

YOU CANNOT LIVE OF LOVE ALONE – THE INTERRELATION OF LEGITIMACY AND EFFECTUATION IN NASCENT MARKETS

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INTRODUCTION

Most people will agree that legitimated firms are firms that have demonstrated legality, eligibility and authenticity in the market as a condition for getting customers to buy their products. New firms does not necessary finance their activities from day one by selling products to customers, they often finance their activities by investors. This paper articulates that new firms in nascent markets cannot live of love alone, meaning that the gained legitimacy from investors and other stakeholders but customers is not enough. The love from these investors might led to overconfidence and pre-mature commitments leading to a delay in customers focus. The result was lack of learning and flexibility so the new firm limited it self from creating a new market together with the investors. The love from the investors vanished when too few customers came after then end of the honeymoon.

Each year hundreds of millions of people are engaged in new venture creation activities (Reynolds et al., 2005). However, many of them fail. A careful review of 57 recent studies confirms that new ventures play very significant roles in employment creation, productivity growth and innovations (Van Praag & Versloot, 2007). Thus, making new ventures survive is of utmost importance for the economy, innovation and growth. Legitimization activities and effectual decision-making are seen as cornerstones for survival and growth in the recent entrepreneurship debate as well as especially important in nascent market settings. The challenges that an entrepreneurial venture faces when engaging in sense-giving activities, effectual decision-making and gaining legitimacy on firm and industry level have however not yet been explored. This paper takes a starting point here by exploring consequences of gaining legitimacy on effectual decision-making of an entrepreneurial firm in a nascent market. For our purpose we follow Aldrich and Fiol (1994) and define a new venture as an independent organization, that is not sheltered by sponsoring organizations, initiating a new activity. By definition, these ventures cannot rely on existing institutions that provide external legitimacy.

Specifically, we examine how effects of gaining legitimacy can influence learning, flexibility and thus the application of effectual decision-making. We do so through an in-depth longitudinal case study of Better Place, one of the first global infrastructure providers of electric mobility. This new venture has attracted widespread support among politicians, policy makers, car manufacturers, and investors, but proved unsustainable. We make some central contributions to the literature, which move us closer to an understanding of legitimacy gaining and effectuation in nascent markets and posit that effectuation and legitimacy theory can be further developed.

NEW VENTURE DEVELOPMENT AND LEGITIMIZATION EFFORTS IN NASCENT MARKETS

Nascent markets are environments in an early stage of formation and are thus characterized by rapid non-linear change and high market structure ambiguity (Aldrich & Fiol, 1994; Eisenhardt, 1989). Nascent markets have unclear product definitions (Hargadon & Douglas, 2001), undefined or fleeting industry structures (Eisenhardt, 1989), and no dominant logic for market actions (Santos & Eisenhardt, 2009). Accordingly, market players lack an understanding of primary dependence relationship (Rao, 1994) as well as the interdependence of firms i.e. which organizations can be suppliers, partners or competitors (Rindova & Fombrun, 2001). In nascent markets, many players are just entering the market space and do not relationships. This gives opportunities for low-power players to cooperate with high-power players (Ozcan & Eisenhardt, 2009). Furthermore, which competencies firms should strategically invest in (Kaplan & Tripsas, 2003), and what industry-wide blue prints should guide action are also quite uncertain (Aldrich & Fiol, 1994; Ozcan & Eisenhardt, 2009).

Many international high-tech new ventures as Better Place are disruptive and faced with high degree of uncertainty especially in the early stage of their life cycle (Etemad, 2014). The uncertainty of nascent markets is compounded when also the entrepreneurial firms populating the new market are new. New ventures are often incompletely formed, deficient in resources, and lacking clear or coherent identities. Consequently, the achievement of legitimacy, which can enable them to acquire resources and create value (Aldrich & Fiol, 1994), can be particularly challenging for new ventures operating in nascent markets (Navis & Glynn, 2010) as both are required – legitimizing the new firm and the new market it operates in.

Legitimization

The term legitimacy commonly refers to the right to exist or perform an activity in a certain way (Suchman, 1995). Institutional theory is thus concerned with regulatory, social, and cultural influences that promote an organization's legitimacy rather than focusing solely on efficiency-seeking behavior (Roy, 1997). As such, legitimization is a complex social process (Fligstein, 1997; Kennedy, 2008; Kennedy & Lounsbury, 2010) involving both entrepreneurial organizations and prospective resource providers, e.g. investors, analysts, customers, media, and other interested audiences, in the social construction of a market offering's meaning, the formation of categorical and organizational identities, and perceptions about the viability of the business model (Tripsas, 2009).

In venture creation, legitimacy is seen as a resource necessary for acquisition of other resources and, thus, as a key factor influencing the survival and growth of new ventures (Zimmerman & Zeitz, 2002). In this line, Delmar and Shane (2004) argue that in the market entry stage, undertaking legitimating activities should be the first step in the firm's organizing process as obtaining legitimacy is a necessary precondition for initiating social ties with stakeholders and accessing resources. Recent research in the field of entrepreneurship and new market creation has helped to illuminate and frame various legitimacy-building approaches that new ventures can take (Bruton, Ahlstrom, & Li, 2010). For example, new ventures can create legitimacy through mimicking business ideas or business models of successfully established firms. Another approach, more suitable in highly volatile settings is the crafting of stories (Lounsbury & Glynn, 2001). Furthermore, researchers have pointed out that gaining pre-

commitment from high-status market partners can serve as an important source of legitimacy (Kennedy, 2008; Ozcan & Eisenhardt, 2009). Stakeholder pre-commitment is central to effectuation theory, which we will review in the following section.

Effectual Transformation

In legitimacy gaining of new ventures in nascent markets it is vital that the goals are co-created with other stakeholders to build the possible future, that is effectual transformation for market creation (Wiltbank et al., 2006). Effectuation theory (Sarasvathy, 2001) applies to entrepreneurial ways of dealing with bounded rationality and thus represents a paradigmatic shift in our understanding of the practices of entrepreneurship. Effectual decision-making focuses on the question of what can be done given possible means and imagined ends (Sarasvathy, 2001). Effectuation processes imply that entrepreneurs start with a generalized aspiration, which they attempt to satisfy using the resources at their immediate disposal. Effectual thinkers believe strongly in shaping the future and controlling outcomes in conjunction with pre-committed stakeholders and customer-partners.

Sarasvathy and Dew (2004) and Dew et al. (2011) have illustrated how effectuation theory can explain the rise of new markets through transformation. This effectual process is an action oriented, inter-subjective, non-predictively way to transform the organization's identity, knowledge and network of stakeholders into new goals (Wiltbank et al., 2006). New markets are not predicted through planning or imagination but co-created with others in order to reconstruct and reorganize the means of the organization. Sarasvathy and Dew (2005) argue that ways to create new markets involve transformation, especially stakeholder-dependent transformation. These particular stakeholders self-select into the new venture and new market creation process. The transformation process can be pictured as a series of transformation of the stakeholders means into novel market offerings. These novel market offerings are artifacts of the effectual process rather than preselected market offerings to be reached through search and selection of appropriate stakeholders with suitable means and goals. In this view market creation is a learning process of solution-formation. Sarasvathy and Dew (2005) describe the transformation process as follows: "The new market (...) gets fabricated, not through the design of any one person, but as a chain of interactive commitments that form the interface between the inner environment of the effectual network and the outer environment." Wu and Barbazon (2009) argue that to create a new market the effectual transformation process is a learning process: learning to increase the knowledge of the effectual network and to converge with regard to the goals of the effectual team.

With the particular focus on stakeholder self-selection and commitment the effectual market transformation process incorporates gaining of legitimization in the market creation process. Each time a new stakeholder self-selects into the process, contributing new means, the new venture and new market gain legitimacy. However, current literature does not offer an in-depth understanding of the intricacy of these processes, tensions that might arise or even downsides when legitimizing and using effectual decision making in nascent industries. To investigate these issues we ask the following research question:

How are legitimization efforts interlinked with effectual decision-making in a nascent market setting?

METHODOLOGY

In order to answer the research question, we draw on a single in-depth case study of one of the first electric vehicle infrastructure providers worldwide, Better Place. It was founded in 2007 with the aim of developing and implementing a battery-charging infrastructure in order to support electric cars as a mass market alternative to petrol engine vehicles. Better Place is the fastest funded new venture in history, partnering with numerous companies from the automotive, energy and battery development industry. Better Place has been awarded the Green Car Breakthrough Award and its founder Shai Agassi was listed among the 100 Top Global Thinkers. Due to his history in founding ventures Shai Agassi can be classified as an expert entrepreneur. Better Place is a case with legitimacy creation and effectual transformation at its core; working from the beginning with pre-commitment of stakeholders. Despite all the received legitimacy and the effectual approach toward market transformation Better Place filed for liquidation during our data collection in 2013 (an overview of the history of Better Place is available from the authors). As a result, it is an information rich and extreme case (Patton, 2002) characterized by “rare” qualities (Eisenhardt, 1998) as we are able to follow a specific case company from cradle to grave and thereby are we able to uncover some unwanted effects of legitimacy creation for new ventures.

This study builds on two main data sources: archival data and interviews. The extensive archival data cover both internal and external data. The internal sources include press releases since founding, white papers, internal reports and presentations as well as video presentations by the CEO at various points in time (90 documents of ca. 644.940 words). The external sources include newspaper articles that we identified using LexisNexis (2014). We complemented these with general and scientific articles as well as analyst reports about the firm and the evolution of the electric vehicle market (587 documents of ca. 429.000 words). The second main data source is semi-structured interviews with internal and external informants (9 recorded interviews of ca. 57.600 words). All face-to-face interviews with informants were conducted on-site, digitally recorded, and subsequently fully transcribed. The interviews that ranged between 35 minutes and 2 hours were coded in our NVivo 10 database.

As the aim was to understand the effects of legitimization and effectual transformation processes, the data was analyzed by identifying how the company developed over time and how gaining legitimacy and applying effectual transformation effected the new venture's development. Our thematic coding uses a set of a priori codes that are strongly presumed to be relevant for the analysis (based on previous literature) but also allows for an inductive evolvement of themes from the data. This technique enables capturing the major thematic ideas in the data. In practice, the data were sorted according to the central themes linked to the research aim. For this study, four overall coding themes were applied: 1) legitimacy gaining, 2) effectuation market transformation process, 3) effects of legitimacy gaining and 4) effects on effectual decision-making which were subsequently divided into subcodes, and again in sub-subcodes.

RESULTS

The case of Better Place provides an intriguing opportunity to understand unwanted implications of gaining legitimacy on flexibility, learning and effectual transformation in nascent markets. Better Place foresaw that to be successful they needed acceptance from a number of key

players. Investors needed proof that electric vehicles were viable technologically and commercially. Consumers, on the other hand, were unwilling to purchase vehicles before the infrastructure was in place to support and service the EV market. Governments, as a provider of incentives for both investors and consumers, played a critical role in ensuring the growth of the EV market. The success of Better Place consequently hung on all parties buying into the future of the electric vehicle, as well as the company's ability to forge effective alliances and partnerships.

Better Place, therefore, placed great emphasis on crafting and disseminating their story. CEO Shai Agassi was a key note speaker at numerous conference and fairs and its team was very busy getting coverage in the press (Andersen & Rask 2012), all of which are approaches institutional and entrepreneurship scholars have portrayed as essential for building legitimacy (e.g. Aldrich & Fiol 1994; Delmar & Shane (2004). Better Place's crafting and disseminating of their story was successful. From the beginning Better Place managed to attract high-status corporate partners who were attracted by Better Place's vision, its already existing network and agreements with Israel as well as the strong background of key employees, especially its founder Shai Agassi. Previous literature has shown that attracting and joining forces with high-status partners as corporate companies and governments is an important source of legitimization toward other potential stakeholders and resource providers (Kennedy, 2008; Ozcan & Eisenhardt, 2009). We see, however, that this kind of commitment and legitimacy has two effects on an entrepreneurial firm in a nascent market. Entrepreneurs and their teams gain *overconfidence in the new venture and its market approach* and therefore *misinterpret how, why and to what extent stakeholders are committed*. Additionally, overconfidence leads to the *rejection of negative feedback*. Furthermore, receiving pre-commitments and legitimacy from high-status partners lead to *premature contractual and identity commitments*. While the first two have a negative impact on the new venture's *capacity to learn* and the latter two have a negative impact on the *firm's flexibility*. Figure 1 illustrates these effects, their impact, and their relationship to Better Place creating and gaining of legitimacy. Given the exploratory nature of our research, this model and its inherent propositions are intended as suggestive rather than conclusive.

 Figure 1 about here

DISCUSSION

In this study we identified potential effects which creating and gaining of legitimacy has on learning, flexibility and in turn effectual transformation, which might be vital to the success of a firm in a nascent market. Of course, a single case study presents limitations. However, given the lack of research in this domain, our goal was to provide novel insights rather than testing theory.

Bearing this in mind, our study makes several contributions to the literature. First, we illustrate how a firm's success in legitimacy building can inhibit its ability to learn, its flexibility and in turn hamper its ability to transform a nascent market. Previous literature has primarily focused on which activities managers and new ventures can undertake in order to gain legitimization – including the crafting of stories (Lounsbury & Glynn, 2001), the use of analogies, metaphors and imitation (Creed, Scully, & Austin, 2002) as well as gaining pre-

commitment from high-status market partners (Kennedy, 2008; Ozcan & Eisenhardt, 2009). Other work has emphasized the importance of trial-and-error, learning, experimentation and iteration with regard to market approach (i.e. business model) as well as to market offering (Sosna, Treviño-Rodríguez, & Velamuri, 2010). Effectual transformation provides an umbrella for this approach in a nascent market setting. Combining these perspectives, our data suggests that creating and gaining legitimacy might have a negative influence on a new ventures ability to transform a nascent market as a consequence of two related effects: overconfidence and premature commitment. Until now legitimacy has been understood as a desirable outcome especially for new ventures (Delmar and Shane (2004) and in nascent market settings (Navis and Glynn 2010). This research might nuance our current understanding.

Our final contribution is to theorize a challenge of effectuation as a transformation process in nascent markets, where stakeholder commitment (i.e. gaining legitimacy) takes a central part. Stakeholder commitment leads, among other things, to goal containment while it is important to stay flexible to adapt to learning from the market. This challenge addresses a strategic trade-off that entrepreneurs in nascent market settings need to address: how can entrepreneurs balance partnering that constrains flexibility and learning from the market?

“REFERENCES AVAILABLE FROM THE AUTHORS”

Figure 1: Effects and consequences of legitimacy creation and gaining

