Fools Rush in? The Institutional Context of Industry Creation*

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Abstract

Now organizations are always vulnerable to the liabilities of newness, but such pressures are especially severe when an industry is in its formative years. We focus on one set of constraints facing entrepreneurs in emerging industries-their relative lack of cognitive and sociopolitical legitimacy. We examine the strategies that founders can pursue, suggesting how their successful pursuit of legitimacy may evolve from innovative ventures to broader contexts, collectively reshaping industry and institutional environments.

Founding a new venture is risky business under any conditions, but especially so when entrepreneurs have few precedents for the kinds of activities they want to found. Early ventures in the formative years of a new industry face a different set of challenges than those that simply carry on a tradition pioneered by thousands of predecessors in the same industry. Such foundings are risky, but are they also foolish? From an institutional and ecological perspective, founders of new ventures appear to be fools, for they are navigating, at best, in an institutional vacuum of indifferent munificence and, at worst, in a hostile environment impervious to individual action. In addition to the normal pressures facing any new organizations, they also must carve out a new market, raise capital from skeptical sources, recruit untrained employees, and cope with other difficulties stemming from their nascent status.

Among the many problems facing innovating entrepreneurs, their relative lack of legitimacy is especially critical, as both entrepreneurs and crucial stakeholders may not fully understand the nature of the new ventures, and their conformity to established institutional rules may still be in question. We capture these problems by using the term *legitimacy* in two related senses: (a) how taken for granted a new form is and (b) the extent to which a new form conforms to recognized principles or accepted rules and standards. The first form of legitimacy is labeled *cognitive*, and the second, *sociopolitical*.

In this article, we examine the social processes surrounding the emergence of new industries, from the early pioneering ventures through the early stages of

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growth, when the form proliferates as the industry becomes established. Legitimacy is not the only factor influencing whether an industry successfully moves beyond the stage of a few pioneers to fully realized growth. Clearly, many other factors are important to a new industry's success, such as the state of the economy, latent demand for the product or service, competitive pressures from related industries, and the skills of new venture owners and workers. Because only a few theorists have examined failed industries (e.g. Astley, 1985), and we have no systematic research in this area, our article is necessarily speculative. However, we believe that legitimacy is a more important issue than previously recognized, and so we focus our arguments and propositions on factors affecting an industry's legitimacy and on legitimating strategies pursued by innovating entrepreneurs.

Our aim is to identify factors hindering and supporting the progression from the founding of a completely new activity, in an institutional void, through its development as a legitimate industry. Our focus is on the development of independent new ventures that are not sheltered by sponsoring organizations. By definition, such ventures cannot rely on existing institutions to provide external legitimacy. Throughout the article, we refer to *new activities* as specific product/process innovations, one aspect of what ecologists refer to generally as new organizational forms; *new ventures* are independent organizations initiating the new activity; and *industries* are groups of organizations with similar products/processes.

Background

This paper extends current theories linking organizational legitimacy and industry creation. Ecological theorists have provided empirical evidence of lower founding and higher disbanding rates when industries are small (Hannan & Freeman, 1989). Borrowing from institutional theory (Meyer & Rowan, 1977; Scott & Meyer, 1983), they have argued that this pattern exists because firms initially lack external legitimacy due to their small numbers. Their strongest arguments have been based on findings from organizational populations with chronic problems of sociopolitical opposition and repression (e.g. labor unions and newspapers) (Delacroix & Rao, 1993). In the 1990s, they have begun to address legitimacy issues stemming from a lack of knowledge and understanding (Hannan & Carroll, 1992).

Theorists using economic models have challenged ecologists' legitimacy arguments, asserting that industry entry and exit patterns are the result of competition and industry consolidation (Delacroix, Swaminathan, & Solt, 1989). The focus of economic theories of industry creation has been on the risks and economic trade-offs that characterize new industry entry decisions (Klepper & Graddy, 1990; Winter, 1984), and they have given little weight to the social context within which those decisions are embedded. Klepper and Graddy's study, however, provided findings that strongly suggest the influence of other than purely economic-technical considerations in the growth of an industry. They found that some industries went from origin to stability (defined as the year when the number of firms reached a peak and remained more or less the same for a few years) in only two years, whereas others took more than 50 years. The average was 29 years, and the