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Legitimizing first: organizing activities and the survival of new ventures

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Abstract

The process by which firm founders create new organizations is of considerable interest to evolutionary theorists and entrepreneurship researchers. This article tracks the life histories of 223 Swedish new ventures started between January and September 1998 by a random sample of firm founders. We explore the effect of legitimating activities on the hazard of disbanding and the transition to other firm organizing activities during their first 30 months of life. We find that undertaking activities to generate legitimacy reduces the hazard of venture disbanding and facilitates the transition to other organizing activities.

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1. Introduction

Firm founders do not instantaneously establish new firms, but create them through a series of actions—obtaining inputs, conducting product development, hiring employees, seeking funds, and gathering information from customers—undertaken to different degrees, in different order, and at different points in time, by different firm founders (Gartner, 1985). This cross founder variation in the firm organizing process raises the question: Does the timing of founders' organizing activities influence the survival of new ventures?

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The prior literature has offered three different arguments for the effect of firm organizing activities on the survival of new ventures: (1) the institutional theoretic strand of evolutionary theory argues that new venture survival is enhanced by activities to make new ventures appear reliable and accountable, thereby increasing the legitimacy of the organizing effort (Hannan and Freeman, 1984; Meyer and Rowan, 1977); (2) the social relationship school of evolutionary theory argues new venture survival is enhanced by activities to establish relationships with external stakeholders, thereby overcoming the liability of underdeveloped social ties between new ventures and their external stakeholders (Stinchcombe, 1965; Stuart et al., 1999); and (3) the Schumpeterian strand of evolutionary theory argues that new venture survival is enhanced by obtaining control over and recombining resources in a way superior to that of established organizations (Nelson and Winter, 1982; Schumpeter, 1934).

Unfortunately, the literature has not yet considered whether one of these categories of organizing activities should precede another (Carroll and Hannan, 2000). As Hannan and Freeman (1989, pp. 148–149) explain: “the founding process can be seen to consist of a series of subprocesses including: 1. initiation, 2. resource mobilization, 3. legal establishment, 4. social organization 5. operational start-up. We suspect that the dynamics of these subprocesses vary in important ways among organizational forms, and we doubt that there is a universal sequence of sub-processes.”

However, firm founders lack the cognitive capacity to undertake all firm organizing actions simultaneously (Gifford, 1992; Simon, 1976). Thus, firm founders will vary as to whether they first engage in actions that generate legitimacy, develop social ties with stakeholders, or recombine resources. We argue that even if firm founders are unaware of the relative efficacy of undertaking firm organizing activities at particular times, undertaking legitimating activities should be the first step in the firm organizing process because obtaining legitimacy is a necessary precondition to initiating social ties with stakeholders and obtaining and recombining resources.

To determine if an initial focus on legitimating activities enhances the survival of new ventures, we analyze a unique dataset capturing the life histories of 223 new ventures initiated by Swedish firm founders in the first 9 months of 1998, and followed over the subsequent 30 months. Controlling for a variety of factors that capture the effects of human capital, the venture opportunity, and the industry sector, we show that (1) undertaking activities to obtain legitimacy with external stakeholders reduces the hazard of venture disbanding during the first 30 months of life and (2) undertaking activities to obtain legitimacy with external stakeholders increases the hazard of undertaking activities to overcome the liability of underdeveloped social ties with external stakeholders and to recombine resources. The paper proceeds as follows: The next section develops the theoretical framework of the paper and generates specific hypotheses. The third section describes our methodology. The fourth section presents the results. The fifth section provides a discussion.

2. Theoretical development

When entrepreneurs found new firms, they organize. Organizing involves establishing the set of routines and structures that support a goal-directed, boundary-maintaining collective

system of activities (Aldrich, 1979). In contrast to much of the static description of organization theory, organizing is a process not a state (Katz and Gartner, 1988). Over a period of several months, or even years, new firms emerge as firm founders engage in activities such as writing a business plan, buying facilities or equipment, seeking financial support, developing a model or prototype, renting facilities, obtaining equipment, hiring employees, and creating legal entities that will compete with existing firms (Aldrich, 1999; Carter et al., 1996).

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The time dimension to organizing is important because new ventures are initially disadvantaged relative to established organizations in three fundamental ways (Schumpeter, 1934; Stinchcombe, 1965). First, new organizations lack the legitimacy—or taken for grantedness—that established firms possess (Hannan and Freeman, 1984). Because new ventures often do not appear as accountable and reliable as existing organizations, they need to create the external perception that they are legitimate to garner resources and survive competition with established firms.

Second, new firms lack the relationships with customers and suppliers possessed by established firms (Stinchcombe, 1965). Social ties are an important lubricant to all economic transactions (Arrow, 1974), making those actors with social ties advantaged in the market place (Granovetter, 1985). New ventures need to establish social ties to external stakeholders that are functionally equivalent to those of established organizations to garner resources and survive competition with these organizations (Aldrich and Zimmer, 1986; Stinchcombe, 1965).

Third, new ventures, by virtue of being new, lack the productive routines that established firms have for transforming resources into products and services (Schumpeter, 1934; Nelson and Winter, 1982). To survive competition with established firms, new firms must obtain the resources that they will transform, develop a set of routines for doing so, and market the output of that transformation.

However, the survival fitness of undertaking specific organizing activities at particular points in time is not generally known. In fact, most researchers have argued that the order of these organizing activities has little effect on the survival of new ventures (Carroll and Hannan, 2000; Hannan and Freeman, 1989). Because firm founders have different mental models of how to organize firms (Baron et al., 1996, 2001), they will begin the organizing

processes in different ways (Carter et al., 1996). Some founders will start with activities to recombine resources, like obtaining inputs, undertaking product development, or initiating marketing and promotion. Other firm founders will begin with activities to develop social ties with important external stakeholders, like talking to customers or interacting with potential investors. Still other firm founders will begin with activities to generate legitimacy for the new venture effort, like establishing a new legal entity and writing a business plan.

We argue that the timing of undertaking particular organizing activities will influence the survival of new ventures for two reasons. First, certain activities will influence the survival of new ventures only during the initial months of a new venture's life, while other activities have their effects later. For example, the failure to identify customer needs may increase the hazard of venture disbanding in the early months of venture life; whereas competition from established firms may not influence new venture survival until the venture has created a product demanded by customers, and established firms have responded to this product.

Second, the ability to undertake certain activities will be enhanced by the completion of other activities. For example, the ability to market a new product or service may be facilitated by the acquisition of the inputs that are used to create the product or service. Similarly, the economic terms under which a particular firm organizing activity is undertaken will be influenced by the completion of other firm organizing activities, as is the case when the establishment of a legal entity allows a firm founder to obtain funds from potential investors on more favorable terms.

In particular, we expect that an initial focus on activities that generate legitimacy for the new venture will enhance survival. First, legitimacy is likely to have its greatest effect on venture survival during the earliest period of the venture's life because this period is the one in which disbanding depends most on the perceptions of external stakeholders, rather than on actual financial performance. Second, the generation of legitimacy improves the terms upon which the new venture may undertake transactions with other actors. For example, suppliers may charge a lower price to a new venture that they perceive as more legitimate than one that they perceive as less legitimate.

We define the legitimacy of a new venture is the extent to which people perceive that it adheres to accepted principles, rules, norms, standards, and ways of doing things (Aldrich and Fiol, 1994). In next section, we develop specific hypotheses about the ways that two activities to generate legitimacy—establishing legal entities and writing business plans—influence the survival of new ventures during their initial months of life; and how these legitimating activities influence the transition of new ventures to other organizing activities.

2.1. Hypotheses

When people found firms, they propose reallocating existing resources to new uses. Persuading others to accept the reallocation of resources is difficult because the founder's ideas challenge the status quo, making those ideas initially suspect (Aldrich and Fiol, 1994). Therefore, to overcome stakeholders' resistance to the reallocation of resources, firm founders often need to demonstrate the value of their ideas.

Because the value of a firm founder's ideas is, by definition, unproven, other members of society do not take those ideas for granted.² The need to get other people to see the value of new venture ideas suggests the importance of generating legitimacy. By convincing potential employees, customers, suppliers and investors that the venture is legitimate, the firm founder can mobilize the tangible and intangible resources that these stakeholders possess on behalf of the venture. Thus, as institutional theorists have long argued, the ability of firm founders to demonstrate the new firm's legitimacy to external stakeholders will enhance the likelihood that the new venture will survive (Meyer and Rowan, 1977).

2.2. *Establishing a legal entity*

Institutional theorists explain that one important mechanism by which firms generate legitimacy is through adherence to commonly held norms and beliefs (Scott and Meyer, 1983), such as adherence to legal authority. In modern society, legal-rational behavior is considered the most legitimate type of behavior; and modern formal organizations typically coordinate activities through rational legal authority that is limited within the bounds of the authority of an office (Weber, 1947).

Because almost all established organizations in the modern business world are legal entities that adhere to the norms of rational legal authority, firm founders need to demonstrate equivalent adherence to these norms to operate in the legitimate business community. Therefore, firm founders often undertake activities to show that they adhere to the norms of legal authority, such as registering with tax authorities, and obtaining any necessary permission from regulatory agencies and localities when they begin their operations. In the absence of this legalizing activity, firm founders could still create new organizations, but they would find it more difficult to obtain resources or approval from important external constituents.³

Moreover, the legitimacy of new venture is increased by the degree to which founders demonstrate their commitment to it (Aldrich, 1999). Demonstrating adherence to legal norms is a visible, voluntary act that is irreversible (Salancik, 1977). By publicizing their adherence to legal norms, firm founders provide evidence of their commitment to the new venture. Because such a free and public choice institutionalizes the founder's intentions, legal registration provides a basis for external stakeholders to believe in the legitimacy of the new venture.

² Although the benefit of hindsight allows us to take most successful firm founders' ideas for granted, the uncertainty of proposed ideas combines with the familiarity of established ways to lead many people to oppose these ideas. For example, when firm founders proposed new ventures to create the gasoline-powered automobile in the late 19th century, many people believed that this product would never replace the horse and buggy. If anything would replace that mode of transportation, it would be the electric or steam powered automobile (Kirsch, 2000; Rao, 1994).

³ In Sweden, founders are expected to establish a legal entity before they hire employees or begin production. However, we observe empirically that this is not the case; many founders hire employees before establishing legal entities. Because founders can actually hire employees without establishing a legal entity, but are in violation of legal norms in Sweden if they do so, establishing a legal entity is a legitimating act.

Demonstrating adherence to legal norms is particularly important during the initial early period of the new venture's life because survival during this period depends heavily on the willingness of external stakeholders to provide support to the new venture. Once a firm has generated financial returns, external stakeholders often make their decisions about whether or not to provide resources based on historical performance. However, during the early months of a new venture's life, evaluation based on historical performance is not possible, and external stakeholders base their decisions on their perceptions of the new venture's legitimacy. Thus, by initially devoting their scarce time and attention to demonstrating adherence to legal norms, firm founders will make their ventures appear more legitimate to these external stakeholders, facilitating their survival. This argument leads to the first hypothesis:

H1: The establishment of a legal entity will lower the likelihood that the new venture will disband during its first 30 months of life.

In the absence of establishing a legal entity, firm founders would be unable to use the legitimacy that comes from adherence to legal norms when they engage in other firm organizing activities. This limits the ability of the new venture to transition to other organizing activities because external stakeholders may be less willing to interact with the new venture until the legal entity is created. For example, investors may be less willing to talk to firm founders about financing the new venture until a legal entity has been created because most investors develop reputations for conducting business only with legitimate organizations. Similarly, potential customers preference for legitimate suppliers may make them less willing to respond to marketing or promotion efforts of new ventures until those ventures are legal entities. Thus, by initially devoting their scarce time and attention to demonstrating adherence to legal norms, firm founders will facilitate the transition of the new venture to other firm organizing activities. This argument leads to the second hypothesis:

H2: The establishment of a legal entity will increase the likelihood that other firm organizing activities will occur.

2.3. *Completing a business plan*

Another mechanism by which people establish legitimacy is through the use of symbolic communication, especially when external validation is not possible (Aldrich, 1999). Most new ventures rely heavily on unobservable assets like the founder's drive and initiative, or their tacit knowledge, rather than proprietary technology or successful historical track records. To persuade others to support their new ventures with little observable evidence to demonstrate their value, firm founders must rely heavily on the story that they tell others about their vision of the future.

Good story telling is useful to obtaining legitimacy because stories are evaluated on their internal coherence rather than on external validation (Fisher, 1985). As Aldrich (1999, p. 100) explains, "given the lack of externally validated arguments, founders must draw on alternative forms of communication, such as narratives, to make a case that their ventures

are compatible with more widely established sets of activities.” Therefore, founders “frame issues in ways that increase their credibility with others [and] use stories and other means of symbolic communication to assure others that the new venture is on the right track and actually has a future” (Aldrich, 1999, p. 99).

The institutionalized mechanism for telling the founder’s story about the future of the venture is the business plan. Business plans are documents in which founders present their vision for the future of a venture. In particular, business plans allow founders to explain their decisions and plans in a way that demonstrates internal consistency. For example, business plans provide information about whether the founder’s proposal for generating revenues is consistent with his or her plan for obtaining raw materials. In fact, investors often evaluate business plans by looking for the internal consistency of different parts of the document.

Moreover, completing a business plan is a visible, voluntary, irreversible act that demonstrates the founder’s commitment to the new venture (Salancik, 1977). External stakeholders are likely to consider a new venture for which the founder has completed a business plan as more legitimate than one for which the founder has not completed the plan because the free and public choice to develop a plan institutionalizes the founder’s intentions to develop the venture.

The benefits of completing a business plan are greatest in the initial months of the new venture’s life because survival during this period depends heavily on the willingness of external stakeholders to provide support to the new venture. The survival of mature businesses depends heavily on their actual financial performance. However, in the early months of new venture life, when financial performance is nonexistent for most ventures, the relationship between financial performance and survival is less closely coupled. Because financial performance is not an important indicator of survival during the early months of a new venture’s life, most external stakeholders use business plans as one basis for evaluating new ventures. The completion of a business plan provides a signal to external stakeholders that the firm founders understand the business and the process of creating an organization. It also provides information about key aspects of the business in a way that contributes to the venture’s cognitive legitimacy (Aldrich and Fiol, 1994). Thus, by initially devoting their scarce time and attention to completing business plans, firm founders will make their ventures appear more legitimate to these external stakeholders, facilitating their survival. This argument leads to the third hypothesis:

H3: The completion of a business plan will lower the likelihood that the new venture will disband during its first 30 months of life.

In the absence of a completed business plan, firm founders would be unable to make use of the legitimacy that comes from having a plan when they engage in other firm organizing activities. Even if the plans themselves are little more than fiction, evidence of a consistent story enhances the legitimacy of the new venture, and facilitates the initiation of social relationships with external stakeholders and the acquisition and recombination of resources. For example, anecdotal evidence suggests that potential investors and important customers often want to see a founder’s business plan before committing to interact with a new venture.

In some cases, the story contained in the business plan may even help to persuade external stakeholders on the legitimacy of a new idea. For example, investors often provide anecdotal information to suggest that they are willing to meet with the founders of a new venture if the founders' plan contains a "good story" that excites them. Thus, by initially devoting their scarce time and attention to completing a business plan, firm founders will facilitate the transition to other firm organizing activities. This argument leads to the fourth hypothesis:

H4: The completion of a business plan will increase the likelihood that other firm organizing activities will occur.

3. Methodology

3.1. Design and sample

Empirically evaluating the effect of founders' actions on the survival of new ventures has been problematic because reliable evidence has been difficult to gather (Katz and Gartner, 1988). Archival sources generally do not record the existence of new ventures that fail very early in their existence, biasing efforts to identify new ventures from lists of new firms (Aldrich et al., 1989; Katz and Gartner, 1988). Consequently, most researchers begin their investigation of new ventures at the point at which new organizations initiate production or are legally established, and ignore what happens to new ventures prior to that point in time (Aldrich and Wiedenmayer, 1993; Carroll and Hannan, 2000; Katz and Gartner, 1988).

However, public records miss many of the firms that fail before they reach their first birthday (Aldrich et al., 1989). Thus, not only does focusing on recorded organizations hamper our understanding of important activities that occur before firms become formally recorded (Katz and Gartner, 1988), but selection processes might make new ventures that survive long enough to become documented organizations systematically different from the population of all new ventures (Aldrich and Wiedenmayer, 1993).

Because we were concerned that the identification of new firms through examination of business directories or government registries suffers from selection bias, we wanted to identify new ventures before they were formally recorded in these sources. This is a daunting task because no sampling frame exists for new ventures. We overcome this problem by first identifying individuals from the general population who are initiating a venture at a particular point in time.

The number of people who initiate a new venture at a given point in time is relatively small, requiring us to screen a large number of people to generate our sample. During the first nine months of 1998, we randomly sampled 35,971 individuals from the population between the ages of 16 and 70 living in Sweden who could be contacted by telephone. Of the sample initially contacted, 30,427 individuals (84.6%) agreed to participate in our study.

Each respondent was asked a series of nested screening questions to identify those people who had initiated a new venture. To meet the sampling criteria, the respondent had to answer that (1) alone or with others, they were in the process of starting a new business, (2) the first

activity to start the new venture began during the first nine months of 1998⁴, (3) the venture was independent (not part of an effort on behalf of an existing organization)⁵, and (4) the respondent was a member of the venture team (not a consultant or a passive investor). If respondents had started more than one venture during the first nine months of 1998, they were asked to discuss only their most recent venture. Of the 30,427 people we surveyed, we found that 453 respondents were members of a venture team of an independent effort to start a business in 1998.

We also asked the respondents the month and year when they first began work on the venture. We defined work on the venture as the taking of an action in the pursuit of the opportunity that they had identified. In this way, we differentiate the period in time in which the founders might have thought about a venture opportunity from the point in time when they first began to exploit it.

We discovered that many of the respondents had started their new venture in prior years. The inclusion of ventures on which founders had begun the start-up process before the time of our survey would cause selection bias because other individuals may have also started new businesses in earlier years, but would not consider themselves still in the process of starting a business. Because “long-in-process” ventures would not represent the population of new ventures initiated in earlier years (those that had already failed or completed the start-up process would not be included), we limit our analysis to the cohort of new ventures that began in 1998, the point in time contemporaneous with our investigation. Of the 453 respondents who indicated that they were in the process of starting a business at the time of our study, 223 had initiated their new ventures in the first nine months of 1998. The 223 ventures that these individuals initiated form the sample for our investigation.⁶

The individuals who founded these 223 ventures were asked to participate in a longer, structured, telephone survey in which they served as key informants about the new venture that they had initiated. Although researchers studying large, established organizations often seek information from several respondents about their organizations this approach is not necessary, and frequently not possible in the case of new ventures. In a large organization, a single respondent may lack information about the activities of many parts of the organization because of the division of labor in the organization, or may disagree with other respondents about the answers to the questions. These conditions are not present in

⁴ Because our research design assumes that firm founders can begin their ventures by initiating a variety of different activities, we cannot ask the respondents when they first began particular activities. Instead, we asked the respondents when they first began work on the venture. We distinguish when the respondents began work on the venture from when they began thinking about the venture by also asking them when they first began thinking about the venture opportunity. In all cases the respondents indicated that they began work on the venture at the same time or after they began thinking about it, lending confidence to this approach.

⁵ Respondents had the option of indicating that their new venture was undertaken on behalf of their employer or other existing organization. Those individuals who indicated that their start-up effort was not independent were excluded from the sample.

⁶ Astute readers will note that approximately 20% of the sample refused to participate in the study at some time after the initial survey. Following standard procedures for event history analyses, we treat the subjects that drop out of the sample as censored as of the date of nonparticipation.

the new ventures we examine. In 40% of the new ventures we study, the entire staff consists of a single founder. Obviously, in these cases, the views of the entrepreneur are perfectly correlated with the average views of venture members. Moreover, the scale of the ventures we examine is so small that division of labor is not yet present. As a result, the respondents we survey possess detailed information about the activities of all aspects of their ventures.

We gathered information about the new ventures in an initial survey, and again after 6, 12, 18, and 24 months or until the start-up effort had been disbanded.⁷ The response rate for the successive waves was high: 90.5% at 6 months, 91.9% at 12 months, 98.5% at 18 months, and 96.1% at 24 months.

3.2. *Advantages of the design*

The sample we explore in this study has several advantages over other samples used to examine of new ventures. First, it was constructed from a random sample of the adult Swedish population and accurately represents the population of new ventures initiated in Sweden in the first nine months of 1998. Second, there are no left-censored new ventures in this dataset because all new ventures are observed from the time that they were initiated until the venture was disbanded, or the observation was censored after 30 months. This is important because the analytical techniques we use are event histories, which depend on the absence of left censoring for accurate parameter estimates (Tuma and Hannan, 1984). Third, the sample does not suffer from the selection bias present in most samples of new ventures. Fourth, this dataset examines the evolution of new ventures from initiation forward in time. This approach allows the examination of the earliest days of the ventures' lives, a part of firm histories that is acknowledged to be important to the evolution of new ventures, but is rarely examined (Baron et al., 1996).

3.3. *Analysis*

If, as we argue, firm formation is an evolutionary process, then investigation of it should begin with the initiation of new ventures and proceed forward over time. In the early part of this process, the milestones that ventures seek to reach are not performance outcomes like return on sales or profits, but are such things as the assembly of resources or the organization of a company. Because the new venture can be disbanded at any time after the identification it has been initiated, performance in the early part of the venture's life is best represented by (not) disbanding.

We measured the disbanding of a venture by asking the informants every six months if the new venture has been terminated by all members of the team pursuing it. If the venture continued to be pursued by some, but not all, members of the venture team, we treat the

⁷ We analyzed the duration between the month of survey and the month of venture initiation to determine if the interval between the two influenced our outcome measures. We find that the timing of the survey does not have a large or a statistically significant effect on the outcome measures.

venture as continuing. We divide the life histories of the ventures into monthly spells that begin when the venture is initiated and ends when the venture is disbanded. If the venture has been terminated by all team members, we ask the respondent to tell us the month when the venture disbanded. We coded the dependent variable as a “1” in the month that the venture was disbanded. Otherwise we coded this variable as “0.”

The new ventures that were not terminated by the end of the 30-month observation period were treated as right censored. We analyze the transition to disbanding using Weibull hazard rate models with robust clustering for each venture because we found that this specification best fit the underlying distribution of the data (Akaike, 1974; Blossfeld and Rohwer, 1995).⁸ Our theoretical arguments propose both time-varying and time-constant covariates that influence disbanding.⁹ We describe those covariates Sections 3.4 and 3.5.

3.4. Predictor covariates

In evolutionary research, the influence of legitimacy has both been inferred from density dependence in single industry studies of firm organizing (Hannan and Freeman, 1984) and has been measured directly from the operationalization of covariates that theory suggests would provide legitimacy to new firms (Baum and Oliver, 1992; Stuart et al., 1999). In this study, we adopt the latter approach to the measurement of legitimacy for three reasons: First, density dependence is an effective measure of industry-level legitimacy, rather than firm-level legitimacy. Second, it can be examined only in single industry studies in which firm density can be accurately captured. Third, the operationalization of specific covariates allows us to measure separately two different dimensions of legitimacy—that which comes from adherence to legal norms and that, which comes from adherence to norms of business planning.

In Sweden, *establishing a legal entity* occurs when firm founders obtain either an “F-skatte bevis” (tax return form) or a “PRV” (patent and registration office form), depending on whether they are establishing a corporation, partnership, or sole proprietorship. Every six months, beginning with the initial survey, we ask respondents if the venture has obtained either document, and, if so, in what month. We coded this variable as “0” in each month the respondent indicated that establishing a legal entity had not yet been established and “1” in each month that a legal entity had been established.

We measure *completing a business plan* by asking respondents every six months, beginning with the initial survey “Has a business plan been prepared?” If they answered yes, we asked them what month that plan was first completed. We coded this variable as “0”

⁸ Although previous studies have found that the survival rate for new ventures measured from the initiation of production is nonmonotonic (see Carroll and Hannan, 2000), we do not find this to be the case for our data, which measures new ventures from the point at which work on the opportunity began.

⁹ We follow a similar pattern to measure the transition to other firm organizing activities. We code the month in which the activity was initiated (see Sections 3.4 and 3.5). Those cases for which activities were not initiated during the observation period were treated as censored. We use Weibull hazard rate models to predict the transition to these activities as a function of the legitimating activities and other covariates.

in each month the respondent indicated that business plans had not been prepared and “1” in each month that a business plan had been prepared.¹⁰

3.5. Other covariates

3.5.1. Generating social relationships

Many founders lack preexisting ties to their customers at the time they initiate their new ventures and must initiate these social relationships during the development of the new organization. Ties to customers are beneficial to new ventures because they provide a mechanism for founders to learn about customer needs and demands, and because they knit the new venture into the customer’s social network, allowing it to take advantage of the benefits that are derived from ties with those actors (Larson, 1992; Stuart et al., 1999). Given that firm founders often need to create ties to customers for their new ventures to survive, and that these ties are often established after the new venture is first initiated, we expect the survival of new ventures to be enhanced by the speed with which firm founders begin interacting with customers.

We measure *talking to customers* by asking respondents every six months, beginning with the initial survey, if “discussion about the product or service the start-up will sell has been initiated with potential customers?” If they answer yes, we ask them the specific month in which this discussion was first initiated. We coded this variable as “0” in each month the respondent indicated that discussion with customers had not yet occurred and “1” in each month that discussion with customers had occurred.

Because firm founders often lack the capital to self-finance the development of their new ventures, they need to obtain capital from investors to obtain needed inputs, engage in product development and to market their products before revenues are generated from sales. The process of obtaining funds from outside investors generally involves soliciting funds from them (investors rarely provide unsolicited funds to new ventures). Therefore, we expect the survival of new ventures to be enhanced by the speed with which firm founders ask investors for funds.

We measure *asking for funds* by asking respondents every six months, beginning with the initial survey, “Have any financial institutions or other people been asked for funds?” If they answer yes, we ask them the specific month in which funds were first requested. We coded this variable as “0” in each month the respondent indicated that funds had not yet been requested and “1” in each month that funds had been requested.

3.5.2. Transforming resources

Schumpeter (1934, p. 140) described the firm formation process as one in which a founder “withdraws a certain quantity of means of production from their previous uses and with them carries out a new combination.” Therefore, firm founders must acquire inputs that are to be

¹⁰ To confirm that the respondents actually had a business plan in the way scholars understand the concept, we asked if the business plan was formally written or not. Substituting the measure of “a formally written business plan” for “a completed business plan” does not qualitatively change the results.

transformed by the new organization during the firm organizing process. We expect the survival of new ventures to be enhanced by the speed with which firm founders undertake this process.

We measure *obtaining inputs* by asking respondents every six months, beginning with the initial survey, “Have any raw materials, inventory, supplies, or components for the start-up been purchased?” and “Have any major items like equipment, facilities, or property been purchased, leased or rented for the new start-up?” (major was defined as an item with a retail value of greater than US\$1000). If they answer yes to either question, we ask them the specific month in which the expenditure was first made. We coded this variable as “0” in each month the respondent indicated that the expenditure had not yet been made and “1” in each month that expenditures had occurred.

The profits from recombining resources cannot be earned until the new venture develops a mechanism for transforming the resources into a more valuable form, a process also known as product development (Nelson and Winter, 1982). We expect firm survival to be enhanced by the speed at which the new venture completes new product development.

We measure *product development* by asking respondents every six months, beginning with the initial survey, “At what stage of development is the product or service this start-up will be selling?” The scale of responses was 1 = no work has been done to develop a product or service; 2 = work to develop the product or service is still in the idea stage; 3 = a model or procedure is being developed; 4 = a prototype or procedure has been tested with customers; and 5 = the product or service is completed and ready for sales or delivery. We update this variable at the time of each six-month survey.¹¹

Before the new venture can earn revenues from the recombination of resources, it must engage in marketing—the set of activities to promote and sell the new organization’s products or services—to persuade others to purchase the new venture’s goods or services.¹² We expect firm survival to be enhanced by the speed at which the new venture initiates marketing and promotion.

We measure *marketing and promotion* by asking respondents every six months, beginning with the initial survey, “Have marketing or promotional efforts been started for the product or service that the start-up will be selling?” If the answer to this question is yes, we asked the respondents for the specific month in which the marketing or promotion first began. We coded this variable as “0” in each month the respondent indicated that the marketing or promotion had not yet occurred and “1” in each month that marketing or promotion had occurred.

¹¹ Readers should note that this measure could increase or decrease over time. Consequently, it captures the fact that product development goes backwards as well as forwards.

¹² Although initiating social relationships with customers are often correlated with marketing and promotion efforts in many new organizations, the two are conceptually distinct. Initiating social relationships with customers involves the set of activities that create personal ties between new ventures and customers either for the purpose of obtaining information for product development or for the purpose of selling products. In contrast, marketing and promotion efforts do not require the development of social ties between new ventures and customers. Moreover, marketing and promotion efforts are efforts to generate revenue from the sale of the new venture’s output.

3.5.3. Firm performance

Previous research has shown that the disbanding of new organizations decreases with organization size because larger organizations have greater resources, superior scale, bigger capacity, and better management (Aldrich and Auster, 1990; Bruderl and Schussler, 1990; Carroll and Hannan, 2000; Hannan and Freeman, 1989). We control for firm size with a time varying measure of the number of employees. We count part-time employees as one half of full time employees. We obtain this measure by asking the respondents every six months how many employees or managers have been hired for pay (workers that would not share ownership). We update this variable at the time of each survey.

Previous research has shown that the disbanding of new organizations decreases with firm age because older organizations are seen as more reliable and accountable (Hannan and Freeman, 1989). Moreover, if new organizations build relationships with external stakeholders over time, and these relationships are survival enhancing, then the mortality of new firms should decline over time (Carroll and Hannan, 2000; Stinchcombe, 1965). We control for firm age with a time varying measure of the number of months since venture initiation.

3.5.4. Competitive advantage

Prior research has shown that the possession of a sustainable competitive advantage affects the survival of new entrants (Caves, 1998). Therefore, we control for the competitive advantage through examination of whether or not the venture can obtain *intellectual property protection* and whether the venture needs a *license or permit* (a barrier to entry).¹³

New firms are at a disadvantage relative to established firms because established firms often have complementary assets in place (Teece, 1986). To create complementary assets before information about their opportunity dissipates to competitors, firm founders must protect their intellectual property against appropriation by others. We expect that new ventures that can obtain intellectual property protection to be less likely to disband. We measured *intellectual property protection* as a dummy variable of “1” if the venture can obtain a patent, copyright or trademark. This variable is time variant and is measured at the time of each survey.

Another factor that reduces the ability of others to imitate a new venture’s competitive advantage is the need for *licenses or permits*. Permit and licensing requirements reduce the likelihood of disbanding because they limit competition. We measured this variable as a dummy variable of “1” if the respondent indicates that the venture needs a permit or license. This variable is time variant and is updated at the time of each survey.

3.5.5. Human capital

Prior research has argued that the survival of new ventures depends on the founder’s human capital (Bates, 1990; Bruderl et al., 1992; Schoonhoven et al., 1990). Therefore, we control for the venture team’s industry and start-up experience.

¹³ In unreported regressions, we also examined whether the venture had a price advantage, was differentiated from competitor products or had a location advantage. Because none of these variables had any effect on disbanding or any dimension of the organizing effort, and are imprecisely measured, we exclude these variables in the reported regressions.

Prior firm formation experience influences the ability of founders to successfully establish new organizations because much of the knowledge necessary for founding a new company—how to hire and lead people, how to manage relationships with investors, how to attract and retain customers and how to develop new products and processes—is learned by doing (Bruderl et al., 1992; Carroll and Mosakowski, 1987; Schoonhoven et al., 1990). We measure prior *start-up experience* as a count of the number of prior firms founded across the team pursuing the new venture. This measure is time-invariant and is generated from the initial survey.

Prior experience working in an industry may provide knowledge useful for running a firm in that industry (Bruderl et al., 1992). Industry experience provides knowledge about customers and suppliers as well as social contacts with key stakeholders (Gimeno et al., 1997; Van de Ven et al., 1984). We measure prior *industry experience* as the number of years of experience in the new venture's industry across the team pursuing the new venture. This measure is time-invariant and is generated from the initial survey.

3.5.6. Industry

New ventures are pursued in industries that have different growth prospects. We expect that the likelihood of disbanding is lower in industries that firm founders perceive to be growing faster. We measure *industry growth* with a four-item scale: 1 = diminishing, 2 = unchanged, 3 = expanding and 4 = strong expansion. This variable is time invariant and is measured at the time of the first survey.

New ventures are pursued in industries of different competitiveness. The greater the competitiveness of the environment, the harder it is for founders to obtain needed resources and the greater the likelihood of disbanding (Eisenhardt and Schoonhoven, 1990). We measure *industry competitiveness* with a four-item scale: 0 = expect no competition, 1 = expect low competition, 2 = expect moderate competition, and 3 = expect strong competition. This variable is time invariant and is measured at the time of the first survey.

Although the growth and competitiveness of an industry pick up some of the variance in different industry environments, industries also vary on many other dimensions. To capture this variance, we divide our sample into three categories: high technology service firms, low technology service firms, and manufacturing firms (sample size limitations precluded a more fine-grained set of dummy variables). We control for industry effects with two dummy variables—one for *high technology service firms* and the other for *low technology service firms* (manufacturing firms was the omitted case). These dummy variables are time invariant and are generated from information collected at the time of the first survey.

3.5.7. Legal form

Bruderl and Schussler (1990) found that the hazard of disbanding of newly formed German firms was lower if the legal form of organization was a corporation. Therefore, we control for the legal form of the new venture effort with a dummy variable of “1” if the venture was a *corporation* rather than a partnership or sole proprietorship. This variable is time variant and is updated at the time of each survey.

3.6. Mitigating selection bias

We expect that investigating the evolution of firms from samples of new firms that are registered with government authorities or that appear in industry directories will suffer from selection bias.¹⁴ For this reason, we sought to determine what percentage of our sample of new ventures initiated in the first nine months of 1998 were disbanded before formal legal establishment of an organization. We find that during the first 30 months of the lives of the ventures we examine, only 61% become legally registered. Moreover, more than one quarter of those ventures were disbanded before legal registration.

Given that a significant portion of our sample is selected out before legal registration occurs, we sought to determine if those ventures that failed to become legally registered were statistically different from those that did become established as legal entities. We examine a Weibull hazard rate model to predict the establishment of legal entities as a function of the control variables we described earlier.

The new ventures that become established as legal entities are significantly different from the overall sample of new ventures that were founded in Sweden in the first nine months of 1998. First, larger firms are more likely to become legal entities than smaller firms. An increase of one employee increases the hazard of establishing a legal entity by 31%. Second, as new ventures age, the likelihood that they will become legal entities decreases significantly. Each one-month increase in age reduces the hazard of establishing a legal entity by 19%. From this analysis, we conclude that examining new firms from a sample of organizations that have become legal entities introduces selection bias into the analysis (Aldrich et al., 1989; Carroll and Hannan, 2000) and suggests the value of examining new ventures from their point of initiation forward in time.

4. Results

The sample we explore consists of new ventures pursuing a variety of opportunities. Fifteen percent of the sample pursuing manufacturing opportunities, 37% pursuing service opportunities characterized by a high level of knowledge (e.g., software), and 48% pursuing an opportunity in low-technology service industries. More than half of the sample, 58%, reported that their main customers would be other businesses. With regards to the human capital of the start-up team, 42% of sample reported that the venture had a single founder in the team, 50% of the teams had no members who had started a firm previously, and 20% of the ventures were lead by teams that had no previous experience in the industry they were entering. Most importantly, we find that 82 of the 223 new ventures we examine (37%) disband during the first 30 months of their lives.

¹⁴ The earliest point at which prior studies define the initiation of new firms is the formal legal establishment of an organization (Barley et al., 1992; Han, 1998; Hannan and Freeman, 1989; Hannan et al., 1990, 1994). As Carroll and Hannan (2000, p. 339) explain, “if many organizing efforts fail prior to ‘official’ starting dates, then conventional demographic analyses of organizational mortality . . . underestimate the actual rates.”

Table 1
Descriptive statistics

Variable	Mean	S.D.	Min.	Max.
<i>Industry</i>				
High-tech service	0.39	0.49	0.00	1.00
Low-tech service	0.47	0.50	0.00	1.00
<i>Human capital</i>				
Start-up experience	2.61	11.78	0.00	150.00
Industry experience	16.86	22.75	0.00	122.00
<i>Opportunity</i>				
IP protection	0.40	0.49	0.00	1.00
Need permits	0.39	0.49	0.00	1.00
<i>Performance</i>				
Number of employees	1.15	12.91	0.00	350.00
Age	14.23	8.77	1.00	30.00
<i>Organizational form</i>				
Corporation	0.33	0.47	0.00	1.00
<i>Legitimization Activities</i>				
Complete plan	0.45	0.50	0.00	1.00
Establish legal entity	0.58	0.49	0.00	1.00
<i>Other activities</i>				
Talk to customers	0.77	0.42	0.00	1.00
Ask for funds	0.35	0.48	0.00	1.00
Obtain inputs	0.68	0.47	0.00	1.00
Product development	4.44	1.00	0.00	5.00
Begin marketing	0.46	0.50	0.00	1.00

Table 1 presents the descriptive statistics.¹⁵ Table 2 presents a correlation matrix. This table shows that the correlations between the independent variables are not sufficiently high to generate biased estimation from multicollinearity in the event history models.

Table 3 reports the results of a Weibull regression model to predict the hazard of venture disbanding. The results for the control variables are, in large part, consistent with previous research on new ventures. For example, new ventures pursued by more experienced firm founders have a lower hazard of disbanding than new ventures pursued by less experienced founders. Each prior start-up undertaken by a venture team reduces the hazard of disbanding by 22%. Moreover, as previous research would suggest, venture age has a strong and significant effect on reducing hazard of disbanding. Each one-month increase in the venture's life reduces the hazard of disbanding by 20%.

¹⁵ Because we use event history analysis in this study, the descriptive statistics measure the value of the variables for the venture-month observations rather than the value for the ventures.

Table 2
Correlation matrix

	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.	16.
1. High-tech service	1.00															
2. Low-tech service	-.76	1.00														
3. Start-up experience	.09	-.07	1.00													
4. Industry experience	-.10	-.02	.10	1.00												
5. IP protection	.00	.00	-.08	.10	1.00											
6. Need permits	-.12	.12	-.03	.06	-.09	1.00										
7. Number of employees	.04	-.05	.00	.02	.01	.08	1.00									
8. Age	-.01	.03	.02	.04	-.01	.17	.06	1.00								
9. Corporation	-.03	.02	.03	.41	-.05	.08	.12	.04	1.00							
10. Complete plan	.10	-.05	.05	.09	.08	.17	.00	.41	.10	1.00						
11. Establish legal entity	-.02	.08	.02	.10	-.02	.12	.07	.37	.17	.36	1.00					
12. Talk to customers	.09	-.11	.03	.05	-.03	.10	.04	.53	.04	.38	.35	1.00				
13. Ask for funds	-.10	.15	-.02	.19	.04	.08	.10	.23	.23	.22	.19	.21	1.00			
14. Obtain inputs	-.06	.01	.06	.05	.01	.06	.06	.24	.04	.33	.42	.30	.20	1.00		
15. Product development	.04	.02	-.02	-.06	-.17	.13	.05	.25	.12	.32	.36	.25	.07	.26	1.00	
16. Begin marketing	.11	-.10	.12	.13	.05	.05	.08	.26	.12	.37	.31	.34	.17	.25	.23	1.00

However, the hazard of survival during the earliest months of the lives of new ventures is not influenced by several of the factors that explain the survival of new ventures during later periods of their existence. For example, firm size has no significant effect on the hazard of disbanding. Moreover, the results show little effect of the nature of competitive advantage on venture disbanding. New ventures that can obtain intellectual property protection are no less likely to disband than those that cannot obtain such protection, and new ventures that require licenses and permits are no less likely to disband than those that do not. Furthermore, the results shown in this model indicate no effects of industry or incorporation on hazard of disbanding.

However, the results show that undertaking firm organizing activities to generate social ties to external stakeholders and to recombine resources reduce the hazard of venture disbanding during the first 30 months of venture life. In particular, *asking for funds* reduces the hazard of venture disbanding by 46%. Similarly, *obtaining inputs* reduces the hazard of venture disbanding by 34%. Oddly, beginning *marketing* increases the hazard of venture disbanding by 86%.

The results shown in Table 3 are consistent with Hypotheses 1 and 3. Ventures for which the founders *establish a legal entity* are 42% less likely to disband as ventures for which

Table 3
Weibull models to predict the transition to venture disbanding

Variable	Hazard (S.E.)
<i>Industry</i>	
High-tech service	0.97 (0.32)
Low-tech service	1.10 (0.39)
Industry growth	1.08 (0.19)
Industry competition	0.93 (0.11)
<i>Human capital</i>	
Start-up experience	0.78 (0.07)***
Industry experience	1.00 (0.01)
<i>Opportunity</i>	
IP protection	0.82 (0.19)
Need permits	0.65 (0.18)
<i>Performance</i>	
Number of employees	0.48 (0.24)
Age	0.80 (0.06)****
<i>Organizational form</i>	
Corporation	1.07 (0.36)
<i>Legitimization activities</i>	
Complete plan	0.43 (0.14)***
Establish legal entity	0.58 (0.16)**
<i>Other Activities</i>	
Talk to customers	1.17 (0.37)
Ask for funds	0.54 (0.19)*
Obtain inputs	0.66 (0.16)*
Product development	0.86 (0.10)
Begin marketing	1.86 (0.49)**
Log Likelihood	– 192
Chi-Square	77.4***

Analysis file consists of 223 new ventures and 82 disbandings.

* $P < .10$ (two-tailed tests).

** $P < .05$ (two-tailed tests).

*** $P < .01$ (two-tailed tests).

**** $P < .000$ (two-tailed tests).

founders do not *establish a legal entity*. Similarly, ventures for which firm founders *complete a business plan* are 57% less likely to disband as ventures for which founders do not *complete a business plan*. These results suggest that undertaking activities to make the venture appear legitimate to external stakeholders survival enhancing during the first 30 months of the lives of new ventures.

We next sought to determine if undertaking legitimating activities influences the transition to other firm organizing activities. For this reason, we examined the effect of *completing a business plan* and *establishing a legal entity* on the hazard of initiating these other activities.

Table 4 shows Weibull event history models to predict the transition to other activities as a function of the two legitimating activities and the control variables. Model 1 predicts

Table 4
Weibull models to predict the effect of legitimization activities on transition to other activities

Variable	Model 1 Product development hazard(S.E.)	Model 2 Marketing hazard(S.E.)	Model 3 Inputs hazard(S.E.)	Model 4 Customers hazard(S.E.)	Model 5 Ask for funds hazard(S.E.)
<i>Industry</i>					
High-tech service	1.17 (0.29)	1.16 (0.40)	0.66 (0.17)	0.92 (0.17)	1.55 (0.68)
Low-tech service	1.41 (0.34)	1.01 (0.35)	0.77 (0.19)	0.63 (0.12)**	2.96 (1.33)**
Industry growth	1.08 (0.11)	1.32 (0.19)*	1.04 (0.13)	1.17 (0.12)	1.65 (0.35)**
Industry competition	1.15 (0.11)	0.98 (0.09)	0.92 (0.08)	1.04 (0.07)	0.87 (0.11)
<i>Human capital</i>					
Start-up experience	0.99 (0.00)**	1.02 (0.00)****	1.02 (0.00)****	1.00 (0.00)	1.00 (0.01)
Industry experience	0.99 (0.00)***	1.01 (0.00)	1.00 (0.00)	1.00 (0.00)	1.01 (0.00)
<i>Opportunity</i>					
IP protection	0.57 (0.09)***	1.13 (0.22)	1.12 (0.21)	0.83 (0.11)	1.21 (0.31)
Need permits	1.20 (0.22)	1.02 (0.22)	1.17 (0.23)	0.92 (0.14)	0.86 (0.22)
<i>Performance</i>					
Number of employees	1.10 (0.08)	1.06 (0.02)***	1.09 (0.06)	0.98 (0.02)	1.14 (0.04)****
Age	0.83 (0.03)****	0.74 (0.04)****	0.61 (0.07)****	0.62 (0.06)****	0.75 (0.04)****
<i>Organizational form</i>					
Corporation	1.46 (0.32)*	0.91 (0.21)	0.66 (0.16)*	0.92 (0.14)	2.27 (0.64)***
<i>Legitimization activities</i>					
Complete plan	2.12 (0.44)****	2.35 (0.58)****	2.64 (0.63)****	1.97 (0.36)****	1.43 (0.44)
Establish legal entity	1.41 (0.25)**	1.89 (0.43)***	2.78 (0.55)****	1.66 (0.24)***	1.12 (0.31)
Log Likelihood	- 334.1	- 268.1	- 287.8	- 203.1	- 210.5
Chi-Square	77.03****	121.13****	169.99****	98.79****	93.69****
Events	173	117	151	195	81

* $P < .10$ (two-tailed tests).

** $P < .05$ (two-tailed tests).

*** $P < .01$ (two-tailed tests).

**** $P < .000$ (two-tailed tests).

the hazard of completing *product development*.¹⁶ Model 2 predicts the hazard of *initiating marketing and promotion*. Model 3 predicts the hazard of *obtaining inputs*. Model 4 predicts the hazard of first *talking to customers*. Model 5 predicts the hazard of *asking for funds*.

The results shown in Table 4 provide empirical support for Hypotheses 2 and 4. *Completing a business plan* and *establishing a legal entity* both enhance the legitimacy of new ventures, thereby increasing the likelihood that the venture will *initiate marketing and promotion*, *obtain inputs*, and *talk to customers*. In particular, *completing a business plan* also more than doubles the likelihood that the venture will complete *product development* (hazard = 2.12); while *establishing a legal entity* makes the venture almost one and a half times as likely to complete *product development* (hazard = 1.41). *Completing a business plan* more than doubles the likelihood that the venture will *begin marketing* (hazard = 2.35); while *establishing a legal entity* approximately doubles the likelihood that the venture will *begin marketing* (hazard = 1.89). Similarly, *completing a business plan* makes the venture more than two and a half times as likely to *obtain inputs* (hazard = 2.64); while *establishing a legal entity* makes the venture two and three quarters times as likely to *obtain inputs* (hazard = 2.78). *Completing a business plan* roughly doubles the likelihood that a venture will *talk to customers* (hazard = 1.97); while *establishing a legal entity* makes the venture over one and a half times as likely to talk to customers (hazard = 1.66). (The results do not provide support for the effect of these variables on the likelihood that the venture will *ask for funds*.)

5. Discussion

We explained that different strands of prior evolutionary research emphasize the importance of three different foci for activities in new ventures: The creation of social ties with external stakeholders, the establishment of external legitimacy, and the creation of routines to transform resources. We argued that different founders choose different activities on which to focus their efforts at different points in time. We argued that new ventures would be selected for survival if the firm founders initially focused their efforts on legitimating activities because legitimacy enhances the ability of founders to create social ties with external stakeholders and initiate routines to transfer resources.

We analyzed a unique dataset capturing the life histories of 223 new ventures initiated by Swedish firm founders in the first 9 months of 1998, and followed over the subsequent 30 months. Controlling for a variety of factors that capture the effects of human capital, the venture opportunity, and the industry sector, we show that (1) activities to generate make new ventures appear legitimate to external stakeholders reduce the hazard of venture failure and (2) that activities to make new ventures appear legitimate to external stakeholders increase the hazard of the venture undertaking activities to overcome the liability of underdeveloped social ties between new ventures and their external stakeholders and to recombine resources.

¹⁶ For this analysis we converted the product development variable into a binary variable in which “1” equals “the product or service is completed and ready for sales or delivery” and “0” equals all other states.

5.1. Implications for equilibrium theorizing about entrepreneurship

Our results also support the arguments of organizational theorists who have criticized the static-equilibrium theorizing that pervades the entrepreneurship literature as a conceptual dead end (Aldrich and Wiedenmayer, 1993; Carroll and Mosakowski, 1987). In particular, the notion that entrepreneurship is best explained by the identification of entrepreneurial and nonentrepreneurial types of people has not yielded persuasive empirical evidence (Aldrich and Wiedenmayer, 1993; Gartner, 1988). Instead of examining who firm founders are, we examined what firm founders do, and find compelling evidence that the evolution of new ventures is influenced by the choice and timing of actions undertaken by firm founders in the organizing process.¹⁷ These results suggest that the examination of firm formation as an evolutionary process, rather than as the embodiment of an equilibrium type, will lead entrepreneurship researchers to develop better explanations for development of new ventures than those currently offered in the literature (Shane and Venkataraman, 2000).

5.2. Implications for theories of new firm survival

Our results confirm prior findings that the creation of social ties to external stakeholders, the establishment of routines to transform resources, and the creation of legitimacy are survival enhancing for new ventures. However, they also emphasize that the creation of legitimacy is a particularly important part of this process because actions to generate legitimacy both enhance new venture survival and facilitate transition to other firm organizing activities. These findings are important because some evolutionary theorists have argued that the timing of firm organizing subprocesses is relatively unimportant (Carroll and Hannan, 2000; Hannan and Freeman, 1989). Our evidence suggests that completing business plans and establishing a legal entity early in the life of a new venture are advantageous to new ventures because these activities facilitate the transition to other firm organizing activities.

5.3. Implications for human agency in longitudinal studies of firm formation

Our study also takes an important step toward bringing evolutionary research on new ventures inside the black box of the organizing effort. Early evolutionary research on new firms did not explicitly examine the actions of firm founders, but concentrated, instead, on population and societal level factors. Although highly informative about a number of research questions, population and societal level studies cannot explain how individual and firm level factors influence why certain new firms succeed and others fail (Schoonhoven et al., 1990). This study follows a small literature that has begun to examine the effect of more microlevel factors on the evolution of new firms (Baron et al., 1996; Baron et al., 2001; Bates, 1990; Carter et al., 1996; Reynolds and Miller, 1992; Schoonhoven et al., 1990). In particular, it

¹⁷ Because the static-equilibrium reasoning dominant in the field of entrepreneurship abstracts away from the effects of time and choice on the organizing process, prior research has not identified these effects.

shows that new ventures are selected for survival, in part, on the basis of human decisions about the choice and timing of organizing actions.

Moreover, our results provide an important methodological implication for researchers conducting evolutionary studies of new organizations. Carroll and Hannan (2000, p. 241) write, “Does the difference between initial organizing and the start of business activity matter substantively? That is, does it matter that commonly available data on organizational foundings cover only those organizations that manage to succeed in passing some kind of hurdle? The answer to this question depends on the dynamics of the initial organizing period. If firms routinely move from initial organizing effort to the state of full-fledged organization, then it presumably does not matter whether demographers have information on only the date of the second event. If, on the other hand, many firms fail to make the transition and the rate of success in making the transition varies with demographic characteristics, then the answer might be different.” Because our data show that new venture efforts are selected for survival before evidence of them is recorded in archival records, the identification of new firms from entry into industry directories or legal records creates selection bias. Therefore, researchers interested in evolutionary processes need to adopt research designs that represent the population of new ventures, rather than just those that become legal entities.

5.4. *Limitations*

This research is not without limitations. First, our measures capture the timing of organizing activities, but not their magnitude or quality. The completion of a business plan, for example, may be an activity that takes more time and effort than the process of asking for funds or talking to customers. Moreover, we have no evidence on the quality of any of these activities. We do not know whether talking to customers generated a sale or whether a business plan was correctly written. The complexity of measuring the evolution of new firms from the point of initiation forward in time precluded us from measuring the magnitude or quality of these different activities. Although the significant effects of activities to recombine resources, develop social relationships and create legitimacy mitigate this problem somewhat, future research would do well to explore the joint effects of timing, magnitude and quality of organizing activities on new venture survival.

Second, because our sample is representative of the population of new ventures, it is heterogeneous as to the opportunities pursued. We attempted to control for this heterogeneity with a series of control variables. However, the controls may not be sufficiently precise to partial out all of the variance attributable to opportunities. Unobserved differences in the opportunities pursued by different firm founders may explain why some engage in survival enhancing activities and others do not.

Third, we use firm founders’ perceptions to measure the growth rate and the competitiveness of the industries that they enter, and do not find any evidence of the influence of these factors on the survival of the new ventures in our sample. Because these measures are perceptual, they might not capture actual conditions, but only founders’ expectations. The tendency of firm founders to be overoptimistic might lead them to underestimate competition

and overestimate industry growth, leading expectations of these factors to fail to influence survival when actual competition and industry growth do.

Fourth, our results do not permit us to make statements about the “success” of new ventures. Positive financial performance is not a meaningful concept in the early months of a new venture’s life, and we do not know about the ultimate financial performance of the surviving new ventures. Things other than the timing of particular organizing activities are undertaken may explain the long-term financial performance of the surviving ventures in our sample. Thus, our findings are consistent with arguments that the possession of a sustainable competitive advantage or superior human capital influences the long-term financial performance of these ventures.

6. Conclusion

In this paper we overcome the methodological obstacles to the examination of the life histories of new ventures. By tracking a random sample of 223 Swedish new ventures initiated in the first 9 months of 1998 over time, we explore which new ventures disband during the first 30 months. We find that undertaking activities to generate legitimacy reduces the hazard of venture disbanding during the first 30 months of a venture’s life and that generating legitimacy with external stakeholders is an important precursor to other organizing activities. We conclude that the initial survival fitness of new ventures depends heavily on undertaking legitimating actions.

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