

Predicting Entrepreneurial Performance: *Can Legitimacy Help?*

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Entrepreneurial organizations are “opaque” regarding the information necessary to evaluate the likelihood of their survival (Rutherford, Buller, & Stebbins, 2009). Compared to publicly traded corporations, there is little information available to individuals when making judgments about private entrepreneurial organizations. To overcome this problem, entrepreneurs should strive to establish themselves as legitimate organizations in the eyes their stakeholders. Here, legitimacy serves as an evaluative tool, analogous to bond ratings. With AAA rated bonds, there is no guarantee the bonds will not decrease in value but the rating does show that there is a consensus that they are of highest quality. The same can be said of entrepreneurs that are perceived to be legitimate by their stakeholders. This study tests whether this legitimacy manifests itself as financial performance.

This study makes three primary contributions to the literature on legitimacy. First, three forms of legitimacy (financial, employer, and customer) are investigated, allowing this study to assist in answering the question “Do other stakeholders view legitimacy differently than do customers?” (Shepherd & Zacharakis, 2003). By looking at the effects of these three forms of legitimacy on performance we intend to bring clarity to this situation. Second, this study extends previous research in the area of legitimacy, focusing on existing (Deephouse & Carter, 2005) and hypothetical (Shepherd & Zacharakis, 2003) firms, with a longitudinal sample of entrepreneurial startup firms. Finally, the longitudinal nature of this study may resolve inconsistencies in previous studies relating to how the effects of legitimacy on performance change over the lifecycle of entrepreneurial firms.

WHY LEGITIMACY IS IMPORTANT FOR ENTREPRENEURS

Hannan and Freeman (1984) state that the most difficult challenge for new entrepreneurs to overcome is the liability of newness and smallness. Thus, to survive, a successful entrepreneur’s primary goal should be to overcome such challenges. Williamson, Cable, and Aldrich (2002) argue that legitimacy is one way to overcome these challenges. Herein, legitimacy is defined as a “social judgment of acceptance, appropriateness, and/or desirability” (Zimmerman & Zeitz, 2002). An organization’s overall legitimacy is a composite of the views held by those with a stake in the organization. Obtaining legitimacy with stakeholders such as customers, employees, and financial institutions makes it easier for entrepreneurs to obtain the resources they need for survival (Rutherford et al., 2009). If legitimacy is not obtained, it is doubtful that an organization will survive (Clarkson, 1995).

LITERATURE REVIEW

From the outset, new organizations lack legitimacy with their customers, suppliers, and financial institutions (Stinchcombe, 1965). Customers are hesitant to purchase from a new business when they have doubts about its chance of survival, due to fears about warranty, follow up service, or other concerns associated with future needs. Potential employees may also be unwilling to work for a new organization, if they have doubts about its survival, making it difficult for new businesses to attract high quality employees. While suppliers will not refuse sales to new businesses, they are hesitant to extend

trade credit until some level of financial legitimacy is obtained. This financial legitimacy also affects how financing is obtained. Banks are not likely to extend credit or loans until an organization has, in their eyes, legitimized itself requiring the entrepreneur to resort to obtaining financing either in his or her name or by making personal guarantees for business financing. These are only a few of the pitfalls that businesses may face on the road to legitimacy.

Rutherford and Buller (2007) describe a legitimacy threshold or point, when crossed, where stakeholders view a venture as legitimate making the venture's acquisition of resources, such as customers, capital, and employees, less difficult. Once this threshold is crossed, survival is more likely. Others concur with this perspective, pointing to legitimacy as a precursor to resources and growth (Zimmerman & Zeitz, 2002). Thus once a company attains legitimacy, vital resources, such as employees and financing, are more easily obtained increasing the likelihood of firm survival.

Unfortunately for entrepreneurs, people make judgments about firms early in the evaluation process (Elsbach, 2003). Often, these judgments are made with little information. This is especially true for external stakeholders such as potential employees and customers. Financiers are often given detailed financial information but many of their judgments are still made using bounded perceptions of the overall firm in question. Thus external stakeholders support often depends on an organization's age and other dimensions such as cognitive legitimacy (taken-for-grantedness) (Choi & Shepherd, 2005). For this reason, entrepreneurs who do whatever it takes to earn the support and confidence of their stakeholders (Krummerle, 2002), leading to perceptions of their venture as legitimate, should more easily obtain resources, be more likely to survive, and experience greater financial performance.

LEGITIMACY

An entrepreneur's legitimacy with groups, such as customers, employees, and financial institutions, is linked to financial performance as well as economic growth and development (Lounsbury & Glynn, 2001). Thus, new entrepreneurial organizations must strive to establish themselves as legitimate ventures to obtain the necessary financial resources for survival. Tornikoski & Newbert (2007) find that to gain legitimacy, new entrepreneurs should focus less on tangible resources and more on the perceptions of external forces such as employees, lenders, and customers. This article focuses on firm attributes that influence the legitimacy perceptions of these three stakeholder groups and test their link to firm performance.

CUSTOMER LEGITIMACY

Customers are key stakeholders for any organization; their perceptions have a substantial influence on the overall legitimacy and success of any organization. Shepherd and Zacharakis (2003) show that customer knowledge of a organization, management, and product lead to higher probability of purchase, which is interpreted herein as a sign of customer legitimacy. "Cognitive legitimacy" and "taken-for-grantedness" are terms often used to understand customer legitimacy (Rutherford & Buller, 2007; Suchman, 1995). Both describe a situation where customers do not actively grant legitimacy to an organization, they simply perceive it to either possess or lack legitimacy. The key point is that the less a customer thinks about the legitimacy of an organization the better (Rutherford & Buller, 2007). If one is required to actively evaluate the legitimacy of an organization, a positive evaluation is not likely to result. For example, when an individual desires a "good" cup of coffee, they may automatically think of Starbucks without evaluating other alternatives. Here, Starbucks has achieved legitimacy because the customer has taken it for granted that they have a superb product. Suchman (1995) describes this, assumed legitimacy, as the most subtle and powerful type of legitimacy an organization can obtain.

To gain legitimacy with customers, new ventures must provide knowledge about their organization and products to potential customers. Shepherd and Zacharakis (2003) found that customers' lack of knowledge about new ventures leads to legitimacy problems. Further, customers prefer more, than less, information about a new organization's products, organization, and management. Thus, organizations that provide customers with more access to this information will obtain higher levels of legitimacy, especially if this information mimics that of firms that customers already perceived to be legitimate.

There are certain actions, such as incorporating, that customers have come to take for granted with organizations. When these assumptions are not met, dissonance builds within the customer. If a customer learns that an organization does not have insurance or is not incorporated it follows that the level of legitimacy they grant this organization will decrease. This decrease should manifest itself by decreasing the likelihood that a customer will patronize an establishment.

The most likely way for customers to gain information about the new entrepreneurial firm is through interaction with the owners, managers, or employees of the organization. Entrepreneurs who actively participate in the running of their organization should be the best vehicle to transfer information about their firm to customers. The more time an entrepreneur dedicates to the venture, the greater the likelihood of interactions with customers, facilitating this transfer of knowledge. Further, organizations that take formal steps toward legitimacy, such as incorporating, and communicate this information to customers should more likely be perceived as legitimate. The extent to which entrepreneurs are able to build legitimacy with customers, as described herein, should contribute to their financial success, leading to the following hypothesis.

H1: Customer legitimacy will have a positive relationship with firm performance.

EMPLOYEE LEGITIMACY

Institutional theory suggests that one way to establish legitimacy is to imitate the effective practices of already legitimized firms (DiMaggio & Powell, 1983). Deephouse (1996) found support for this contention in the banking industry showing that isomorphism is related to legitimacy. Thus, if one is to compete in an industry, he or she should imitate many of the practices of the leading firms in this industry. Williamson (2000) builds upon this by proposing that for small organizations to be perceived as legitimate, by potential employees, they must adopt the human resource and recruitment practices of larger more established firms, thus legitimizing themselves as employers. Tornikoski and Newbert (2007) state that the ability of an organization to attract and retain qualified individuals is of primary importance for a new organization to become operationally competent. Thus to attract and retain qualified and competent employees, organizations must maintain the perception that they offer the benefits expected of similar firms.

To successfully mimic the human resources of more established firms, new entrepreneurs should begin by imitating the most easily recognizable forms of employee benefits. Specifically, new ventures could benefit most from offering taken-for-granted benefits such as healthcare for full time employees. If the cost of healthcare is prohibitive, entrepreneurs should offer more affordable benefits such as retirement plans. This is more feasible because the employer contribution can vary depending on their revenue stream. If either of these alternatives is not feasible, the entrepreneur must improvise to find ways to attract and retain employees. This ability to improvise is important for successful entrepreneur emergence (Tornikoski & Newbert, 2007). Other more feasible options may include tuition reimbursement or performance based bonuses.

With concern to employee needs and perceptions, new organizations can acquire legitimacy by visibly conforming to norms and values of other, more powerful, organizations (Zimmerman & Zeitz, 2002). Further, legitimacy is based on perceptions that organizational actions are “desirable”, “proper”, and “appropriate” (Suchman, 1995). Thus for employees to perceive an organization as legitimate, the organization must comply with the norms set by other organizations and meet employee perceptions of what is appropriate treatment. Hart and Carraher (1995) found that many employees view benefits not as incentives but as obligations of their employer. In addition, benefits such as healthcare and retirement are shown to be significantly related to commitment and satisfaction (Weathington & Tetrick, 2000). Taken as a whole, this discussion highlights how, to be perceived as legitimacy by one’s employees, organizations should, at a minimum, provide many of the benefits common to larger more established employers such as retirement, healthcare, tuition reimbursement, and, if possible, bonuses.

New entrepreneurs that are able to more successfully provide benefits that meet the expectation of their employees, thus enhancing legitimacy, should more easily attract and retain competent employees; here legitimacy is seen as increasing access to employees as a resource (see Selznick, 1957 for discussion link between legitimacy and resource acquisition), leading to higher performance relative to similar firms lacking these benefits. Indeed, in a recent meta-analysis, Crook, Todd, Combs, Woehr, and Ketchen (2011) found a strong relationship between human capital and firm performance. Therefore, by attracting and retaining higher quality employees, relative to their competitors, legitimate (employee) entrepreneurs should experience greater financial performance, than less legitimate (employee) entrepreneurs, leading to hypothesis 2.

H2: Employee legitimacy will have a positive relationship with firm performance.

FINANCIAL LEGITIMACY

Berger and Udell (1998) proposed a financial growth model for small firms; this model consists of three stages. In order, the distinguishing characteristics of these three progressive stages are: (1) financing requiring no collateral and no track record such as credit cards, loans in owner’s name, and loans from family members, (2) financing requiring some track record and possibly collateral, such as venture capital, lines of credit, bank loans, and trade credit, and (3) financing requiring a track record and formal risk assessment, such as public equity. Most organizations begin at stage one and as they gain legitimacy progressively reach stage three.

Zimmerman and Zeitz (2002) note that when a company reaches the legitimacy threshold it can more easily access capital and other resources. Rutherford and Buller (2007) discuss that a financial legitimacy threshold exists between stage one and two of Burger and Udell’s (1998) three stage model. This threshold is supported and built upon the liabilities of newness and liabilities of smallness theories. In brief, these theories state that being less established and of smaller size leaves firms of this type disadvantaged when compared to their more established counterparts (Hannan & Freeman, 1984). Thus once a new company has established a positive track record and can establish credit in its own name it has crossed a threshold of legitimacy where it can be said to be financially legitimate.

The legitimacy threshold is reached when an organization moves from the first to second stage of Berger and Udell’s (1998) three stage financial growth model. Herein financial legitimacy is conceptualized in accordance with Berger and Udell’s (1998) three stage model. Where legitimacy is evaluated based on how financing is obtained. Thus, as the level of personal debt provided by the entrepreneur for the business decreases, the greater the financial legitimacy of the organization and as the business debt obtained in the name of the organization increases, the greater the financial legitimacy of the organization.

When speaking of legitimacy, Deephouse and Carter (2005) state that “Most definitions of legitimacy focused on the social acceptance resulting from adherence to regulative, normative, or cognitive norms that qualify one to exist” (p. 350). This follows with our conceptualization of legitimacy related to how financing is obtained. In a sense, to be judged legitimate, an organization should meet the norm of obtaining financing on its own merit, instead of on the merit of its proprietor, if it is to be seen to exist as a legitimate creditor/organization in its own right. It is important to understand that lifecycle likely plays a role in this process (Deephouse & Carter, 2005). Meaning that startups may have lower expectations placed upon them than existing firms. But, it is reasonable that social expectations dictate that firms obtaining financing on their own should be perceived as more legitimate, in credit worthiness terms, than those unable to do so (see Hirsch & Andrews, 1984; Meyer & Scott, 1983; and Pfeffer & Salancik, 1978 for a discussion how failure to meet social expectations can damage legitimacy). Thus the financial legitimacy referred to herein is proxied by the legitimacy (funding) extended to an organization by financial institutions.

As the shift from various alternative forms of financing to financing in the firm’s name through financial institutions occurs, the financial legitimacy of the organization should increase allowing it to more easily obtain resources, thus increasing its financial performance leading to hypothesis three.

H3: Financial legitimacy will have a positive relationship with firm performance.

METHOD

DATA

The data in this study were obtained from The Kauffman Foundation, a nonpartisan foundation for entrepreneurship and innovation. The dataset used is titled the Kauffman Firm Survey. It is a longitudinal study consisting of nearly 5,000 organizations, each beginning operations in 2004 and following their progress for consecutive calendar years from 2004 to 2007. The study is broad in scope asking 1,884 questions for each time period on a variety of topics designed to be applicable to a diverse range of entrepreneurship researchers. This study uses the data from calendar year 2004 as time period one and calendar year 2007 as time period two.

MEASURES

All survey items used for this research study are from the Kauffman Firm Survey at two points in time (2004 and 2007). All items herein were asked in both time periods using the same wording by a representative of the Kauffman Foundation. Results were compiled by the Kauffman Foundation and released via posting on their website. Free access is granted to researchers with acceptable university affiliation.

Dependent Variable. In this study, customer, employee, and financial legitimacy’s effect on financial performance is investigated. Return on assets (ROA) is identified as an acceptable and current measure of financial performance (Dalton, Daily, Certo, & Roengpitya, 2003). In this study ROA is calculated as net income divided by total assets. This measure lends itself well to the Kauffman Foundation data because both measures are specifically identified for each firm in both time periods.

Independent Variables. The three categories of independent variables in this paper measure new venture employee, customer, and financial legitimacy. Each category consists of multiple indicators identified as relevant to their respective topic as discussed earlier in this paper and throughout entrepreneurial literature.

Employer Legitimacy. The extent to which an organization is perceived to be legitimate by its current and potential employees is operationalized by six items relating to the availability of benefits to both full-time and part-time employees. The items are the availability of healthcare, retirement plan, tuition reimbursement, and bonuses to full-time employees, as well as the availability of healthcare and retirement plan to part-time employees. The response to each of these items was recorded as a dichotomous response of either yes or no, obtained by asking the primary entrepreneur if these benefits are available to employees.

Customer Legitimacy. Customer legitimacy is operationalized by items pertaining to owner participation and legal status. Ownership participation was recorded by asking the primary owner if he or she actively participated in the day-to-day operations of the business. A yes or no response was recorded for each item. The primary owner of each firm in this study was asked how many hours he or she worked in their business per week and given the following six options: (1) 1-19, (2) 20-35, (3) 36-45, (4) 46-55, (5) 56-65, (6) 66 plus. The authors believe that the number of hours the entrepreneur works within his or her organization increases the amount of interaction he or she has with customers. Because entrepreneurs often occupy the role of spokesperson (Goldsby, Kuratko, & Bishop, 2005) and managers of small firms often act as the figurehead of their organization (Paolillo, 1984; also see, Mintzberg, 1975; D'Amboise & Muldowney, 1988), increased interaction with customers by these highly influential members should increase customer legitimacy by conveying a positive image of the firm. Legal status was obtained by asking the primary owner to choose between the following seven options: (1) Sole Proprietorship (2) Limited Liability Company (3) Subchapter S-Corporation (4) C-Corporation (5) General Partnership (6) Limited Partnership (7) Something Else. Option 1 (Sole Proprietorship) is theoretically associated with lower customer legitimacy because the organization has not applied to be recognized as a legal entity in and of itself.

Financial Legitimacy. Five questions concerning financial practices were used to assess financial legitimacy. Respondents were asked if they used business loans from a commercial bank and if they use business loans from non-banking institutions. A yes or no response was recorded for both questions. Additionally, the primary owners were asked the total business debt of the organization; a response was recorded on a scale from 1 to 9 with 1 representing less than \$500 and 9 representing greater than \$1,000,000. To determine how this debt is distributed, the primary owners were asked the following: the dollar amount of loans in his or her personal name, loans with personal guarantees, and his or her total amount of personal credit card debt associated with the business. The same nine item scale used for the total business debt questions was used for these two questions.

ANALYSIS

This study employs hierarchical logistic regression to analyze the effects of customer, employer, and financial legitimacy on financial performance. Firm size was used as a control for both time periods. Regression was run separately for the two time periods in this study. Due to time period one representing startup, it is possible that the effects of legitimacy were not given time to manifest themselves in ROA in time period one. For this reason time period two was included to allow an adequate amount of time to pass for the three aspects of legitimacy identified in this study to affect the organization's performance as measured by ROA.

RESULTS

FACTOR ANALYSIS

Before testing the proposed model, the factor structure of the 14 items was evaluated by conducting a factor analysis with varimax rotation. Factor analysis was performed separately for both time periods.

Table 1 shows the results of the factor analysis for time period one. A varimax rotation resulted in four factors. The scree plot indicates that four factors are appropriate; further, each factor’s eigenvalue was greater than one. Component one shows that all six employer legitimacy items loaded neatly onto one factor with no cross loadings. The factor loadings for “Full-time Tuition Reimbursement” and “Full-time Bonus Plan” are moderate but all other factor loadings are high, indicating the six items represent the same construct. The same is true for the customer legitimacy items “Owner Active Participation,” “Legal Status,” and “Owner Weekly Hours of Participation.”

Table 1. *Factor Analysis Time Period 1*

	Component			
	1	2	3	4
Full-Time Healthcare Plan	.661	.137	-.037	-.262
Full-Time Retirement Plan	.715	.187	.063	-.076
Part-Time Retirement Plan	.726	-.016	-.088	.139
Part-Time Healthcare Plan	.633	-.024	-.134	.053
Full-Time Tuition Reimbursement	.372	.018	.239	-.094
Full-Time Bonus Plan	.438	-.069	.106	.072
Owner Active Participation	.406	.076	.215	.468
Legal Status	.082	-.035	-.031	.687
Owner Weekly Hours of Operation	.182	.018	.103	-.519
Business Loans from Financial Institutions	.019	.840	.010	.106
Total Business Debt	.070	.866	.152	.034
Business Loans from Non-Financial Institutions	.017	.517	-.075	-.134
Personal Loans for Business Purposes	-.043	-.064	.801	.160
Dollar Amount of Personal Credit Card Debt for Business Purposes	.048	.096	.664	-.234

Interestingly, the items representing financial legitimacy loaded onto two separate factors. “Business Loans From Financial Institutions,” “Total Business Debt,” and “Business Loans From Non-financial Institutions” loaded on factor two with “Dollar Amount of Personal Credit Card Debt for Business” and “Personal Loans for Business Purposes” loading onto factor three. The items loading onto factor two each represent debt obtained in the name of the business which is theorized to be a positive sign of financial legitimacy. The two items loading on factor three represent financing obtained in the name of the primary owner for business purposes, described herein as a negative sign for financial legitimacy. It is understandable that these two financial legitimacy concepts would load onto two different factors.

Table 2. *Factor Analysis Time Period 2*

	Component				
	1	2	3	4	5
Full-Time Healthcare Plan	.512	.160	.448	-.026	.175
Full-Time Retirement Plan	.767	-.068	.185	-.099	.100
Part-Time Retirement Plan	.837	-.014	.020	.035	.053
Part-Time Healthcare Plan	.695	.095	.007	.055	-.122
Full-Time Tuition Reimbursement	.060	.098	.665	.078	.057
Full-Time Bonus Plan	.117	.006	.757	-.010	-.109
Owner Active Participation	.038	.030	.135	.151	.627
Legal Status	-.003	-.013	-.153	-.069	.752
Owner Weekly Hours of Operation	.077	.220	.389	-.254	.371
Business Loans from Financial Institutions	.079	.795	-.027	.059	-.057
Total Business Debt	.140	.854	.047	.014	.081
Business Loans from Non-Financial Institutions	-.109	.449	.164	-.040	.042
Personal Loans for Business Purposes	.037	.025	-.147	.735	.070
Dollar Amount of Personal Credit Card Debt for Business Purposes	-.037	.002	.199	.781	-.023

Table 2 shows the results of the varimax factor analysis for time period two. For the most part, these results mirror those of Table 1. With the exception of the cross loading of “Owner Weekly Hours of Participation,” the customer legitimacy items loaded together. Financial legitimacy again loaded on two separate factors as before. Interestingly, employer legitimacy loaded onto two factors. The four items loading onto factor one measure healthcare and retirement benefits, standard benefits offered by most organizations. The two items loading onto factor three “Tuition Reimbursement” and “Employee Bonus Plan” are less traditional benefits that represent the improvisation of benefits suggested by Tornikoski and Newbert (2007). It may be that by time period two the entrepreneurs in this study developed the ability to improvise, which resulted in offering alternative benefits to compete with larger more established firms. If so, it is reasonable that these two items load separately because they are measuring two aspects of employer legitimacy.

In sum, the factor structure found in the Kauffman Foundation data fit the three categories of legitimacy discussed herein. In time period one, factor one represents employee legitimacy, factors two and three combined represent financial legitimacy, and factor four represents customer legitimacy. In time period two, factor one represents employee legitimacy, factors three and five represent customer legitimacy, and factors two and four together represent financial legitimacy.

Table 3. *Correlations Time Period 1*

	Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. ROA Time 1	-0.26	0.89															
2. NAICS Time 1	49.32	15.68	-.035														
3. Full-Time Healthcare Plan	0.36	0.48	.174**	-.060													
4. Full-Time Retirement Plan	0.13	0.34	.204**	-.006	.449**												
5. Part-Time Retirement Plan	0.04	0.20	.057	-.022	.195**	.461**											
6. Part-Time Healthcare Plan	0.09	0.29	.099*	-.092*	.375**	.124**	.348**										
7. Full-Time Tuition Reimbursement	0.09	0.29	.102*	.025	.147**	.273**	.156**	.088*									
8. Full-Time Bonus Plan	0.32	0.47	.271**	.122**	.280**	.236**	.167**	.163**	.243**								
9. Owner Active Participation	2.08	0.92	.110*	-.061	.193**	.228**	.195**	.122**	.108*	.104*							
10. Legal Status	2.90	0.98	.040	-.057	-.009	.038	.101*	.040	.032	-.002	.132**						
11. Owner Weekly Hours of Operation	3.92	1.60	.031	-.012	.161**	.081	.034	.021	.071	.102*	-.005	-.046					
12. Business Loans from Financial Institutions	0.18	0.39	.040	.041	.106*	.137**	.036	.018	.032	.099*	.075	.012	.022				
13. Total Business Debt	2.88	3.43	-.051	.027	.113*	.173**	.076*	.113	.017	.087*	.081	-.042	.066	.631**			
14. Business Loans from Non-Financial Institutions	0.05	0.22	-.044	.006	.102*	.090*	.012	-.029	.091*	-.078	.058	-.039	.026	.141**	.282**		
15. Personal Loans for Business Purposes	0.09	0.29	-.063	-.083*	.091*	.140**	.022	-.006	.049	-.066	.029	-.105*	.026	.032	.103*	.009	
16. Dollar Amount of Personal Credit Card Debt for Business Purposes	0.18	0.38	-.096*	.007	-.063	-.036	-.028	-.023	.040	.041	.123**	.010	.043	-.041	.093*	-.042	.205**

Table 4. *Correlations Time Period 2*

	Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. ROA Time 1	.18	1.02															
2. NAICS Time 1	47.51	14.98	.011														
3. Full-Time Healthcare Plan	.47	.50	.033	-.092*													
4. Full-Time Retirement Plan	.25	.43	.027	.033	.373**												
5. Part-Time Retirement Plan	.11	.31	.009	.051	.260**	.607**											
6. Part-Time Healthcare Plan	.11	.31	.085*	-.016	.369**	.248**	.402**										
7. Full-Time Tuition Reimbursement	.12	.33	.084*	-.040	.229**	.165**	.133*	.038									
8. Full-Time Bonus Plan	.41	.49	.163**	-.031	.298**	.200**	.102*	.102*	.247**								
9. Owner Active Participation	1.96	1.07	-.004	-.058	.125*	.089*	.063	.005	.076	.035							
10. Legal Status	2.91	.97	-.084*	.028	.087**	.036	.024	-.048	.019	-.060	.095*						
11. Owner Weekly Hours of Operation	3.65	1.50	.004	-.079	.208**	.106*	.101*	.086*	.130**	.157*	.114*	.103*					
12. Business Loans from Financial Institutions	.11	.31	-.021	.053	.082*	.046	.050	.050	.129**	.064	.049	.001	.056				
13. Total Business Debt	2.29	3.22	-.072	-.018	.201*	.063	.103*	.132*	.109*	.080	.099*	.044	.186**	.526**			
14. Business Loans from Non-Financial Institutions	.03	.16	-.080*	-.030	.145	-.025	-.009	-.009	.077	.015	.006	-.047	.148**	.085*	.246**		
15. Personal Loans for Business Purposes	.04	.19	-.139**	.050	-.002	-.051	.016	.016	-.032	-.057	-.005	.018	-.084*	.014	-.013	.048	
16. Dollar Amount of Personal Credit Card Debt for Business Purposes	.10	.30	-.074	.039	.012	-.048	.034	.034	.093*	.069	.079	-.051	-.043	.031	.053	-.007	.231**

Table 5. *Regression Results Time Period 1*

	<i>B</i>	<i>SE B</i>	β
Employee Legitimacy			
Full-Time Healthcare Plan	.097	.085	.047
Full-Time Retirement Plan	.275*	.131	.089
Part-Time Retirement Plan	-.152	.201	-.031
Part-Time Healthcare Plan	.163	.138	.046
Full-Time Tuition Reimbursement	.108	.125	.031
Full-Time Bonus Plan	.366**	.080	.168
Customer Legitimacy			
Owner Active Participation	-.027	.029	-.024
Legal Status	-.023	.021	-.027
Owner Weekly Hours of Operation	-.003	.015	-.005
Financial Legitimacy			
Business Loans from Financial Institutions	.148	.110	.061
Total Business Debt	-.018	.012	-.070
Business Loans from Non-Financial Institutions	-.103	.167	-.024
Personal Loans for Business Purposes	-.125	.115	-.041
Dollar Amount of Personal Credit Card Debt for Business Purposes	-.067	.091	-.028

*p<.05; **p<.01
N = 416

Table 6. *Regression Results Time Period 2*

	<i>B</i>	<i>SE B</i>	β
Employee Legitimacy			
Full-Time Healthcare Plan	.101	.081	.052
Full-Time Retirement Plan	.137	.103	.059
Part-Time Retirement Plan	-.138	.152	-.039
Part-Time Healthcare Plan	.125	.119	.041
Full-Time Tuition Reimbursement	.124	.103	.044
Full-Time Bonus Plan	.260**	.073	.131
Customer Legitimacy			
Owner Active Participation	-.003	.030	-.003
Legal Status	-.039	.025	-.045
Owner Weekly Hours of Operation	.014	.018	.022
Financial Legitimacy			
Business Loans from Financial Institutions	.004	.127	.014
Total Business Debt	-.025*	.013	-.089
Business Loans from Non-Financial Institutions	-.433*	.222	-.076
Personal Loans for Business Purposes	-.517*	.206	-.097
Dollar Amount of Personal Credit Card Debt for Business Purposes	-.124	.116	-.042

*p<.05; **p<.01
N = 416

DESCRIPTIVE STATISTICS

Tables 3 and 4 show the means, standard deviations, and correlations for the parameters evaluated in time period one and two respectively. Seven of the 14 items (correlations) in period one are significantly related to ROA in time period one and six in time period two. Tables 5 and 6 show the regression results for each form of legitimacy addressed herein, results are presented for time periods one and two. Multicollinearity was tested using the variance inflation factors (VIFs) for the variables. The VIFs for each variable are all below two, well below the maximum acceptable value of 10 suggested by Netter, Kutner, Nachtsheim, and Wasserman (1996). For this reason, each variable is retained in the model.

LEGITIMACY

The first hypothesis states that customer legitimacy has a positive relationship with firm performance. In time period one, all correlations are in the proposed direction, but only one is significant. For time period two, two of the three correlations are counter to the proposed direction, with one significant. The third variable is both small and insignificant. The data in Table 3 and Table 4 (correlations) fail to provide strong significant support for hypothesis 1 in either time period.

The regression results and correlations are very similar for customer legitimacy. Specifically, all variables in time period one resulted in low beta's (-.003 to -.027) none of which are significant. The regression results for time period two are not much better, only one low magnitude significant predictor. Taken as a whole, neither the regression analysis nor the correlations provide substantial support for hypothesis 1.

Hypothesis 2 asserts that employer legitimacy will have a positive relationship with performance. In time period one and two all correlations are in the proposed direction indicating a positive effect of employer legitimacy on performance. Five of the six correlations in time period one were significant and three in time period two. All values are in the proposed direction, most significant so, indicating support for hypothesis 2.

The regression analysis for time period one, with concern to employer legitimacy, is similar to the correlation results. In time period one, full-time retirement benefits and bonus plan are significant predictors of ROA, thus providing support for hypothesis two. In time period two, full-time bonus plan is the only significant predictor. Taken as a whole, in terms of employer legitimacy, both the regression analysis and correlation results for time period one support hypothesis 2, with diminished support in time period two.

Our final hypothesis asserts that financial legitimacy has a positive relationship with performance. With the exception of "Business Loans from Financial Institutions," all correlations are negative, three significantly. Because "Business Loans from Financial Institutions" serve as a symbol of legitimacy, while "Business Loans from Non-Financial Institutions", "Personal Loans for Business Purposes", and "Credit Card Debt for Business Purposes" serve to indicate that a firm lacks financial legitimacy, we expected the signs of these two classes of debt to be in opposite directions. In time period one all correlations are in the proposed direction, but only one significantly. The correlations in time period two are the same with the exception of "Business Loans from Financial Institutions" where the correlation is near zero and non-significant. In time period two, two of the three indicators of a "lack" of legitimacy were significant. We interpret these results to provide moderate support hypothesis 3.

The regression results of financial legitimacy, as with the other two form of legitimacy, closely mimic those of the correlations. In time period one, none of the regression coefficients were significant, failing to provide support for hypothesis 3 in this time period. The regression results for time period two, on the other hand, provide substantial support for hypothesis 3. Here, three of the five regression coefficients are significant and in the proposed direction. The discussion sections will bring clarity to why we believe the relationship between financial legitimacy and ROA to be stronger in time period two than time period one.

DISCUSSION

This study further develops our understanding of how legitimacy affects firm performance. We extend the work put forth by Deephouse and Carter (2005) and Shepherd and Zacharakis (2003) by identifying three influential stakeholder groups and testing how legitimacy judgments of entrepreneurial firms link to performance as measured by ROA. Specifically, our paper uses longitudinal data from nearly 5,000 companies, across several industries to investigate a more fine-grained approach to the relationship between legitimacy and financial performance by examining several different forms of legitimacy.

Our results demonstrate that legitimacy is a multi-faceted construct where different dimensions play lesser/greater roles on the overall effect of legitimacy on firm financial performance. We extend prior theory by showing that employer legitimacy is important during firm startup and that financial legitimacy is more pronounced in later years. Our discussion will address how different questions associated with each of our three legitimacy dimensions are effected by time.

Employer legitimacy had a positive and significant impact on firm performance. The effect was more pronounced at startup than three years later in time period two. These results may indicate that establishing legitimacy with employees early in the evolution of an organization has a greater effect because the overall legitimacy of the organization is low. Accordingly, as the organization grows (progresses through its lifecycle) and gains legitimacy with other stakeholders, as in time period two, employer legitimacy is less pronounced on firm performance. The two most important questions when determining employer legitimacy were whether the employer offered a full-time retirement plan and a full-time bonus plan. Healthcare plans, tuition reimbursement, and part-time retirement plans did not significantly affect financial performance. Based on these results it is important for entrepreneurs to consider adherence to social norms when offering retirement benefits and bonus programs.

It was theorized, based on customer cognitive legitimacy (Shepherd & Zacharakis, 2003) that increased owner participation would lead to higher levels of customer knowledge of the product offered, management, and the organization; which would lead to increased firm performance. Customer legitimacy was not found to increase financial performance at start up or three years later. The two questions used to determine owner participation were whether the owner was active and how many hours the owner worked. In this study we proposed that the more an owner participates in the operation of the business the more he or she is likely to interact with customers, providing them with information about the product, manager, and organization. It could be that the entrepreneurs in this study did not play roles that involved interactions with customers. Many of them may be in managerial roles with employees buffering them from the general public. It is also possible that other measures such as number of repeat customers and advertising expense are better predictors of the amount of information reaching customers. The second facet of customer legitimacy was based on the legal status of the company. It was theorized herein that companies that abide by social norms to become more legitimate business entities would increase the customer cognitive legitimacy and therefore improve financial performance. There was no significant relationship between organization legal status and financial performance in either time period. This may be attributed to the lack of transparency in the filing of legal status (i.e. that the customer did not know the status) or that the customer did not care about the legal filing status.

Finally, our research investigated the relationship between financial legitimacy and financial performance by looking at those dimensions that increase legitimacy and those that decrease legitimacy. It was hypothesized that loans from financial institutions in the firm's name indicates that a firm has established a certain level of financial legitimacy and that loans in other forms damage firm legitimacy, or at least prevent it from crossing the desired legitimacy "threshold" (Zimmerman & Zeitz, 2002). This study showed that those items associated with damaging firm legitimacy were not significant at the time of start up, and two of the factors were negatively related to firm performance for firms three years after startup. Based on Berger and Udell's (1998) three-stage modeled we predicted that financial legitimacy could be evaluated by determining the amount of debt held by the owner versus the amount of debt held by financial institutions. As expected at start up there was no relationship between firm performance and the level of personal loans obtained for the business. However, as the firm matured and moved into the second stage it was hypothesized that legitimacy could be gauged based on personal debt. Our research indicated that this had begun to occur even at the three year point as indicated by the significant negative relationship between personal loan debt and firm performance. A similar relationship was expected between business loans that were obtained

from non-financial institutions and firm financial performance. Our results again showed that this form of financing was not significant for legitimacy during nascence, but was significant and negative three years after startup. A third related question examined the relationship between personal credit card debt and financial legitimacy. Even though at both time periods this factor was negatively related to financial performance, it never attained significance at the .05 level. Finally, it was anticipated that the total amount of debt would have a negative effect on firm financial legitimacy. Our results showed a small negative, but not significant, relationship at both start up and three years. Based on these non-significant results it is possible that other factors such as definitional differences between legitimacy and reputation (Deephouse & Carter, 2005) are affecting our interpretation of financial legitimacy.

The second part of our financial legitimacy investigation looked at the positive effects of using business loans from financial institutions. The results herein show that loans from financial institutions in a firm's name had a near zero, non-significant effect on performance in both time periods. We interpret this to mean that obtaining these forms of loans may be a "taken-for-granted" aspect of legitimacy, meaning that these forms of financing may be viewed as necessary but not sufficient for financial performance by external stakeholders, thus explaining their near zero correlation. One explanation for these results is that financial performance has been linked to legitimacy as both an antecedent and as an outcome. We chose to use financial performance as an outcome.

PRACTICAL IMPLICATIONS

Berger (1981) stated that legitimacy does not just happen; it is something that is constructed by countless observers and it must be maintained by all those supporting it. Our discussion of practical implications will follow this categorization of the construction and maintenance of legitimacy for an organization.

Businesses are often built upon the desire of a single individual to provide a product or service. This product/service must have a real customer, must be produced by employees, and must be initially funded either by the founder or through external financial support. We will examine the implications of each of these stakeholders in the construction and maintenance of legitimacy.

In most cultures, customers are faced with a multitude of options for almost every service or product that they desire/need. On some occasions the customer may desire high product quality (digital camera) and other times they may only want to fulfill an immediate requirement (fast food hamburger). Regardless of their desire for quality the customer must scan their list of options and determine if the product or service will meet their minimum requirements. Businesses, especially small businesses, must be uniquely in-tune with the minimum requirements associated with their potential customers. This idea of minimum requirements certainly extends to the minimum legitimacy of a new venture. If a business does not look like other legitimate companies, or does not offer similar products and services, as already predetermined legitimate companies, then the customer is likely to not associate the new venture as being legitimate. The immediate result is a loss of sales for the small business.

An example of this legitimacy was seen during the initial development of Amazon.com. Most customers associated a book store with having an inventory of books that could be quickly delivered to the customer. This could have significantly affected the customer's initial beliefs of the legitimacy of service that they would receive. Over time, Amazon gained legitimacy by convincing customers that they could provide a minimum standard of service with a substantially lower inventory of books. New ventures should therefore determine prior to their initial entry into the market, whether they will try to construct legitimacy by imitating their competitors, or if they will be able to financially support their venture until they can change the customer's perceptions and construct an alternative legitimate company in that market space.

Businesses will certainly face similar legitimacy issues when trying to construct a minimum level of legitimacy to attract new employees. Even in today's economy, companies are not guaranteed to find, hire, and retain the quality of employees necessary to run a new venture. Employees often move from job to job trying to improve their financial position, or meet a career goal. Initially, new ventures must construct their legitimacy to a level to entice these mobile resources to join the company. In this context, legitimacy can be seen through the lens of whether the venture will still be in business a year from now, or five years from now. If a new company cannot offer a 401(k) retirement plan, health benefits, tuition assistance or reimbursement, and paid vacations, then the potential employee may not view the company as financially stable and therefore not as a legitimate long term employer. This may cause the potential employee to either reject any employment offers or to enter into a work agreement knowing that they will be looking for a more stable and more legitimate job in the future. In the first case, the new venture chances losing the best quality talent due to their lack of legitimacy. In the second case, the employee may not be willing to work at the highest level of performance based on their lack of commitment to the organization. Either way the company may face significant financial problems if they are not able to attract the best talent and then retain them.

New businesses must therefore either meet the standards of payment and support offered by their competitors or they must find other means to entice employees. Some examples that may be used to attract employees are to offer more flexible work schedules, delayed bonuses, greater involvement in work planning, or a more relaxed entrepreneurial environment that is free from bureaucratic burdens.

The third group of participants instrumental in constructing the legitimacy of an organization is the financial institution. Small businesses are often at the mercy of financial institutions to provide initial startup capital, funds to fuel growth, or provide financial stability during times of financial income variability. New venture owners will have significant difficulty convincing financial institutions to provide funding if they cannot act like and look like other successful companies that the institutions have funded in the past. During this construction phase it is imperative for the new venture to display a low risk profile necessary to gain the confidence of the investors. This will most likely mean that the company will be required to imitate their competitors.

This construction of legitimacy through the use of financial institutions will often be the first step in maintaining that legitimacy. As mentioned before, companies are constantly trying to construct and then maintain the legitimacy of their institution in the eyes of their stakeholders. Businesses that have trouble finding the necessary financial support can immediately destroy their perceived legitimacy. The recent downgrading of the United States bond rating is a prime example of how customers and employees will react to the legitimacy associated with financial support and stability. Businesses must realize the implication of having degraded financial support. Companies that have significant financial changes or even rumors of layoffs often destroy the legitimacy of the institution. This loss of legitimacy can cause employees to immediately start looking for more legitimate organizations. Often the first employees to leave will be the most qualified, which further damages legitimacy.

Similar effects will be seen by customers who may now be concerned with the long term legitimacy of the new venture. These changes will most likely have strong implications for customers who are contracting with the company for long term services or for products that have a service agreement. A recent example of this occurred in the United States automobile industry with the financial bailout of 2009. Potential customers began contemplating the legitimacy of these automakers within days of the acceptance of government support. Their concerns were met through messages from the United States government announcing that the automobile warranties would be honored by the United States government. Such efforts were aimed at restoring the legitimacy of the auto manufacturers. These efforts appeared to be successful as customers returned to support the vendors, over time.

These examples point to the necessity that new ventures have to first construct and then maintain legitimacy. A loss of legitimacy in the eyes of the customers, employees, and financial institutions are directly tied to the financial viability of the company. Small businesses are extremely susceptible to these effects based on their relatively small base of stakeholders, but even the giants of the auto making industry are not immune to these effects.

LIMITATIONS

The primary limitation of this study was imposed by the restrictions of the Kauffman Foundation data. Although the study provides a broad range of information, it is not ideal for studying customer interactions. The data worked well for identifying employer and financial legitimacy because it is tailored to investigating interactions with stakeholders intimate with the firms in question, entrepreneurial firms, not external stakeholders with limited interaction with the firm, such as customers. The Kauffman Foundation data primarily consists of many variables examining benefits, demographic information, and basic financial information.

A second limitation is that we chose to use financial performance as an outcome of financial legitimacy. Financial performance has been used in other studies as both an antecedent and as an outcome. This alone indicates that our current understanding of financial performance is not fully understood since strict causality cannot be inferred. Deephouse and Carter (2005) stated that complex relationships among performance, legitimacy and reputation exist and that further investigation including resource dependence theory (Pfeffer & Salancik, 1978) and the resource based view of the firm (Lengnick-Hall, 1992) may help identify the true causal relationship.

The third limitation of our research stems from construct validity. Since construct validity cannot be assessed directly (Schwab, 2005) it was necessary to look at supporting procedures. Our conceptualization of employer legitimacy was based on selection of questions that had significant face validity and content validity as determined by previous researchers. However, our results indicated that there were significant differences associated with the size, and sometimes direction, of the relationship between our construct of employer legitimacy and financial performance. These differences indicate that the questions we chose may not have adequate convergent validity across all measures. Adding to this discussion of construct validity is the potential of violating discriminant validity. It is possible that some of the questions that we chose to measure financial legitimacy may have been more closely related to determining financial reputation, which has been shown to be a uniquely different construct (Deephouse & Carter, 2005). As we continue to research this phenomenon it will be increasingly important to ensure proper construct validity.

FUTURE RESEARCH

First, future research should empirically investigate the influence of customer legitimacy on financial performance. It is possible that the variables used in this study do not delve deeply enough into details concerning individual customer perceptions of firm performance. Additional research should include variables that involve aspects of customer loyalty such as repeat purchases, use of store credit, and purchase of gift cards. All three of these variables should indicate that customers do perceive the organization to be legitimate because they indicate some amount of trust. Second, researchers should examine other types of legitimacy such as regulative, normative, and cognitive as proposed by Zimmerman and Zeitz (2002) to see how well they predict financial performance.

CONCLUSION

In this study, we proposed that customer, employer, and financial legitimacy have positive ramifications for financial performance. Customer legitimacy did not significantly predicted financial performance as proposed herein. Employer legitimacy does prove to significantly predict financial performance in both time periods. The effects of financial legitimacy manifested themselves much more clearly in time period two. This study indicates that greater access to information, enjoyed by employees and financial institutions, may allow them to form better judgments about the legitimacy of new entrepreneurial firms than customers with limited contact and access to firm information.

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