results and Implications

Preliminary results indicate that having a written business plan and a formal organizational structure are positively associated with the size of the new venture's interorganizational network (H1b and H1c

supported). The effect of having a formal organizational structure is stronger for younger ventures, in support of H2b. The effect of the formal business plan was not moderated by firm age (H2a not supported). Finally, the effect of the education level of the entrepreneur was not significant (H1a not supported). These findings suggest that a level of cognitive legitimacy is necessary in order for new ventures to gain access to the interorganizational networks of large and established players. The sources of this cognitive legitimacy, however, may be different for new ventures in emerging economies. Thus, our study adds to the conversation on different paths to building legitimacy in emerging markets (Ahlstrom et al., 2008), using empirical evidence from Saudi Arabia, a context relatively unexplored by current entrepreneurship research. For practicing entrepreneurs and entrepreneurship educators, our results reaffirm the importance of a formal business plan and organizational structure as important instruments in the quest for legitimacy.