Searching for the Legitimacy Threshold

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In this article, the authors lay the groundwork for a concept known as the legitimacy threshold. The legitimacy threshold is defined as the point at which, from the entrepreneur’s perception, the organization moves from an untenable collection of resources to a potentially sustainable enterprise. Entrepreneurs generally describe it as a “made it” feeling. The authors’ focus was twofold: (a) to develop a theory base for such a concept and (b) to conduct multiple case studies to verify such a theory base. They make a case for the existence of thresholds and then more fully define the legitimacy threshold before providing support for universal components of the construct. They conclude by presenting 11 case studies that lend support to the idea of a universal legitimacy threshold.

Keywords: legitimacy; new firm; exploratory; change

This work came about as a result of our work with small, growing enterprises (SGEs). We have observed that most entrepreneurs at these firms express very similar stories about when, where, and how they “made it.” This made-it feeling is a general feeling of relative permanence as opposed to a general feeling of impending failure. We term the point where this occurs the legitimacy threshold (LT), because the made-it stories told by entrepreneurs almost always involved the endorsement—or legitimizing—of the entrepreneur’s organization by some major stakeholder. Borrowing from related work by Zimmerman and Zeitz (2002), we define the LT as “[the point] below which the new venture struggles for existence and probably will perish and above which the new venture can achieve further gains in legitimacy and resources” (p. 414). In life cycle parlance, it can be thought of as a firm moving from the birth stage to the growth stage. Scott and Bruce (1987), for example, term this the “inception to survival crisis.”

After realizing that firms seem to develop in this manner, we set out to develop a theory base for (a) why this event is usually noticeable within the firm and (b) why it seems to have some universal components across firms. This article is an attempt to establish that theory base and extend the notion of the LT via interviews with 11 entrepreneurs within SGEs. Although certainly not unheard of, this concept has not been explicitly sought in previous studies. Reasons for this are not hard to understand. It is a difficult undertaking to find any universal constructs in modern-day commerce, especially in the chaotic world of the small, entrepreneurial firm. We, however, believe the LT is one of these universal constructs; not that the threshold will occur in
exactly the same manner in every SGE, but our research shows that there are enough broad similarities in a majority of SGEs to define it as such.

What may be gained by understanding the nature of an LT? Based on our experience and subsequent research, it appears that some methods are more fruitful than others when it comes to reaching and moving through the threshold. For researchers, it is hoped that this base of theory will encourage research into empirically identifying the LT. We believe that once the LT is more clearly understood, entrepreneurs, and those that aid them, can develop strategies and tactics to help navigate the firm through this complex and treacherous stage of existence. Furthermore, we regard the LT as a necessary, but not sufficient, transition to the growth phase. By understanding how to facilitate and capitalize on the LT, entrepreneurs can set the stage for growth and future success. In this work, we integrate punctuated equilibrium, resource dependency, and stage-model theory to lay the theoretical groundwork for the existence of the LT. We then combine the literature on the liabilities of newness and smallness to make a case for the universal LT.

THE LT

Although other researchers (e.g. Downs, 1967; Scott & Bruce, 1987; Steinmetz, 1969) have alluded to an LT, Zimmerman and Zeitz (2002) were the first to explicitly use and operationalize this term. The authors do not venture a prediction as to when or where the event may happen, but they do state that “An organization must achieve a base level of legitimacy that is dichotomous—it either does or does not meet the threshold” (p. 428). Legitimacy is defined parsimoniously here as “a social judgment of acceptability, appropriateness, and desirability, [that] enables organizations to access other resources needed to survive and grow” (p. 414).

In Figure 1, our notion of the LT can be more fully expressed. It can be seen that there are distinct configurations separated by the LT—a prethreshold configuration and a postthreshold configuration. The prethreshold configuration is one that is highly centralized around the entrepreneur and focused externally (Miller & Friesen, 1984a; Mintzberg, 1980). The prethreshold period is one of intense struggle for the entrepreneur. He or she is attempting to attain legitimacy from stakeholders who are unlikely to grant them legitimacy until legitimacy has been granted from another source—legitimacy begets legitimacy. This paradoxical condition is difficult to overcome and is a reason the failure rates for prethreshold firms are much higher than for postthreshold firms (Jawahar & McLaughlin, 2001; Singh, Tucker, & House, 1986; Stinchcombe, 1965). The prethreshold entrepreneur and the firm are virtually indistinguishable from one another, and the vast majority of decisions are made by the entrepreneur. The key stakeholders in this configuration are customers and financiers. The postthreshold configuration is one where decentralization begins to take hold as the entrepreneur is forced to deal with the complexities of growth (Kelley & Marram, 2004). Reaching the LT is a predecessor to growth, but it does not ensure growth. In fact, the firm may still fail, but it is much less likely.

The idea of early-stage legitimacy essentially holds that external stakeholders accord the firm the clout to grow. Legitimacy cannot be taken, rather, it must be granted by influential stakeholders (e.g., financiers, employees, suppliers, consumers). These stakeholders, either analytically or tacitly, at some point decide that a given firm has the necessary influence to interest them, and most stakeholders want to have a feeling of relative permanence from an organization—a feeling that it is not teetering on the edge of extinction (Aldrich & Fiol, 1994). Because of liabilities of newness and smallness, the prethreshold period is a time filled with severe cash shortages, frustrating negotiations with more powerful stakeholders, and ethical dilemmas as the entrepreneur attempts to convince others that the firm is valid and valuable even though it has not been legitimized (Carroll & Delacroix, 1982; Jawahar & McLaughlin, 2001; Morris, 2001).

In developing support for the LT, we draw from three established and related theory bases. The first base, punctuated equilibrium, is relatively recent. The second and third, resource-dependency theory and stage-model theory, respectively, have a longer history.

Punctuated Equilibrium (PE)

This theory holds that that large-scale change in organizations is discontinuous, abrupt, infrequent, and noticeable, and as a result, these periods of change (i.e., thresholds) are noticeable and identifiable. The support for the idea that organizations are in one of two states—relative stability or major upheaval—at
any given time has been established in recent literature (Gersick, 1988, 1991; Gould & Eldredge, 1977; Meyer, Brooks, & Goes, 1990; Romanelli & Tushman, 1994; Tushman, Newman, & Romanelli, 1986). This change process has been termed *punctuated equilibrium* (PE) and is contrasted with piecemeal change or incremental change, which holds that major change is gradual and nonrevolutionary. In periods of relative stability, organizations are in equilibrium, and small changes are all that is needed to keep the organization aligned with its environment. However, less frequently organizations must undergo large-scale reorientations to keep the organization aligned. “If the environment changes substantially, frame-breaking change is the only way to realign the organization with its competitive environment” (Tushman et. al., 1986, p. 39). It is these reorientations that represent punctuations. A key focus of our research is to examine a particular punctuation in the SGE: the LT. We are proposing that a major, identifiable reorientation occurs early the life of most SGEs (see Figure 2).

The more recent work on PE (i.e., Romanelli & Tushman, 1994) is an extension of the work of Miller and Friesen (1984a), who found substantial empirical support for punctuated change, which they term frame-breaking or quantum change. They, in turn, built on and supported Mintzberg (1980, 1984), who found support for the idea that firms are in one of a limited number of configurations at a given time and that change between these configurations is disruptive. These disruptions are, and should be, dramatic and noticeable (Miller & Friesen, 1982, 1984b). In this model, a firm changes strategy, structure, people, and processes at the same time to reduce expense and to
limit adjustment time. Miller and Friesen (1984b) completed a comprehensive work on this argument, presenting abundant anecdotal and empirical evidence that seems to verify this form of change. By concluding that if organizations change in a piece-meal fashion, they would collectively exhibit far too much variety to allow the emergence of very common configurations; all organizations would be in slightly different states of mutation. Piecemeal change, in other words, is inconsistent with the notion of configurations. Only quantum change that keeps the organization in the common “permitted” configurations allows us to find such configurations. (p. 3)

Their research suggests that configurations are identifiable and, by extension, the points where an organization moves from one configuration to another are also noticeable. If the opposite were true, that is, if organizational change were a smooth and imperceptible transition from one period to the next, then identification of configurations and the thresholds between them would be impossible. This logic is very similar to the argument presented here. In the context of this work, we propose that a prethreshold configuration is followed by a postthreshold configuration, and the transition is represented by the LT. In other words, a firm must reorient after being legitimized, thus yielding two distinct configurations.

A final important concept in the discussion of punctuation is the notion that some trigger is required to push a given configuration over its threshold of stability. Gersick (1991) expresses this as organizations having a “deep structure” that exists until it is no longer possible to sustain, that is, pushed over the threshold of stability by some trigger. Deep structure is related to the configuration concept, but more inclusive. Gersick discusses it as a relationship not only between internal system networks but also as a relationship between the internal system networks and networks external to the organization. In other words, it is the relationship between the configuration and that configuration’s external elements. It is generally these external elements that function as triggers for a given punctuation. Deep structures will resist change until it is triggered by either an environmental jolt (Meyer, 1982) or a breaking point brought on by a gradual accumulation of stress (Gould & Eldredge, 1977; Meyer et al., 1990). Both types of triggers require a metamorphic reaction by management to survive.

With regard to the LT, the trigger is usually a major stakeholder legitimizing the organization. It is interesting that triggers are usually thought of in terms of crises, but for the prethreshold firm, this destabilizing force is generally welcome. Meyer (1982) describes triggers as “transient perturbations whose occurrences are difficult to foresee and whose impacts on organizations are disruptive and potentially inimical . . . [that bring about] opportunities, threats, crises, or catastrophes” (p. 515). Triggers do create problems, but as one entrepreneur told us, they are “problems that you want to have.”

The fact that “[PE] recently emerged as a prominent theoretical framework for characterizing and investigating fundamental organizational change” (Romanelli & Tushman, 1994, p. 1141) is important because it lends credence to our claim that an LT is, in
fact, identifiable within firms. In addition, when combined with the following discussion this theory will aid us in making predictions regarding the placement of the LT: “Punctuated equilibrium models first and foremost enable predictions about patterns of fundamental organizational transformation” (Romanelli & Tushman, 1994, p. 1142).

Resource Dependency

To further explore the nature of the LT trigger, we turn to the rich body of work on resource dependency. It is generally accepted that no organization can survive without receiving legitimization from its stakeholders (Clarkson, 1995). Resource-dependency theory (Pfeffer & Salancik, 1978), for example, holds that an organization is dependent upon its environment for the resources needed to survive. The extent to which an organization is dependent upon a given stakeholder group can be determined by the organization’s need for the resource controlled by that stakeholder group (Frooman, 1999; Mitchell & Agle, 1997). This dependency places varying degrees of constraint on the strategic choices that a firm can make, and in general, the smaller and younger the firm, the more severe the constraint level (Hrebiniak & Joyce, 1985). For the young, small firm, the implications of this condition are straightforward: It must cater to customers and financiers because it is these groups that control the firm’s most scarce resource—cash (Dodge & Robbins, 1992; Dodge, Fullerton, & Robbins, 1994; Jawahar & McLaughlin, 2001; Kazanjian, 1988). Jawahar and McLaughlin (2001) hold that the prethreshold stage is so treacherous, entrepreneurs will adopt a risky methodology; the need to secure financial resources and gain customer acceptance is so severe at this stage that the SGE will likely defend against or ignore other stakeholder groups. They will actively pursue only those stakeholders that can provide cash, and they will ignore or even actively defend against other stakeholders. Although this may have negative implications postthreshold, the entrepreneur’s tenuous hold on survival makes this a necessary tactic.

Stage-Model Theory

Another important literature providing support for, and insight into, the LT is that of stage-model theory. It is not the intent here to get involved in a debate surrounding the appropriateness of stage models, but some of the richest work on thresholds comes from this body of knowledge. This work will not look at stage theory from a content perspective but from a process perspective. The value of stage-theory research lies not in the idea that firms develop through discrete, sequential stages but in how firms move through stages (i.e., transitions; Covin & Slevin, 1997). Although the number of stages and the characteristics present at each stage are sources of debate, the idea that the transitioning between stages is abrupt, discontinuous, and noticeable is consistent across most studies.

The reason for this abrupt disconnect is based on the fact that it is the entrepreneur’s management of distinct sets of problems that causes firms to transition from one stage to the next (Adizes, 1979; Greiner, 1972; Kazanjian, 1988; Miles & Snow, 1978; Smith, Mitchell, & Summer, 1985; Steinmetz, 1969). In the current stage of existence, the entrepreneur is faced with a set of problems. These problems generally culminate to emergency level, and as a result, these problems either get solved or the firm fails. However, the successful solving of this set commonly leads to a new and different problem set. The transition of problem sets is what triggers to the entrepreneur that a new state of being has been entered (Churchill & Lewis, 1983; Greiner, 1972).

The problem set the entrepreneurs encounter in the prethreshold stage—usually called birth—has been fairly well documented among stage-model theorists (Chandler, 1962; Greiner, 1972; Kazanjian & Drazin, 1989). As alluded to above, the problems here are associated with securing cash, so the problems are cash flow and customer acceptance (Dodge et al., 1994; Dodge & Robbins, 1992). Also, the need to switch to a different problem set from one stage to the next has been widely agreed upon (Kazanjian & Drazin, 1989; Smith et al., 1985; Steinmetz, 1969). After legitimization, the venture become less risky,
and postthreshold entrepreneurs are likely to adopt different tactics when dealing with stakeholders. Entrepreneurs begin to look internally to increase efficiency and controls—the beginnings of bureaucracy. Specifically, “proactive attention is likely to be devoted to employee and supplier stakeholders in order to address the need to build a quality workforce and products and to obtain resources to accommodate such rapid growth and expansion” (Jawahar & McLaughlin, 2001, p. 408).

A commonly cited scenario in our research is one where the entrepreneur toils diligently to gain legitimacy from consumers, and once this problem is solved, he or she is suddenly scrambling to fulfill orders. So the solving of these prethreshold problems gives birth to a new and different set of problems postthreshold. To further illustrate the change that must take place at the threshold, if the entrepreneur continues to work on prethreshold types of problems (e.g., pursuing customers) instead of moving to postthreshold types of problems (e.g., fulfilling orders), the venture will likely fail. In other words, the success factors prethreshold become failure factors postthreshold (Kazanjian, 1988). This ironic situation means that the most effective manner in which to navigate punctuation between configurations is for a firm to “temporarily become its own antithesis,” because surprises “invert virtues and vices” (Meyer et al., 1959) conceptualizes this idea by holding that a postthreshold firm cannot be thought of as an older, bigger, prethreshold firm but more like a butterfly being related to a caterpillar.

The works presented in this section provide support for the idea that an LT occurs early in the life of most growing firms. The next step is to examine any reasons why this threshold might have some universal components.

Before moving on, an alternative should be mentioned here. Based on our research, not all SGEs will encounter a threshold. For example, two entrepreneurs we spoke to did not feel that any one event forced them to restructure. One purchased a number of struggling restaurants and simply “tweaked” the system to grow. Another received venture capital financing in the “prebirth” stage and was able to grow relatively seamlessly. In a related fashion, just because a given firm made it through to the LT does not mean that it cannot or will not fall back below it—an important customer could easily “fire” the company.

A UNIVERSAL LT

Supporting the claim that the threshold is identifiable within firms is less problematic than supporting the claim for some sort of universality, as there are several solid organization theories that do an excellent job of demonstrating that firms change in dramatic fashion. In contrast, studies supporting some degree of universality surrounding these dramatic changes (i.e., thresholds) are sparse.

Just as some SGEs will be able to avoid (or not perceive) the early-stage punctuation, it is also unlikely that all firms that do experience the LT will do it at precisely the same time and place. That being stated, there appear to be enough similarities surrounding the LT that looking for generalities will provide value. The literature on the concepts of liabilities of newness (LON) and liabilities of smallness (LOS) provide support for a universal LT by suggesting that a window of likelihood exists for the occurrence of the LT.

LON and LOS

LON occurs because new firms do not yet have the systems established internally or externally that are required to compete effectively against larger firms (Carroll & Delacroix, 1982). LOS describes a condition in which small firms are more susceptible to environmental forces because of limited debt capacity, internal cash restrictions, and a limited product line (Morris, 2001).

Regardless of the stakeholder under consideration, the key antecedents to achieve legitimacy are largely the same (e.g., historical financials, reliability, size, etc.; Singh et al., 1986). So, even though SGEs are all very different, the environment (stakeholders) judges them on similar criteria. As a result, the intertwined concepts of LON and LOS make it unlikely that a given firm will be very small or very young when stakeholders confer their favor upon it. Stakeholders like to have a feeling of permanence from the entities that they legitimize, and this requires some degree of age and size on the part of the organization.

The fact that small firms are subject to LOS and LON, on the other hand, also makes it unlikely that a given firm will be very large or very old when it is legitimized. Firms need resources from the environment, and because of LOS and LON, prethreshold firms are not receiving them. As a result, these
firms face much higher failure rates than their larger, postthreshold counterparts (Singh et al., 1986; Stinchcombe, 1965); therefore, if these firms are not legitimized relatively quickly after formation, they will fail and will not have the opportunity to face the LT. This lays the initial groundwork for the existence of a window of likelihood. To shed further light on this notion, we briefly examine key stakeholder groups and how the concepts of LON and LOS relates to them.

Customers

In customer terms, LON and LOS are accounted for in the concept of taken-for-grantedness (Hannan & Freeman, 1989). This describes a situation whereby the less a customer actually thinks about the source of legitimacy before legitimizing an organization, the better. This has also been termed cognitive legitimacy and generally requires social actors to become so comfortable with an organization that they do not actively think about it (Aldrich & Fiol, 1994; Shepherd & Zacharakis, 2003). Obviously, achieving taken-for-grantedness is a difficult task for the small and young firm.

Financiers

In terms of financier stakeholders, these liabilities are manifested in adverse selection and moral hazard problems. Adverse selection describes a situation in which a high-quality firm may not be able to attain funding simply because the financier is unable to discern its quality (Akerlof, 1970). Moral hazard is an agency issue, which deals with the possibility that a SME owner or manager mismanages resources for personal gain, and because of opaqueness, investors may be unable to detect this behavior (Gregory, Rutherford, Oswald, & Gardiner, 2005). Both problems make it difficult for the small and young firm to obtain financing.

Employees

In a similar fashion, prospective employees will not choose a small firm without some level of employer legitimacy. This manifests itself as the problem of lack of familiarity and the problem of low levels of influence on population norms (Williamson, 2000). Lack of familiarity simply describes the fact that if a prospective employee is not sufficiently aware of a given organization, he or she is unlikely to legitimate that firm. In a similar manner, illegitimate firms cannot affect the current state of human resource (HR) practices in a given population. These issues make attracting the best and brightest employees unlikely.

Deep Structure Revisited

Earlier, we discussed deep structure as being an important component underlying the LT within a given firm. Here, we utilize it to provide support for a universal threshold. The condition formed by the interaction of LON and LOS forms the “playing field” for the small, growing firm, and most firms must play on this field. Gersick (1991) refers to this playing field as a deep structure that encourages SGEs to form (a) similar “basic parts” and (b) similar “basic activity patterns” to survive. As organizations mature, they develop proprietary resources and cultures that allow them to differentiate their organizational development (Barney, 1991), but the extreme pressure placed on small, young firms by their environment forces them to develop similarly. For example, they must seek funding and satisfy investors with a business plan, they are autocratically run, and they have few divisions (Mintzberg, 1980).

These similarities drive small firms (more than larger firms) to develop similarly and adopt similar configurations that Mintzberg (1980) and Miller (1984a) term the entrepreneurial configuration, which fits most small organizations because situational factors (age, size, and environmental stability) drive them to the same general form.

In fact, most new organizations seem to adopt [the same] configuration, whatever their sector, because they generally have to rely on personalized leadership to get themselves going—to establish their basic direction, or strategic vision, to hire their first people, and set up their initial procedures. (Mintzberg, 1996, p. 616)

When organizations grow quickly, they “make a relatively quick transition to another configuration” (Mintzberg, 1980). Mintzberg holds that factors surrounding the organization’s situation will influence the choice of structure. Furthermore, the antecedents and outcomes of punctuations within organizations are dependent upon the strategies they pursue, the structures they adopt, the ideologies they espouse,
and the slack resources they amass (Beyer, 1981; Bourgeois, 1981; Miles & Snow, 1978). Because most small businesses are homogeneous with regard to each of these issues, the antecedents and outcomes of the LT are also likely to be similar.

SAMPLE AND STUDY DESIGN

The sample for this exploratory study was a group of start-up companies in the Northwest region of the United States that met the following criteria: (a) a new venture at least 3 years old, (b) with at least five employees, (c) with the founder not far removed from managing the company, and (d) had achieved at least 20% sales growth in 1 or more years since inception. As shown in Table 1, 11 companies were selected in a variety of industries, most with a technology focus.

The data were gathered primarily through a semi-structured interview conducted by the two authors. The interview was designed to elicit the founder’s own description of the time and events and activities associated with a moment when they felt that they had first made it in the new venture and why they felt that way. The following opening question was asked in all interviews: “Do you remember a single event that occurred that made you feel as if your organization was going to make it?” Probing questions were used to elicit more detailed information surrounding this moment. Following the interviews, the researchers compared notes to ensure the accuracy of the information. The entrepreneurs were also given a one-page survey to complete and return via mail. Discrepancies were checked and corrected through follow-up communications with the entrepreneurs.

FINDINGS

Summaries of Firms That Experienced LT

Company A

The founder of this real estate development company began his career developing several projects on the East Coast in 1996. He moved back to his hometown in 1998 to concentrate development efforts there, thinking it was a place he could establish a reputation by applying ideas he had learned on the East Coast and in Europe. He experienced a threshold in 1998 with the purchase of a large building downtown in a key area of the city core known as the Terabyte Triangle. He received a loan to purchase the building from the city’s prominent local bank and began to attract reputable technology companies as lessees. These events signaled to this young entrepreneur that he and his business had achieved “credibility” in the community. At the time of this threshold, the company had 15 employees and revenues of about $1,250,000.

Company C

This company was founded in 1994 by a long-time information technology (IT) services employee of IBM. The founder and a business partner, also from IBM, planned to develop an IT consulting services company to “pay the mortgage and put food on the table,” initially not intending it to take off like it did. He experienced the threshold in 1995 when the CEO of a major medical services and insurance provider signed on as a client. The founder viewed this as a sign that the company was on the “right track.” Because the medical services firm was a bellwether company in the area, this engagement signaled to other potential customers that the company was legitimate. Company C had six employees and about $200,000 in revenues.

Company D

Company D is a biotechnology training company founded in 1996. After trying a number of different methods for attracting clients and experiencing only modest gains, the entrepreneur believed that the company finally achieved a “critical mass” of clients in 2000. According to the entrepreneur, it was like a “switch just went on.” She believed this outcome was a result of some national media exposure and enough past clients who provided positive word-of-mouth advertising. The company had four employees and sales of $100,000 at the threshold.

Company E

This computer and technology manufacturing company was founded in 1998. After some modest success in the local market, the founder experienced a threshold in early 2002 by signing a contract to distribute...
### Table 1
Descriptives (Current)

<table>
<thead>
<tr>
<th>Company</th>
<th>Firm Age</th>
<th>Financed</th>
<th>Full-Time</th>
<th>Part-Time</th>
<th>Sales Last Year ($)</th>
<th>5-Year Growth (%)</th>
<th>Owner Age</th>
<th>No. of Businesses Started</th>
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<th>Industry</th>
<th>Industry Experience</th>
<th>Team Members</th>
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<tr>
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<td>6-15</td>
<td>34</td>
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<td>Harvest</td>
<td>Real estate</td>
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<td>90</td>
<td>20</td>
<td>10,000,000</td>
<td>100</td>
<td>43</td>
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<td>Software development</td>
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<td>Company C</td>
<td>9 (sold 2003)</td>
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<td>4</td>
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<td>Growth</td>
<td>Biotech training</td>
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**Note:** VC = venture capital; IT = information technology; ND = not disclosed.
products for a major Japanese technology company. The entrepreneur believed that this contract brought “instant credibility” and opened up many more doors. At the time the contract was signed, Company E had 12 employees and annual sales of $5 million.

**Company F**

Company F, a coffee-roasting company with retail and wholesale accounts, was launched in December 1993. The entrepreneur believed he achieved legitimacy at about the year-and-a-half mark when his first store was financially self-sustaining and he was able to open a second store (i.e., “I looked at a P&L [profit and loss] statement with a positive number, and we had accounting integrity”). At this threshold in 1995, Company F had 12 employees, with about $360,000 in revenues. With the confidence that “If I can do it once, I can do it again,” the entrepreneur opened a second store in 1995 to repeat the cycle again.

**Company G**

Company G is an IT services company founded by two partners in early 2000. After struggling most of the first year, the founders experienced a “defining moment” at the end of 2001. This defining threshold was a contract with the most prominent local bank in the city. Because the bank was central to the market that Company G was targeting, this contract established the company’s presence in the market and “made others pay attention.” At the time of this threshold, Company G had four employees and $100,000 in revenues. The contract opened the doors to a number of other customers and also to talented employees.

**Company H**

This retail food services company was founded in 1991 and opened its first store in 1992. The founders experienced the LT in 1995, stated in the following financial terms: “when our revenues met expenses plus debt service.” According to their business plan, the founders wanted to add new stores only at the point where they felt like they had “made it” financially. In 1995, Company H had five employees, sales of $94,000, and revenue growth of 50%.

**Company K**

Company K is a software and IT consulting company founded by a husband-and-wife team in 1996. The company grew steadily in the first several years with several smaller contracts and one major contract with a health care provider in the local market. The founders experienced the LT in 1999 when they landed a large, 18-month contract with Microsoft. According to the founders, this contract was a “stamp of approval” because it was with the premier software firm in the country and moved Company K beyond the local market. This contract ultimately led to Company K’s “preferred vendor” status at Microsoft. At the time of this threshold, Company K had four employees, with $160,000 annual revenues.

**Summaries of Firms That Did Not Experience LT**

**Company B**

Company B, a software company in the utilities industry, was founded in 1996 after the founder had worked for several years as an independent consultant. After receiving a large amount of venture capital, the founder spent much of his time in the first few years selling software products to early adopters, several of whom helped test and refine the software. Customers funded much of the R&D in the early years. This initial “hard selling” effort was followed by a relatively smooth strategic shift in the company to invest in marketing (i.e., direct marketing through additional sales staff, advertising).

**Company J**

Company J, a local restaurant company, was incorporated in 1990 after the founder purchased her first restaurant. The entrepreneur believed that the restaurant, which was barely profitable at the time of purchase, had tremendous upside potential with a greater emphasis on customer service and attention to detail. For the first 2 years, the founder worked “24/7” to turn the restaurant around, and first-year revenues more than doubled. She believed that her ability to recognize underperforming operations is the key to avoiding a LT. She felt that the organizations already possessed some legitimacy because the brand was well known, and all that was needed was effective management to grow.
This biotechnology company was founded in 1997 and has spent much of the time since trying to commercialize its technologies. It has attracted seed funding from federal grants and venture capital firms. The company’s first sale in 2003 was viewed as a major milestone. The founder sees this as a “significant validation of what we are doing—it says we can make it.” However, he believes that the company is still “not out of the woods” and does not believe they have hit the LT. At the time of the first sale, the company had five employees and about $50,000 in annual sales.

Threshold Events

Eight of the 11 company founders identified a clear threshold event in the growth of their company. Threshold descriptives can be seen in Table 2. The nature of the defining moment varied across companies. The most common event or activity was securing a key customer (4 companies). This event provided a visible sign of legitimacy to the founder as well as other stakeholders (e.g., employees, suppliers, investors, and other potential customers). One other company also identified customer or marketing results as thresholds. For example, one founder of a biotech training company believed that they had made it once the company reached a critical mass of clients attending its training courses. Two retail or wholesale company founders, one in coffee and one in bagels, believed that they had made it when they opened their second store. The founders of each of these companies said that once the first store was financially stable, they had a solid base from which to replicate the success and grow by opening a second store. Another company founder, a developer, identified his defining moment as the purchase of a significant historic building in the city’s core. He believed that this purchase signaled to the community that he was a serious developer. The fact that this project received a loan from a prominent local bank aided the developer’s credibility in the eyes of other investors, developers, and potential tenants.

Prethreshold and Postthreshold Actions by Entrepreneurs

In our interviews, we asked entrepreneurs to describe specific actions they took to get to the point at which they felt as though they had made it. We also asked them to describe actions they took subsequent to the LT. These pre- and post-LT actions are summarized in Figure 3. As shown, there were a number of common actions taken by the eight entrepreneurs who experienced the LT. The most commonly mentioned actions were networking (e.g., attending trade shows, using key relationships, advice from mentors), focusing on a specific niche, persistent personal selling, hiring good people, and bootstrapping (e.g., working out of the house, using contract employees, not taking salary). Other strategies mentioned by
entrepreneurs were “chasing” awards and recognitions, providing good customer service, producing a quality product, having a desire to grow, empowering employees, and hiring a consultant.

Seven of the eight entrepreneurs that experienced the LT reported that their company had substantial growth immediately following the LT. They took a number of specific actions in responding to and facilitating that growth. The most common post-LT actions taken were hiring key people (e.g., sales, administrative assistant, operations, accounting), moving to bigger space, and adding more formal structures (e.g., job descriptions, employee handbook, IT systems). Other actions taken after the LT included more marketing, use of mentors, and narrowing focus to the growth market. It is interesting to point out that one of the entrepreneurs who experienced the LT did not experience substantial growth immediately following the threshold. For this entrepreneur, the LT was still important to a sense of confidence that the business was going to survive, and she was comfortable with the size and stability of the company.

The pre- and post-LT actions taken by entrepreneurs in this study are consistent with the findings of previous research on new venture creation (Bhide, 2000; Kelley & Marram, 2004). Because they lack sufficient resources in the early stages, most entrepreneurs have to rely on their ingenuity, adaptiveness, personal selling skills, and persistence to gain legitimacy for the new venture. Networking and forming relationships with key people are particularly important strategies in the early stages. Once legitimacy is gained, entrepreneurs are faced with a new set of problems due to increased growth. They are forced to respond by hiring more people, adding space, and formalizing structures and systems to keep pace with the growth.

Figure 3: Prethreshold Actions Versus Postthreshold Actions

Note: LT = legitimacy threshold. The numbers in parentheses are the numbers of entrepreneurs who mentioned that action (out of eight entrepreneurs who experienced the LT).
DISCUSSION

This study set out to investigate and provide a foundation for our observation that small, growing firms encounter a legitimacy threshold that is (a) noticeable within a given firm and (b) has some common components across many firms. Through combining theories on PE, resource dependency, life cycle, configurations, and legitimacy, we submit that the threshold exists. PE provides a basis for the fact that thresholds in firm development exist, whereas legitimacy and resource-dependency theories suggest that one such punctuation may exist early in the lives of most growing firms. Configurations—along with deep structure and the liabilities of newness and smallness—offer a foundation for the idea that most small, growing firms have similar experiences with the LT.

Building on these theories, we conducted 11 interviews with high-growth entrepreneurs and essentially asked them to describe their threshold experiences. With regard to experiencing a threshold, 8 out of 11 reported that they had. Seven of those 8 associated the threshold with validation from the marketplace, whether it was a key customer or a critical mass of customers that allowed them to pursue growing the business. It seems this initial business model validation from buyers is important, at least to the entrepreneur.

Of the three firms that did not experience a threshold, one had simply not reached it and the two others gained legitimacy without a major event, validation, or disruption. One felt it was because she acquired an ongoing business, and the other felt it was because he received major venture capital funding before launching the venture.

Based on our discussions, we are able to submit that the LT does, in fact, exist within most firms. Moreover, it also appears that commonalities exist among firms that experienced a LT. The argument for the notion that firms will reach the LT at similar times and points centers on two facts of life in the SGE: (a) Organizations must have some perceived permanence before the environment will endorse them; therefore, they cannot be too young, and (b) organizations cannot live long without resources from the environment; therefore, they cannot be too old. These conditions form the deep structure, or playing field, for SGEs. This unique nature of the SGE and its relationship with the environment may make the LT the only universal punctuation in the life of the firm.

With regard to when and where the threshold occurs, our sample bears out our initial leanings: The firm is young (2.4 years) and small (7 employees; $1 million in revenues). The range around age was relatively narrow (1-4 years), as well as the range around number of employees (4-15). However, the range around revenues varied widely from $94,000 to $5 million. This leads us to suggest that industry membership has some bearing on threshold occurrence, but this clearly cannot be determined by such a small sample. It is important to note that some variability will most certainly exist between firms reaching the LT; also, just because a firm reaches the LT does not ensure growth or even survival, but it is necessary to have a chance.

The results of this study also suggest that entrepreneurs tend to use a variety of common strategies to enhance the likelihood of achieving legitimacy. Actions such as networking, focusing on a niche, persistent personal selling, hiring good people, and bootstrapping were mentioned by several of the entrepreneurs as being important to reaching legitimacy. Once legitimacy was gained, most of our entrepreneurs faced new problems due to increased growth. Common actions taken to respond to growth included hiring more people, moving to larger space, and formalizing structures and systems.

Directions

For researchers, the value of this study lies in the establishment of groundwork for meaningful inquiry into when and where the threshold takes place. Logically, the next step would be an investigation over a much larger sample of SGEs. The true value of this research is, of course, an increased ability to predict when a given firm will reach the LT, for once that is established, strategies could be developed to help entrepreneurs expedite the process of reaching the LT (Adizes, 1979, 1988, 1999; Greiner, 1972; Steinmetz, 1969). Another possibility is to more closely examine entrepreneurs (such as our two) who were able to grow their businesses without experiencing a threshold, for there may be no need endure a disruptive transition. Initially, some cross-sectional work may add some value, especially if an instrument can be developed. Like most constructs, however, this one must be studied with time-series data to provide real insight. Only through time-series studies can more accurate measurement regarding when and where the LT occurs be made.

For entrepreneurs, and those that aid them, the value of this work lies also in its foundational explanation.
of the LT. Admittedly, a theory-forming study has relatively little to offer the entrepreneur, but if the current work is to provide guidance to the practitioner, it is that a turbulent time will most likely occur between pregrowth and growth. Our study suggests that there are specific actions that entrepreneurs can take to facilitate the occurrence of the LT. Furthermore, this is a highly desired event that is a precursor to growth and will involve key stakeholders—most likely customers. Although this event is desired, it will mean a fundamental shift in the way the entrepreneur does business, because once resources are being acquired, they must be managed. As with most of the entrepreneurs in our study, the LT can lead to substantial growth and a new set of problems. Entrepreneurs who anticipate and prepare for these problems are more likely to be successful during the growth phase.

Limits

An exploratory study of this nature has implicit limits that preclude strong cause-and-effect statements. There are some specific points that must be addressed here. First, we only looked at firms who survived. It may be that entrepreneurs from firms that failed also perceived a LT. Related to this point, the LT is viewed as being dichotomous, but there are clearly degrees of legitimacy. Moreover, not all legitimization will result in growth, but again, initial growth results from legitimization. Finally, we only looked at growth firms. It would be interesting to know if so-called “lifestyle” firms had similar experiences.

This work is clearly speculative. We believe that we have grounded our speculation in relevant theory and cases, but there are limits to what we can say about the LT. In sum, it appears that such a construct exists in SGEs. The idea that the LT exists universally across SGEs is less robust, however, this implication of our findings does merit further study. The purpose of this article was to introduce and provide a theoretical foundation for the LT and in so doing, encourage researchers to begin serious study of the concept and its many facets. We believe that further theoretical and empirical development of the LT will ultimately contribute to improving the success rate of new ventures.

REFERENCES


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